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Orrick: SEC Expands its Focus in the Municipal Bond Market, Bringing First-Ever Charges Against an Underwriter for Pricing Violations Related to Primary Offerings.

Coming on the heels of the SEC's first wave of settlements with underwriters as part of its Municipalities Continuing Disclosure Cooperation ("MCDC") initiative, the agency has brought yet another precedent-setting enforcement action against an underwriter in the municipal bond market. On August 13, 2015, the SEC brought a settled enforcement action against the brokerage firm Edward Jones, in which the firm agreed to pay more than \$20 million to settle charges that it overcharged customers in connection with the sale of municipal bonds in the primary market. Edward Jones settled without admitting or denying the SEC's findings.

According to the SEC, Edward Jones regularly underwrote—usually as part of an underwriting "syndicate" or group—and sold municipal bonds to the public through negotiated offerings. Underwriters of municipal bond offerings are generally required (as part of an agreement between the members of an underwriting syndicate) to offer municipal bonds to the public at the "initial offering price," which is the price negotiated between the issuer and underwriter. To compensate the underwriter for its services, the issuer typically sells the bonds to the underwriter at a price below the initial offering price.

The SEC charged that, on numerous occasions, Edward Jones violated its agreements with both bond issuers and its fellow underwriters by improperly reselling municipal bonds to its customers at prices above the initial offering price. The SEC found that between 2009 and 2012, Edward Jones overcharged its customers in 75 different negotiated offerings, netting the Firm more than \$4.6 million in additional revenue.

The SEC also found that Edward Jones regularly purchased bonds without disclosing to the underwriting syndicate that the purchases were for Edward Jones' own inventory. While underwriters are permitted to make orders for their own inventories, the SEC contended that they are required to disclose that fact, as customer orders are given priority over orders for an underwriter's own account. Consequently, the SEC found that Edward Jones' failure to disclose this information enabled it to purchase bonds that it otherwise may not have been able to purchase.

In addition, with respect to Edward Jones' trading of municipal bonds in the secondary market, the SEC separately charged the firm with failing to establish an adequate supervisory system to determine whether the markups it charged on certain transactions were reasonable.

The SEC ordered Edward Jones to cease and desist from future violations of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and a number of rules promulgated by the Municipal Securities Rulemaking Board ("MSRB"), which regulates dealers of municipal securities. Edward Jones agreed to pay \$5.2 million in disgorgement, as well as a \$15 million penalty. It also undertook a number of remedial measures, including: (i) hiring a dedicated compliance officer for its fixed income desk; (ii) adopting new procedures for the sale of municipal bonds, including a requirement that bonds acquired in new issuances may only be sold at the initial

offering price; (iii) disclosing in writing the amount of any markup or markdown on all fixed income trades; and (iv) making restitution to affected customers.

This action sends a signal to municipal market participants that the SEC continues to be on the lookout for violations of securities laws or MSRB regulations in connection with both disclosure and pricing. Indeed, as Andrew Ceresney, the SEC's Director of Enforcement, stated in the SEC's press release announcing the Edward Jones case, the enforcement action "reflects [the Commission's] commitment to addressing abuses in all areas of the municipal bond market." Moreover, in the aftermath of the case, four SEC commissioners took the unusual step of issuing a separate statement calling for the completion of clear rules requiring dealers to disclose markups and markdowns on municipal securities trades.

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