

Bond Case Briefs

Municipal Finance Law Since 1971

Municipal Securities Issuers to Face Enforcement Actions.

Nov. 13 — The Securities and Exchange Commission crackdown on municipal securities disclosure violations is poised to enter a new phase of enforcement cases targeting the issuers of those securities, practitioners and others told Bloomberg BNA.

The agency's Municipalities Continuing Disclosure Cooperation (MCDC) initiative encouraged municipal securities underwriters and issuers to self-report prior violations of federal securities laws by Dec. 1, 2014. In exchange, participants could expect to receive less severe, more uniform sanctions in any subsequent enforcement action. Industry observers concede underwriters and issuers often didn't fully comply with SEC rules regarding the accuracy of disclosures intended to enhance investor protections for years, and the initiative sought to address that deficiency.

After announcing a single MCDC enforcement case in 2014, the SEC launched two waves of enforcement cases in June and September against 58 underwriters participating in the initiative. Now, municipal securities lawyers said the agency is preparing its first cases against issuers.

"I had initially thought that, while the SEC came down hard on underwriters, they may not even meaningfully look at issuers who had self-reported because of the volume of issuer self-reports. But now it appears to be clear that the SEC is going to fully review all issuer self-reports too," Daniel Deaton, Nixon Peabody LLP partner and municipal finance specialist, said.

SEC spokeswoman Judith Burns declined to comment on the matter.

Report or Else

The SEC announced an enforcement action less than four months after the program was launched, alleging that the Kings Canyon Joint Unified School District in California misled investors about its failure to provide contractually required financial information and notices (148 SLD, 8/1/14).

Perhaps to spur participation in the initiative, the school district was neither fined nor required to admit wrongdoing.

In June 2015, the SEC announced a group of enforcement actions against 36 municipal-securities underwriters, alleging they sold municipal bonds between 2010 and 2014 using offering documents that contained materially false statements or omissions about the bond issuers' compliance with continuing disclosure obligations (118 SLD, 6/19/15).

In September, the SEC announced enforcement actions against an additional 22 municipal-securities underwriters for allegedly selling municipal bonds using offering documents that contained materially false statements or omissions about the bond issuers' compliance with continuing disclosure obligations. The firms also allegedly failed to conduct adequate due diligence to identify the misstatements and omissions before offering and selling the bonds to customers. The firms paid a collective \$4.12 million in fines.

The initiative and its resultant enforcement cases should not come as a total surprise. One of the

SEC enforcement division's five specialized units, created in 2010 by former SEC enforcement division director Robert Khuzami, focuses on municipal securities and public pensions. LeeAnn Ghazil Gaunt is the unit's current chief.

Sooner or Later

If underwriters fully disclosed the information required to participate in the MCDC initiative, the SEC likely possesses data that could help construct enforcement cases against issuers, and practitioners predicted the SEC is now preparing those cases. The practitioners said the initiative was more popular with the municipal securities industry than the SEC expected, and the agency has had to spend more time than expected analyzing the mounds of data disclosed by the underwriters and issuers.

"The SEC got hit with a lot of material, so I think they just have to dig through it all," Ballard Spahr LLP partner and municipal securities enforcement specialist Norman Goldberger told Bloomberg BNA in November.

As the agency digests the MCDC disclosures, cases against issuers will be announced, Goldberger said. "Sooner or later," he said.

While there was broad agreement the SEC will launch future enforcement cases against issuers, there was dispute about additional cases being brought against underwriters.

"My view is the SEC will likely bring a third wave of settlements against underwriters prior to bringing the first wave of issuer settlements," Elaine Greenberg, Orrick, Herrington & Sutcliffe LLP partner and a former chief of the SEC enforcement division's municipal securities and public pensions specialized unit, said.

"Although I believe that the SEC has begun contacting issuers who have self-reported under MCDC, I think it probably makes sense to finish up with the underwriter settlements prior to embarking on the first wave of issuer settlements," she told Bloomberg BNA Nov. 13.

Terms of Program

Under the MCDC program, underwriters and issuers had to provide the SEC with information about past municipal securities offerings with which they were involved that contained potentially inaccurate statements, including the identities of the lead underwriter, municipal advisor, bond counsel, underwriter's counsel and disclosure counsel.

The program was launched in March 2014 and issuers had to self-report no later than Sept. 10, 2014, in order to receive the relatively less severe sanctions for any violative behavior, while issuers were required to self report by Dec. 1, 2014.

The 1933 Securities Act and the 1934 Securities Exchange Act include broad exemptions for municipal securities, but not from antifraud provisions such as Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. In 1975, Congress enacted amendments to that program, including the Tower Amendment that expressly limits the SEC authority to require municipal securities issuers to file any application or document with the agency prior to any sale of municipal securities by a municipal issuer.

Under that program, the SEC has direct regulatory supervisory authority over underwriters, but only has authority over issuers under its antifraud provisions.

SEC Endgame?

That the SEC lacks statutory authority to supervise muni-market disclosures may be another motivation behind the initiative, at least according to Ben Watkins, director of the Florida division of bond finance and a vocal critic of the MCDC initiative. The MCDC initiative is less concerned with promoting investor protections and more aimed at gathering information to argue that Congress needs to give the SEC statutory authority to oversee disclosure in the municipal securities.

"I think that's their endgame," he told Bloomberg BNA Nov. 12.

"I do not know one single issuer that intentionally set out not to file information they agreed to provide to investors. That's not the issue. The issue is, because of the composition of our markets and the diversity of issuers and their different responsibilities and their level of sophistication and all of that, that inevitably things slipped through the cracks. Now, does that rise to the level of a securities fraud? I think not," Watkins said.

The Securities Industry and Financial Markets Association also concluded that using the blunt instrument of enforcement cases instead of issuing guidance to the financial community may have been misguided.

"SIFMA members fully support the SEC's goal of improving disclosure and transparency in the municipal market. It is disappointing that the SEC chose to bring violations under authority that includes mandatory statutory disqualifications when other authority was available, especially as firms that participated in the MCDC program did so voluntarily and in good faith," Michael Decker, managing director and co-head of municipal securities at SIFMA, said in a Nov. 13 statement

BNA Bloomberg

By Stephen Joyce

November 17, 2015

To contact the reporter on this story: Stephen Joyce in New York at sjoyce@bna.com

To contact the editor responsible for this story: Heather Rothman at hrothman@bna.com