Bond Case Briefs

Municipal Finance Law Since 1971

SEC: Don't Argue About Materiality After MCDC Submission.

WASHINGTON – Issuers are not likely to change the Securities and Exchange Commission staff's minds about the violations they have disclosed under the commission's municipal self-reporting initiative, the commission's top cop for municipal securities enforcement said on Thursday.

LeeAnn Gaunt, chief of the SEC enforcement division's municipal securities and public pensions unit, said that by the time her office calls issuers who have submitted information under the Municipalities Continuing Disclosure Cooperation initiative to talk about settlement terms, they have already looked at all of the issuer's reported disclosure violations and concluded which are material.

She made her comments during a panel discussion at the National Association of Bond Lawyers' Tax and Securities Law Institute held here. The panel focused on what issuers and their attorneys can expect as the MCDC initiative moves towards issuer settlements.

MCDC, first announced in March 2014, allows underwriters and issuers to receive lenient settlement terms if they voluntarily self-report any instances during the past five years in which the issuers falsely claimed in official statements that they were in compliance with their self-imposed continuing disclosure agreements and the underwriters failed to discover the misstatements. The underwriter portion of the initiative concluded with a third round in January. Altogether, 72 underwriters representing 96% of the underwriting market by volume, paid $18 million to settle violations with the SEC.

The SEC has already started reaching out to issuers about settlements and has said it intends to pursue actions against non-reporting entities after it finishes settling with those who did report. The commission also has left open the possibility of taking enforcement actions against individuals related to the disclosure failures.

Underwriters that raised materiality defenses after being contacted by the SEC about settlement terms "did not get much traction with trying to argue with us," Gaunt said, adding she expects issuers to follow the same trend. However, she said the SEC will not "close its ears" to such arguments if they do arise.

Gaunt said the communication between her office and reporting issuers is expected to be brief. All issuers who submitted information under the initiative will receive a response as to whether the unit found material disclosure failures. Any settlement discussions resulting from the disclosures should take at most a couple of weeks, she said. The SEC's goal is to have all of the issuer settlements completed within the calendar year.

"Certainly we will be applying pressure because we want to get [this] done," she said. "We're going to try to keep people on a pretty tight leash when we offer settlement terms."

She added that the SEC understands issuers may need more time to get an authorized person or authority to sign off on a settlement.

Mitchell Herr, a partner in Holland & Knight's Miami office, moderated the panel and said after listening to Gaunt's explanation of the MCDC settlement talks that he came to the conclusion that those who submitted information were "in a way confessing instead of just self-reporting."

Peter Chan, a partner at Morgan Lewis in Chicago and architect of the MCDC initiative, said that issuers who wanted to defend the materiality of some of their submissions should have included those arguments in what they originally sent the SEC.

Both Herr and Ken Artin, NABL's president and a lawyer at Bryant, Miller & Olive, asked Gaunt if issuers could obtain further leniency under MCDC from the SEC's 2001 Seaboard Report. That report explains that cooperation can lead to leniency in enforcement actions. They asked if issuers might be allowed to file Wells Submissions, in which a defendant in an SEC action explains its position through a memo or videotape in hopes of getting SEC commissioners and officials to change their minds.

Gaunt said that MCDC, while not explicitly linked with the Seaboard Report, already follows its message by allowing self-reporters more lenient terms than they may have received in full enforcement actions. She also said that Wells Submissions are not generally found with settlements and that if issuers wanted the benefit of a Wells Submission, they could opt out of the MCDC settlement and be subject to further SEC investigations under a more normal enforcement process.

When asked whether the commission may pursue individuals at a later date under MCDC, Gaunt did not offer much insight except to say her unit is focused on asking about settlement terms for reporting entities at this point. Chan said he suspects "that there is tremendous interest by the commission and staff" as well as the industry to move on from MCDC. Because of that, he wondered if the SEC would investigate every case and every self-report to try to identify potentially liable individuals.

He hypothesized that the SEC could use the "gigantic" amount of data it is currently sitting on from MCDC to find possible cases by looking for individuals that come up more often than others or instances where there is a red flag because an individual seemed to know there were issues with the continuing disclosure certifications.

The Bond Buyer

By Jack Casey

March 10, 2016