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Commentary: Key Takeaways from the SEC's Post-MCDC, Beaumont Cease and Desist Order.

While many would prefer the SEC's MCDC Initiative be a distant memory, on August 23, the SEC's Chief of the Enforcement Division's Public Finance Abuse Unit reminded issuers and underwriters alike that "[i]ssuers and underwriters will continue to be held accountable when they fail to provide investors with an accurate picture of past compliance with continuing disclosure obligations." SEC Press Release, Muni Bond Issuer and Underwriter Charged With Disclosure Failure, 8/23/2017.

In an Order Instituting Cease and Desist Proceedings, Making Findings and Imposing Sanctions and a Cease and Desist Order ("Order"), the SEC followed through on its commitment to focus on market participants that had not voluntarily self-reported under the MCDC initiative. The SEC's press release highlighted that the Municipal Finance Authority in Beaumont, California ("Beaumont"), its then-executive director and the underwriting firm behind certain offerings had settled charges that Beaumont had made false statements about compliance with continuing disclosure obligations and the underwriter failed to conduct reasonable diligence.

This Order (and the O'Connor Order demonstrate that the SEC is not done focusing on disclosure by issuers and diligence by underwriters and that the penalties for parties that did not voluntarily self-report under MCDC will be more severe.

In its Legal Discussion, the Order set forth the legal basis for holding the issuer accountable and, as emphasized below, noted that "negligence is sufficient to establish violations." The Order provided, in part: Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities … directly or indirectly … to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2). Section 17(a)(3) of the Securities Act makes it unlawful "in the offer or sale of any securities … directly or indirectly … to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. § 77q(a)(3). Negligence is sufficient to establish violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988). Order at para. 17. Emphasis Supplied.

The SEC held the issuer, the City Manager and the underwriter accountable and, in each instance, imposed "undertakings" well beyond what was required of those that submitted and settled with the SEC under its MCDC initiative.

For issuers and their officials, there are several takeaways from these Orders that are beyond what was required by those that voluntarily submitted and were subject to Orders under the MCDC initiative:

- Imposition of undertakings that require, amongst other things, the retention of an independent consultant and to follow the recommendations of the consultant.
- An individual being held accountable — $37,500 fine and barred from participating in any future muni bond offerings (as cited in the SEC Press Release).

There is another message that shouldn't be overlooked. Accountability seemingly begins and ends with the issuer and underwriter even where, as in Beaumont, a dissemination agent was engaged by the issuer. A review of outstanding Official Statements shows Beaumont engaged a dissemination agent. While the Order does not discuss the role of the dissemination agent, it does highlight missed and late filings, the failure of the district to properly disclose the same and the fact that the Executive Director was responsible for reviewing and approving the content of the OS.

While many dissemination agents do a fine job filing on behalf of the obligated party, the mere fact that an obligated party uses a dissemination agent does not absolve it from having policies, procedures and practices to ensure obligations are met and, where not met, properly discussed. Over-reliance on a dissemination agent can be fraught with risk. The parties cannot simply point to a dissemination agent as being responsible to fulfill its legally required obligations.

What's an issuer and obligated party to do? As highlighted in our May 25, 2017 commentary and below, the MCDC Issuer Cease and Desist Orders ("MCDC Orders") and the GFOA's August 24, 2016 Alert to Members ("GFOA Alert") provide excellent starting points. In addition, the engagement of an *independent third party* to review CDA obligations and actual filings can be a critical part of your policies, procedures and practices. Having the party responsible for making the filings (be they an employee of the obligated party or a dissemination agent) conduct such a review puts that party in the awkward position of self-reporting their own failures where a filing is late or missed and, as some have opined, might be considered a conflict of interest.

The MCDC Orders, in part, require issuers to:

- Comply with existing continuing disclosure undertakings, including updating past delinquent filings and;
- Establish policies and procedures and periodic training regarding continuing disclosure obligations within 180 days.

The GFOA Alert provided "essential practices" that, combined with the SEC Orders, can serve as best practices for Issuers. It provides, in part:

- Understanding and discussing the issuer's policies and procedures on disclosure.
- Knowing who within the issuer is filing what, when and where.
- Knowing what the issuer has promised to do in its continuing disclosure agreement.
- Being aware of what the issuer has posted on EMMA.
- Recognize that each official statement must include a statement about whether the issuer failed to materially comply with previous commitments within the past five years.

As issuers and obligated parties digest the Beaumont Order in conjunction with the MCDC Orders and their obligations under 17(a)(2), it is prudent they contemplate a Disclosure Management policy and practice to ensure an understanding of filing obligations, an understanding of what has or has not been filed properly and a process to be alerted of current filing obligations. Any Disclosure Management policy and practice should include an independent review to confirm filings are done properly.

The Bond Buyer

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