Bond Case Briefs

Municipal Finance Law Since 1971

Outlook 2018: SEC's Top Muni Cop Lists Enforcement Priorities.

PHOENIX – The Securities and Exchange Commission's municipal market enforcement activities in the coming year will focus on offering and disclosure fraud, broker-dealer abuses, municipal adviser misconduct and breaches of fiduciary duty, public corruption, and pay-to-play abuses.

LeeAnn Gaunt, chief of the SEC Enforcement Division's Public Finance Abuse Unit, cited these priorities when asked about them by The Bond Buyer.

"Our enforcement priorities are a direct reflection of our continuing focus on protecting investors, including the many retail investors who invest in the municipal securities market," said Gaunt.

Securities lawyers and regulators interviewed by The Bond Buyer said they expect the focus on muni enforcement actions to be on wrongdoing that harms investors. Several sources said they expected to see less of an emphasis on technical errors or smaller transgressions.

John Grugan, a partner at Ballard Spahr in Philadelphia, said he expects to see the SEC pivot away from the "broken windows" enforcement approach that characterized the commission during Mary Jo White's tenure as chair between April 2013 and January 2017.

White explained the "broken windows" concept in a speech in 2013, saying it's important to punish small transgressions to send a message that lawlessness of any kind will not be tolerated.

Current chair Jay Clayton replaced her in May. Grugan said he expects the SEC's emphasis going forward to be on fewer, but higher quality, enforcement cases.

"I think that they intend to look at if there are systemic issues that allow investors to be taken advantage of," he said.

Grugan pointed to the Municipalities Continuing Disclosure Cooperation initiative, an effort that wrapped up in late 2016. The MCDC program offered issuers and underwriters reduced settlement terms for self-reporting instances in which issuer's offering documents were not truthful about their continuing disclosure history.

Some lawyers criticized the MCDC for focusing heavily on "foot faults," Grugan said, adding that it doesn't seem as if the SEC is making a concerted effort to go after more issuers and underwriters for similar conduct.

"I think that their focus is receding and it is returning to the types of cases that they historically have brought," said Grugan, such as misuses of funds, rather than the "technical violations" of the MCDC.

"By no means is the SEC retreating from enforcement, I just think their priorities are changing," he said.

Paul Maco, a partner at Bracewell in Washington DC, also said he believes the enforcement division has moved on.

“One thing that might be fading into the shadows, if not going away, is the ‘broken windows’ concept,” he said.

“I think the focus will be continued on serious disclosure problems,” he added. “Where there are serious concerns, you’ll see them looking for serious remedies.”

Clayton’s testimony before Congress earlier this year indicated that he is interested in punishing individual bad actors so market participants should not be surprised to see a continued emphasis on enforcement actions against individuals in the coming year, Maco said.

Ernie Lanza, a senior counsel at Clark Hill in Washington, said the SEC is placing more and more emphasis on data-driven enforcement, using the analytical tools at its disposal to guide its actions. Lanza said he sees a slowdown in SEC enforcement, but that it will still make its presence felt.

“There’s always going to be a baseline level of enforcement,” Lanza said.

Robert Doty, the president and proprietor of municipal bond consulting firm AGFS in Annapolis, Md., said the new SEC chairman has not yet tipped its hand on a particular focus.

The commission had been operating for months with only three commissioners: Clayton, Michael Piwowar, and Kara Stein. The first two are Republicans and Stein is a Democrat. The Senate has only just confirmed on Dec. 21 George Mason University senior research fellow Hester Peirce, a Republican, and lawyer Robert Jackson, a Democrat, to fill the other two slots. After their swearing in, the two will likely need a little time to get up to speed.

“We don’t know what will happen as the new commissioners sink their teeth into things,” Doty said.

Doty said he doesn’t think enforcement will be “as surprising” in 2018 as it was the past year, but that he thinks there is a particular area where there could be a focus.

“Municipal advisor enforcement is a story to watch,” he said.

Muni advisors have spent much of the past several years adjusting to being regulated under an entirely new regime arising out of the Dodd-Frank Act. For MAs who are not also broker-dealers it has been their first experience being regulated at all.

The Municipal Securities Rulemaking Board’s Rule G-42 on the duties of non-solicitor municipal advisors only became effective in June 2016. There is a sense among the MA community that the SEC and the Financial Industry Regulatory Authority, which also enforces MSRB rules, spent 2017 getting a sense of the MA space and exploring the effects of those rules.

Doty said that in his view, the SEC has been very patient in advising the MA community with respect to regulatory compliance. “At some point that approach may give way to a more strict approach, especially where more egregious violations are found,” Doty said.

Doty added that the fiduciary duty owed by municipal advisors to issuers and other municipal entity clients could be a source of enforcement actions in the new year. The fiduciary duty is a strict standard requiring MAs to put the interests of their clients above their own. Doty said that while many MAs understand the fiduciary duty and act accordingly, he believes many MAs may not fully understand the weight of being a fiduciary.

“That will probably give some room for enforcement against municipal advisors,” he said.

By Kyle Glazier

BY SOURCEMEDIA | MUNICIPAL | 12/26/17 07:21 PM EST