Bond Case Briefs

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SEC Fines Firm and Ex-CEO for Failing to Disclose Conflict of Interest.

Arkansas-based Crews & Associates has agreed to pay more than $200,000 and its former CEO more than $100,000 to settle Securities and Exchange Commission charges they violated fair dealing and supervision rules by failing to disclose the firm's relationship with an affiliate that profited from business the firm did with a West Virginia county.

The SEC announced the settled administrative proceedings against the firm and former CEO Rush Harding III Thursday, a significant enforcement action that is only the third muni case of 2021 following a busy 2020 for the Public Finance Abuse Unit.

The charges stem from Crews? October 2015 recommendation that Ohio County, West Virginia, reduce its debt burden through a tender offer for bonds it had issued in 2006.

The SEC said that following the discussions of the tender offer, Crews, with Harding's approval, purchased millions of dollars of the county's outstanding bonds and sold them to an entity affiliated with Crews and to Crews' customers. Almost all of the bonds Crews acquired were eventually sold to its affiliate and tendered back to the county at a price that Crews had recommended, resulting in a net profit to the affiliate.

"In municipal bond offerings, underwriters must fully disclose to issuers their financial interests in the deal," said LeeAnn G. Gaunt, chief of the Enforcement Division's Public Finance Abuse Unit. "Failure to do so is a violation of their obligation to deal fairly with issuers."

Both Crews and Harding agreed to the settlements without either admitting or denying the SEC's findings.

The 2006 bonds, maturing in 2035 and bearing interest at 8.25%, contained a make-whole call provision that rendered calling them cost-prohibitive, and an ordinary refunding or advance refunding impractical, the SEC said. Crews had a business relationship with the county since 2007, and had underwritten nine bond offerings for it.

According to the SEC, Crews recommended that the county offer to pay bondholders a price higher than the current market price of its outstanding bonds to incentivize bondholders to tender their bonds. Crews also recommended that the county fund its purchase of those previously issued bonds through the sale of new, lower interest rate bonds, which Crews would underwrite. When Crews made these recommendations, the SEC found, the firm did not disclose to the county that Crews had recently acquired more than $1 million of the county?s outstanding bonds at market prices and then sold them to two customers.

In the months following the initial discussions of the tender offer, the SEC alleged, as Crews and the county finalized the terms of the proposed transaction, Crews purchased some $4.8 million more of the county's outstanding bonds at market prices and sold them to an affiliated entity and to Crews' customers. Almost all of the bonds Crews acquired were eventually sold to the affiliate and tendered back to the county by the affiliate at a price that Crews had recommended. Crews did not disclose to the county that the affiliate had acquired bonds to be tendered, or the resulting conflict of interest created by the affiliate's financial interest in the tender offer, the SEC said.

The county authorized the issuance of $10 million of new municipal bonds to fund its purchase of the 2006 bonds. In January 2016, the notice of tender was publicly posted, with the maximum acceptable price set at 110% of par.

Crews then continued to buy 2006 bonds from third parties and from Crews customers at market prices, in some cases mark them up, and selling them to the affiliate, the SEC said.

By the time of the tender date, Crews had purchased $5.9 million in principal value of the bonds on behalf of its affiliate. On the tender date of Feb. 16, 2016, the affiliate offered to tender all of these bonds to the county's tender agent at the maximum acceptable price. Since the county did not receive a sufficient number of tender offers at prices lower than the maximum acceptable price, the county accepted the offer of the affiliate.

In all, the SEC found, the affiliate tendered 71% of all 2006 bonds that were tendered to the county. The deal did save the county money, the SEC found.

But as a result of the markups it charged on its transactions with its customers and the affiliate, Crews made a net profit of $34,631. The affiliate made a net profit of $27,153 as a result of its purchases of the bonds from Crews and its tender of those same bonds to the county.

MSRB Rule G-17 requires broker-dealers to deal fairly with all market participants, which the SEC said the firm violated by failing to make the county aware of the secondary market transactions going on. MSRB Rule G-27 requires that firms have in place a supervisory system reasonably designed to ensure compliance with all applicable securities laws and rules, but the SEC found that Crews' system provided no means of accountability and so the transactions were not reviewed as they should have been.

By violating these rules, the SEC found, Crews violated Section 15B(c)(1) of the Securities Exchange Act, which prohibits dealers from using the mail or "any means or instrumentality of interstate commerce" to execute municipal securities transactions in violation of any MSRB rule.

Crews agreed to pay a civil penalty of $200,000 and disgorgement of $34,631 and prejudgment interest of $9,441. The SEC said Crews has already taken steps to correct the supervisory problems that led to the action.

"Crews and Associates is pleased to resolve this matter and is now looking to the future," said Paul Maco, a Bracewell attorney who represented the firm. Maco said the firm is devoting its full attention to serving its customers and growing its business.

Harding agreed to pay a $100,000 penalty and disgorgement of $36,524 and prejudgment interest of $9,957. Harding, who is still a registered broker, may not participate in new issues or tender offers for 12 months. An attorney for Harding did not respond to a request for comment.

By Kyle Glazier

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