Bond Case Briefs

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SEC Brings Actions Against Underwriters In First-Ever Municipal Bond Disclosure Cases: Shearman & Sterling

On September 13, 2022, the Securities and Exchange Commission ("SEC") filed suit in the United States District Court for the Southern District of New York against an underwriter for allegedly failing to comply with the regulatory requirements of the Exchange Act's Rule 15c2-12 (17 C.F.R. § 240.15c2-12), which provides a limited exception to certain disclosure requirements where underwriters have a reasonable belief that the municipal securities are being sold only to sophisticated investors that are each buying the securities for a single account. See *SEC v. Oppenheimer & Co., Inc.,* S.D.N.Y. No. 1:22-cv-7801 (Sept. 13, 2022). The SEC also initiated settled enforcement actions with three other firms for similar alleged violations. This is the first time that the SEC has initiated municipal-bond disclosure cases.

Under the Exchange Act's Rule 15c2-12, broker-dealers that are participating as underwriters in municipal securities offerings of $1 million or more are required to obtain certain disclosures from issuers and disseminate these disclosures to investors. However, the "Limited Offering Exemption" provides that a municipal issuer and their underwriters can be excused from the disclosure obligations if they meet certain requirements stated in Rule 15c2-12(1)(i). Specifically, the exemption applies to underwriters who sell securities in denominations of $100,000 or more and do not sell to more than 35 investors, in circumstances where the underwriter has a reasonable belief that the securities are being sold only to sophisticated investors that are each buying the securities for a single account without a plan to distribute them.

According to the SEC, from June 15, 2017, through April 27, 2022, the underwriter defendant sold securities in at least 354 municipal offerings in reliance on the Limited Offering Exemption when it in fact did not satisfy the exemption requirements. The SEC asserts that the underwriter sold securities to broker-dealers and investment advisers when it did not have any reasonable belief that such entities were buying the securities for their own account. To the contrary, the SEC claims that the underwriter knew or should have known that the entities may have bought securities on behalf of their client accounts. According to the SEC, the firm allegedly failed to make any inquiry to determine the nature of the securities bought by the entities and allegedly did not implement proper policies and procedures to ensure compliance with the exemption. The SEC alleges that the firm made $1.9 million from noncompliant bond sales over several years, and the SEC is seeking both disgorgement and a civil monetary penalty in relief.

Simultaneously, the SEC announced settlement agreements totaling $1.2 million in disgorgement and civil penalties with three other bond underwriters. Those firms allegedly sold securities without providing the necessary disclosures because they purportedly relied on the Limited Offering Exception while allegedly not meeting the criteria for its applicability.

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