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SEC Focuses on VRDO Rate-Resetting Process Amid Ongoing Lawsuits Against Banks.

The Securities and Exchange Commission will review broker-dealers' process for resetting interest rates on variable-rate demand bonds as part of its 2026 examination priorities as the issue has gained attention last year from lawsuits alleging fraudulent practices by Wall Street rate-resetters.

The SEC's Fiscal Year 2026 Examination Priorities includes "the rates reset process on variable rate demand obligations," under its focus on broker-dealer practices in municipal securities.

It's the first time the regulator has named VRDO rate-resetting practices as an area of review.

The focus comes as the long-standing, state-level False Claims Act lawsuits brought by Minnesota-based municipal advisor Johan Rosenberg continue to wind their way through the courts. The lawsuits in California, New York and New Jersey accuse top Wall Street banks' of rigging the interest rates on their VRDOs. The New York case last year analyzed the banks' rate-setting practice over the course of a two-day hearing. An Illinois case was settled in October 2023 for $70 million.

"It wouldn't surprise me if that litigation colored the SEC's choice about including this as an exam priority," said Michael Decker, senior vice president for research and public policy at the Bond Dealers of America.

"My guess is that it's that litigation, and the statements and actions around that litigation, that have motivated the SEC."

An SEC spokesperson confirmed that the VRDO rate reset process was not included in previous published annual priorities.

"In developing the examination priorities, the Division of Examinations considers multiple sources of information, including information received from other commission divisions and offices and prior examinations, to identify the areas we believe exhibit the highest risks to investors and the markets or are trending in that direction," the spokesperson said.

Rosenberg filed the complaints under the name of a Delaware-incorporated entity called Edelweiss Fund LLC. Edelweiss sued on behalf of the states and their entities that issued variable-rate debt and entered into contracts with banks as remarketing agents and liquidity providers.

Edelweiss accuses the banks of conspiring to keep VRDO interest rates high in a "robo-resetting" scheme so investors would not exercise their rights to tender the VRDOs back to the banks serving as remarketing agents, thus allowing the banks to collect fees for serving as RMAs and for providing letter of credit services for a fee without having to actually remarket the bonds.

A two-day hearing in the New York case last March dug deep into banks' rate-resetting process with Judge Andrew Borrok peppering attorneys from both sides with dozens of specific questions about how their rate-resetting processes worked. Borrok in April rejected the bank's motion for dismissal

in a strongly worded 44-page opinion that lambasted many of the banks' arguments.

The banks' appeal of that ruling is set to be heard on Feb. 21. The Superior Court of San Francisco County will hear oral arguments on summary judgments in the California case on Feb. 19. The New Jersey Supreme Court has agreed to hear an appeal – likely in the spring – of a lower court's decision that granted summary judgment to the banks.

The amount of VRDOs in the municipal bond market has fallen dramatically since 2008 but firms that provide rate-resetting practices are serious about compliance, Decker said.

"Most firms take the process seriously, and especially since the lawsuit has been filed and as it has progressed incrementally in the plaintiff's favor," he said. "We always pay attention to what the SEC is focused on," Decker said. "For the firms that do VRDO remarketing work, this compliance around that process was probably top of mind anyway."

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