
MSRB Proposes Rule Amendments to Allow Testimonials in Muni Advisor Advertisements.

The MSRB proposed to amend MSRB Rule G-40 ("Advertising by Municipal Advisors") to allow for the use of testimonial statements in municipal advisor advertisements.

In addition to allowing the use of testimonials, the proposal would (i) establish supervisory obligations specific to testimonial use, (ii) modify the definition of municipal advisory client with regard to soliciting municipal securities business to align with MSRB Rule G-38 ("Solicitation of Municipal Securities Business") and (iii) create a conforming obligation under MSRB Rule G-8 ("Books and Records to be Made by Brokers, Dealers, and Municipal Securities Dealers and Municipal Advisors") to keep any records relating to testimonial advertising, including any record of payment for testimonials.

Fried Frank Harris Shriver & Jacobson LLP

January 31 2023

SIFMA Urges MSRB to Broaden Proposed Exemption on Requalification.

SIFMA asked the MSRB to broaden a proposed exemption to allow individuals who have been out of the securities industry for a limited time to requalify as municipal advisors without having to retake examinations. SIFMA urged the MSRB to harmonize the exemption with requirements for muni dealers and broker dealers.

In its comments, SIFMA said that such harmonization is important because many firms and individuals are dually registered with FINRA and the MSRB. SIFMA also requested that the MSRB's relief be extended to municipal advisor principals.

Fried Frank Harris Shriver & Jacobson LLP

January 31 2023

SIFMA Urges MSRB to Extend Filing Deadlines in Proposal to Streamline Primary Offering Form Submissions.

In a Comment Letter on the MSRB's proposal to standardize deadlines on Form G-32 requirements in connection with primary offerings, SIFMA urged the MSRB to extend the window for underwriters

to file official statements.

SIFMA recommended that the MSRB extend the deadline for underwriters to file official statements through the Electronic Municipal Market Access Dataport system ("EMMA") to ensure that the finalized statements are accurate. SIFMA said that the current requirement to file the official statement "within one business day after receipt of the official statement from the issuer or its designee, but by no later than the closing date" does not consider that certain information may not be available until after the security is sold, nor does it account for statements received outside of normal business hours.

SIFMA recommended that the MSRB establish a single deadline no later than the closing date of an offering for underwriters to submit all applicable information to EMMA for both NIIDS-eligible and ineligible primary offerings. For transactions where no placement agent or underwriter is involved, SIFMA said that the municipal advisor involved should be required to submit a Form G-32 filing.

Fried Frank Harris Shriver & Jacobson LLP

January 30 2023

Financial Accounting Foundation Announces Changes to Online Access to Accounting Standards Codification and Governmental Accounting Research System.

Norwalk, CT, January 30, 2023 — The Financial Accounting Foundation (FAF) today announced it will provide free, enhanced online access to the Accounting Standards Codification® and the Governmental Accounting Research System™ in an effort to make financial accounting standards even more widely accessible to stakeholders and the public.

The FAF has not yet determined the firm date for this change to online access to the accounting standards, but it is expected to occur this spring.

The Accounting Standards Codification® ("the Codification") is the complete and official version of Generally Accepted Accounting Standards (GAAP) published by the Financial Accounting Standards Board (FASB) and used by public companies, private companies, nonprofit organizations, and employee benefit plans in the United States. The Governmental Accounting Research System™ ("GARS") is the complete and official version of GAAP published by the Governmental Accounting Standards Board (GASB) and used by states, cities, and other governmental entities in the United States.

While free versions of both the Codification and GARS have been available online for years, the new system will provide enhanced features compared to the current free offering (known as "Basic View"). These include enhancements to navigation, search, printing, copy/paste, and the ability to provide feedback.

As a result of this move, the "Professional View" paid subscription service will be eliminated and users who previously accessed Professional View can instead use the enhanced free versions of the Codification and GARS. Current Professional View subscribers will be transitioned off the current system. Pro-rated refunds will be issued for those subscribers whose paid terms extend beyond the cutover date.

“We believe this move, which is consistent with a recent recommendation from the Investor Advisory Committee of the U.S. Securities and Exchange Commission, will increase our stakeholders’ access to these important resources, and thereby improve the understanding and implementation of financial accounting standards in the United States,” said FAF Executive Director John Auchincloss.

Financial Accounting Foundation Board of Trustees Notice of Meeting.

Meeting Notice.

02/01/23

What To Do When Your Muni Bond Rating Is Withdrawn.

Publicly traded corporations that fail to file audited financial statements as prescribed by the SEC risk their stock tanking and being delisted from the exchange. Grave consequences to be sure. Yet there is no consequence to those municipal bond issuers for the same failure to file. Until now.

Moody’s rating agency has finally had enough of dealing with municipal bad citizens. We count 861 CUSIPs on which they have withdrawn their ratings. Many issuers have multiple CUSIPs owned by investors just like you. In the Muniverse, 861 CUSIPs is not huge. But it’s a beginning. Sure, the issuer may have decided to dump Moody’s, causing the rating agency to withdraw their rating. Still, it’s an impressive number and something to my knowledge that hasn’t been done on this scale before.

How do we investors assess a bond issuer’s ability to continue paying the coupons when due without timely financials or a credit rating report from a rating agency? The answer is, we can’t.

Perhaps Moody’s ratings withdrawal is a wakeup call that municipal bond issuers must file their financials or risk the consequences.

Actions To Take

What if your bond issuer fails to file its financial statements and/or their ratings agencies withdraw their ratings. Suddenly you are flying blind. Often financials aren’t filed for an entire year after close of the fiscal year on which they’re reporting. A lot can change during that time. For example, on June 4, 2021, S&P Global withdrew ratings on various local government and utility debt. Here’s what they said:

> …the withdrawal is due to insufficient information. Specifically, the withdrawals reflect our failure to receive adequate and timely financial information necessary to maintain surveillance of the ratings in accordance with our applicable criteria and policies. Such financial information includes, for example, audited financial statements or similar financial information.

There are many money managers and municipal bond funds that cannot hold non-rated bonds. Withdrawn ratings may force them to sell. As you may have experienced, selling begets lots more

selling in Muniland. Bond prices plummet.

If you self-manage your municipal bonds, use the Electronic Municipal Market Access (EMMA) website (emma.msrb.org) that publishes municipal annual reports and audited financial statements. You'll find disclosure documents, trade activity and ratings. If you use the Schwab retail trading platform, you have access to Moody's reports when you click the name of the issuer before buying or selling a bond. Both the MSRB and Schwab information are free. Perhaps your bond platform offers free rating reports too.

Using free information systems such as the MSRB makes sense for all municipal bond investors. Checking on the issuers whose bonds you own that are not following the rules by filing timely financials can save you thousands in losses should the bond tank.

As the economy slows, tax receipts will decline. Certain municipalities may not wish to disclose what is happening to them. So they just miss the filing date of their financials. If you see this happen and your bond is not insured, sell.

Forbes

by Marilyn Cohen

Feb 3, 2023

The SEC's Fast-Approaching Cybersecurity Overhaul for Public Companies and Regulated Entities.

As the SEC staff picks up the pace of cyber investigations, Chair Gensler continues the push to beef up the Enforcement Division's already meaty toolkit.

TAKEAWAYS

- The SEC has nearly doubled the size of its Crypto Assets and Cyber Unit and has aggressively pursued cyber-related enforcement actions against public companies and regulated entities.
- In a few months the SEC will finalize new rules governing firms' cybersecurity obligations, ushering in an unprecedented wave of oversight.
- Companies must proactively prepare for changes to the cyber-regulatory regime by assessing the adequacy of their security protocols, disclosure controls and procedures, and disclosures to investors regarding cyber matters.

Continue reading.

By Brian E. Finch, David Oliwenstein, Sarah M. Madigan

Feb 2, 2023

Pillsbury Winthrop Shaw Pittman LLP

Hawkins Advisory: The Federal Reserve's Regulation ZZ Implementing the Adjustable Interest Rate (LIBOR) Act

This Hawkins Advisory describes the Federal Reserve's recently published regulation, which clarifies the federal law treatment of United States dollar-denominated LIBOR contracts that do not adequately provide for interest rate-setting that can function independent of USD LIBOR or other inquiry-based determination of interbank lending or deposit rates. The Regulation establishes the substitute interest rate benchmarks that will be automatically substituted for USD LIBOR upon the expected June 30, 2023 end of USD LIBOR rate publication in the absence of prior action by contracting parties and clarifies related operational details.

View the Hawkins Advisory.

FINRA Issues 2023 Examination and Risk Management Program Report: What It Says and How to Respond

On January 10, FINRA published its "2023 Report on FINRA's Examination and Risk Management Program" (Report) — FINRA's third annual compendium of guidance, covering key topics and emerging risks for member firms to consider when evaluating the efficacy of their compliance programs and operations procedures. Among other things, the Report identifies relevant rules, summarizes noteworthy findings, outlines effective practices, and provides additional resources that may be helpful to member firms when assessing their compliance obligations.

This year, the Report is organized into five sections: (1) Financial Crimes, (2) Firm Operations, (3) Communications and Sales, (4) Market Integrity, and (5) Financial Management. The Financial Crimes section is a new addition for this year, whereas each of the other four sections were included in last years' report. In addition to adding the Financial Crimes section, this year's Report also builds on the structure and content of the 2021 Report and 2022 Reports by adding: (i) new material (findings and effective practices) to existing sections; and (ii) new topics to the Market Integrity section. The Financial Crimes section (its topics and emerging risks) is summarized below, followed by a summary of the regulatory obligations and related considerations for each of the new Market Integrity topics.

I. Financial Crimes

This new section of FINRA's annual report is a deliberate effort by FINRA to focus on areas where member firms face potential criminal exposure. It includes one new topic (Manipulative Trading) and two topics that were previously included in the Firm Operations section (Cybersecurity and Technology Governance and Anti-Money Laundering, Fraud, and Sanction).

Manipulative Trading (new): Certain FINRA rules prohibit member firms from engaging in impermissible trading practices, including manipulative trading, including, among others: Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2020 (Use of Manipulative, Deceptive, or Other Fraudulent Devices), 5210 (Publication of Transactions and Quotations), 5220 (Offers at Stated Prices). Additionally, under Rule 3110 (Supervision), member firms are required to supervise their associated persons' trading activities, and a firm's supervisory procedures must include a process for the review of securities transactions.

Cybersecurity and Technological Governance: Rule 30 of SEC Regulation S-P requires member

firms to have written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information. In addition to member firms' compliance with SEC regulations, FINRA reminds firms that cybersecurity remains one of the principal operational risks facing broker-dealers and expects firms to develop and maintain reasonably designed cybersecurity programs and controls that are consistent with their risk profile, business model, and scale of operations.

Anti-Money Laundering, Fraud, and Sanction: FINRA Rule 3310 (Anti-Money Laundering Compliance Program) requires that each member firm develop and implement a written AML program that is approved in writing by senior management and is reasonably designed to achieve and monitor the firm's compliance with the Bank Secrecy Act (BSA) and its implementing regulations.

Notably, each of the "emerging risks" identified in this year's Report fall within the ambit of Financial Crimes:

Manipulative Trading in Small Cap IPOs: FINRA, NASDAQ, and NYSE have recently observed that initial public offerings (IPOs) for certain small cap, exchange-listed issuers may be the subject of market manipulation schemes, similar to so-called "ramp and dump" schemes. FINRA has also observed significant unexplained price increases on the day of or shortly after the IPO of certain small cap issuers.

Sanctions Evasion: Since February 2022, OFAC has taken several significant sanctions actions related to the Russian financial services sector in response to Russia's actions in Ukraine. In response, on February 25, 2022, FINRA issued Regulatory Notice 22-06 (U.S. Imposes Sanctions on Russian Entities and Individuals) to provide firms with information about these actions, and to encourage firms to continue to monitor the OFAC website for relevant information.

ACATS Fraud: FINRA has observed an increased number of fraudulent transfers of customer accounts through ACATS in which a bad actor will use the stolen identity of a legitimate customer to open an online brokerage account.

Senior Investors: Senior investors can be vulnerable to fraud, theft, scams, and exploitation. When firms are assessing how they monitor customer account activity for red flags of financial crimes to which senior investors may be vulnerable, they should consider whether they maintain specialized senior investor-focused or other exception reporting or surveillance that is reasonably designed to detect and report suspicious activity related to financial crimes. Member firms should also consider whether their monitoring program incorporates red flags of elder financial exploitation.

II. Market Integrity

Each of this year's remaining new topics sits within the Report's Market Integrity category.

Fixed Income: The fair pricing obligations under FINRA Rule 2121 (Fair Prices and Commissions) apply to transactions in all securities — including fixed income securities — and MSRB Rule G-30 imposes similar obligations for transactions in municipal securities. In addition, FINRA Rule 2121 and MSRB Rule G-30 also include specific requirements for transactions in debt securities. These rules generally require a dealer that acts in a principal capacity in a debt security transaction with a customer, and who charges a markup or markdown to mark up or mark down the transaction from the prevailing market price (PMP).

Fractional Shares: FINRA's trade reporting rules generally require member firms to transmit last

sale reports of transactions in equity securities to a FINRA trade reporting facility (TRF) or FINRA's over-the-counter trade reporting facility (ORF) as applicable. Although the TRF and the ORF do not currently support the entry of fractional share quantities, such trades are required to be reported subject to FINRA guidance.

Regulation SHO: Rules 203(b) (Short Sales) and 204 (Close-Out Requirement) of Regulation SHO provide exceptions for bona fide market making activity. Member firms must confirm and demonstrate that any transaction for which they rely on a Regulation SHO bona fide market making exception qualifies for the exception, consistent with Regulation SHO and guidance.

The Report also highlights several topics that FINRA has identified as ongoing key areas of risk to investors and the markets, including: (1) Regulation Best Interest and Form CRS; (2) best execution obligations and conflicts of interest; (3) the increasing prevalence and sophistication of cybersecurity attacks; and (4) securities trading via mobile applications. The Report also is of interest for what it does not include. Notably, although special purpose acquisition companies (SPACs) were considered a key topic for the 2021 Report — and have seen focused attention from other regulatory bodies, such as the SEC — they are not referenced in this year's issue at all.

The findings and best practices outlined in the Report can serve as a guide for member firms to identify possible deficiencies or gaps in their compliance programs and operations procedures that could result in the types of exam findings highlighted therein. FINRA member firms are encouraged to thoroughly review the Report. In particular, member firms should identify the findings, observations, and effective practices relevant to their business models. The Report also may serve as a road map to prepare for an examination. If concerns arise before an examination, member firms would be well served by including counsel familiar with these issues in their preparation for the examination.

If you have any questions regarding the 2023 Report, FINRA's Examination and Risk Management Program, your company's policies and procedures, or questions otherwise relating to the above alert, please contact any of the Troutman Pepper attorneys listed on this advisory.

Troutman Pepper – Jay A. Dubow, Ghillaine A. Reid, Casselle Smith and John S. West

January 24 2023

Municipal Securities Regulation and Enforcement: 2022 Year in Review and Look Ahead: Ballard Spahr

As is widely known, the new issue market slowed down in 2022 due to a variety of factors, including rising interest rates, reduced institutional demand resulting from municipal bond fund outflows, inflation and recession fears, international tensions, and overall market volatility.

View the Ballard Spahr publication.

by M. Norman Goldberger, John Grugan, Teri Guarnaccia, Ernesto Lanza, Kimberly Magrini, William Rhodes, Tesia Stanley

January 25, 2023

Ballard Spahr LLP

Bloomberg to Pay $5 Million for Misleading Disclosures About Its Valuation Methodologies for Fixed Income Securities.

Washington D.C., Jan. 23, 2023 — The Securities and Exchange Commission today announced settled charges against Bloomberg Finance L.P. (Bloomberg) for misleading disclosures relating to its paid subscription service, BVAL, which provides daily price valuations for fixed-income securities to financial services entities.

The SEC's order finds that from at least 2016 through October 2022, Bloomberg failed to disclose to its BVAL customers that the valuations for certain fixed-income securities could be based on a single data input, such as a broker quote, which did not adhere to methodologies it had previously disclosed. The order finds that Bloomberg was aware that its customers, including mutual funds, may utilize BVAL prices to determine fund asset valuations, including for valuing fund investments in government, supranational, agency, and corporate bonds, municipal bonds and securitized products, and that BVAL prices, therefore, can have an impact on the price at which securities are offered or traded.

"Bloomberg has assumed a critical role as a pricing service to participants in the fixed-income markets and it is incumbent on Bloomberg, as well as on other pricing services, to provide accurate information to their customers about their valuation processes," said Osman Nawaz, Chief of the Division of Enforcement's Complex Financial Instruments Unit. "This matter underscores that we will hold service providers, such as Bloomberg, accountable for misrepresentations that impact investors."

The SEC's order finds that Bloomberg violated section 17(a)(2) of the Securities Act. Without admitting or denying the findings, Bloomberg agreed to cease and desist from future violations and to pay a $5 million penalty. The SEC's order notes that Bloomberg voluntarily engaged in remedial efforts to make improvements to its BVAL line of business.

The SEC's investigation was conducted by Gregory Smolar of the Complex Financial Instruments Unit and Emily Rothblatt of the Chicago Regional Office under the supervision of Natalie Brunson, Ana Petrovic, and Osman Nawaz of the Complex Financial Instruments Unit, with assistance from trial counsel Robert Gordon and Howard Kaplan of the Enforcement Division's office of Investigative and Market Analytics.

MSRB Discusses Regulatory Initiatives to Improve Municipal Market Transparency at Quarterly Board Meeting.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) met on January 25-26, 2023 for its second quarterly Board of Directors meeting of Fiscal Year 2023, where it discussed regulatory initiatives to improve municipal market transparency. The Board also discussed other initiatives to advance the four pillars of the self-regulatory organization's long-term strategic plan.

Market Regulation

"The MSRB continues to focus on regulatory initiatives to make meaningful improvements in the transparency in our market throughout the lifecycle of a bond transaction," said MSRB Chair Meredith Hathorn. "The Board's discussions are deeply informed by dialogue with market

stakeholders and data analysis."

The Board discussed the various perspectives raised by market participants in response to the MSRB's request for comment on its proposed amendments to MSRB Rule G-14 to shorten the timeframe for trades to be reported. The Board intends to continue stakeholder outreach and data analysis to inform potential next steps in coordination with fellow regulators.

The Board also discussed the forthcoming publication of a previously authorized request for comment on proposed amendments to MSRB Rule G-47, which would codify certain interpretive guidance and specify certain additional information that may be material and require time-of-trade disclosures to customers. This request for comment also seeks stakeholder input on proposed amendments to Rule D-15, defining the term "sophisticated municipal market professional."

In support of regulatory coordination and communication, the Board regularly meets with fellow regulators. At this meeting, the Board met with Securities and Exchange Commission Chair Gary Gensler and Financial Industry Regulatory Authority (FINRA) President and CEO Robert Cook.

Market Transparency and Technology

The Board received an update on the ongoing systems modernization effort, including work to modernize the Electronic Municipal Market Access (EMMA®) website and related market transparency systems. To help keep stakeholders informed of upcoming and longer-term EMMA enhancements, the MSRB publishes a forward roadmap of its transparency and technology initiatives on its website.

Market Structure and Data

The Board discussed market structure topics, including a potential pre-trade data collection initiative for the municipal securities market in coordination with fellow regulators. The Board also discussed the recently enacted Financial Data Transparency Act and its potential impact on the municipal securities market.

Public Trust

At each meeting, the Board conducts essential oversight of MSRB governance, finances and operations to uphold the public's trust. The Board received an update from its Nominating Committee on efforts to seek a diverse pool of applicants to join the Board in FY 2024, with a particular focus on soliciting applicants with compliance, technology and data proficiency, and applicants from all regions of the United States. Interested candidates must submit their applications by February 6, 2023.

In addition to prioritizing diversity and inclusion in the composition of the Board itself, the MSRB seeks to broaden its accessibility and engagement with diverse market participants so that all perspectives, concerns and expertise are heard. The Board received an update on the final roundtable in a series of roundtable discussions with minority-, women- and veteran-owned firms that the MSRB hosted in collaboration with FINRA to identify opportunities to foster greater diversity, equity and inclusion in the municipal securities market.

"Through these roundtables, the MSRB and FINRA have gained greater insight into the particular business models, challenges and pain points of diverse firms operating in the municipal market," said MSRB CEO Mark Kim. "We are very grateful for the industry's engagement to date, and we look forward to continuing to broaden and deepen our touchpoints with stakeholders."

Date: January 27, 2023

Contact: Leah Szarek, Chief External Relations Officer
202-838-1300
lszarek@msrb.org

BDA Submits Letter on MSRB Rule G-32 Changes.

BDA today provided comments to the MSRB on its proposal to amend MSRB Rule G-32 related to information reporting for municipal new issues. BDA generally supports the proposal.

The MSRB has proposed to amend Rule G-32 to streamline the submission of new issue data on Form G-32. Under the proposal, underwriters would be required to submit certain information by the end of the first trading day for new issues and the remainder of the information by the closing date. The proposal would not amend the scope of type of information underwriters must report. It would streamline timing only.

We told the MSRB that "BDA generally supports the amendments in the Notice. We believe these changes would provide additional compliance flexibility for underwriters without threatening investor or issuer protections." We also asked the MSRB to formally acknowledge that underwriters could of they choose continue to make G-32 information submissions according to the standards in the current rule and still be in compliance with the proposed amendments.

Thanks to all who contributed to this project. Our comment letter is available here. Please call or write with any questions.

Bond Dealers of America

January 17, 2023

SEC Looks to Finalize Proposed Cyber Rules, Issue New NPRM.

The U.S. Securities and Exchange Commission (SEC) appears to have big plans for cybersecurity regulation in 2023.

The SEC's rulemaking agenda, which was recently published by the Office of Management and Budget's Office of Information and Regulatory Affairs, includes finalizing two sets of cybersecurity rules proposed last year and issuing a new notice of proposed rulemaking (NPRM) on cybersecurity risk disclosures and cybersecurity measures. The new NPRM will include requirements for SEC-regulated public companies, broker-dealers, funds, investment advisors, self-regulatory organizations (SROs), and others.

The SEC has been one of the most active federal agencies in the cybersecurity space over the last several years. The Commission proposed new cybersecurity regulations for registered investment advisors (RIAs) and funds in February 2022 (see our blog post here) and new cyber disclosure, governance and risk management rules for public companies in March 2022 (see our blog post here). According to the recently published rulemaking agenda, final action on both of these proposed

rules is expected in April 2023 (see here and here). If these rules are finalized:

- RIAs and funds will need to adopt cybersecurity policies and procedures, conduct documented risk assessments, implement access controls, monitor and remediate vulnerabilities, and detect, respond to, and report cybersecurity incidents. Covered RIAs and funds will be required to report cybersecurity incidents with 36 hours.
- Public companies will be required to include in mandatory disclosures information about the board of directors' oversight of cybersecurity risk, individual board members' cybersecurity expertise, and the role of management in addressing cybersecurity risk, among other aspects of companies' cybersecurity risk management programs. Public companies will be required to report material cybersecurity incidents within four business days.

According to the recently published rulemaking agenda, the SEC also intends to release a new NPRM to "address registrant cybersecurity risk and related disclosures, amendments to Regulation S-P and Regulation SCI, and other enhancements related to the cybersecurity and resiliency of certain Commission registrants." While the description of this NPRM indicates that its subject matter may overlap with the existing proposed rules, it is clear that the new NPRM will tread some new ground such as in amending Regulations S-P and SCI.

Regulation S-P, which was promulgated under section 504 of the Gramm-Leach-Bliley Act (GLBA), contains numerous data privacy and security-related requires for registered broker-dealers, funds, and investment advisers. Section 30(a) of Regulation S-P, commonly known as the Safeguards Rule, requires registered broker-dealers and investment advisers to "adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information." The SEC may intend to follow the example of the Federal Trade Commission (FTC), which recently amended its own Safeguards Rule for non-bank financial institutions by adding numerous specific cybersecurity requirements, including risk assessments, continuous monitoring, encryption and multifactor authentication (we discussed the FTC's amendments to its Safeguards Rule in a prior blog post and webinar). The SEC's February 2022 RIA and funds cybersecurity proposal acknowledged that Regulation S-P (which applies to RIAs and funds) also addresses cybersecurity but did not seek to amend that rule.

Regulation Systems Compliance and Integrity, or Regulation SCI, applies to computer systems that support key securities market functions and covers SROs—including stock and options exchanges, registered clearing agencies, the Financial Industry Regulatory Authority (FINRA), and the Municipal Securities Rulemaking Board (MSRB)—and other "SCI Entities," including certain alternative trading systems, disseminators of consolidated market data, and certain exempt clearing agencies.

Davis Wright Tremaine LLP – Michael T. Borgia and Alexander Sisto

January 19 2023

SEC Proposes to Establish a New Best Execution Standard.

On Dec. 14, 2022, Gary Gensler, Chair of the U.S. Securities and Exchange Commission (SEC), released a statement announcing a proposal to establish an SEC rule setting forth a best execution standard for broker-dealers. Chair Gensler expressed his support of the new rule, stating it would help ensure brokers have policies and procedures in place to seek best execution for investors.

Currently, the SEC does not have its own best execution rule. It does, however, enforce best execution duties under antifraud statutes, the Financial Industry Regulatory Authority (FINRA), and the Municipal Securities Rulemaking Board (MSRB) execution rules. Chair Gensler stated that a best execution standard was "too important, too central to the SEC's mandate to protect investors, not to have on the books as [SEC] rule text." The Chair noted that the proposed SEC rule would enhance investor protection by providing for additional enforcement capabilities, and he further noted that FINRA's best execution rule hadn't been updated since 2014, and that markets had changed vastly since then.

The SEC's proposal aims to make enhancements to brokers' duty to investors. Chair Gensler highlighted three such enhancements in his statement:

- Heightened requirements for transactions that involve conflicts of interest with retail investors: brokers would be subject to additional policies and procedures and documentation requirements if the broker has a conflict of interest with respect to a transaction. Additional policies and procedures include enhanced diligence in seeking best execution and documentation showing the basis for determining that conflicted transactions comply with the best execution standard.
- Narrowing best execution requirement exemptions for introducing brokers: for example, broker-dealers using wholesalers for execution would no longer be able to solely rely on the wholesaler's quality reviews.
- More detailed policies and procedure requirements: policies and procedures would need to include specific considerations that the broker would need to address, such as market evaluation and specified price/non-price considerations, to comply with the new best execution standard.

The proposed rule is open for public comment, and the public comment period will remain open until March 31, 2023, or 60 days after the proposal's publication date in the Federal Register, whichever is later.

Greenberg Traurig LLP – William B. Mack and Mark D. Shaffer

January 20 2023

The Securities and Exchange Commission New Year's Resolution? Market Restructuring for All!

In Brief

On 14 December 2022, the Securities and Exchange Commission (SEC) proposed four separate rulemakings under the Securities Exchange Act of 1934 ("**Exchange Act**") that would create a federally defined best execution standard for broker-dealers and overhaul the US equities market structure (collectively, "**Market Structure Proposals**").

If adopted in their current form, these proposals would meaningfully impact market participants and practices. Given the nearly 1,700 pages of combined rules proposals, firms may need to devote significant resources just to digest their potential impact on particular business models.

In a series of Client Alerts, we will attempt to dissect each of these Market Structure Proposals. In this Client Alert, we provide an overview, insights, and key takeaways for the Regulation Best Execution (Reg Best Ex) Proposal.

Continue reading.

Baker McKenzie – Amy J. Greer, Jennifer L. Klass and Gavin Meyers

January 18 2023

The Financial Data Transparency Act Casts a Looming Shadow Over Municipal Securities Disclosure

In December of 2022, Congress enacted the Financial Data Transparency Act (the "FDTA"), legislation intended to modernize and improve the organization, readability and availability of financial information collected by certain federal agencies from regulated organizations. Focusing on the public finance industry, the FDTA directs the Securities and Exchange Commission (the "SEC") to adopt new uniform data reporting standards for financial disclosures filed by municipal issuers and obligors with the Municipal Securities Rulemaking Board (the "MSRB"). It is important to note that the FDTA does not add any new disclosure requirements. Rather, it is intended to change the way in which financial information is presented in disclosure filings, facilitating a better understanding of the context behind the data. Theoretically, these new standards will enhance the accessibility, transparency and comparability of the data included in the financial disclosures, resulting in a more user-friendly product for investors and other municipal market participants. Nevertheless, the practical impact on issuers and obligors of implementing these new data reporting standards, in terms of time, expense and resources, remains to be seen.

Broad in its scope, the FDTA mandates across-the-board improvements in the quality and transparency of private sector and public sector financial disclosures. As such, the FDTA applies to a number of other federal financial regulatory agencies in addition to the SEC, including the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the National Credit Union Administration.

The rulemaking process to effectuate the FDTA relative to municipal securities will occur in two stages. First, the SEC and the other federal agencies are required to jointly publish proposed rules establishing the data standards to be applied to financial disclosures under their jurisdictions. The proposed rules must be published for public comment by June of 2024, with the final rules published by December of 2024. The data standards established in the final rules are to take effect no later than December of 2026.

These jointly-issued data standards are intended to provide the SEC with the framework to then develop uniform municipal securities data standards and rules for the financial disclosures submitted by issuers and obligors to the MSRB. However, these specific municipal securities data standards must be compatible with the jointly-issued data standards (to the extent feasible and applicable). Under the FDTA, the SEC must publish final rules adopting these uniform data standards by December of 2026, the expectation being that proposed rules would be published earlier in 2026 to allow for public comment. Although the FDTA does not mandate a specific effective date for the municipal securities data standards established in the final rules, they could become effective as early as 2027.

Under these new uniform data standards, financial disclosures by municipal issuers and obligors would be presented in a fully machine-readable and searchable structured format, tagged with

identifier codes allowing for greater data analysis and comparability. By way of example, since 2009, the SEC has required that private companies use a similar structured data format, the eXtendable Business Reporting Language (XBRL), in making their financial disclosures. Although not mentioned in the FDTA, the SEC could use XBRL as a model for implementing the FDTA's requirements.

Notably, the FDTA's requirements are not limited in scope to a particular type of financial information (i.e., an issuer's or obligor's financial statements). Such ambiguity raising questions as to whether the SEC might extend the reach of the new data standards to other types of disclosures, such as particular portion(s) of an official statement (beyond any attached financial statements) or the sixteen event notices included in an issuer's or obligor's continuing disclosure undertaking. Additionally, the new data standards could impact the format in which financial information is submitted under current MSRB rules, such as Rule 15c2-12, Rule G-32 or Rule G-34. Other open questions include the establishment of an enforcement mechanism to ensure compliance and the impact on ongoing disclosure relative to outstanding bond issues.

In the end, the manner in which the SEC effectuates the FDTA will determine the impact on issuers and obligors specifically and the public finance industry overall. Significantly, the FDTA requires the SEC to consult with municipal market participants in developing the new data standards. Furthermore, the FDTA permits the SEC to adjust the data standards to reduce any unjustified burden on certain reporting entities and minimize disruptive changes overall. These mitigating factors, coupled with the approximately four-year window until adoption of the final rules, allow for meaningful participation in the rulemaking process and some time to prepare for the eventual outcome. At a minimum, issuers and obligors should consult their various advisors, counsel and professional associations to develop: (1) effective strategies for commenting on the proposed rules and (2) best practices to modify their disclosure processes, update software or other technology, and train appropriate staff members in anticipation of the effective date of the final rules.

Bowditch & Dewey LLP – Neal R. Pandozzi

January 18 2023

Proposed Regulation Best Execution: SEC Considers Market Structure Shakeup.

View the article.

Morgan, Lewis & Bockius LLP

January 17 2023

More and Better Uses Ahead for Governments' Financial Data.

A new federal law will eventually make some data searches and comparisons easier, but implementation will be a challenge. Software vendors will be staking their claims, but public-sector finance associations should take the lead.

In its lame duck session last month, Congress tucked a sleeper section into its 4,000-page omnibus

spending bill. The controversial Financial Data Transparency Act (FDTA) swiftly came out of nowhere to become federal law over the vocal but powerless objections of the state and local government finance community. Its impact on thousands of cities, counties and school districts will be a buzzy topic at conferences all this year and beyond. Meanwhile, software companies will be staking claims in a digital land rush.

The central idea behind the FDTA is that public-sector organizations' financial data should be readily available for online search and standardized downloading, using common file formats. Think of it as "an http protocol for financial data" that enables an investor, analyst, taxpayer watchdog, constituent or journalist to quickly retrieve key financial information and compare it with other numbers using common data fields. Presently, online users of state and local government financial data must rely primarily on text documents, often in PDF format, that don't lend themselves to convenient data analysis and comparisons. Financial statements are typically published long after the fiscal year's end, and the widespread online availability of current and timely data is still a faraway concept.

The primary rationale for this initiative has been transparency of data in the municipal bond marketplace, but a broader vision lies beyond the letter of this law. The last thing that the public finance world needs is yet another walled garden in which data structures are built to benefit a narrow group of industry analysts, muni bond fund managers and regulators. The ultimate benefits of data transparency should be far broader, at little or no cost to taxpayers, students and public agencies. Therein lies an opportunity for the nonprofit associations focused on public finance to take the lead rather than letting software vendors call the shots.

Continue reading.

governing.com

by Girard Miller

Jan. 17, 2023

January 2023 MSRB Board of Directors Meeting Discussion Items.

The Board of Directors of the Municipal Securities Rulemaking Board (MSRB) will meet in Washington, D.C. on January 25-26, 2023, where it will discuss the following topics:

Market Regulation

The Board will discuss comments received in response to its request for comment on its proposed amendments to MSRB Rule G-14 to shorten the timeframe for trades to be reported and receive an update on additional MSRB data analysis and stakeholder outreach.

Market Transparency

The Board will receive an update on ongoing work to modernize the Electronic Municipal Market Access (EMMA®) website and related market transparency systems.

Market Structure and Data

The Board will discuss market structure topics, including a potential pre-trade data collection initiative for the municipal securities market in coordination with fellow regulators. The Board also will discuss the recently enacted Financial Data Transparency Act (FDTA) and its potential impact on the municipal securities market.

Public Trust

In furtherance of its mission to create a more fair and efficient market, the Board will receive an update on the final roundtable in a series of roundtable discussions with minority-, women- and veteran-owned firms the MSRB hosted in collaboration with the Financial Industry Regulatory Authority to identify opportunities to foster greater diversity, equity and inclusion in the municipal securities market.

The Case for More Federal Oversight of State and Local Budgets.

An influential good government group is calling for tighter standards and is out with new recommendations for how Congress and regulators can begin taking action.

Hundreds of billions of dollars for pandemic recovery, infrastructure projects, economic development and climate programs that Congress and President Biden have approved for states, cities and counties during the past two years has drawn a great deal of attention.

But even before the Covid-era spending boom, the federal government was directing more than a $1 trillion annually in grants and tax incentives toward states and localities, as a new report from the nonprofit Volcker Alliance points out. Despite that degree of financial aid, the authors of the report argue that Congress and presidential administrations have “demanded surprisingly little in continuing, high-level oversight” of state and local budgeting and borrowing.

The report goes on to make a case for why it’s time for lawmakers and regulators to tighten up standards around state and local government finance, and it offers recommendations for how they can go about it.

Continue reading.

Route Fifty

By Bill Lucia

JAN 9, 2023

MSRB 2022 Municipal Bond Market in Review.

Detailed analysis of the municipal market detailing significantly higher interest rates, record outflows from tax-exempt mutual funds and a record number of trades.

View the MSRB report.

Publication date: 01/12/2023

MSRB Publishes 2022 Annual Report and Audited Financial Statements.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) today published its annual report for the 2022 fiscal year. The report highlights progress on the goals outlined in the MSRB's four-year Strategic Plan, which was developed with extensive public input.

"Our mission to protect investors and issuers in this market has never been more important as financial markets continue to evolve at an ever-increasing pace," said MSRB Chair Meredith Hathorn and MSRB CEO Mark Kim in their letter to stakeholders. Commenting on the MSRB's Congressional mandate to establish rules that ensure a transparent, efficient and fair market, Hathorn and Kim added: "Strong markets function best when regulations keep pace with evolving market practices and technologies."

The report demonstrates how the MSRB works to uphold the public's trust in the $4 trillion municipal securities market and give America the confidence to invest in its communities.

Progress on the MSRB's four Strategic Plan goals:

Market Regulation: The MSRB worked closely with fellow financial regulators to undertake a comprehensive examination of fixed income market structure looking at post-trade, time of trade and pre-trade transparency, starting with the issuance of a request for comment on proposed amendments to post-trade reporting requirements. In addition, as part of the organization's ongoing retrospective rule review, the MSRB furthered its multi-year initiative to review the MSRB's entire library of interpretive guidance and update, codify or retire guidance, as appropriate.

Market Transparency: The MSRB continued to work on enhancing its Electronic Municipal Market Access (EMMA®) website to facilitate regulatory compliance and make EMMA easier to use, and completely redesigned the MSRB.org website to improve navigation and make information easier to find.

Market Data: As the central repository of data for the municipal securities market, the MSRB leveraged its investment in cloud computing and data analytics to enhance the quality, accessibility, security and value of this data for market participants. This included the launch of EMMA Labs, the MSRB's innovation sandbox, where municipal market participants can collaborate to test and provide feedback on prototypes of new tools for their potential release on EMMA.

Public Trust: Recognizing that the MSRB's duty to uphold the public trust in the municipal securities market and in the MSRB as the market's self-regulatory organization requires a commitment to fiscal transparency and accountability, the MSRB instituted a new fee-setting process that better manages the organizations reserves and ensures the MSRB has sufficient revenues to fund its operations as it delivers on its multi-year strategic plan. The MSRB also took important steps to advance its diversity, equity and inclusion action plan by co-hosting with the Financial Industry Regulatory Authority a series of roundtable discussions with women-, minority- and veteran-owned businesses on key issues impacting these firms in the municipal securities market.

The annual report includes audited annual financial statements for the fiscal year that ended September 30, 2022, which help ensure transparency around how the organization manages its resources and financial reserves.

Read the report.

Date: January 13, 2023

Contact: Leah Szarek, Chief External Relations Officer
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2023 Reminder to Issuers and Borrowers of LIBOR-Based Tax-Exempt Bonds: Now is the Time to Protect the Tax-Exempt Status of Bonds in Anticipation of Upcoming Discontinuation of LIBOR - Foster Garvey

As we welcome 2023, and the final six months of certain London Interbank Offering Rates ("LIBOR"), issuers and borrowers of LIBOR-based tax-exempt bonds should evaluate whether changes to their financing documents are necessary to implement a replacement rate, while avoiding changes that could negatively affect the tax-exempt status of those bonds.

As many are aware, the Intercontinental (ICE) Benchmark Administrator plans to cease publishing the overnight, one-month, three-month, six-month and twelve-month U.S.-dollar LIBOR after June 30, 2023. As a result, existing debt instruments that use LIBOR as the reference rate for determining their interest rates may need to be modified.

In general, modification of a tax-exempt municipal bond may be treated as a significant modification that constitutes a "reissuance," and a reissuance could call into question whether interest on the modified bond continues to qualify for tax exemption. The Treasury Department and Internal Revenue Service ("IRS") have adopted a new regulation (Treas. Reg. §1.1001-6) designed to support an orderly transition of LIBOR-based instruments to new reference rates. If a modification of a LIBOR-based instrument made between March 7, 2022 and June 30, 2024, is structured to qualify as a "covered modification" under Treas. Reg. §1.1001-6, the modification will not result in a reissuance. Issuers and borrowers should consult with bond counsel before finalizing changes to the terms of a tax-exempt financing instrument.

Treasury Regulation Facilitates Transition From LIBOR

LIBOR as Reference Rate Discontinued After June 30, 2023. The Intercontinental (ICE) Benchmark Administrator, as administrator of the London Interbank Offering Rate ("LIBOR"), has announced that its publication of overnight, one-month, three-month, six-month and twelve-month U.S.-dollar LIBOR will cease following June 30, 2023. As a result, various types of existing debt instruments, including loan contracts and municipal bonds, that contain provisions requiring the use of LIBOR as the reference rate for determining the interest rate on the debt instrument may need to be modified.

These modifications may raise federal tax issues. For example, the modification of a loan contract may be treated as a taxable exchange of property for other property differing materially in kind or extent for purposes of §1001-1(a) that gives rise to gain or loss, and the modification of a tax-exempt municipal bond may be treated as a significant modification that constitutes a "reissuance" under §1.1001-3 that would raise a question whether the interest on the modified bond continues to qualify for tax exemption.

For such a modification to transition from LIBOR to be treated as a "covered modification" (described below) that will not result in a taxable exchange or "reissuance" of the debt instrument,

the modification must be made not later than one year after the discontinuance of LIBOR, i.e., by June 30, 2024.

Treasury Regulation §1.1001-6 Facilitates "Covered Modifications" Made to Transition From LIBOR. In an effort to minimize potential market disruption and facilitate an orderly transition from LIBOR to other reference rates, the Treasury Department and Internal Revenue Service ("IRS") adopted Treas. Reg. §1.1001-6. The basic purpose of §1.1001-6 is to facilitate modifications to contracts that are made to transition from LIBOR to new reference rates, while preserving the same business and economic terms.

Treas. Reg. §1.1001-6 applies to a modification of the terms of a contract that occurs on or after March 7, 2022. In general, the operative rules of §1.1001-6 provide that certain "covered modifications" of a contract made to transition from LIBOR to a "qualified rate" will not result in a taxable exchange of property under §1.1001-1(a) or a reissuance of a debt instrument under §1.1001-3. A "covered modification" is a modification made to transition from a discontinued interbank offered rate such as LIBOR to a "qualified rate" and to make "associated modifications," if any, of technical, administrative, or operational terms of the contract reasonably necessary to implement the covered modification. The operative rules also permit certain "qualified one-time payments" to be made to compensate a party for all or part of the basis difference between the discontinued interbank offering rate and the interest rate benchmark used for the new qualified rate.

"Modification" of Contract Broadly Defined. For the purposes of §1.1001-6, a "modification" of a contract, including a debt instrument such as a tax-exempt municipal bond, is defined broadly to include any modification of the terms of the contract, regardless of the form of the modification. For example, a modification could include an exchange of one contract for another, an amendment to an existing contract, or a modification accomplished indirectly through one or more transactions with third parties, regardless of whether the modification is evidenced by an express agreement, conduct of the parties, or otherwise. Therefore, when considering modifications to a tax-exempt bond to transition from LIBOR to another reference rate, the issuer of a tax-exempt bond should evaluate, in advance of any agreement with the bondholder and in consultation with bond counsel, whether the modification would be treated as a "covered modification" under §1.1001-6.

"Qualified Rates." The question whether a modification of a debt instrument will be treated as a covered modification depends on whether the new reference rate is a "qualified rate." Under §1.1001-6(h)(3)(ii), a qualified rate is any of the following rates having a benchmark that is reasonably expected to measure contemporaneous variations in the cost of newly borrowed funds:

(A) A "qualified floating rate" as defined in §1.1275-5(b), but without the requirement that any fixed multiple applied to the qualified floating rate must be greater than .65 but not more than 1.35. Such a qualified rate includes "SOFR," which is the Secured Overnight Floating Rate developed by the Alternative Reference Rates Committee ("ARRC") and published each business day on the website of the Federal Reserve Bank of New York (the "New York Fed");

(B) An alternative, substitute or successor rate selected, endorsed or recommended by the central bank, reserve bank or monetary authority as a replacement for LIBOR in that governmental jurisdiction;

(C) A rate selected, endorsed or recommended by ARRC as a replacement for LIBOR, so long as the New York Fed is then an ex officio member of ARRC—e., SOFR, as noted above, as well as CME Group's forward-looking one-month, three-month, six-month and twelve-month Term SOFR Reference Rates ("Term SOFR") recommended by ARRC on July 29, 2021, and also published each

business day on the website of the New York Fed;

(D) A rate determined by reference to one of the rates described in (A), (B) or (C) above by adding or subtracting a specified number of basis points to or from the rate or by multiplying the rate by a specified number; and

(E) A rate identified for purposes of §1.1001-6 by the IRS and published in the Internal Revenue Bulletin.

"Waterfall" of "Fallback Rates" May Be Qualified Rate. A single qualified rate also may be comprised of one or more "fallback" rates. A "fallback" rate is a rate, such as 30-day Term SOFR, which the parties to a contract agree will become operative following the discontinuance of LIBOR. For example, a "waterfall" or series of "fallback" rates specified in a contract may constitute a qualified rate, but only if each individual fallback rate in the waterfall separately meets the requirements of a qualified rate. If it is not possible to determine at the time that a modification is being tested as a covered modification whether a fallback rate will satisfy the requirement that it must be reasonably expected to measure contemporaneous variations in the cost of newly borrowed funds, then that fallback rate, and any waterfall of fallback rates that includes that fallback rate, will not be treated as a qualified rate. If, however, the likelihood that any value will ever be determined under the contract by reference to a particular fallback rate that would not be a qualified rate is "remote," then it is treated as a qualified rate.

Depending on the manner in which a fallback rate becomes operative, it may need to be tested as a covered modification both at the time the debt instrument is modified and at the time the fallback rate becomes effective. For example, if the fallback rate becomes effective by operation of the terms of the debt instrument or as the result of the exercise of a unilateral option by the holder of the debt instrument, the fallback rate would not need to be retested as an additional modification, whereas a fallback rate that becomes effective only by mutual agreement of the parties would need to be retested as an additional modification. In addition, a fallback rate may need to be retested at the time it becomes effective in order to confirm that it continues to be a qualified rate.

"Noncovered Modifications." Certain modifications of contracts are excluded from being treated as "covered modifications." These noncovered modifications are viewed as being beyond the scope of facilitating the transition from LIBOR to another qualified rate while preserving the same business and economic terms of the unmodified contract. Under §1.1001-6(j), each of the following modifications that change the amount or timing of cash flows under the contract is a noncovered modification:

1. The modification is intended to induce one or more parties to perform any act necessary to consent to the replacement of LIBOR with a qualified rate, make associated modifications, if any, and make a qualified one-time payment, if any—for example, an agreement by the issuer of a debt instrument to add an additional 10 basis points to the basis adjustment spread to induce the holder to consent to the LIBOR replacement modification;
2. The modification is intended to compensate one or more parties for a modification other than one that replaces LIBOR with a qualified rate, makes associated modifications, if any, and provides a qualified one-time payment, if any—for example, an agreement by the issuer of a debt instrument to add 30 basis points to the interest rate to compensate the holder for agreeing to modify a customary financial covenant for the issuer's benefit;
3. The modification is a concession to a party experiencing financial difficulty or a concession obtained by one party to account for a deterioration in the credit of the other party—for example, an agreement by the holder of a debt instrument to reduce the interest rate by 50 basis points to assist an issuer that is experiencing financial difficulties;

4. The modification is intended to compensate one or more parties for changes in rights or obligations that are not derived from the contract being modified—for example, an agreement by the issuer to add 30 basis points to the interest rate on one debt instrument in order to induce the holder to agree to modify customary financial covenants made by the issuer in a different debt instrument that is also held by the holder; and
5. The modification is identified in future guidance by the IRS as having a principal purpose of achieving a result that is unreasonable in light of the purpose of §1.1001-6.

The federal tax consequences of each of the foregoing types of "noncovered modifications," if made, would need to be analyzed separately from any covered modification under the general rule for a taxable exchange of property under §1.1001-1(a) and the rule for a significant modification of a debt instrument under §1.1001-3.

No Adverse Effect Opinions. In a situation where the issuer and holder of a debt instrument that consists of a tax-exempt bond are considering an agreement to modify the bond in order to transition from LIBOR to a new reference rate such as SOFR, the financing documents for the bond may require, or the holder of the bond may request, that the issuer provide an opinion of bond counsel to the effect that the modification of the bond will not adversely affect the tax-exempt status of interest on the bond (a "no adverse effect opinion"). In order to provide a no adverse effect opinion, bond counsel would need to conclude that the modification is a covered modification made to transition from a discontinued interbank offering rate, such as LIBOR, to a qualified rate. In order to reach that legal conclusion, bond counsel may require that the issuer and holder of the bond provide certifications to the effect that no facts and circumstances exist that would show that the proposed modification is a noncovered modification of the type described above.

Alternative Analysis of Noncovered Modifications. Even if all or part of the modification is determined to be a noncovered modification, bond counsel could conclude that the noncovered modification is not a significant modification of the terms of the bond that would cause the bond to be treated as "reissued" under the general rule set forth in §1.1001-3. Further, even in the event that the noncovered modification of the bond would cause it to be treated as "reissued," bond counsel nonetheless may be able to provide a no adverse effect opinion if the issuer takes the steps needed to qualify the reissued bond as a newly issued tax-exempt current refunding bond used to refund the prior bond. Depending on whether the reissued bond is a tax-exempt governmental bond or a tax-exempt private activity bond, these steps could include, for example, testing whether the reissued bond remains eligible to be treated as a governmental bond or a qualified 501(c)(3) bond under the applicable private activity bond regulations, filing a new Form 8038-G or Form 8038 Information Return for the reissued bond, holding a TEFRA hearing and obtaining a public approval for the issuance of the reissued bond, and obtaining volume cap for the reissued bond.

The issuer also would need to comply with the arbitrage rebate requirement, if otherwise applicable, with respect to the prior bond deemed to be currently refunded and retired by the reissued bond. The date on which the prior bond is treated as retired would be the final computation date for any rebate amount due with respect to gross proceeds of the prior bond. Any such rebate amount would be payable to the United States with Form 8038-T filed with the IRS not later than 60 days after that final computation date.

Certain Economic or Financial Considerations. An issuer that modifies a tax-exempt bond to transition from LIBOR to SOFR, for example, may wish to consider whether certain other adjustments should be made to SOFR as the new qualified rate on the bond, regardless of the tenor of the SOFR rate. For example, because SOFR is a taxable rate, it may be appropriate that the applicable SOFR rate on a tax-exempt bond held by a corporation be multiplied by 79% (0.79) to take account of the federal corporate tax rate of 21% that would otherwise apply to interest received

on the bond if it were taxable. Also, because SOFR rates reflect essentially risk-free interest rates, whereas LIBOR was not considered a risk-free rate, there is an understanding that SOFR rates, regardless of the tenor, may be lower than what otherwise would be a LIBOR rate.

by Allison Schwartzman & William Tonkin

January 5, 2023

Foster Garvey PC

New Standards Coming By 2027 for Reporting Information to EMMA: Kutak Rock

On December 23, 2022, President Biden signed into law the Financial Data Transparency Act of 2022 (Act). The Act requires the Securities and Exchange Commission (SEC) to develop and implement new standards for municipal issuers and obligors to use when reporting financial and operating information on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access website (EMMA). Specifically, the Act provides that the SEC's new standards will require municipal issuers and obligors to submit information on EMMA in a machine-readable, structured format. The new standards are expected to be similar to the reporting standards currently used by publicly traded companies when making disclosures on the SEC's Electronic Data Gathering, Analysis and Retrieval system (EDGAR).

Notably, neither the Act nor the standards to be proposed and implemented by the SEC will change the substance of what municipal issuers and obligors are required to report on EMMA; only the format in which the information is uploaded to EMMA will be affected.

The new reporting standards will require that financial and operating data submitted by municipal issuers and obligors be both structured and open. Currently, many issuers and obligors submit their financial and operating information to EMMA in PDF or HTML formats, which can be considered unstructured formats. While these formats have the benefit of being easily readable to humans, they are not conducive to data analysis on a large scale—the type of analysis often carried out by regulatory entities. In contrast, *structured* data uses identifier codes to classify financial data, allowing for aggregation and comparison among reporting entities.

The new reporting standards are expected to become effective in approximately four years or by the start of 2027. The SEC will be required to consult with market participants (including municipal issuers) in formulating the new standards. Over the next 18 months the SEC will be required to issue proposed rules regarding the new reporting standards, which will then be subject to public comments. The public comment period will allow interested parties, including municipal issuers and obligors, to submit feedback to the SEC regarding the proposed rules. After the SEC finalizes the new rules (expected within two years), municipal issuers and obligors will have two years to bring their financial reporting into compliance with such rules (the new rules are expected to be effective at the start of 2027).

Municipal issuers and obligors and other municipal market participants should be aware of the Act and consider reviewing the SEC's proposed rules when such rules are made available to the public. Municipal issuers and obligors are encouraged to participate in the public comment process to ensure the SEC is made aware of undue burdens or unintended consequences, and whether

exceptions or accommodations should be incorporated into the rules. Issuers and obligors should consider the format in which they have routinely submitted data to EMMA and confer with their technology personnel on the feasibility of transitioning to a structured and open data format. If preferred, issuers and obligors may want to confer with third-party technology consultants to determine whether and to what extent technology upgrades will be required to comply with the new standards.

Kutak Rock will continue to monitor the implementation of the Act and update our clients on its progress through the SEC. If you have any questions about the new reporting standards, or how they may impact your organization, please contact your Kutak Rock attorney or a member of the firm's Public Finance Practice Group.

Client Alert | January 4, 2023

Kutak Rock LLP

Machine-Readable Financial Reporting Is Less Scary Than You Think: Bond Buyer

Despite opposition from various municipal bond market experts and interest groups, Congress has now instructed the Securities and Exchange Commission to develop machine-readable standards for EMMA filings.

As implementation of the Financial Data Transparency Act (FDTA) begins, it is important to clear up some misunderstandings about this legislation.

Opponents of FDTA expressed concern that a single template would be imposed on a wide range of municipal issuers around the country. If true, this would be a very serious issue because the financial statements of cities differ greatly from those produced by school districts, water districts, road districts, etc.

There is also substantial variation across states, including some that have not implemented Governmental Accounting Standards Board standards for local government financial reporting.

But this concern is easily addressed during implementation.

First, there is no hard and fast requirement that all entities must use a single reporting taxonomy (i.e., a dictionary of financial statement concepts). There could be one or more specialized taxonomies for New Jersey cities, Washington state school districts and other non-GASB compliant issuers.

More importantly, a taxonomy does not straitjacket issuers into a fixed set of concepts.

General purpose governments and special districts use overlapping categories of revenues and expenditures. But there is no limit to the number of categories that can be included in an eXtensible Business Reporting Language (XBRL) taxonomy and no requirement to use all the categories provided.

When my colleagues at XBRL US partnered with University of Michigan's Center for Local, State and Urban Policy (CLOSUP) to develop an XBRL taxonomy for Michigan local governments, we

reviewed a large number of Annual Comprehensive Financial Reports (ACFRs) to determine which financial statement captions appeared most frequently.

We included all of these in the taxonomy. Also, we provided a mechanism for financial statement filers to include concepts that were not specifically listed in the taxonomy.

Filers can use a feature of XBRL to add custom line items they need to report that are not explicitly included in the taxonomy. An entity-specific line item can be created that rolls up into assets or revenues, for example. Issuers can report what they need, and data can still be compared across issuers at the asset or revenue level.

The CLOSUP project was XBRL US's fourth version of an ACFR taxonomy in four years, which brings me to another point about the opposition critique of FDTA.

Contrary to critics' assertions, two years is plenty of time to develop machine-readable reporting standards. In fact, if the SEC chooses to base its taxonomy on XBRL US's work products, the development time could be significantly shorter.

Another contention was that the compliance costs would be very high: perhaps $1.5 billion over two years as public agencies replace accounting systems and/or hire expensive consultants. But neither of these options is necessary.

The XBRL community includes firms that offer document production solutions, which can take the form of Software-as-a-Service (SaaS) web sites, desktop software, or Excel add-ins, as well as companies that can prepare an XBRL version of a financial statement from the filer's PDF.

Open-source tools, which are free to use, are also available.

During the runup to implementation, the community will be updating their products to support ACFRs and other municipal market disclosure.

Open data standards foster competition among tool and service providers which keeps costs low and encourages innovation. Reporting packages and applications in use today by government entities can be adapted to work with the open standard, minimizing potential disruption to issuers.

Municipal market participants who want to learn more about machine-readable disclosure are welcome to join a free webinar hosted by XBRL US and University of Michigan CLOSUP on Jan. 24.

Even if concerns over implementation time and cost are overblown, some industry observers still question the need for machine-readable municipal disclosure. After all, market participants have been investing in bonds based on paper disclosures, PDFs, or perhaps not even consulting disclosures at all, so why bother?

But since research shows that certain financial ratios are associated with heightened default probabilities, ignoring the data in municipal disclosures is a recipe for making suboptimal investment decisions.

The inability to quickly access free fundamental issuer data sets the municipal bond market apart from the U.S. corporate securities markets and is one reason why our market is so inefficient. Corporate securities investors can quickly find issuer data on SEC EDGAR or one of a dozen free web sites.

Machine-readable disclosures will lead to the commoditization of municipal finance fundamentals

because it will become extremely inexpensive to create municipal databases from XBRL filings. While data commoditization may be an adverse development for today's data vendors, it is a prerequisite for an efficient municipal securities market, which will benefit issuers and investors alike.

By Marc Joffe

BY SOURCEMEDIA | MUNICIPAL | 01/04/23 09:13 AM EST

White Paper: Structured Data is Coming to the Municipal Securities Market–Now What? - Ballard Spahr

The Financial Data Transparency Act of 2022 (FDTA), enacted by Congress as Title LVIII of the National Defense Authorization Act for Fiscal Year 2023, was signed into law by President Biden on December 23, 2022. The FDTA is likely to usher in significant changes in how information is prepared, disseminated, and consumed by municipal securities market participants.

Please see Publication below for more information.

by Teri Guarnaccia, Ernesto Lanza, Kimberly Magrini

January 6, 2023

Ballard Spahr LLP

Designation Information Regarding Mandatory Participation in MSRB Business Continuity and Disaster Recovery Testing.

View the MSRB Informational Notice.

Notice 2023-01 – Informational Notice

Publication date: 01/05/2023

SEC Proposes Comprehensive Best Execution Framework for Broker-Dealers: Sidley

On December 14, 2022, the U.S. Securities and Exchange Commission (SEC) proposed rules that would establish SEC best execution rules and impose related obligations on firms subject to the standard (the Proposal).1 The Proposal would generally require brokers, dealers, government securities brokers, government securities dealers, and municipal securities dealers (collectively, broker-dealers) to have detailed policies and procedures addressing how they achieve best execution for their customer orders, with heightened obligations for broker-dealers subject to certain conflicts of interest.2

Specifically, the SEC is proposing three rules — Proposed Rules 1100, 1101, and 1102 under the Securities Exchange Act of 1934, as amended (Exchange Act) — to implement its best execution framework for broker-dealers. The Proposal is broad in scope and would apply to customer transactions in all securities.3

The comment deadline is March 31, 2023, or 60 days after publication of the Proposal in the *Federal Register*, whichever is later. The Proposal was made concurrently with three other SEC proposals that are interrelated and could significantly change practices related to securities order handling and execution.4 The proposals collectively appear to advance the SEC's view that better prices for investors may result through encouraging competition among trading venues and increasing trading through certain exchanges or alternative trading systems (ATSs) that disseminate quotations rather than over-the-counter (OTC) market makers.5 The Proposal is unique among the four proposals in that it would apply to all securities transactions (e.g., equities, fixed income, private securities, digital assets), while the other three proposals apply only to national market system (NMS) stock.

Key Takeaways

If the Proposal is adopted, broker-dealers would need to undergo a thorough compliance review of their practices for handling customer orders to determine whether they have policies and procedures sufficiently detailed to satisfy the specified criteria. While broker-dealers may already have policies and procedures designed to comply with the Financial Industry Regulatory Authority, Inc. (FINRA) Rule 5310 and the Municipal Securities Rulemaking Board (MSRB) Rule G-18, many aspects of the Proposal extend beyond FINRA and MSRB requirements, such as provisions for conflicted transactions (as described in more detail below). Broker-dealers would also need to have an established process to conduct the required execution quality reviews and comparisons.

Broker-dealers, particularly those that engage in conflicted transactions, may also have to consider changes to their business models or current practices if necessary to satisfy the new obligations under the Proposal. For example, broker-dealers may need to incur the expense of incorporating access to additional markets into the broker-dealer's order handling practices. The SEC claims the policies- and procedures-based nature of the Proposal would provide broker-dealers "flexibility to exercise [their] expertise and judgment when executing customer orders";6 however, the prescriptive criteria established by the Proposal would effectively require broker-dealers to assess and potentially modify existing practices to satisfy the policies and procedures they would be required to adopt.7

The Proposal would provide an alternative compliance mechanism for introducing brokers that meet certain conditions (as described in more detail below). Broker-dealers that seek to qualify as introducing brokers may similarly need to modify their business practices to satisfy the qualifying criteria under the Proposal, such as by no longer accepting payment for order flow. Even if a broker-dealer meets the introducing broker criteria, such broker-dealer would have to develop a process by which it can compare the execution quality of its executing brokers to other executing brokers.

In many ways, the Proposal would extend beyond the current FINRA and MSRB best execution rules. Key examples include that the Proposal

- explicitly requires a more detailed assessment of specified factors relevant to a best execution analysis to be included in a broker-dealer's policies and procedures
- imposes additional policies and procedures obligations and documentation requirements for conflicted transactions
- applies its execution quality review requirements to a broader range of broker-dealers
- requires a comparative analysis as part of its execution quality reviews (which is consistent with

FINRA but broader than the MSRB)
- provides a narrower exception for introducing brokers with more strict qualification requirements

The SEC states that the Proposal would not alter broker-dealers' existing obligations to comply with the FINRA and MSRB Rules and that broker-dealers should comply with any additional or more specific requirements in each rule, as applicable. Nevertheless, it remains unclear whether FINRA or the MSRB would amend their best execution rules if the Proposal is adopted.

Overall, many questions remain about whether the proposal is necessary and how, if at all, it may be reasonably justified to address regulatory gaps. Much of what the SEC proposes, excepting its not-so-subtle attempt to eliminate payment for order flow practices, is not new and would be consistent with the guidance, examination, and enforcement activity conducted by FINRA in this area.8

Background

The duty of best execution, which predates the federal securities laws, generally requires that a broker-dealer execute a customer's trades at the most favorable terms reasonably available under the circumstances. Today, FINRA has a rule detailing the best execution obligations of its member broker-dealers and has, through enforcement actions and regulatory notices, issued guidance to its members on those obligations.9 The MSRB has a comparable best execution rule applicable to municipal securities dealers for transactions in municipal securities.10 However, there is currently no SEC rule or standard governing best execution for broker-dealers' customer orders.

According to the SEC, the impetus for the Proposal is its belief that the existing regulatory framework can be made more effective. The SEC is concerned that current best execution policies and procedures may vary and alleges that customers would benefit from "consistently robust best execution practices" with "heightened attention" by broker-dealers that have certain order handling conflicts of interest.11 The SEC also states that the Proposal would enable it to exercise additional enforcement capabilities.

Regulation Best Execution

Best Execution Standard

The Proposal would establish a best execution standard for broker-dealers, requiring a broker-dealer to use reasonable diligence to ascertain the best market for a security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions (referred to as the "most favorable price").12

Policies and Procedures

The Proposal would require broker-dealers to establish, maintain, and enforce written policies and procedures addressing how the broker-dealer will comply with the best execution standard and make routing or execution decisions for customer orders, including by

- obtaining and assessing reasonably accessible price, volume, and execution quality information concerning markets trading the relevant securities
- identifying markets reasonably likely to provide the most favorable prices
- incorporating those markets into the broker-dealer's order handling practices and ensuring it can efficiently access each of them
- assessing reasonably accessible and timely information with respect to displayed prices, price improvement opportunities, and order exposure opportunities
- assessing customer order attributes and securities trading characteristics

- balancing the likelihood of obtaining better prices in assessing additional markets with the risk that a delay in executing a customer order could result in a worse price

Conflicted Transactions

A broker-dealer transacting with a retail customer13 that engages in a principal trade or routes to or from an affiliate or provides or receives payment for order flow14 (each a "conflicted transaction") would be subject to additional obligations under the Proposal. In particular, these broker-dealers' best execution policies and procedures must address how the broker-dealer will obtain and assess additional information and evaluate a broader range of markets beyond what is required for nonconflicted transactions. In addition, these broker-dealers would have to document the details of any payment for order flow arrangement and their compliance with the best execution standard for conflicted transactions, including their efforts to enforce their policies and procedures and the basis and information relied on for their determination that the conflicted transaction was consistent with the best execution standard.

Other than a questionable requirement for the broker-dealer to assess and consider immaterial market centers, the Proposal is largely consistent with current FINRA guidance and application. Moreover, the SEC admits that compliance with this aspect of the Proposal would be more expensive than what is received through payment for order flow so that a significant number of broker-dealers would elect to stop receiving payment for order flow.15

Regular Review of Execution Quality

The Proposal would require broker-dealers to, at least quarterly, review the execution quality of their customer transactions, compare such execution quality with the execution quality that might have been obtained from other markets, and revise their best execution policies and procedures and order handling practices accordingly.16

Introducing Brokers

The Proposal would provide an alternative compliance mechanism for a broker-dealer that routes its customer orders to another broker-dealer for execution and meets certain conditions17 (referred to as an "introducing broker"). Rather than comply with the policies and procedures and execution quality review requirements described above, an introducing broker would need to have policies and procedures that require it to regularly review the execution quality obtained from its executing broker, compare such execution quality with what it might have obtained from other executing brokers, and revise its order handling practices accordingly. This aspect of the Proposal regarding introducing brokers takes aim at the use of payment for order flow. Many introducing brokers route order flow to wholesalers that pay for order flow and execute orders in a principal capacity. Such arrangements may effectively be eliminated by the Proposal.

Annual Report

The Proposal would require broker-dealers (including introducing brokers) to, at least annually, conduct a review of their best execution policies and procedures and order handling practices and prepare a written report presented to the broker-dealer's board of directors.

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1 Exchange Act Release No. 96496 (December 14, 2022), https://www.sec.gov/rules/proposed/2022/34-96496.pdf.

2 While the proposed rules apply to broker-dealers, investment advisers should pay close attention to the Proposal.
The SEC was careful to note in the Proposal that investment advisers have a similar duty to seek best execution of a client's transactions where the adviser has responsibility to select broker-dealers to execute client trades. See Proposal at 11 n.11.

3 The SEC specifically emphasized that the Proposal would also apply to any digital asset that is a security. Proposal at 37 (referring to a "digital asset" as "an asset that is issued and/or transferred using distributed ledger or blockchain technology …, including, but not limited to, so-called 'virtual currencies,' 'coins,' and 'tokens' ").

4 See Sidley updates: SEC Proposes Rule to Enhance Competition for Certain Individual Investor Orders; SEC Proposed Amendments to Modernize Disclosure of Order Execution Information; and SEC Proposes Rules Related to Minimum Pricing Increments, Access Fee Caps, and Transparency of Better Priced Orders.

5 See Chair Gary Gensler, Competition and the Two SECs, address before the SIFMA Annual Meeting (October 24, 2022), https://www.sec.gov/news/speech/gensler-sifma-speech-102422.

6 Proposal at 9.

7 For example, because broker-dealers engaging in conflicted transactions would be required to have policies and procedures that address how the broker-dealer will obtain and assess additional information and evaluate a broader range of markets beyond those identified as material potential liquidity sources, they may ultimately need to seek additional market information or connect to new trading venues.

8 "The release is thinner when it comes to assessing how the rule alone, or in combination with the other rules on today's dockets, will change markets and affect investors." Commissioner Hester M. Peirce, Is This the Best Execution We Can Get? (December 14, 2022), https://www.sec.gov/news/statement/peirce-best-execution-20221214.

9 See FINRA Rule 5310. See also, for example, FINRA Regulatory Notice 15-46, Best Execution: Guidance on Best Execution Obligations in Equity, Options, and Fixed Income Markets (November 2015), https://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-46.pdf.

10 See MSRB Rule G-18. See also MSRB Implementation Guidance on MSRB Rule G-18, on Best Execution (last updated February 7, 2019), https://msrb.org/Implementation-Guidance-MSRB-R-le-G-18-Best-Execution.

11 Proposal at 7.

12 The Proposal sets forth certain exemptions for a broker-dealer where (i) another broker-dealer is executing a customer order against the broker-dealer's quote, (ii) an institutional customer exercising independent judgment executes an order against the broker-dealer's quote, or (iii) the broker-dealer receives an unsolicited instruction from a customer to route its order to a particular market. This is consistent with existing FINRA guidance and application. The Proposal would not include an exemption for transactions with a "Sophisticated Municipal Market Professional" that is currently in place under MSRB Rules. See MSRB Rules G-48(e) and D-15.

13 A "transaction for or with a retail customer" would be defined as "any transaction for or with the account of a natural person or held in legal form on behalf of a natural person or group of related

family members." Proposed Rule 1101(b)(4)(i).

14 See 17 CFR 240.10b-10(d)(8) (defining "payment for order flow").

15 See Proposal at 344-45, 357-58.

16 The SEC states that while comparable to existing FINRA and MSRB requirements this review obligation would apply to more broker-dealers than FINRA Rule 5310 and be more frequent than under MSRB Rule G-18. See Proposal at 134-37.

17 These conditions include that the broker-dealer (i) does not carry customer accounts or hold customer funds or securities, (ii) has entered into an arrangement with an unaffiliated broker-dealer to handle and execute all of its customer orders on an agency basis, and (iii) has not accepted any payment for order flow from the executing broker. Proposed Rule 1101(d)(1)-(3).

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December 29, 2022

Municipal Securities Disclosure Will Be Subject To New Data Standards.

The Financial Data Transparency Act of 2022 (the "Act"), which was included as part of the National Defense Authorization Act, was signed into law on December 23, 2022. The Act requires that various federal regulatory agencies jointly issue proposed rules within eighteen (18) months, which establish data standards for financial disclosure. Final rules must then be enacted no later than two (2) years from passage of the Act after public comment is received.

Within two (2) years after promulgation of these final rules, the Securities and Exchange Commission (the "SEC") must then issue compatible rules that apply to information submitted to the Municipal Securities Rulemaking Board by issuers and obligors of municipal securities. With this two-step process for promulgation of rules, the final rules that will govern disclosure for municipal securities may not become effective for four (4) years.

The Act requires that the SEC consult with market participants in establishing these data standards. The SEC "may scale those data standards in order to reduce any unjustified burden on smaller regulated entities." The Act also mandates that the SEC "seek to minimize disruptive changes to the persons affected by those rules."

The Act sets forth certain requirements for the data standards adopted by the SEC such that the rules must, to the extent practicable:

1. render data fully searchable and machine-readable;
2. enable high quality data through schemas, with accompanying metadata documented in machine-readable taxonomy or ontology models, which clearly define the semantic meaning of the data;
3. ensure that a data element or data asset be consistently identified in associated machine-readable metadata;
4. be nonproprietary or made available under an open license;

5. incorporate standards developed and maintained by voluntary consensus standards bodies; and
6. use, be consistent with, and implement applicable accounting and reporting principles.

It is anticipated that the rules will adopt a structured data format similar to extendable business reporting language (XBRL), which is currently required by the SEC for private companies.

The new data standards will likely increase the costs of municipal disclosure for issuers and obligors who may need outside services or software to ensure compliance. A full assessment of any additional costs and burdens will not be possible until the rules, and any exceptions, are promulgated and finalized by the SEC, though the Act makes clear that some new mandates will be imposed in the coming years.

Partridge Snow & Hahn LLP

by Eugene Bernardo II, David DiSegna

December 30, 2022

Real-Time Data on What Muni Bond Investors Think of Your City.

A new data tool offers a window into how investors are responding to changes affecting the financial outlook of individual governments, including trends like the rise of remote work.

Welcome back to Route Fifty's Public Finance Update! I'm Liz Farmer and this week, we're looking at a new way to gather data on how municipal bond market investors view changes in government finances.

While the muni market is still viewed as a sort of black hole by onlookers due to slow or inconsistent financial disclosure practices compared with the corporate world, the last decade or so has seen a lot of progress when it comes to analyzing bond issuance data. In particular, the Municipal Securities Rulemaking Board's EMMA database has made issuance information much more accessible. MSRB is now even experimenting with a data analytics component.

Still, getting comprehensive information about the secondary market—how muni bonds are traded—has required a lot of individual legwork. But now thanks to a new dashboard developed by the University of Chicago's Center for Municipal Finance, our window into what investors are doing and thinking just became a lot clearer. It's similar to the S&P CoreLogic Case-Shiller Home Price Index, but for muni bonds. In the same way that real estate agents, buyers and sellers use the home price index to inform their decisions, market participants can use the Center for Municipal Finance Muni Index to get a more contextualized picture of the fiscal health of cities, counties and school districts. The Index goes up when investors are willing to pay higher prices for an issuer's bonds, and vice versa.

Continue reading.

Route Fifty

By Liz Farmer | DEC 20, 2022

Brokerage Firm Settles Charges for Violations of Muni "Private Placement" Requirements.

A brokerage firm settled SEC charges for failing to comply with the disclosure requirements under Exchange Act Rule 15c2-12 (“Municipal securities disclosure”) when acting as an underwriter in connection with multiple limited offerings of municipal securities.

According to the Order, the SEC found that the firm offered municipal securities in reliance on the limited offering exemption under Rule 15c2-12. The exemption would have permitted the firm to make the offerings without Rule 15c2-12’s “continuing disclosure undertaking.” The SEC said that to qualify under the limited offering exemption, a firm is required to limit the distribution to (i) no more than 35 persons, (ii) persons who hold the requisite financial experience and knowledge and (iii) persons who are not purchasing for multiple accounts or intending to distribute. The SEC found that for 36 limited offerings, the broker-dealer sold these securities without first forming a reasonable belief that these requirements were met.

The SEC determined that the firm violated Exchange Act Rule 15c2-12, Exchange Act Section 15B(c)(1) (“Municipal securities”) and MSRB Rule G-27 (“Supervision”). To settle the charges, the firm agreed to (i) cease and desist, (ii) a censure, (iii) a civil monetary penalty of $100,000 and (iv) disgorgement of $81,362 with an additional $16,961 in prejudgment interest.

Fried Frank Harris Shriver & Jacobson LLP

December 23 2022

The Financial Data Transparency Act: Orrick

The Financial Data Transparency Act of 2022 (Act) will change the way issuers and obligors of municipal securities report required disclosure information on the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access website (EMMA). In short, the Act requires the Securities and Exchange Commission (SEC)[1] to create organizational standards for information reported by issuers and obligors on EMMA. The goal of the Act is to provide users with an easier way to view, access, and explore the contextual information of the underlying data.

Here’s what you need to know:

What Happened?

The Act was passed into law on December 23, 2022. The Act directs certain regulatory agencies (including the SEC) to jointly issue proposed rules for public comment that establish new data reporting standards within 18 months of enactment of the Act. These new SEC rules will impact entities that post on EMMA. Proponents of the Act believe it will make the information collected and made publicly available by regulatory agencies easier to access, analyze and compare by requiring data to be posted in a machine-readable format, similar to the requirements for the information posted to the Electronic Data Gathering, Analysis and Retrieval system (EDGAR) by publicly traded companies, mutual funds and other regulated entities. The Act only changes how information is submitted; it does not contain any new disclosure requirements.

What Will the Law Change for Affected Issuers and Obligors?

The Act will require that information posted on EMMA be structured so that it is fully searchable and consistently identifiable by machine-readable technologies through the use of identifier codes or tags (i.e., structured data). Structured data allows the reader to access more granular information about the data presented, such as the accounting codifications and guidance associated with the information.[2] Additionally, the Act requires information to be made available in an open data format that allows for digital access and bulk downloads with no restrictions.

It is anticipated that the SEC will require data collection in a structured format such as the extendible business reporting language (or XBRL) format, with each piece of data being tagged/barcoded to enable simpler comparisons between sets of data. XBRL is an open standard, commercially available software language that is nonproprietary and royalty free. Benefits of XBRL are that it can identify what is and is not reported and any data quality errors.[3] XBRL can also compare results across data sets and generate time series charting and benchmarking.[4] The SEC first implemented structured data requirements in 2009, and currently, both the SEC and the Federal Energy Regulatory Commission require information reported by their regulated entities to be in the Inline XBRL format, which allows readers to download information directly into spreadsheets for comparison and analysis purposes.

To implement the structured data standard, the SEC must develop taxonomies or classifications to create standard tags for the reporting of information. Each reporting entity must translate data from its accounting system into a format consistent with the classifications developed by the SEC. Once the initial translation is complete, if an entity's financial statements include unique line items, it may create an "extension" to a standard tag to modify the nomenclature so that it corresponds to its existing unique line items.[5] For example, if an entity refers to "net revenues" as "operating revenues," it may extend the "net revenues" tag to refer instead to "operating revenues."[6] Although extensions provide entity-specific information that may facilitate meaningful analysis, extensions diminish the comparability of data across entities, which is one of the main purposes of structured data.

Who Does the Law Most Affect?

The Act, once implemented after the rules are finalized, may significantly alter the way issuers and obligors format the information posted to EMMA. Specifically, the translation of financial information into a format consistent with the classifications developed by the SEC may be different from the format currently required by the Government Accounting Standards Board (GASB), Financial Accounting Standards Board (FASB) and Generally Accounting Standards Board (GAAP). The National League of Cities[7] and the Government Finance Officers Association[8] (GFOA) recently raised concerns about the new reporting requirements, including cost concerns and concerns that information unique to a specific type of issuer such as a state, city, public utility provider or hospital will be lost in the standardization of information.

Inherent with the new standards will be the increased costs of preparing, reviewing and validating that the information presented in the new form is an accurate representation of the underlying data. The GFOA predicted that the transition to standardized reporting categories will be costly, and the "unfunded mandate [will] require extensive staff time along with the need for consulting resources and potentially risky updates to governmental financial systems."[9] In 2017, the CFA Institute conducted a study of companies required to report in a structured data format and found that although implementation of structured data was initially costly, over time larger companies reduced the number of outsourcing services used to create their XBRL filings as they became more confident in preparing and reviewing their reports in-house.[10] However, smaller companies found the costs

of the structured data reporting requirement as a consistent burden given their limited resources.[11]

To minimize the burden of implementation of the structured data standards, the Act directs the SEC to consult with market participants, scale the data standards in order to reduce any unjustified burden on smaller entities and minimize disruptive changes to the affected entities. These requirements were added to the final version of the Act to address concerns from municipal market participants about the increased costs of implementing the structured data format, including increased capital costs for the purchase of software, increased operating expenses for entities that contract with a third-party vendor to perform data tagging services and increased personnel costs for the preparation and review of the data. In the municipal securities market, the Act applies only to issuers and obligors that are required to file continuing disclosure reports on EMMA. As such, it remains to be seen whether the increased costs associated with implementing the new rules will create a barrier to entry in the municipal market for smaller governmental issuers and nonprofit organizations who may choose to avoid the new requirements by opting for private placement offerings that are exempt from such continuing disclosure obligations.

What Happens Next?

The SEC will work with the other regulating entities named in the Act to draft rules for public comment within the next 18 months. The Act does not mandate a specific time period for public comments to be received and reviewed by the regulated entities. Once the public comment period ends and the final rules are issued, issuers and obligors that are required to post on EMMA will have two years before they must comply. This means that the earliest possible date for when affected entities will need to transform their EMMA filings is over 3 ½ years away (and likely much longer given that time will be needed for public comments and the release of the final rules). It remains to be seen what consequences might apply to municipal issuers and obligors that fail to report in the new machine-readable, structured data format when required, although it is expected that the new rules will likely explain the effect of non-compliance with the reporting requirements. In the corporate world, for public companies already subject to structured data requirements, non-compliance means the subject company is non-compliant with statutory reporting requirements and is deemed to not have adequate public information available for purposes of Rule 144 of the Securities Act of 1933.

Affected entities should get involved in the design of the data standards by participating in the public comment process with the SEC. To minimize implementation costs, aligning the new standards with current reporting requirements under GASB, FASB or GAAP is crucial. Additionally, as the national data standards are promulgated, local issuers should contact state agencies to work towards synchronizing any state reporting requirements with the new national reporting requirements. Issuers and obligors of municipal securities may also consider earmarking resources to implement the requirements of the Act as the implementation date approaches.

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[1] The Act as first passed by the House of Representative originally provided for the MSRB to set and implement the new rules. However, municipal bond issuers expressed their concerns about expanding the MSRB's current authority over state and local governments as bond issuers in contravention of the Tower Amendment. Under the Act as passed, the SEC, which is subject to congressional oversight, will design and implement the new rules for the municipal market.

[2] Caroline A. Crenshaw, Commissioner, U.S. Sec. and Exch. Comm'n, The Lessons of Structured Data, November 10, 2021, located at https://www.sec.gov/news/speech/crenshaw-lessons-structur-

d-data-111021.

[3] Id.

[4] Id.

[5] U.S. Sec. and Exch. Comm'n, Interactive Data for Financial Reporting, https://www.sec.gov/corpfin/infosmallbussecginteractivedata-secg (last visited Dec. 16, 2022).

[6] Id.

[7] Michael Gleeson, Proposed Legislation Includes Costly Unfunded Mandates for Local Governments, National League of Cities, https://www.nlc.org/article/2022/12/15/what-you-need-to-know-about-the-financial-data-transparency-act/, (last updated Dec. 15, 2022).

[8] New Financial Reporting Requirements for Governments Proposed in U.S. Senate: A Costly and Burdensome Unfunded Mandate, Government Finance Officers Association, https://www.gfoa.org/new-financial-reporting-requirements-proposed (last visited Dec. 19, 2022).

[9] Id.

[10] Mohini Singh, ACA, The Cost of Structured Data: Myth vs. Reality, CFA Institute, https://us.aicpa.org/content/dam/aicpa

/interestareas/frc/accountingfinancialreporting/xbrl/downloadabledocuments/cfa-institute-the-c-st-of-structured-data.pdf, (last visited Dec. 16, 2022).

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by James Hernandez, Jenna Magan, Donna McIntosh, Hoang Vu

December 27, 2022

Orrick, Herrington & Sutcliffe LLP

SEC Charges PNC in Latest Limited Offering Disclosure Action.

PNC Capital Markets (PNC) has been added to the newly-formed list of underwriters who failed to meet the exemption requirements in connection with 36 limited offerings in violation of Securities and Exchange Commission Rule 15c2-12 and Municipal Securities Rulemaking Board Rule G-27 on supervision.

Without admitting or denying the findings, PNC agreed to be censured and pay disgorgement of $81,362, prejudgment interest of $16,961 as well as a civil money penalty of $100,000. The administrative action comes just over three months after the SEC filed litigation against Oppenheimer & Co., in addition to three separate administrative settlements against BNY Mellon Capital Markets, TD Securities and Jefferies for failing to comply with municipal bond offering disclosure requirements in connection with limited offerings.

Those actions were the first time the Commission had ever charged underwriters in such fashion, and the swift follow-up suggests this has been an area of focus for the SEC's public finance

enforcement team. All underwriters charged for failing to comply with the limited offering exemption allegedly violated SEC Rule 15c2-12, which generally requires underwriters to obtain disclosure documents from issuers and to reasonably determine that the issuer is able to provide certain information on a continuing basis to the MSRB.

But the rule contains an exemption from those requirements for municipal securities issuances in denominations of $100,000 or more sold to no more than 35 persons if the underwriter reasonably believes the purchaser is capable of evaluating the merits of the investment as well as if the purchaser is not doing so for more than one account with a view to distribute.

“From at least March 2018 through November 2021, PNC acted as sole underwriter for at least 36 offerings of municipal securities where it sought to rely on the exemption provided in Exchange Act 15c2-12(d)(1)(i), but where the offerings did not actually satisfy the exemption’s requirements,” the complaint said. “PNC did not provide investors in these securities with copies of any preliminary official statement or final official statement for the securities, or determine that a continuing disclosure undertaking has been entered into by the issuer, or an obligated person, as required by Exchange Act Rule 15c2-12(b).”

With these 36 limited offerings, PNC sold the bonds to broker-dealers and/or investment advisors with separately managed accounts and when the sale occurred, PNC did not have a reasonable belief that the broker-dealers and investment advisors were purchasing the bonds for investments as required under Exchange Act Rule 15c2-12(d)(1)(i).

PNC did not inquire further as to whether the brokers were purchasing the securities for more than one account or for distribution and failed to ascertain for whom the bonds were purchased.

“PNC was therefore unable to form a reasonable belief that the broker-dealers and investment advisors were purchasing the securities for investors who possessed the necessary knowledge and experience to evaluate the investments,” the complaint said. “As a result, these 36 limited offerings did not qualify for the exemption under Exchange Act Rule 15c2-12(d)(1)(i).”

The SEC also found that the firm failed to consistently follow or enforce its own policies, which required that each municipal primary offering be evaluated to determine whether it was exempt from the rule, and maintain documentation and evidence that the exemption was met. The failure to do was a violation of the MSRB’s supervisory rule, which requires that firms “adopt, maintain, and enforce” procedures “reasonably designed” to ensure compliance with all applicable laws and rules, the SEC found.

PNC did not immediately respond to a request for comment.

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 12/22/22 09:43 AM EST

Comment Deadline Set for MSRB Proposal to Extend Electronic Registration Filing Deadline.

The MSRB proposed a rule change to extend the time period to January 31 to annually affirm the information on Form A-12, the MSRB’s consolidated electronic registration form. The operative date for the proposed rule is January 1, 2023. The MSRB will accept comments on the proposal until

January 12, 2023. The Notice was published in the Federal Register.

The rule change applies to brokers, dealers and municipal securities dealers and municipal advisors.

As previously covered, the proposal would also remove the requirement for firms to provide a separate notice to regulators in Form A-12 prior to engaging in municipal securities or municipal advisory activities. Instead, each firm would be required to provide (i) its principal regulator (which will be a banking agency for banks that are registered as muni dealers) and (ii) contact information for the firm's contact at that regulator. The primary regulatory contact at a municipal advisor firm would also be required to register as a municipal advisor principal after passing the Series 54 Municipal Advisor Principal Qualification Examination.

Fried Frank Harris Shriver & Jacobson LLP

December 22 2022

GASB Proposes Guidance To Assist Stakeholders With Application Of Its Pronouncements.

Norwalk, CT, November 15, 2022 — The Governmental Accounting Standards Board today issued proposed implementation guidance in the form of questions and answers intended to clarify, explain, or elaborate on certain GASB pronouncements.

The Exposure Draft, *Implementation Guidance Update—2023*, contains proposed new questions and answers that address application of GASB standards on leases, subscription-based information technology arrangements, and accounting changes. The proposal also includes amendments to previously issued implementation guidance on leases.

The GASB periodically issues new and updated guidance to assist state and local governments in applying generally accepted accounting principles (GAAP) to specific facts and circumstances that they encounter. The GASB develops the guidance based on:

- Application issues raised during due process on GASB pronouncements,
- Application issues identified during the first stage of the GASB's post-implementation reviews of the leases standards,
- Questions it receives throughout the year, and
- Topics identified by members of the Governmental Accounting Standards Advisory Council and other stakeholders.

The guidance in Implementation Guides is cleared by the Board and constitutes Category B GAAP.

Stakeholders are asked to review the proposal and provide input to the GASB by January 20, 2023. Comments may either be submitted in writing or through an electronic input form.

More information about commenting on the Exposure Draft can be found in the front of the document, which is available on the GASB website, www.gasb.org.

MSRB Amends Rule A-12, on Registration, and Provides Accompanying Form A-12 Changes.

View the MSRB notice.

12/13/2022

MSRB Proposes Extending Filing Deadlines.

The MSRB proposed extending the deadline for muni brokers, dealers, municipal securities dealers and municipal advisors to annually affirm the information on Form A-12, the MSRB's consolidated electronic registration form (*see* MSRB Rule A-12.)

The proposal would extend the deadline to affirm Form A-12 information from 17 business days after January 1 to January 31. The proposal would also remove the requirement for firms to provide a separate notice to regulators in Form A-12 prior to engaging in municipal securities or municipal advisory activities. Instead, each firm will be required to provide (i) its principal regulator (which will be a banking agency for banks that are registered as muni dealers) and (ii) contact information for the firm's contact at that regulator. The primary regulatory contact at a municipal advisor firm would also be required to register as a municipal advisor principal after passing the Series 54 Municipal Advisor Principal Qualification Examination.

The MSRB filed the rule change for immediate effectiveness, and it will go into effect beginning on January 1, 2023.

December 14 2022

Fried Frank Harris Shriver & Jacobson LLP

New State and Local Government Financial Reporting Requirements Headed to Biden's Desk.

State and local advocates opposed the provisions, which were attached to a massive defense bill and call for financial data to be standardized, searchable and machine-readable.

The U.S. Senate on Thursday sent legislation to President Biden's desk that includes new financial reporting requirements for states and local governments that critics say will be difficult and expensive for them to comply with.

Government organizations, including the National League of Cities, the U.S. Conference of Mayors, the National Association of Counties and the Government Finance Officers Association, told Senate leaders in a letter that it would cost governments and charities "well over $1.5 billion" to meet the new standards, including a requirement for financial data to be in a standardized, machine-readable and searchable format.

Despite those concerns, the provisions were embedded into an $858 billion defense bill the Senate

passed in on an 83-11 vote. The House passed the National Defense Authorization Act last week, meaning it now just needs Biden's signature to become law.

Continue reading.

Route Fifty

By Kery Murakami

DECEMBER 15, 2022

Financial Accounting Foundation (FAF) Trustees Reappoint Chair and Vice Chair of the Governmental Accounting Standards Advisory Council (GASAC).

Norwalk, CT, November 15, 2022 — The Board of Trustees of the Financial Accounting Foundation (FAF) announced today the reappointment of Elizabeth Pearce as chair and Robert Hamilton as vice chair of the Governmental Accounting Standards Advisory Council (GASAC) respectively. Both will serve their terms starting January 1, 2023 and concluding on December 31, 2024, at which time they will be eligible for reappointment for one additional term.

The GASAC advises the Governmental Accounting Standards Board (GASB) on strategic and technical issues, project priorities, and other matters that affect standards setting. Members of the GASAC are responsible for consulting with the GASB on technical issues on the Board's agenda, project priorities, matters likely to require the attention of the GASB, and such other matters as may be requested by the GASB or its chair.

"The FAF and the GASB are pleased to have both Elizabeth and Robert serve in these essential roles. As members of the GASAC, and during their first terms as chair and vice chair, they have shown a genuine interest in listening to all perspectives while also sharing their own. They are both thoughtful when giving their opinions and are well received by other GASAC members," said Kathleen L. Casey, chair of the Financial Accounting Foundation. "We are excited for them to continue in these leadership roles and in their continuing encouragement of all GASAC members to share their views to enhance the standards-setting process," added Ms. Casey.

For a complete list of current GASAC members, visit the GASAC webpage.

MSRB Seeks Board of Directors Applicants.

Washington, D.C. – The Municipal Securities Rulemaking Board (MSRB), the self-regulatory organization (SRO) established by Congress to safeguard the $4 trillion municipal securities market, is soliciting applications for four positions on its Board of Directors for the 2024 fiscal year. Selected candidates will be elected to four-year terms beginning October 1, 2023, where they will have the opportunity to oversee the advancement of the organization's Strategic Plan to deploy the tools of regulation, technology and data in impactful ways that strengthen the municipal market and serve the public interest.

"In order to uphold the public's trust in the municipal market's SRO, we must ensure our governing

Board is diverse and inclusive and reflects the wide variety of perspectives that contribute to the field of public finance across our nation," said Thalia Meehan, MSRB Board member and Chair of the Board's Nominating Committee, which leads the process of identifying new Board members. "While we are particularly interested in applicants with compliance, technology and data proficiency, we encourage individuals with municipal securities experience from all regions of the United States to apply for membership on the Board."

The Board is charged with setting regulatory policy, authorizing rulemaking, enhancing market transparency systems and overseeing operations for the organization. The Board is currently overseeing the execution of the MSRB's long-term strategic goals of modernizing the MSRB rule book, enhancing market transparency through investments in technology, fueling innovation through data, and upholding the public trust through a commitment to social responsibility, diversity, equity and inclusion. Board members are compensated for their service.

Board Composition

The Board is composed of 15 total members. During the current nominating process, the Board will elect two public and two regulated representatives to join a Board that will consist of eight members who are representatives of the public, including investors, municipal entities and other individuals not regulated by the MSRB, and seven members from firms that are regulated by the MSRB, including representatives of broker-dealers, banks and non-dealer municipal advisors. With respect to the two public member positions, the MSRB is interested in including an investor in municipal securities, either institutional or retail. All applicants must be knowledgeable of matters related to the municipal securities market.

Application Details

Applications are available on the MSRB Board of Directors Application Portal and will be accepted from December 14, 2022 through February 6, 2023. At least one letter of recommendation must be submitted with the application. Additional details on the Board application process, information about Board service requirements and FAQs are available on the MSRB's website. Questions regarding the application and selection process should be directed to Jake Lesser, General Counsel, at 202-838-1395 or jlesser@msrb.org.

Date: December 14, 2022

Contact: Leah Szarek, Chief External Relations Officer
202-838-1300
lszarek@msrb.org

The Municipal Securities Rulemaking Board (MSRB) protects and strengthens the municipal bond market, enabling access to capital, economic growth, and societal progress in tens of thousands of communities across the country. The MSRB fulfills this mission by creating trust in our market through informed regulation of dealers and municipal advisors that protects investors, issuers and the public interest; building technology systems that power our market and provide transparency for issuers, institutions, and the investing public; and serving as the steward of market data that empowers better decisions and fuels innovation for the future. The MSRB is a self-regulatory organization governed by a board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is overseen by the Securities and Exchange Commission and Congress.

MSRB Announces Members of 2023 Compliance Advisory Group.

View the MSRB press release.

December 12, 2022

SEC Releases 2022 Enforcement Division Results: Dechert

The Securities and Exchange Commission ("SEC") released an annual summary, on November 15, 2022, of actions brought by the Division of Enforcement ("Division") over fiscal year 2022 ("Enforcement Summary"), providing an overview of its results and priorities over fiscal year 2022, Gurbir Grewal's first full year as the Division's Director.1 While these summaries, by their nature, always include a focus on the amounts obtained in penalties and disgorgement, and, in recent years the continuing importance of the whistleblower program to the Division's work, the overriding theme of this past year's report is the "breadth of issues" covered by the Division and the expectation of more proactive enforcement sweeps to come.

Overview

In fiscal year 2022, the SEC filed a total of 760 enforcement actions, which represents a nine percent increase over fiscal year 2021. Over the past year, the SEC has generally sought large monetary results, as well as bespoke undertakings depending on the particular allegations in an action. In 2022, the SEC obtained a record $6.436 billion in disgorgement, civil penalties, and prejudgment interest. The increase of almost 70 percent compared to 2021 is largely attributable to the increase in civil penalties, which nearly tripled from $1.456 billion to $4.194 billion. The SEC also returned $937 million to affected investors, compared to $521 million in fiscal year 2021.

The Enforcement Summary emphasized that "individual accountability is a pillar of the SEC's enforcement program." To support this point, the SEC cited cases it had brought against public company senior executives and senior portfolio managers in the financial industry. The SEC also noted enforcement actions brought to compel clawbacks of public company executive compensation under Sarbanes-Oxley Section 304, which Director Grewal addressed in a speech given on the same day that the Enforcement Summary was released.2

The SEC has also been more willing to litigate than in past years, which the Enforcement Summary highlighted by noting that the Division litigated a record 15 trials in 2022, the most conducted in a single year over the past decade. The SEC has also been willing to bring actions against market participants notwithstanding potential collateral consequences, such as potential waivers, particularly when cases may send a "message" to the market concerning the Division's priorities. Director Grewal's November 15 speech noted in particular that, "proactive enforcement sweeps that specifically target recurring issues … not only demonstrate[] accountability, but also [have] a more pronounced deterrent effect than if the [SEC] filed separate standalone cases."

The Enforcement Summary drew particular attention to the Division's actions against 17 market participants for what the SEC described as "failures to maintain and preserve work-related text message communications conducted on employees' personal devices." These "off-channel communications" have been a focus of the Division over the past year and have led to $1.235 billion in civil penalties (or almost 30% of the $4.194 billion in total civil penalties for 2022), as well as

tailored undertakings, such as the retention of compliance consultants to ensure compliance going forward.

The SEC also identified other areas of focus for the Division, including financial fraud and issuer disclosures, gatekeepers, crypto assets, cybersecurity, ESG, private funds, insider trading and other market abuses, and complex investment products among others.

Substantive Areas of Focus

The Enforcement Summary highlighted the breadth and depth of the Division's enforcement actions over the past year, specifically naming certain industries and types of violations that the SEC found particularly noteworthy. For example, the SEC routinely brings a significant number of actions against market participants for inadequate or inaccurate disclosures. The Division continued that emphasis this year, with the SEC noting that it "places a high priority on pursuing issuers or their employees who make materially inaccurate disclosures, as well as auditors and their professionals who violate appliable laws and rules in connection with such disclosures." More broadly in this year's summary, the SEC made explicit the Division's focus on bringing actions against gatekeepers, including auditors, lawyers, and transfer agents, when the SEC believes that they "fail[] to live up to their heightened trust and responsibility."

With the continued expansion of the Division's Crypto Assets and Cyber Unit—it is set to nearly double in size—the SEC continues its focus on enforcement in the crypto asset space, as well as on cybersecurity violations broadly. For example, the SEC brought actions against crypto lending platforms, individuals in an alleged "crypto pyramid and Ponzi scheme," and those involved in insider trading related to a crypto asset trading platform. The SEC also brought actions regarding failures to comply with record-keeping and customer data requirements.

The Division continues to address "concerns" by investors regarding environmental, social, and governance ("ESG") issues. The Enforcement Summary noted that the Division will focus on principles of materiality, accuracy of disclosures, and fiduciary duty when evaluating potential enforcement actions against public companies and with regard to investment products and strategies.

The Division has increased its attention to the private funds industry, which it has signaled repeatedly over the past year. The SEC expressed its likely emphasis on the risks associated with the "unique features" of private investment, including "undisclosed conflicts of interest, fees and expenses, valuation, custody, and controls around material nonpublic information." The Division has brought several actions against private fund advisers and associated individuals over the past year, which have included fraud charges in some instances.

The Enforcement Summary also described actions over the past year addressing regulated entities, including broker-dealers and investment advisers,3 as well as associated individuals, including actions concerning trading restrictions placed on "meme stocks," failures to disclose conflicts of interest regarding SPACs, and the first action enforcing Regulation Best Interest.

As in prior years, the Division highlighted its market abuse actions involving violations such as insider trading, market manipulation, and cherry-picking, as well as actions involving complex products and strategies, and violations of the Foreign Corrupt Practices Act. Last, the Division summarized its activity in bringing actions involving public finance abuse, including actions in the municipal bond sector

Other Areas of Emphasis

In addition to the substantive areas highlighted as part of the Division's work during fiscal year 2022, the Enforcement Summary also highlighted the Division's process and areas of emphasis as it considers, investigates, and adjudicates potential enforcement actions. The SEC places an emphasis on the deterrent effect of its enforcement actions on future misconduct. For example, the Division "recalibrated penalties for certain violations," including using undertakings to require retention of compliance consultants, requiring admissions as part of settlements, and continuing to focus on individual accountability, with more than two-thirds of the SEC's stand-alone actions involving at least one individual defendant or respondent.

The Enforcement Summary also described the Division's continued use of sophisticated data analytics in assisting its work, noting a wide range of types of cases resulting from data analytics, including insider trading, market manipulation and "cherry picking." The Enforcement Summary discussed the SEC's continued support for its whistleblower program, noting its receipt of over 12,300 whistleblower tips that led to 103 awards totaling $229 million. The Enforcement Summary also noted the SEC's reliance on both parallel criminal proceedings and "[t]angible cooperation," including "significant remedial measures" by firms under investigation.

Looking Ahead to 2023

Fiscal year 2023 will likely continue to see an active enforcement climate. Chairman Gary Gensler, as well as Director Grewal and the enforcement staff, have made clear their desire to pursue alleged violations of the securities laws vigorously, including by "push[ing] the pace of investigations" and ensuring that the Division operates with "tremendous breadth." While the SEC is expected to face increased Congressional oversight with a new, Republican-controlled House of Representatives in 2023, we expect enforcement to continue apace, particularly in priority areas such as ESG, private funds, crypto and cybersecurity, and "high-impact" actions.

Conclusion

Fiscal year 2022 brought a significant rise in the number of actions filed by the SEC, as well as a new record in total money ordered to be paid by respondents. The familiar emphasis on actions involving regulated firms, financial fraud and inadequate disclosures was coupled with an increasing number of actions brought as a result of investigations by specialized teams, including the Crypto Assets and Cyber Unit and the Climate and ESG Task Force. Those trends can be expected to continue and, more likely than not, accelerate in the coming year.

To view all formatting for this article (eg, tables, footnotes), please access the original here.

Dechert LLP – David P. Bartels , Catherine Botticelli , Anthony S. Kelly, Mark D. Perlow, Dennis Lawson and Eric Auslander

December 12 2022

A Closer Look at Rule 15c2-12 Exemptions Following Unprecedented SEC Enforcement Actions: Frost Brown Todd

In September of 2022, the Securities and Exchange Commission (SEC) took enforcement actions against four municipal security underwriting firms for failing to comply with Rule 15c2-12 disclosure requirements. The firms believed that they were exempt from such requirements under the "limited offering exemption," yet they allegedly failed to satisfy the "reasonable belief" requirements

necessary for the disclosure exemption.

Three of the firms have since elected to settle with the SEC, agreeing to disgorgement, ranging from $40,000 to $656,000, and financial penalties, ranging from $100,000 to $300,000, while the fourth firm is proceeding with litigation. These enforcement measures are noteworthy as this is the first time that the SEC has taken action against an underwriter for failing to meet the legal requirements of Rule 15c2-12's disclosure exemption.

What You Need to Know About SEC Enforcement

These recent, unprecedented actions and statements made by the SEC regarding the use of the limited offering exemption by municipal underwriters indicate that compliance with the requirements of the exemption, specifically the reasonable belief component, has become an enforcement priority. The SEC appears to be setting the tone, with four major underwriting firms facing penalties and SEC staff having already begun investigations into other firms' reliance on the limited offering exemption. Gurbir S. Grewal, the director of the SEC's Division of Enforcement, has encouraged underwriters to examine their practices and self-report any failures "before we identify them ourselves."

Accordingly, now is the time for underwriters that utilize the limited offering exemption to strengthen or establish measures, whether through revised investment letters or written supervisory procedures, that ensure compliance with any Rule 15c2-12 exemptions they utilize.

Rule 15c-12's Disclosure Requirements and Exemption

In primary offerings of municipal securities, Rule 15c2-12 requires that an underwriter provide certain disclosures to investors in an effort to prevent fraudulent, deceptive, or manipulative acts or practices. However, Rule 15c2-12 also provides a limited offering exemption which discharges underwriters from their typical disclosure obligation in qualified transactions. To qualify for the limited offering exemption, the offering must be sold in denominations of $100,000 or more and sold to no more than 35 investors that the underwriter reasonably believes (1) have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and the risks of the prospective investment, and (2) are not purchasing for more than one account or with a view to distributing the securities.

According to the SEC, the four underwriting firms sold newly issued municipal bonds without providing the required Rule 15c2-12 disclosures, citing the limited offering exemption as their justification. The issue arises from the SEC alleging that the underwriting firms failed to demonstrate compliance with the previously mentioned reasonable belief requirements to qualify for the exemption. Specifically, in the SEC's view, the firms allegedly sold securities intending to meet the limited offering exemption without a reasonable belief that the purchasers were buying for their own account. The SEC observed that some of the broker-dealers who purchased the primary offering from one of the underwriters resold the securities to multiple customers. The SEC reasoned that therefore the underwriter in question "did not reasonably believe the broker-dealers were buying for their own accounts because the broker-dealers were in the business of servicing brokerage customer accounts." Further, since the firms failed to determine if the securities were being purchased for more than one account or for distribution, the SEC then reasoned that the firms were therefore also unable to have a reasonable belief whether the ultimate purchasers of the security had the requisite financial knowledge and experience to evaluate the investment.

SEC Comments and Guidance

The SEC's complaint against the firm that did not settle provides additional information as to the nature of the alleged violations, as well as guidance as to what the SEC views as the proper diligence required of an underwriter claiming the limited offering exemption. First, the SEC claims that in violation of Rule 15c2-12, the underwriting firms allegedly "made no inquiry to determine if those entities were buying on behalf of their customers and/or clients and, if so, whether such investors met the exemption criteria." The complaint provides a list of information that, at a minimum, an underwriter asserting the limited offering exemption must obtain about potential investors: (1) the size of each investor's investment, (2) the number of investors, (3) whether each investor is buying the securities for a single account, and (4) each investor's level of financial experience and/or sophistication.

Notably, however, the SEC does not provide guidance or suggestions as to the proper way this information should be obtained by underwriting firms from potential investors. One suggestion currently circulating the municipal securities industry is the modification of traditional investment letters to better and more specifically obtain the information that the SEC has outlined. Investment letters, sometimes referred to as "big boy letters," are an SEC-approved method often used by underwriters to confirm the investment intent of potential investors—the thought being that such letters could be modified going forward and used to confirm whether the securities being purchased are for a single account or, if for multiple accounts, the number of investors and the size of their investments. Similarly, revised letters could more thoroughly address the investor's level of financial experience and sophistication. Unfortunately, the SEC has neither confirmed nor denied whether an investment letter used in this manner is sufficient for the purpose of the limited offering exemption.

MSRB Rule Violations

In addition to Rule 15c2-12 violations, the SEC alleges that all four underwriting firms also violated the Municipal Securities Rulemaking Board (MSRB) Rule G-27, and that the firm that opted not to settle violated MSRB Rule G-17. MSRB Rule G-27 requires that municipal underwriters have written supervisory procedures (WSPs) in place to ensure compliance with federal security laws. MSRB Rule G-17 prohibits deceptive, dishonest, or unfair practices by an underwriter, and as the SEC contends, this rule was violated by making assurances to issuers that, as the underwriter, the limited offering would be conducted in accordance with federal law.

If the SEC is indeed ramping up enforcement activities for Rule 15c2-12 violations in the municipal securities market, underwriters would be advised to review their existing procedures or establish new measures before claiming the limited offering exemption. It also might be wise to create or modify investment letters to solicit the kind of information cited in the SEC complaint.

Frost Brown Todd LLP – Ben Hadden , Emmett M. Kelly and Beau F. Zoeller

December 9 2022

A Chance to Make Government Financial Data Transparent and User-Friendly.

Federal legislation requiring machine-readable reporting has its critics, but it would go a long way toward modernizing how data is collected, used and shared. It also could lower borrowing costs for states and localities.

Congress may soon pass the Financial Data Transparency Act (FDTA), which would require certain regulatory agencies to adopt data standards that would increase transparency and make financial

information more easily accessible. In effect, the legislation would require data reported on behalf of municipal bond issuers to the Municipal Securities Rulemaking Board to be in a machine-readable format instead of the current PDF document format.

The FDTA is part of a larger trend already underway to modernize how governments at all levels collect, use and share data with the public. We believe the long-term upsides of streamlined reporting and increased transparency far outweigh any short-term transition costs.

Some groups associated with municipal governments and public finance are arguing that the FDTA would create an unfunded burden for them to change how they report financial data. They also object to standards being imposed from the top down without giving municipal stakeholders a seat at the table. We agree that local governments will need resources to implement the act and that they should be involved in designing the data standards. In fact, we've already gotten a significant head start in tackling these challenges.

Continue reading.

governing.com

by Stephanie Leiser and Robert J.F. Widigan

Dec. 7, 2022

Final Defense Bill Includes New Muni Disclosure Standards.

Congress unveiled a final version of the 2023 defense bill Tuesday night that includes, as feared by municipal market issuers, a closely watched and controversial financial disclosure mandate.

The mandate is slightly altered from the original version, which the House passed in July, in that it shifts rulemaking and enforcement to the Securities and Exchange Commission and away from the Municipal Securities Rulemaking Board.

That opens a path to more direct communication through Congressional oversight, said Emily Brock, federal liaison for the Government Finance Officers Association.

"We certainly didn't hope for this to happen, but this is a new opportunity to work with the SEC to help them better understand our financial reporting requirements and to have a sequence of events that allows for Congressional oversight," Brock said.

Muni issuer groups like the GFOA pushed hard against the disclosure standard provision, which would move municipal issuers and other financial entities toward a financial reporting standard like eXtensible Business Reporting Language, or XBRL. Issuers argue it's a costly unfunded mandate that fails to recognize the wide variety of governments that make up the market.

The House is expected to take up the 2023 National Defense Authorization Act as soon as today. The Senate could vote on it next week.

The disclosure provision requires that no later than two years after the bill's enactment, the SEC must issue rules to adopt the new data standards.

The provision assigns to the SEC the responsibility to "scale" the standards "to reduce any

unjustified burden on smaller regulated entities" and "to minimize disruptive changes to the persons affected by those rules," which could include small issuers or other types of issuers, Brock said.

The provision also requires the SEC to "consult market participants in establishing data standards."

It also features expanded language that prohibits any new disclosure information requirements beyond what is already required.

Muni issuers have always been free of direct regulatory requirements on the presentation and delivery of their financial disclosure, though the SEC since 2009 has required private companies to use XBRL on their financial statements.

Shifting the data standards rulemaking and oversight away from the MSRB is a "key distinction," Brock said.

"With the SEC, we at least know there are administrative procedures that have to be followed, and we can stay in touch with Congressional delegates and they can communicate with the SEC," she said.

Negotiations over the bill were briefly hung up on whether it would include various non-defense related amendments, including Sen. Joe Manchin's permitting provision for energy infrastructure projects, which ultimately was not included in the final version.

By Caitlin Devitt

BY SOURCEMEDIA | MUNICIPAL | 12/07/22 11:27 AM EST

"Lame Duck" Congress May Take Up Modified Financial Transparency Rules.

Concerning proposals imposing strict financial reporting on governments may, in an amended form, be part of late-term congressional considerations on omnibus legislation.

The National Association of Counties (NACo) has offered a late-year update on the progress of newly proposed financial reporting rules that may prove burdensome and difficult for many local governments. The assessment is below – indicating that the proposal appears on target to become part of a large omnibus legislative package in December, but that some of the concerning specifics have been altered for the better.

From NACo:

> *On December 6, House and Senate Armed Services Committee leadership unveiled a bicameral, bipartisan Fiscal Year (FY) 2023 National Defense Authorization Act (NDAA). The NDAA is annual, must-pass legislation that, in recent history, serves as a legislative vehicle for additional bipartisan, bicameral bills (or policy riders) so they can be enacted without receiving a standalone vote.*
>
> *The FY 2023 NDAA agreement includes the Financial Data Transparency Act (FDTA), led by Reps. Carolyn Maloney (D-N.Y.) and Patrick McHenry (R-N.C.) in the U.S. House and Sens. Mark Warner (D-Va.) and Mike Crapo (R-Idaho) in the U.S. Senate. This bill was included as an amendment to the House Armed Services Committee's version of the*

NDAA that passed the U.S. House in July 2022. The bill would generally establish new financial data reporting standards for municipal securities market participants separate from the standards established by the Government Accounting Standards Board (GASB).

NACo opposes federally imposed standards for county financial accounting and reporting and supports those principles put forth by the GASB. *As such, counties had several concerns with the bill as it was initially written. On September 29, NACo and the Public Finance Network (PFN), a coalition of municipal bond issuers, sent a letter to U.S. Senate leadership outlining these concerns, and NACo provided counties with a template letter to send to their members of Congress.*

Additionally, we worked closely with our State Association partners to express these concerns to the bill sponsors in both the U.S. House and U.S. Senate and coordinated our efforts with a coalition of municipal advisors, counsel and underwriters to suggest alternate language. Suggested changes included moving the rulemaking away from MSRB, lengthening the rulemaking timeline to allow for input from issuers and market participants and/or creating a pilot program or study to better determine the impact these new standards would have on the municipal industry.

We are pleased to report that several of these suggestions were incorporated into the final NDAA agreement.

The new language directs the Securities and Exchange Commission (SEC) to set and implement these new data standards instead of the MSRB. This language is more favorable since SEC already has regulatory authority and procedures and the commission is subject to congressional oversight. Further, this move doesn't expand MSRB's current authority to oversee state and local governments as bond issuers.

The section also includes new language specifically directing SEC to consult with market participants (such as counties) when drafting these standards and requires the SEC to scale these reporting standards for smaller regulated entities and work to ensure these rules cause minimum disruption.

Lastly, the new language does not prescribe a timeline for SEC to issue a proposed rule but does retain the requirement that there be two years to implement the rule. Not setting a definitive timeline for the rule to be drafted will allow the SEC to conduct meaningful consultation with counties and other municipal market participants and understand the impact these new data reporting standards will have on the municipal industry once implemented.

The bottom line: *While the provision included in the NDAA still represents a potential unfunded mandate and a federally imposed reporting standard, the changes made to the text will allow counties to work with SEC to address these concerns during the rulemaking process.*

National Association of Counties

by Michael Sanderson

December 8, 2022

NFMA DE&I Survey.

The NFMA is conducting important research on diversity, equity, and inclusion experiences within the public finance industry. Along with our partners at Anavi Strategies and PFM's Center for Budget Equity and Innovation, the NFMA is excited to launch a new survey initiative to study these critical issues and share learnings that can help enhance the experience of all municipal market participants.

We are asking you to share your experience, feedback, and opinions on the current and future state of DE&I, both within your organization and within the industry at large. We estimate that thoughtful respondents will need 15-20 minutes to complete the survey.

You can access your survey by clicking this link: Take our survey

Because this time of year is busy for everyone – but seems to be especially busy for our colleagues – we know your time is valuable. The survey will remain open until January 9th, 2023.

GASB's New Concepts Statement on Note Disclosures.

Theory in Practice? GASB's New Concepts Statement on Note Disclosures … and a Proposal for More Notes!

In June 2022, the Governmental Accounting Standards Board (GASB) issued its latest expansion of the conceptual framework for governmental generally accepted accounting principles (GAAP), Concepts Statement No. 7, Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements: Notes to Financial Statements (CS7).

Concepts statements are not themselves GAAP standards, of course; instead, they provide current and future board members with a framework that should help to set standards that are consistent with each other and logically function together.

Also in June, GASB issued an exposure draft of a statement, Certain Risk Disclosures (ED), that, if adopted in final form, would require new note disclosures.

Let's look at both and then consider how closely the ED seems to follow CS7.

Download.

Local Governments, Many on Wall Street Line Up Against Muni-Data Bill.

Effort to improve transparency by requiring machine-readable financial disclosures raises hackles

A pitched battle over data is under way in the $4 trillion market that finances roads and sewers. At issue is a little noticed measure in proposed federal legislation that would mandate how state and local governments across the country present their financial results to investors.

The municipal-bond market in some ways remains stuck in the last century. Municipalities file reports erratically according to different standards, and the files aren't machine-readable by investors attempting to study city or state finances before they buy or sell. That marks a contrast to corporate disclosures, where standardized data can be extracted by computers.

Lawmakers sponsoring the measure—and companies that sell financial reporting software—say it will aid investors and the public by improving transparency. But Congress's proposed fix hasn't gotten much of a welcome in the muni market. Bankers, investors and local officials all warn of problems from increased costs to accounting headaches if Congress passes the measure.

Continue reading.

The Wall Street Journal

By Heather Gillers

Nov. 26, 2022

GFOA Executive Board Approves Accounting Best Practices Focused on Federal Grants Reporting.

In September, GFOA's Executive Board approved updates to several accounting best practices recommended by the Accounting, Auditing, and Financial Reporting Committee including a prevalent and timely suite of best practices focused on federal grants reporting.

As part of the best practice review, the AAFRC created two groupings or "suites" of related best practices: one for the best practices pertaining to grants and another for those pertaining to internal controls.

The new SEFA Preparation best practice helps guide governments in completeness and accuracy when preparing a Schedule of Expenditures of Federal Awards. In the best practice Internal Control for Grants, GFOA recommends that governments adhere a comprehensive framework of internal control that includes a control environment, risk assessment, control activities, information and communication, and monitoring. In addition to changing the recommended actions from "consider" to "should," the best practice Grants Administration now includes a recommendation for governments to establish a post-implementation review process for grant programs.

Stay tuned: these new best practices will inform a new training to be released in January, "Undergoing a Federal Funds Single Audit." The training will provide an overview of the Single Audit and Uniform Guidance as well as how to prepare a SEFA.

All Updated Best Practices

- **Departmental Reports and Supplementary Information** – VIEW
- **Fund Accounting Applications** – VIEW
- **Grants Administration** – VIEW
- **Indirect Cost Allocation** – VIEW
- **Internal Control Deficiencies in Audits** – VIEW
- **Internal Control for Grants** – VIEW
- **Internal Control Environment** – VIEW

- **Internal Control and Management Involvement** – VIEW
- **Periodic Disclosure and the Annual Comprehensive Financial Report** – VIEW
- **SEFA Preparation** – VIEW

Proposed Rule Change to Amend Rule G-3, on Professional Qualification Requirements, to Delete References to Certain Temporary Regulatory Relief Implemented During the Height of the Coronavirus Disease.

View the MSRB Proposed Rule Change.

SEC Filing SR-MSRB-2022-09

11/16/2022

Proposed Rule Change to Amend MSRB Rule G-27, on Supervision, to Further Extend the Current Regulatory Relief for Remote Office Inspections through June 30, 2023.

View the MSRB Proposed Rule Change.

SEC Filing SR-MSRB-2022-08

11/16/2022

MSRB Extends Regulatory Relief for Remote Inspections and Files Amendments to Remove Expired Professional Qualifications Relief.

View the MSRB notice.

Notice 2022-12 – Informational Notice

11/16/2022

GASB Proposes Guidance to Assist Stakeholders with Application of its Pronouncements.

Norwalk, CT, November 15, 2022 — The Governmental Accounting Standards Board today issued proposed implementation guidance in the form of questions and answers intended to clarify, explain, or elaborate on certain GASB pronouncements.

The Exposure Draft, Implementation Guidance Update—2023, contains proposed new questions and answers that address application of GASB standards on leases, subscription-based information

technology arrangements, and accounting changes. The proposal also includes amendments to previously issued implementation guidance on leases.

The GASB periodically issues new and updated guidance to assist state and local governments in applying generally accepted accounting principles (GAAP) to specific facts and circumstances that they encounter. The GASB develops the guidance based on:

- Application issues raised during due process on GASB pronouncements,
- Application issues identified during the first stage of the GASB's post-implementation reviews of the leases standards,
- Questions it receives throughout the year, and
- Topics identified by members of the Governmental Accounting Standards Advisory Council and other stakeholders.

The guidance in Implementation Guides is cleared by the Board and constitutes Category B GAAP.

Stakeholders are asked to review the proposal and provide input to the GASB by January 20, 2023. Comments may either be submitted in writing or through an electronic input form.

Financial Accounting Foundation (FAF) Trustees Reappoint Chair and Vice-Chair of the Governmental Accounting Standards Advisory Council (GASAC).

Norwalk, CT, November 15, 2022 — The Board of Trustees of the Financial Accounting Foundation (FAF) announced today the reappointment of Elizabeth Pearce as chair and Robert Hamilton as vice chair of the Governmental Accounting Standards Advisory Council (GASAC) respectively. Both will serve their terms starting January 1, 2023 and concluding on December 31, 2024, at which time they will be eligible for reappointment for one additional term.

The GASAC advises the Governmental Accounting Standards Board (GASB) on strategic and technical issues, project priorities, and other matters that affect standards setting. Members of the GASAC are responsible for consulting with the GASB on technical issues on the Board's agenda, project priorities, matters likely to require the attention of the GASB, and such other matters as may be requested by the GASB or its chair.

"The FAF and the GASB are pleased to have both Elizabeth and Robert serve in these essential roles. As members of the GASAC, and during their first terms as chair and vice chair, they have shown a genuine interest in listening to all perspectives while also sharing their own. They are both thoughtful when giving their opinions and are well received by other GASAC members," said Kathleen L. Casey, chair of the Financial Accounting Foundation. "We are excited for them to continue in these leadership roles and in their continuing encouragement of all GASAC members to share their views to enhance the standards-setting process," added Ms. Casey.

For a complete list of current GASAC members, visit the GASAC webpage.

About the Financial Accounting Foundation

Established in 1972, the Financial Accounting Foundation (FAF) is an independent, private-sector, not-for-profit organization based in Norwalk, Connecticut. Its Board of Trustees is responsible for the oversight, administration, financing, and appointment of the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB).

The FASB and GASB (collectively, “the Boards”) establish and improve financial accounting and reporting standards—known as Generally Accepted Accounting Principles, or GAAP—for public and private companies, not-for-profit organizations, and state and local governments in the United States. Both Boards set high-quality standards through a process that is robust, comprehensive, and inclusive. The FASB is responsible for standards for public and private companies and not-for-profit organizations, whereas the GASB is responsible for standards for state and local governments.

The Foundation’s Board of Trustees comprises 14–18 members from varied backgrounds—users, preparers, and auditors of financial reports; state and local government officials; academics; and regulators. The Trustees direct the effective, efficient, and appropriate stewardship of the FASB and GASB in carrying out their complementary missions, select and appoint FASB and GASB members and their advisory councils, oversee the Boards’ activities and due process, and promote and protect the independence of the Boards. For more information, visit www.accountingfoundation.org.

About the Governmental Accounting Standards Board

Established in 1984, the GASB is the independent, private-sector organization based in Norwalk, Connecticut, that establishes accounting and financial reporting standards for U.S. state and local governments that follow Generally Accepted Accounting Principles (GAAP). These standards are recognized as authoritative by state and local governments, state Boards of Accountancy, and the American Institute of CPAs (AICPA). The GASB develops and issues accounting standards through a transparent and inclusive process intended to promote financial reporting that provides useful information to taxpayers, public officials, investors, and others who use financial reports. The Financial Accounting Foundation (FAF) supports and oversees the GASB. For more information, visit www.gasb.org.

MSRB Proposes Amendments to Streamline EMMA Data Submission Process.

The MSRB proposed amendments to MSRB Rule G-32 (“Disclosures In Connection With Primary Offerings”) to standardize deadlines for underwriters to submit information on Form G-32 for all types of offerings.

The amendments would require underwriters to populate certain data on the form in the Electronic Municipal Market Access Dataport system by the close of business on the first execution date. Certain other information would not be required until the close on the settlement date. The MSRB said that the proposal does not alter what data needs to be submitted and would standardize the deadline for data submission, which would streamline the submission process and mitigate the burden placed on underwriters.

The MSRB requested feedback on specific areas of the proposal, but said that it will accept all comments until January 17, 2023.

Fried Frank Harris Shriver & Jacobson LLP

November 11 2022

MSRB Underwriter Considerations for Assessing Written Supervisory Procedures Regarding New Issue Pricing.

View the MSRB Underwriter Considerations.

Publication date: 11/07/2022

MSRB Considerations for Assessing Written Supervisory Procedures for Municipal Advisory Services.

View the MSRB Considerations.

Publication date: 11/07/2022

MSRB Request for Comment on Draft Amendments to MSRB Rule G-32 to Streamline the Deadlines for Submitting Information on Form G-32

View the MSRB Request for Comment.

Publication date: 11/09/2022 | Comment due: 01/17/2023

Broker-Dealer Settles Charges for Disclosure Failures and Defective Account Statements.

A broker-dealer settled FINRA charges for (i) failing to disclose that certain corporate and municipal bonds held by its customers were in default and (ii) failing to deliver a number of required disclosures to its customers.

In a Letter of Acceptance, Waiver, and Consent, FINRA said that the broker-dealer distributed account statements to certain customers showing that some of the held bonds were making payments when they were actually in default. FINRA determined that the broker-dealer had notice of the defaults, but the account statements did not reflect this information. In failing to maintain accurate records for these bonds, FINRA found that the broker-dealer violated FINRA Rule 4511 (“Books and Records Requirements — General Requirements”) and MSRB Rule G-8 (“Books and Records to be Made by Brokers, Dealers, and Municipal Securities Dealers and Municipal Advisors”).

FINRA concluded that the firm failed to deliver certain (i) privacy disclosures in violation of Regulation S-P (“Privacy of Consumer Financial Information and Safeguarding Personal Information”), (ii) order execution notices in violation of SEC Regulation NMS Rule 242.606 (“Disclosure of order routing information”), and (iii) margin disclosures in violation of FINRA Rule 2264 (“Margin Disclosure Statement”). FINRA found that the firm had inadequate supervisory systems, violating FINRA Rule 3110 (“Supervision”) and MSRB Rule G-27 (“Supervision”).

To settle the charges, the broker-dealer agreed to (i) a censure, (ii) a civil monetary penalty of

$850,000 ($300,000 pertaining to the MSRB rule violations) and (iii) undertake improvements to its notice and disclosure processes.

Fried Frank Harris Shriver & Jacobson LLP

November 4 2022

Relief For The Digital Data-Starved $3.9 Trillion Municipal Bond Market.

Like a bug trapped in amber, crucial financial information on thousands of bonds in multi-billio--dollar municipal bond mutual fund portfolios held by millions of shareholders is in a similar fossilized state, embedded in decades-old technology.

The municipal bond market is a $3.9 trillion capital market without digital financial data.

Financial Reporting: Digitized and Machine-Readable

The Financial Data Transparency Act (S. 4295 – "FDTA"), pending before the Senate, offers a readily available solution to free that information, making it widely available and usable. In doing so, FDTA expands the adoption of machine-readable, digitized financial reporting. Wholly based on existing information that is already required, collected, and making it available to anyone for free, this legislation is potentially transformative for the $3.9 trillion municipal bond market. It ushers in access to and transparency in government financial reporting that, while standard for public companies in the U.S. and the rest of the world, is unprecedented in the public sector.

All of these are why the co-sponsors of the legislation, U.S. Senators Mark R. Warner (D-VA) and Mike Crapo (R-ID) introduced the bill. FTDA provides "greater transparency and usability for investors and consumers, along with streamlined data submissions and compliance for our regulated institutions," offered Senator Warner. Senator Crapo noted the bill would be an important step forward in "making financial data used by federal regulators more accessible and accessible to the American public" as well as "improving government transparency and accountability."

Machine-readable, digitized, standardized, transparency, accountability. All very technical and aspirational, but what does this mean practically for investors and regulators?

It means all the financial information available from cities and towns and authorities—assets, debts, tax and fee revenues, cash flows, and so forth—can be easily downloaded or uploaded into a spreadsheet and treated just like any other bunch of numbers. It means it can be readily categorized, analyzed, tracked, charted, graphed, and the dozens of other things you do with financial information to better understand what it means. That's just for starters.

Just as an individual investor, investment advisor, or portfolio manager cannot effectively make prudent investment decisions without this essential data in a readily accessible structured format, neither can regulators perform their Congressionally mandated roles to ensure fair and efficient markets without consistent, standardized financial data.

How much is at stake for investors as well as capital markets regulators?

Start with this number. Six hundred thirty-one eight hundred fifty-nine million. Sounds like one of those made-up numbers used for exaggeration, right? Floating somewhere between a bazillion and a

gazillion? It’s kind of hard to take seriously.

Yet $631,859,490,332 is exactly the total amount of assets under management held in the open-end funds of the top 10 municipal bond mutual fund managers as of July 2022, according to Morningstar direct.

Now here’s another number: $908.9 billion. That’s the total assets in all open-end municipal bond mutual funds as calculated by the Federal Reserve as of the end of Q2-2022.

(For the intrepid, data on municipal bond holdings of the entire market is in the Municipal Securities section of the Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release Z.1 Financial Accounts of the United States, Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts).

Align the time frames and compare the Fed number to the prior AUM number. You’ll quickly find that close to 70% of all municipal bond mutual fund holdings are held by these top 10 fund managers.

It is a uniquely stunning concentration of assets in this sector of the financial markets, raising a host of concerns for investors and regulators alike. Not the least of these are liquidity risk in general, liquidity during market dislocations, increased volatility, interest-rate commodification, a redefinition of systemic risk, and fair market pricing.

Keeping It Together

For the mutual fund managers overseeing these vast amounts of other people’s money at that size, it becomes less of an investment strategy and more of an operations and logistics challenge.

Give this some thought. A multibillion-dollar mutual fund has thousands upon thousands of holdings in its portfolio. Vanguard Tax-Exempt Index Fund is an example, but any one of the funds in the Top 10 will do. It has $19.2 billion invested in 6,330 bonds (as of 9/30/22). Now expand that by the billions held in all the other funds making up the Top 10. In those portfolios, there are tens of thousands of bonds.

There is no way to manage portfolios of these sizes without very carefully established and coordinated structures to keep track of all the various facets of managing billions of dollars, from trading to accounting to valuation to surveillance to analysis to compliance…the list goes on.

What holds all of these pieces together is standardized, machine-readable, digitized data. Data capturing information on the bond, its coupon, maturity, purchase price, premium, discount, rating, and call features. Data on interest accruals, capital gains, capital losses, dividends, shares bought, and shares sold. Data on valuations, variance, and spread relationships. Data on compliance parameters, shareholder fees and expenses.

All these data fields and a myriad more track each and every component of managing thousands of bonds and billions of dollars.

Every day.

Except for one series of data.

A $3.9 Trillion Capital Market with No Digital Financial Data

There is no readily publicly available, comprehensive, digitized, downloadable, structured financial data source on the underlying issuers of the bonds. None. Not from the Securities and Exchange Commission, not from the Department of the Treasury, not from the Federal Reserve Board, and not from other the four capital markets regulators noted in the FTDA.

Not even the Municipal Securities Rulemaking Board, the regulatory agency with the Congressional mandate to "protect municipal securities investors, municipal entities, obligated persons and the public interest." Not even the MSRB's central disclosure repository for the municipal bond market, EMMA, where nearly every financial report by municipal bond issuers has to be filed. From states to cities to towns to authorities, all their financial disclosures filed in EMMA are in an unstructured format: the PDF.

A PDF is not digitized data. The numbers aren't even really numbers, just pictures of numbers, images comprised of pixels, like a picture you take with your camera. It is not directly convertible into digital data. As research has shown, even the best attempts to scrape the PDF to digitize the data have serious shortcomings. Most of the time, to convert the information on the PDF pages to digital data, it has to be entered into a spreadsheet by hand.

Like a bug trapped in amber, crucial financial information on tens of thousands of bonds held in multi-billion-dollar investment portfolios, information essential to assessing, surveilling, accounting, and valuing these investments held by millions of mutual fund shareholders, sits locked like a Lucite-entombed relic.

A Simple Fix

It is a simple fix. By and large, this financial information is already collected as data and organized to match the widely followed rules established by the Government Accounting Standards Board as generally accepted accounting principles. It requires only a modest effort to digitally tag this data, linking it to the already well-defined GAAP categories.

Which is all this legislation gives regulators the ability to request. No new disclosures. No new authority. No changes in data governance. Just more information available, for free, to any investor with a computer can use—from multi-billion-dollar mutual fund managers or individual investors—in the $3.9 trillion municipal bond market.

Transparency at a click.

Forbes

by Barnet Sherman

Nov 7, 2022

Recent SEC Enforcement Actions Highlight Continuing Disclosure Obligations of Municipal Bond Underwriters.

On September 13, 2022 the Securities and Exchange Commission filed litigation against four separate municipal securities underwriters for failing to comply with municipal bond offering disclosure requirements. The four firms at issue (three of which have settled with the Commission) sold new issue bonds without first obtaining required disclosures for investors. Each firm attempted

to rely on an exemption to Rule 15c2-12 known as a limited offering. In each case, however, the participating underwriter failed to satisfy the requirements of the limited offering exemption for continuing disclosure. Among other things, the underwriters failed to establish a reasonable belief that the broker-dealers who were purchasing the securities were doing so for investment purposes, as opposed to resale. The SEC has begun further investigations of firms relying on limited offering exemptions and has opened a communication line for self-reporting and additional information. These recent enforcement actions highlight the need for underwriters to fully understand their obligations relating to continuing disclosure, including Rule 15c2-12 and its relevant exemptions.

by Richard Spoor

November 1, 2022

Keating Muething & Klekamp PLL

Financial Accounting Foundation Board of Trustees.

Meeting Notice

11/01/22

GFOA Scholarship Applications Open for 2023.

Eligibility for scholarships range from full- to part-time, undergraduate to graduate, and first-time to returning students. Any student interested in state, local, and provincial government finance, public service, governmental accounting, or public administration is strongly encouraged to apply. GFOA awards over $100,000 in scholarships annually. The deadline to apply is December 30, 2022.

Learn More.

Small Muni Issuers See A Potential 620% Windfall For Their Taxpayers.

Currently pending before the Senate, the Financial Data Transparency Act (S. 4295 – “FDTA”) is legislation taking financial reporting by companies and municipalities to the next level. It ushers in the implementation of machine-readable, digitized financial reporting, wholly based on existing information that is already collected and required, and making it available to anyone for free.

For the municipal bond market, where disclosure has always been and remains a struggle, this legislation is potentially transformative. It creates access to and transparency in government financial reporting that, while the standard for public companies, is unprecedented in the public sector.

A Boon For Small Municipalities

It is also potentially a boon for small municipal bond issuers. The Financial Data Transparency Act

has the potential to generate a 620% return on investment for small municipal bond issuers. Hard to believe? Read on.

Continue reading.

Forbes

by Barnet Sherman

Oct 27, 2022

Primary Offerings of Municipal Securities: Impact of COVID-19 Crisis on Competitive and Negotiated Offerings - MSRB Report

View Publication.

Publication date: 10/24/2022

MSRB Seeks Volunteers for FY 2023 Compliance Advisory Group.

View the MSRB notice.

Notice 2022-10 – Informational Notice

Publication date: 10/31/2022

MSRB Holds First Quarterly Board Meeting of New Fiscal Year.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) met on October 26-27, 2022 for its first quarterly Board of Directors meeting of Fiscal Year 2023, where it approved a number of rulemaking initiatives and discussed other efforts to advance the four pillars of the self-regulatory organization's long-term strategic plan.

"The MSRB's self-regulatory focus is squarely on modernizing rules and increasing transparency to protect and strengthen the municipal securities market," said MSRB Chair Meredith Hathorn. "As part of our commitment to upholding the public trust, we are continuously engaging in open dialogue with our stakeholders as we work to deliver on our strategic objectives and give America the confidence to invest in its communities."

Market Regulation

The Board discussed the status of its ongoing retrospective rule reviews and rule modernization efforts to holistically consider its rules and interpretive guidance and identify opportunities to streamline, update and, where appropriate, promote consistency with rules of other regulators.

As part of this discussion, the Board discussed public comments received in response to the MSRB's proposal to amend MSRB Rule G-14 to require that, absent an exception, transactions be reported to the MSRB as soon as practicable, but no later than within one minute of the time of trade. The Board also received an update regarding a potential pre-trade data collection initiative for the municipal securities market.

"Strong markets function best when regulations keep pace with evolving technologies and market practices for increasing transparency, efficiency and fairness," said MSRB CEO Mark Kim. "We are actively engaging with stakeholders and fellow regulators on effective solutions to strengthen the structure of the municipal securities market."

In addition, the Board authorized a request for comment on a proposal to amend Rule G-3, on professional qualifications, to add an exemption from municipal advisor representatives having to requalify by examination in cases of a lapse in qualification, thereby replacing the waiver provision under the rule. The exemption would extend the time a municipal advisor representative can be disassociated from a municipal advisor firm (i.e., not actively engaging in municipal advisory activities on behalf of a municipal advisor) without having to requalify by examination from two years to three years, subject to certain conditions.

Additionally, the Board:

- Authorized a filing with the SEC regarding COVID-19 regulatory relief under Rule G-27, on supervision of dealers, to permit dealers an additional six months (until June 30, 2023) to conduct office inspections remotely; and
- Determined to pause collecting, on a voluntary basis, information from regulated entities pertaining to their certification as a minority- and woman-owned business enterprise (MWBE) or veteran-owned small business (VOSB) on Form A-12.

Market Transparency and Technology

The Board received an update on ongoing work to modernize the Electronic Municipal Market Access (EMMA®) website and further enhancements to its redesigned MSRB.org website.

Market Structure and Data

The Board discussed a number of market structure topics, as well as ongoing efforts to improve the quality of the municipal market data the MSRB collects.

Public Trust

The Board received an update on ongoing efforts to create a more fair and efficient market, including roundtable discussions with MWBE and VOSB firms the MSRB is hosting in collaboration with FINRA. "We believe this joint effort is important for identifying opportunities to foster greater diversity, equity and inclusion in this large and diverse market," said Hathorn.

Date: October 28, 2022

Contact: Bruce Hall, Senior Manager, Communications
202-838-1300
bhall@msrb.org

Cities and States Bristle Over Proposal to Change How They Report on Finances.

Congress is weighing a plan that calls for overhauling how state and local government financial data is made public, stirring worries about new costs for software and staff. But supporters of the revamp say it's long overdue.

State and local governments are raising alarm over a proposal in Congress that would impose significant new requirements on how they share information about their finances with the public.

Those pushing for the changes say they are needed to make it easier for investors and residents to search and analyze governments' fiscal data. But state and local governments are rejecting the proposal as an "unfunded mandate" and claim it would cost them over $1.5 billion to buy the software and hire the consultants needed to comply.

Though it has nothing to do with the military, the plan to impose the new reporting requirements on governments and nonprofits was included in the House's version of the National Defense Authorization Act, an annual defense spending bill, which could be taken up as soon as next month. Senate lawmakers have put forward a similar plan.

Continue reading.

Route Fifty

By Kery Murakami

OCT 17, 2022

GASB Going Concern Uncertainties and Severe Financial Stress Disclosures Task Force Formed.

GASB Chair Joel Black recently announced the appointment of a task force to assist with the Board's project addressing going concern uncertainties and severe financial stress disclosures. Members of the task force, by stakeholder group type, are:

Users

- Lisa Washburn, Managing Director, Municipal Market Analytics, Inc.
- Shripad Joshi, Senior Director & Accounting Officer, Corporate and Government Ratings, S&P Global
- Stephen Spencer, Managing Director, Houlihan Lokey
- Sharon Edmundson, Director, North Carolina Department of State Treasurer
- Amanda Beck, Assistant Professor of Accounting, Georgia State University
- Mary Murphy, Senior Director, The Pew Charitable Trusts
- Angus Maciver, Legislative Auditor, Montana Legislative Audit Division.

Preparers

- Kristine Brock, Assistant City Administrator/Chief Financial Officer, City of Franklin, Tennessee
- Linda Short, Deputy Director of Finance, City of Fort Lauderdale, Florida
- Chad Greenwell, Associate Controller, University of Michigan
- Mark Merry, Assistant Director, Florida Department of Financial Services
- Kathy Ketchum, Manager, Accounting and Assistant Controller, Sacramento Municipal Utility District
- Elizabeth Hill, Deputy Comptroller, Nassau County, New York.

Auditors

- Jodi Dobson, Partner, Baker Tilly US, LLP
- Tim Lyons, Partner, Mauldin & Jenkins, LLP
- Chris Pembrook, Partner, Crawford & Associates, P.C.
- Robert Hinkle, Deputy Auditor of State, State of Ohio.

WHAT DO TASK FORCES DO?

The GASB assembles task forces for most major current projects and certain research activities. Task forces serve as a sounding board, providing suggestions and feedback to the GASB as a project or research progresses. Task force members also review the papers the GASB staff prepares for Board meetings and monitor the Board's deliberations, commenting as appropriate.

HOW ARE PARTICIPANTS SELECTED?

Task forces are officially appointed by the GASB chairman after consultation with the other GASB members, the Governmental Accounting Standards Advisory Council (GASAC) chairman, and GASB staff.

Task force members typically have a particular expertise or experience with the issue being addressed in the project or research and also are capable of articulating the views of other, similar constituents. They can identify possible implementation difficulties, assess the potential cost of proposed standards, or opine on the usefulness of the information that will result from those standards.

Potential participants are primarily identified from the GASB's constituent database, from the GASAC, and from the lists of persons submitting comment letters in response to proposed standards. The GASB attempts to maintain an appropriate balance of financial statement preparers, auditors, and users on each task force. In addition to identifying persons that possess relevant knowledge and experience and that are representative of various types of constituents, the GASB tries to select persons it believes will actively participate by reviewing papers and proposed standards prepared for the Board and by providing regular feedback to the project staff.

SEC Municipal Advisor Examination Observations: Mayer Brown

SEC risk alert highlights areas of continuing deficiencies and future focus of examinations

On August 22, 2022, the Division of Examinations (the "Division") of the U.S. Securities and Exchange Commission ("SEC") published a risk alert (the "2022 Risk Alert") to raise awareness of the most frequently cited deficiencies and weaknesses observed in recent municipal advisor examinations.1 Topics include municipal advisor registration and filings, recordkeeping, supervision

and disclosure of conflicts of interest. The Division previously highlighted many of these topics in a 2017 risk alert (the "2017 Risk Alert") with respect to newly registered municipal advisors.2 The Division has included examinations of municipal advisors as an examination priority each year since 2019.3 The 2022 Risk Alert, together with two SEC enforcement actions against municipal advisors in June of this year,4 may signal an increase in scrutiny from SEC examination and enforcement staff regarding municipal advisor practices, policies and procedures relating to the topics highlighted in the risk alert. As such, firms should consider reviewing and assessing their compliance with each of the topics. In this regard, we note that the Division indicated that it intends for future examinations "to include a more prominent focus on the core standards of conduct and duties applicable to municipal advisors."5 The following is a brief summary of the Division's key observations in the 2022 Risk Alert.

Registration and Filings

Municipal advisors filed SEC Forms MA and MA-I with inaccurate or incomplete information, including information regarding their associated persons' other business and other required disclosures (e.g., customer complaints, tax liens). Additionally, municipal advisors did not amend, or did not amend timely, SEC Forms MA and MA-I and Municipal Securities Rulemaking Board ("MSRB") Form A-12, such as to reflect changes in ownership of the firm or disciplinary actions involving the firm or its associated persons (e.g., disclosure of judicial actions or judgments/liens, change in employment or other business).

Recordkeeping

Municipal advisors did not make or keep true, accurate and current copies of certain required books and records, or did not preserve such records, including with respect to:

- Written communications relating to municipal advisory activities, particularly electronic communications, such as business-related email sent from a personal email address, text messages on mobile devices and instant messages. We note that this topic has been a focus of the SEC with respect to brokerdealers.
- Financial and account documents, including cash reconciliations and general ledgers.
- Written agreements entered into by the municipal advisor with municipal entities and their employees, obligated persons or otherwise relating to the firm's business.

Supervision

Municipal advisors either did not have any written supervisory procedures ("WSPs") or the WSPs were not sufficient, not implemented and/or not enforced. For example, deficiencies related to gifts, gratuities and expenses, and, as noted above, the preservation of electronic communications and/or the filing and updating of required forms. Moreover, some firms failed to promptly amend their WSPs to reflect the adoption of MSRB Rule G-42 (Duties of Non-Solicitor Municipal Advisors),6 which became effective in 2016, or MSRB Rule G-40 (Advertising by Municipal Advisors),7 which became effective in 2019. Firms also failed to conduct annual reviews of their WSPs pursuant to MSRB Rule G-44(b) and/or their Chief Executive Officers failed to certify annually, in writing, that the firm had in place processes to establish, maintain, review, test and modify WSPs, pursuant to MSRB Rule G-44(d).

Disclosure to Clients

Municipal advisors failed to disclose in writing to clients, or did not disclose timely, their material conflicts of interest, including with respect to the firms' relationships with other parties (e.g.,

underwriters or other parties providing services to or on behalf of a municipal entity client) or between the municipal advisor and the municipal entity client itself. Other deficiencies involved disclosures relating to fee-splitting arrangements and contingent compensation arrangements. Finally, firms failed to document, or did not document adequately or timely, their municipal advisory relationships.

To view all formatting for this article (eg, tables, footnotes), please access the original here.

Mayer Brown – Steffen Hemmerich, Anna T. Pinedo, Leslie S. Cruz and Stephen Vogt

August 25 2022

BDA is Happy to Release the Fall Issue of Our Quarterly Magazine, Fixed Income Insights.

BDA is happy to release the Fall issue of our quarterly magazine, ***Fixed Income Insights***.

Please click here for full access to our Fall issue.

Welcome to football seasons and the national mid-term elections! And to Fall issue of Fixed Income Insights – the BDA's quarterly magazine on the U.S. fixed income markets, Federal policy and the BDA's advocacy.

In this issue we're really pleased to feature Q&As with two members of congress – U.S. Senator John Boozman of Arkansas and U.S. Congresswoman Terri Sewell of Alabama. Both continue to be staunch advocates for the municipal bond market and provisions on Capitol Hill which BDA continues to aggressively advance.

Our featured profile this quarter is of SouthState | DuncanWilliams, a founding BDA member firm independent for 53 years and now part of a regional bank. The impact, the benefits and look forward provided through Q&A between SJ Guzzo, MD and Head of Debt Capital Markets and Mike Nicholas of the BDA.

We also have sections on the Muni Market, the Taxable Market, Technology and Market Structure, Regulation, Market Trends, and BDA Federal Advocacy and Industry Events.

This quarterly magazine is an extension of BDA advocacy for and representation of securities firms and banks active in the U.S. bond markets. We hope you find it of value – but please offer feedback when you can.

Thank you to our many content contributos and advertisers. For more informtion on Fixed Income Insights including opportunities to add content and to advertise please contact Mike Nicholas at mnicholas@bdamerica.org.

Climate-Related Financial Risk: SIFMA Comment Letter

SUMMARY

SIFMA, SIFMA AMG, and the Institute of International Bankers (the IIB) provided comments to the Commodity Futures Trading Commission (CFTC) regarding climate-related financial risk (RFI).

View the SIFMA Comment Letter.

FINRA Proposes Expanding the Application of FINRA Rules to Government Securities.

FINRA proposed amendments to Rule 0150 ("Application of Rules to Exempted Securities Except Municipal Securities") to expand the application of certain FINRA rules to business transactions in U.S. government securities. The proposed rule change also amends the Capital Acquisition Broker Rule 015 (Application of Rules to Municipal Securities) "for consistency with the revisions to FINRA Rule 0150 made pursuant to this rule filing."

The amendment goes through an extensive list of FINRA rules and explains how they will apply to transactions in government securities. The proposed rule change is considered "non-controversial," was published in the Federal Register for comments, and is immediately effective.

Comments are due by November 3, 2022.

Commentary

Notwithstanding the number of FINRA rules that may be expanded in scope, as a practical matter the effect on firms should be limited. That said, firms should review carefully both the rules and their business practices, as there will be some impact. For example, firms should consider whether there are new employee registration requirements applicable to employees engaged in distribution activities with respect to government-sponsored enterprise securities.

Fried Frank Harris Shriver & Jacobson LLP – Steven Lofchie

October 13 2022

SEC Steps Up Enforcement With Respect to Municipal Bond Offerings: ArentFox

In September 2022, the US Securities and Exchange Commission (SEC) announced that it had filed suit against one broker-dealer underwriter and entered into settlements with three other broker-dealer underwriters in cases alleging that the underwriters repeatedly violated the limited offering exemption rules applicable to municipal bond offerings.

Alleged Limited Offering Exemption Violations
In general, the limited offering exemption applies to primary offerings that are made to a limited number of sophisticated investors who are capable of evaluating the risks of the investment without aid of the disclosures that are normally required. In instances where an exemption does not apply, disclosures are made through public offering materials, Preliminary Official Statements in the municipal securities area, which, as is the case with corporate securities, are subject to SEC Rule 10b-5 disclosure standards.

Default Disclosure Requirements and the Limited Offering Exemption
The point of public disclosure in both corporate and municipal securities offerings is to ensure that investors can make informed investment decisions after full disclosure so that investors are protected from potential material misrepresentations and omissions.

This is particularly critical in the municipal area, where 45% of municipal securities are held directly by retail investors or indirectly by retail investors through mutual funds.[1] Many of these retail investors may not be sophisticated in complex financial products, hence the default requirement for comprehensive disclosure and the restricted scope of the limited offering exemption.

In a typical private placement of municipal or corporate securities to sophisticated investors, the broker-dealer obtains a certification that the purchaser is purchasing for its own account and not with the intent to resell, and that it understands the merits and risks of the investment. This certification is colloquially known as a “big boy” letter. It is then up to the sophisticated investor to determine whether it needs some disclosure, such as through a private placement memorandum.

The limited offering exemption to the default disclosure rules with respect to municipal securities is contained in SEC Rule 15c2-12(d), which was promulgated in consultation with the Municipal Securities Rulemaking Board (MSRB), which is a self-regulatory organization subject to SEC oversight. The rule provides an exemption from the public disclosure requirements applicable to underwriters offering municipal securities if the securities are offered in denominations of $100,000 or more and sold to no more than 35 persons. Rule 15c2-12(d) is parallel to SEC Rule 506(b) in the corporate securities context.

With respect to purchasers in limited offerings, Rule 15c2-12(d)(1)(i) also requires that the underwriter have a reasonable belief that each purchaser has “such knowledge or experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment” and “is not purchasing for more than one account or with a view to distributing the securities.” It should be noted that, unlike with corporate securities, the SEC does not directly regulate municipal issuers due to concerns with respect to the Tenth Amendment of the United States Constitution. Instead, the SEC regulates the underwriters who offer municipal securities.

The Actions

Background
In each case brought by the Commission, the underwriters allegedly relied on the limited offering exemption in situations where the exemption requirements were not satisfied. In particular, the Commission alleged that the underwriters sold the securities to other broker-dealers and investment advisors without the requisite reasonable belief that those entities were purchasing the securities for their own investment, rather than purchasing the securities for resale to others. In addition, because the underwriters purportedly did not make any inquiries as to the identities of the customers for whom the broker-dealers and investment advisors were purchasing the securities, the Commission also asserted that the underwriters were unable to form the requisite reasonable belief that the purchasing broker-dealers or investment advisors were purchasing the securities for investors who possessed the requisite knowledge and experience to evaluate the investments—a factor the Commission asserts requires that a subjective determination be made with respect to each ultimate purchaser.

Finally, the Commission alleged that the underwriters violated MSRB Rule G-27(c) because they failed to have written supervisory procedures reasonably designed to ensure compliance with the limited offering exemption rules.

Underwriter Settlements; SEC Complaint
Three firms entered into cease and desist settlements with the Commission, where each agreed to disgorge the profits they made from the offerings that purportedly did not qualify for the exemption, along with the payment of prejudgment interest and civil monetary penalties. Those firms also agreed to cease and desist from future violations of the rules at issue and were censured. In each of the settlements, the Commission noted that the firms promptly took remedial action and cooperated with the Commission.

The remaining firm, Oppenheimer & Co., apparently was unable to reach a settlement with the Commission and the Commission filed suit in the U.S. District Court for the Southern District of New York. The complaint alleges Oppenheimer violated the exemption rules more often than the settling firms – in at least 354 municipal offerings – while also making deceptive statements to governmental issuers that it would comply with the limited offering exemption, in contravention of MSRB Rule G-17 (which prohibits deceptive practices). The Commission requests permanent relief enjoining Oppenheimer from future violations of the federal securities laws and MSRB rules, disgorgement of profits, prejudgment interest, and the imposition of a civil penalty. Although Oppenheimer will presumably assert that it acted reasonably and complied with the rules, the nature of Oppenheimer's factual and legal arguments is not yet known.

Although Oppenheimer is a mid-sized broker-dealer, its mutual fund affiliate is one of the largest institutional holders of municipal bonds in the country.

Takeaways

Although the Commission's litigation release noted that the four actions are the first time that it has pursued underwriters for failing to comply with the municipal bond offering disclosure requirements, the Commission also stated that it is actively investigating whether other underwriters complied with the exemption and it urged firms who believe they might have violated those rules to self-report to the Commission. As a result, underwriters who are, or who have in the past, relied on the exemption should work with counsel to carefully evaluate both their conduct and their supervisory procedures to ensure that those procedures were sufficient for prior transactions and are adequate to avoid future violations. Depending on the results of such an evaluation, the prudent course might be to self-report any possible violations as a way of attempting to reduce the penalties that the Commission might later seek if it uncovers violations during the course of an investigation and institutes enforcement proceedings or files a civil action.

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[1] *See* 'How 2022 Volatility is Shifting Muni Ownership', The Bond Buyer (Jessica Lerner), September 23, 2022 (referencing Federal Reserve statistics).

[2] *See also* Client Alert entitled 'Intriguing FINRA Enforcement Action in the Bond Market: More to Come?', September 22, 2021, available here.

Tuesday, October 11, 2022

A Teachable Moment: Latest SEC Enforcement Actions Remind Underwriters of Limited Offering Exemption's "Reasonable Belief" Requirements - Orrick

In an unprecedented move, the Securities and Exchange Commission (the "SEC") recently filed litigation against one underwriter of municipal securities and announced settlements with three others. The litigation and settlements concern transactions treated by the underwriters as exempted from the requirements of Rule 15c2-12 under the so called "Limited Offering Exemption." The SEC alleges that the underwriters did not take the steps necessary to satisfy the exemption's criteria. According to the SEC, these are the first actions the agency has taken addressing underwriters who fail to meet the legal requirements that would exempt them from Rule 15c2-12's requirements to obtain disclosures for investors.

Rule 15c2-12: What's Typically Required and Related Exemptions

Generally speaking, Rule 15c2-12 requires underwriters (as defined in Rule 15c2-12) in most primary offerings of municipal securities to obtain disclosure documents from issuers and to reasonably determine that there is an appropriate undertaking to provide certain continuing disclosures. Rule 15c2-12, however, provides two complete exemptions from its requirements: (1) a short-term security exemption, and (2) the "Limited Offering Exemption." Each of these exemptions require that the security be in large denominations of $100,000 or more.

For the Limited Offering Exemption to apply, the securities must also be sold to no more than 35 persons each of whom the "Participating Underwriter" **reasonably believes**: (A) has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment; and (B) is not purchasing for more than one account or with a view to distributing the securities. The Limited Offering Exemption can be the more difficult exemption to establish in that it imposes "reasonable belief" requirements on underwriters. The SEC's recent actions focus on these requirements and the alleged deficiencies of the underwriters in forming the requisite reasonable beliefs.

The Scope of an "Underwriter" in Rule 15c2-12: Broader Than Expected

It is important to note that the term "underwriter" within Rule 15c2-12 is broader than it suggests at face value. Within Rule 15c2-12, the term "underwriter" includes not only those purchasing securities with a view to reselling them to investors. Of particular importance to the Limited Offering Exemption, this term also includes those serving as placement agent in a limited offering.

What the SEC's Actions Mean for Underwriters

Within the SEC's Complaint in the litigated action (the "Complaint") and the agreed orders in the settled actions (the "Settlement Orders"), the SEC sheds light upon its view of the Limited Offering Exemption and, in particular, the reasonable belief requirements of the exemption.

In addition to the actions alleging that the underwriters failed to comply with the Limited Offering Exemption, the SEC also alleges that the underwriters violated MSRB Rule G-27 in that they failed to adopt, maintain and enforce written supervisory procedures ("WSPs"). In the litigated action, the SEC also alleges that the underwriter violated MSRB Rule G-17 by breaching assurances made to issuers that the underwriter would conduct the limited offerings in compliance with federal law.

As an initial matter, the Complaint states that underwriters relying on the Limited Offering Exemption must obtain certain information about investors in the securities. This key information

includes, at a minimum, the following:

- the size of each investor's investment,
- the number of investors,
- each investor's level of financial experience and/or sophistication, and
- whether each investor is buying the securities for a single account.

A recurring theme throughout the actions is that the underwriter must determine the identity of the actual investors when the underwriter knows or should know that the securities are being purchased for another's account. If an underwriter fails to determine the identity of the actual investors, the underwriter obviously cannot obtain the key information concerning those investors.

Most or possibly all of this key information could presumably be obtained through statements of investors in a "big boy letter" or similar document. The SEC's prior guidance indicates that an underwriter may confirm investment intent (i.e., whether securities are purchased for one's own account and without a view to distributing the securities) through an investor's statements. Underwriters could also use the same document to determine the total number of investors and the amount invested by each.

The final and perhaps the most difficult piece of key information to obtain relates to the investor's sophistication. The SEC's guidance is clear that the underwriter must make a subjective determination in this regard. In practice, many issuer agreements with placement agents or underwriters contain language confirming that each investor is an "accredited investor" or a "qualified institutional buyer." These terms are undefined (and have no direct significance) in Rule 15c2-12. Still, industry practice has been to use these terms to refer to a readily identifiable investor group in order to confirm that an investor is sufficiently sophisticated and knowledgeable. Underwriters should, at a minimum, obtain these confirmations in limited offerings. If a "big boy letter" or similar document is unable to be obtained, underwriters could consider otherwise documenting through a memo to file the diligence process undertaken to support why it has a reasonable belief that the investor satisfies the requirements of the Limited Offering Exemption.

The recent actions make it clear that underwriters must adopt, maintain and enforce WSPs reasonably designed to enable them to comply with the Limited Offering Exemption. To align with the SEC's positions, underwriters who do not currently have WSPs addressing the Limited Offering Exemption should consider adopting them as soon as is reasonably possible. WSPs should contain procedures regarding the exemption's reasonable belief requirements and should instruct personnel on how to obtain the key investor information. WSPs should also contain guidance as to how the underwriter will comply with the Limited Offering Exemption when an entity may be or actually is purchasing securities on behalf of another party.

Looking Around the Corner: Additional Investigations Into Other Firms and Potential Actions Appear Likely
The SEC's press release regarding these actions telegraphs that more actions regarding the Limited Offering Exemption may follow. The SEC indicates that its staff has begun investigations of other firms' reliance on the Limited Offering Exemption. The press release also encourages firms that may have wrongfully relied upon the Limited Offering Exemption to email the SEC at LimitedOfferingExemption@sec.gov. Underwriters should consider whether self-reporting to the SEC is appropriate.

Public Finance Alert | September.20.2022

Orrick Herrington & Sutcliffe LLP

MSRB FY 2023 Budget Advances Strategic Plan Goals.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) today published its annual budget to report on the allocation of resources to advance its FY 2022-2025 Strategic Plan. The budget provides transparency on plans to support the Board's goals for modernizing market regulation, enhancing the Electronic Municipal Market Access (EMMA®) website as the municipal bond market's transparency system, improving the quality of market data, and upholding public trust in the market that enables economic and social progress and access to capital for tens of thousands of communities.

"As the self-regulatory organization (SRO) for the $4 trillion U.S. municipal securities market, we understand that fiscal transparency and accountability are critical to earning and maintaining public trust," said MSRB Chair Meredith Hathorn and MSRB CEO Mark Kim in a letter to stakeholders. "The Board has approved the MSRB's budget for the new fiscal year beginning on October 1, 2022 to advance our priorities in support of the Strategic Plan we adopted last year with extensive input from our diverse stakeholders."

The MSRB's FY 2023 Budget projects revenue of approximately $45 million balanced against $45 million of expenses. This year's budget incorporates a new fee setting process, which became operative on October 1, 2022. It is intended to ensure that the MSRB establishes a sustainable financial model that more closely aligns revenue with expenses and better maintains organizational reserves at target levels. Last year, the MSRB operated at a substantial deficit in line with its stated objective to spend down excess reserves built up over prior years. For the FY 2023 budget, the Board has held expenses to a relatively modest 4.9% increase despite historically high inflation.

"Importantly, the budget reflects our continued efforts to manage reserves and expenses in a manner that responsibly funds the important work of the MSRB to protect and strengthen our market and uphold the public interest," wrote Hathorn and Kim.

Modernizing Market Regulation

As market practices continually evolve, the MSRB is adapting and modernizing its rules to ensure they continue to promote fairness and efficiency in the municipal securities market. A major emphasis for the MSRB in FY 2023 will be a coordinated review with the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) of fixed income market structure. This coordinated initiative includes the recently issued Request for Comment on MSRB Rule G-14 to shorten the time of trade reporting requirement to one minute, as well as ongoing efforts to examine the potential collection of pre-trade data in the fixed income markets. The MSRB will continue to identify opportunities to streamline and update its rules and interpretive guidance to best achieve their intended purpose to protect investors, issuers and the public interest.

Providing Transparency Through Technology

The MSRB continues to invest in its multi-year strategy with planned enhancements to its flagship EMMA website. The MSRB is focused on making the market's transparency and disclosure system easier to navigate and more intuitive to use, while continuing to deliver new features users have requested, such as actionable alerts to help monitor portfolios of securities and tools for streamlining issuers' continuing disclosures. The MSRB has also launched its redesigned website as a resource for issuers, investors, regulated entities and the general public.

Improving the Quality of Market Data

In the coming year, the MSRB plans to leverage its investments in technology to migrate market data into the cloud and to develop analytic tools and services to enhance the quality, accessibility and security of market data for all market participants. This includes exploring opportunities to support the market's use of structured data by leveraging EMMA Labs, the MSRB's innovation sandbox, to advance the transparency, quality and comparability of data in the municipal securities market.

Upholding the Public Trust

Hathorn and Kim noted the MSRB's new approach to fee setting that will annually adjust fee rates to account for prior year results and thus ensure the organization has sufficient annual revenue to fund operations while allowing it to more effectively and efficiently manage reserve levels as it delivers on its multi-year strategic plan. "Our promise to uphold the public trust also means that we are committed to prudent stewardship of the revenue we receive principally from regulated entities," they stated in their letter. The MSRB Chair and CEO also highlighted efforts with fellow regulators to engage with a wide range of stakeholders to understand evolving market trends, best practices and challenges in this large and diverse market. "We are expanding our touchpoints with minority-, women- and veteran-owned enterprises to understand their unique challenges and the opportunities to enhance the market's efficiency, fairness and access to capital," wrote Hathorn and Kim.

Board of Directors Update

Natasha A. Holiday, Managing Director, RBC Capital Markets, has joined the Board as bank representative, replacing Patrick O. Haskell, who withdrew from the incoming class of four new Board members for FY 2023.

As head of the New York City office and Operating Committee member for RBC Capital Markets' public finance group, Holiday structures debt and sells bonds in the public markets to raise capital on behalf of large city and state governments. Previously, Holiday served as senior managing consultant for Public Financial Management (PFM) and Vice President for financial advisor Scott Balice Strategies (acquired by PFM), having begun her public finance career at Goldman Sachs & Co. Holiday earned her Master of Public Policy from Harvard Kennedy School of Government and a BA in History/BS in Political Science from Xavier University.

MSRB Leadership Update

Effective with the start of the new fiscal year on October 1, Chief Regulatory Officer Gail Marshall has transitioned to the role of Senior Advisor to the CEO and Saliha Olgun, Deputy Chief, Market Regulation, has been named Interim Chief Regulatory Officer.

Read the FY 2023 Budget.

Date: October 04, 2022

Contact: Bruce Hall, Senior Manager, Communications
202-838-1300
bhall@msrb.org

GFOA Member Alert: Proposed Financial Data Transparency Act A Costly and

Burdensome Unfunded Mandate

GFOA members should be aware of proposed legislation in the U.S. Senate that would mandate governments to report financial information using uniform reporting categories, or “data standards,” which may require costly updates to financial systems or extensive workarounds.

LEARN MORE

DC Fly-In Recap: BDA Meets with Key Policy Makers to Discuss Muni Priorities.

This week, the BDA hosted a DC advocacy fly-in, meeting with key senior Congressional staff to discuss BDA’s tax priorities. This is the first BDA IN PERSON FLY-IN since the onset of the COVID pandemic and we plan to host multiple similar events next year as the new Congress gets underway.

Educational efforts such as this are key to ensure Members and staff understand the importance of the tax exemption, as well provide opportunities for staff to hear how the market is performing-further guiding their decision making.
The BDA was represented by:

- Crews & Associates
- RBC Capital Markets, and
- HilltopSecurities

The focus of the event was the protection of the tax-exemption, as well gauge the probabilities that key BDA priorities such as the reinstatement of advance refundings could pass in a years end tax package this December.
The group met with both personal office and Committee staff in both the House and Senate including meetings with:

- Senior Tax Staff Covering Ways and Means, Office of Rep. David Kustoff (R-TN)
- Senior Staff Covering Ways and Means, Office of Rep. Terri Sewell (D-AL)
- Ways and Means Minority Staff
- Senate Finance Minority Staff Director, Office of Senator John Cornyn(R-TX),
- Senate Finance Tax Police Advisor, Office of Senator Tom Carper (D-DE)

Following these discussions, we feel confident that no matter the outcomes of the November elections, the tax-exemption has many friends on the Hill. While not a strong possibility, we do feel that House Ways and Means Chairman Richard Neal (D-MA) plans to make a strong push for a years end tax package, and would like to include key muni priorities that remain outstanding.

We will provide more updates as the situation develops, and please let us know if you would like to participate in future DC events.

Bond Dealers of America

October 4, 2022

SIFMA Criticizes FINRA and MSRB Proposals to Reduce Reporting Times for Fixed Income Securities.

SIFMA criticized two proposals to shorten the required reporting time for certain fixed income securities – one by FINRA and the other by the MSRB. (*See* FINRA Notice 22-17; MSRB Notice 2022-07.)

The proposed rule changes would amend FINRA Rule 6730 ("Transaction Reporting") and MSRB Rule G-14 ("Reports of Sales or Purchases") to require trades in covered fixed income securities to be reported to their respective trade reporting systems within one minute from the time of execution (*see* prior coverage here). The FINRA proposal would be relevant to corporate debt securities, securities of the government-sponsored enterprises and U.S. government securities; the MSRB proposal would be relevant to municipals.

In the Comment Letters, SIFMA said that the SROs failed to provide the industry with an adequately comprehensive study in support of the proposed rule changes. SIFMA noted that potential benefits derived from moving to a one-minute reporting standard for fixed income securities are unclear, while the costs are being underestimated and the impacts on the market are being ignored. SIFMA provided extensive detail as to how the rule change could negatively impact various stakeholders, including certain types of firms, nonelectronic trading strategies, smaller customers and trading and settlement systems.

October 5 2022

Fried Frank Harris Shriver & Jacobson LLP

SEC Alleges Fraud and Deceptive Practices in Case Against City of Rochester, New York - Dinsmore

The Securities and Exchange Commission ("SEC") recently filed fraud charges against the City of Rochester, New York ("City"), former City executives, and the City's municipal advisor, reminding us of the importance of up-to-date, accurate disclosures when it comes to the financial condition of political subdivisions, as well as the risks of issuing debt using outdated financial statements.

On June 14, 2022, the SEC charged the City, along with its former finance director Rosiland Brooks-Harris and former Rochester City School District ("District") CFO Everton Sewell, with misleading investors in a $119 million note offering. The City's municipal advisor Capital Markets Advisors, LLC ("CMA") and two CMA principals, Richard Ganci and Richard Tortora, were also charged with misleading investors and breach of fiduciary duty to the City.

The offering document for the notes, prepared by the City and its municipal advisors, included financial statements more than a year old and failed to disclose a dramatic increase in spending on teacher salaries. This increase reportedly contributed to a financial decline of the District. However, this financial decline was not depicted in the note offering since it occurred after preparation of the District's most recent financial statements.

A mere 42 days after the note offering, the District's auditors discovered the magnitude of the District's financial distress; the District's budget was overspent by almost $30 million. This

information was not disclosed to investors at the time of the offering. Ultimately, this over expenditure resulted in a downgrade of the City's debt rating and required intervention by the State of New York in the form of a $35 million loan.

As a result, the SEC filed a complaint in the U.S. District Court for the Western District of New York. The complaint alleges that the City's note offering documents were materially misleading to investors because of their reliance on outdated financial statements, which failed to reflect the true financial condition of the District at the time of the offering. Additionally, the SEC's complaint alleges that the District's "unusual financial distress" was omitted from the offering documents, further misleading investors.

The SEC also claims that Sewell misled a credit rating agency by downplaying the severity of the District's financial condition, despite his knowledge that the District was facing a budget deficit of at least $25 million. Further, the SEC alleges that both Brooks-Harris and Ganci knew of the District's extreme financial distress. However, prior to the note offering, neither party attempted to investigate the District's financial condition, nor did they share their knowledge of the District's overspending with investors.

The SEC is seeking injunctive relief and financial penalties against all parties as a result of one or more of the following allegations: (a) fraud, (i) in the offer or sale of securities and (ii) in the purchase or sale of securities, (b) deceptive, dishonest, and/or unfair practices, (c) breach of fiduciary duties, (d) supervisory breaches and (e) MSRB violations to name a few of the allegations. Although the matter is still pending in the Western District of New York, the fact that charges were filed demonstrates the significance in discovering, and disclosing to investors, the issuer's most current financial condition prior to issuing municipal securities. It is essential that investors have all necessary, up-to-date information so they are able to make well informed decisions regarding municipal investments.

Dinsmore & Shohl LLP – Bradley N. Ruwe

October 3 2022

What Is an Industrial Development Bond and Why Does It Matter When Interpreting Blue Sky Laws? - Harris Beach

When it comes to the proper application of Blue Sky laws relating to the issuance of municipal securities, interpretations matter. And so does a sense of history, given evolutions in various related state and federal regulations.

Today we're taking a look at one of the finer points in the analysis of the Blue Sky law in Arizona. You will recall that we previously wrote about Arizona and its approach to the municipal issuer exemption.

One ambiguity in Arizona concerns the proper definition of industrial development bonds, or IDBs.

The Arizona statute refers to IDBs as defined in the 1954 code, which has been superseded by the 1986 code. The 1986 Code no longer uses the definition of IDBs and instead uses the alternative term of "private activity bond" in place of industrial development bond.

Some practitioners take the position that 501(c)(3) Bonds, which were new to the 1986 Code, would

have been IDBs under the 1954 code — and therefore, the exemption from registration does not apply.

Others argue that since 501(c)(3) Bonds were not IDBs under the 1954 Code, the exemption does apply because these bonds do not get captured by the express language of the statute.

In our view, short of further guidance from Arizona, a strict interpretation of the law means it is limited to just IDBs from the 1954 Code and 501(c)(3) bonds are not included and therefore exempt.

by Christopher Andreucci

October 4, 2022

Harris Beach PLLC

The Finance Industry Needs Better Climate Disclosures.

Secretary Yellen rightly celebrates the Inflation Reduction Act, John Kostyack says, but the law shines a light on an urgent problem that she and other regulators must address in the financial industry—undisclosed climate risk.

Treasury Secretary Janet Yellen recently celebrated the Inflation Reduction Act's potential to drive down climate-damaging pollution, accelerate technology innovation, and reduce energy costs for businesses and consumers.

The economic opportunities created by this law are indeed worthy of celebration. But as chair of the Financial Stability Oversight Council, Yellen is also obliged to address economic risks associated with these dramatic changes.

Hidden Risks
Last year, the FSOC expressed concerns about the emerging threat of a climate-related financial crisis, including transition risks that arise when businesses and financial institutions aren't prepared to shift to a clean energy economy.

Among the top FSOC recommendations was for a Securities and Exchange Commission mandate that public companies disclose these risks to their investors. A proposed mandate is pending and expected to be finalized this year.

Financial experts fear that lack of attention to hidden climate risk could lead to a "green swan" event, or a sudden and widespread asset deflation that devastates the global economy.

As increasingly ambitious climate laws like the IRA are put in place—and clean energy technologies become increasingly available, affordable, and reliable—greater proportions of fossil fuel reserves become uneconomic, leaving billions in assets valueless and stranded.

Individual savers in the US are uniquely threatened by this poorly disclosed climate risk. A recent study shows they hold $300 billion in high-risk fossil fuel assets, more than individuals in any other country. Even more worrisome, $681 billion of risky fossil fuel assets are on the balance sheets of financial institutions—far more than the subprime housing assets that triggered the 2008 crisis.

Transparency a Given

Expecting public companies to be transparent with their investor-owners is not controversial. In fact, the SEC has been addressing market failures and protecting investors with disclosure rules since the 1930s, with little fanfare.

Thus, the five-alarm response of the fossil fuel industry and its allies to the SEC's climate risk disclosure proposal seems bizarre, perhaps leading a casual observer to believe the SEC, not Congress, limits the industry's greenhouse gas emissions.

Just a month before the IRA's enactment, oil industry leaders filed comments with the SEC vehemently opposing its proposal. Ignoring the enthusiastic support expressed by thousands of investors, the American Petroleum Institute argued that climate risk is not a serious investor concern.

Dismissing concerns about businesses' lack of preparedness for the energy transition, it claimed, despite powerful evidence, that emerging climate laws can safely be ignored until they are implemented.

The Western Energy Alliance's comments on the proposal symbolize the depth of denialism about climate risk in the marketplace and show why the SEC must act now to strengthen its regulations. The WEA falsely claims the SEC is "purposefully suppressing American oil and natural gas production" for the benefit of Russia, which is allegedly conspiring with US climate advocacy groups.

How Disclosures Should Look

In reality, the SEC is not proposing to regulate how or where energy is produced—but instead that public companies' responses to changes in policy, technology, and customer preferences spurred by climate change be disclosed in a useful format for investors.

If there were ever doubts about whether these changes are meaningful enough to warrant investor concern, Congress's enactment of the IRA has dispelled them—along with the launch of similarly ambitious policies this year by California, Australia, the UK, and the European Union. A clean energy revolution is now well underway.

The question facing the SEC is how to provide a disclosure format that enables investors to evaluate companies' preparedness for these changes, and efficiently allocate capital to those that are truly prepared. The most important step will be to require standardized and comprehensive GHG emissions disclosures.

A particular component of these disclosures will be especially important for investors: Scope 3 emissions, or the emissions of customers and suppliers, are a critical measure of transition risk for many companies.

For example, Scope 3 emissions of oil companies and banks include auto emissions. Thus, disclosures would tell investors how exposed these companies are to collapsing demand for gasoline due to the IRA's electric vehicle incentives and EV mandates recently enacted by California.

The good news for investors is that the SEC has demonstrated its understanding of these and other climate risks and has put forward a strong proposal, with only small adjustments needed to strengthen Scope 3 emissions disclosure requirements.

Once the rule is finalized and climate risks are fully disclosed, climate risk-aware investors will be empowered to allocate their dollars to businesses that are taking a thoughtful approach to the twin challenges of decarbonization and resilience to climate change impact.

The SEC has no role in promoting this reallocation of capital. Its statutory mandate is to protect investors by ensuring they receive consistent and reliable information about the risks that threaten the financial condition of public companies.

However, once climate risk information is properly disseminated, the fundamental weaknesses of businesses with no meaningful decarbonization strategies will emerge.

With properly functioning capital markets, investment in well-run, climate-smart businesses will flourish. This will be good news for investors, the stability of our financial system, and the habitability of our planet.

Bloomberg Law

by John Kostyack

Sept. 29, 2022

John Kostyack is an adviser to the Sierra Club and other nonprofits and foundations that promote sustainable investing. For nearly three decades, he served in leadership positions at leading advocacy organizations including the National Wildlife Federation, the Wind Solar Alliance, and the National Whistleblower Center. He previously worked as an attorney at a private law firm.

MSRB Notice 2022-07 and FINRA Regulatory Notice 22-17 – Proposals to Shorten Fixed Income Trade Reporting Timeframes: SIFMA Comment Letter

SIFMA and SIFMA AMG provided comments to the Municipal Securities Rulemaking Board (MSRB) and Financial Industry Regulatory Authority (FINRA) on Notice 2022-07 issued by the Municipal Securities Rulemaking Board and Regulatory Notice 22-174 issued by the Financial Industry Regulatory Authority.

View the SIFMA Comment Letter.

Groups Voice Opposition to Data Reporting Requirements for State, Local Borrowers.

The American Public Power Association (APPA) has joined with 17 other members of the Public Finance Network in writing Senate leaders in opposition to data reporting requirements for state and local borrowers included in the Financial Data Transparency Act of 2022.

The Public Finance Network consists of state and local governments and other tax-exempt bond issuers, borrowers and municipal market professionals.

The bill would require the Municipal Securities Rulemaking Board (MSRB) to require state and local governments to report financial information using uniform reporting categories, or “data standards,” which may require costly updates to financial systems or extensive workarounds.

The changes would take effect no later than two years after final rules implementing the change are

promulgated.

The concern is that the provisions of the Financial Data Transparency Act of 2022 (S. 4295) were added as an amendment to H.R. 7900, the National Defense Authorization Act for Fiscal Year 2023 (NDAA). The NDAA passed the House in July, and a companion bill (S. 4534) has passed the Senate Armed Services Committee.

State and local governments “do not oppose transparency and accessibility of information, and in fact, significant financial transparency standards are already in place,” the Sept. 29 letter noted.

“Most issuers of municipal securities (e.g., entities represented by the undersigned groups) adhere to governmental reporting standards established by the Governmental Accounting Standards Board (GASB), while others follow standards as determined under state law. In whole, issuers of municipal securities exhibit transparency to stakeholders through very established and standardized means.”

APPA and the other groups voiced concern about the impact of the Financial Data Transparency Act’s Section 203 on state, county, municipal, public utilities, hospital and education entities required to submit financial information to the MSRB for several reasons.

“Among others, a primary concern is that this provision would result in an unfunded mandate on state and local governments due to the increased costs to ensure systems are able to comply with future standards,” the letter said.

“Further, this provision represents a substantial federal overreach into the content and structure of issuer disclosures, and more broadly the accounting and reporting principles of government entities, contrary to the principles of federalism,” the groups argued.

Also, Section 203 “could create more confusion and ultimately reduce transparency by forcing vastly different kinds of governmental entities to report using a rigidly standardized schema or taxonomy.”

publicpower.org

by Paul Ciampoli

October 1, 2022

SEC Speaks 2022: Ongoing Efforts to Restore Public Trust, Aggressive Enforcement Agenda - McGuireWoods

On Sept. 8 and 9, 2022, Securities and Exchange Commission Chairman Gary Gensler, Division of Enforcement Director Gurbir Grewal and senior officials from the Enforcement Division convened at the annual SEC Speaks conference. Enforcement Director Grewal opened the enforcement panel by discussing the Enforcement Division’s continued efforts to restore trust in government and the legal and regulatory processes.

For its part, Director Grewal stated, the Enforcement Division is focused on hiring, promoting and retaining a diverse and talented workforce to make it more efficient and effective. He explained that an Enforcement staff that broadly reflects the country’s diversity can foster trust and encourage victims to come forward, and it enables the Enforcement Division to protect all investors. Director Grewal also sought to dispel the notion that the SEC is “picking winners and losers and stifling

innovation in the crypto space," and conveyed unequivocally that crypto remains an enforcement priority and the crypto industry will not have immunity "from the application of well-established regulations and precedents."

Building on Director Grewal's theme of restoring trust, Deputy Director Sanjay Wadhwa emphasized the Enforcement Division's commitment to deter misconduct, shape industry behavior and ensure accountability through enforcement actions. Deputy Director Wadhwa stressed the SEC's expectation that market participants engage in proactive compliance, noting meaningful consequences for those who fall short, such as cases involving admissions of violations in settlements. To further shape behavior, Deputy Director Wadhwa highlighted efforts to provide greater transparency to market participants into how the Enforcement Division rewards firms that provide extraordinary cooperation to Enforcement staff in investigations. Deputy Director Wadhwa also discussed the Enforcement Division's practice of empowering front-line Enforcement staff to make key decisions in the enforcement process, including limiting meetings with senior Enforcement officials in connection with the Wells process.

Deputy Director Wadhwa and other panelists rounded out the discussion by highlighting enforcement priorities, including regulation of crypto markets, the aggressive use of remedies, a willingness to litigate, disclosures and fiduciary obligations in the municipal securities space, broker-dealer gatekeeper responsibilities and protection of whistleblowers.

Reining in Crypto Markets

Chair Gensler focused his opening remarks on the SEC's intent to continue applying existing rules and regulations to all aspects of the crypto industry — from tokens to stablecoins to intermediaries — explaining that new technologies do not diminish the need for investor protection. Rejecting requests for additional clarity, Chair Gensler noted that his predecessor, Chairman Jay Clayton, spoke frequently about the applicability of the federal securities laws to the crypto space, as has the SEC through Section 21(a) Reports of Investigation and enforcement actions. Although Chair Gensler's remarks portend an aggressive enforcement posture, he also offered an olive branch, inviting crypto projects and intermediaries to work with the SEC to comply with existing regulations and stressing the benefits of true cooperation and meaningful engagement.

Director Grewal echoed Chair Gensler's resolve to apply longstanding and well-established rules to the crypto markets, reiterating his belief that the "*Howey* and *Reves* tests remain vital and accurate means of identifying instruments that fall within the jurisdiction of the securities laws." He dismissed the suggestion that the SEC is picking winners and losers in the digital asset space and preventing innovation by not giving crypto markets a free pass, asserting that doing so would require the Enforcement Division to abandon its responsibilities to capital markets and the investing public.

Crypto Assets and Cyber Unit Chief David Hirsch emphasized the importance of registration in primary and secondary crypto markets. He explained that requiring registration encourages the development of enhanced compliance functions and robust protocols to promote accountability and to prevent misconduct.

Aggressive Use of Remedies

Expanding the initiative publicized at SEC Speaks 2021 to aggressively seek stark remedies in enforcement actions and settlements, Deputy Director Wadhwa indicated that market participants who do not undertake proactive compliance measures could face vigorous enforcement to further the programmatic goals of deterring misconduct, shaping conduct and promoting accountability.

(For highlights from SEC Speaks 2021, see McGuireWoods' Oct. 25, 2021, alert.)

Illustrating this precept, Deputy Director Wadhwa pointed to the 2021 settlement with a registered broker-dealer and investment adviser for its failure to maintain and preserve written communications on personal devices, resulting in an admission and civil monetary penalties to the SEC and Commodity Futures Trading Commission totaling $200 million. Citing the number of law firm client mailings on the action, Deputy Director Wadhwa explained that significant remedies against a major financial institution garner widespread attention and help to repair trust by demonstrating a commitment to evenhanded enforcement.

Chief Counsel Samuel Waldon reiterated the approach to officer and director bars that Director Grewal announced at SEC Speaks 2021, which includes seeking an officer and director bar even against a person who was not serving as an officer or director at the time of the conduct, or was not even an employee of a public company, if there is egregious conduct and there is a chance the individual might have the opportunity to serve as an officer or director of a public company in the future. Chief Counsel Waldon also made it clear that Enforcement staff will seek bars in any settlement, not just those involving scienter-based violations, where the facts show a person is unfit to serve in an officer or director role.

In the realm of gatekeeper accountability, Deputy Director Wadhwa and Chief Counsel Waldon discussed the Enforcement Division's increased use of Sarbanes-Oxley Act Section 304 orders, which permit the SEC to order the disgorgement of bonuses and incentive-based compensation earned by the CEO and CFO in the year following the filing of any financial statement that the issuer is required to restate because of misconduct. This remedy is available even where the CEO and/or CFO did not engage in misconduct, thus incentivizing implementation of robust internal controls and inducing companies to address matters of the tone at the top and corporate culture.

Importance of Proactive and Effective Cooperation

To help restore trust in the SEC and its legal and regulatory processes and to shape conduct, Deputy Director Wadhwa and other staff members described efforts to include in settlement documents details of the Enforcement Division's evaluation and assessment of creditworthy cooperation. Common among firms benefiting from cooperation has been early self-reporting of violations and robust remediation efforts.

An example of this approach includes a recent settlement with an issuer in which the administrative order contained specific details regarding its cooperation that "substantially advanced the quality and efficiency of the staff's investigation and conserved Commission resources" — such as "providing detailed explanations [of how certain transactions worked], summarizing witness interviews, and providing other relevant information to the staff[.]" The SEC's press release also referred to these efforts as an important consideration in assessing sanctions.

A second example discussed was an administrative order that expressly cited the company's cooperation as a basis for limiting the financial penalties imposed. The cooperation included voluntary disclosure of information not uncovered in the government's investigation and providing detailed updates on the issuer's internal investigation, as well as sharing key documents identified through the investigation.

In another matter identified by panelists, no penalty was imposed against an issuer in recognition of its extraordinary cooperation. This cooperation included, among other things, self-reporting of issues (including those giving rise to the settlement) uncovered during an unrelated internal investigation that did not reveal anything of substance, management and board personnel changes and

reimbursement to the company of improper expense reimbursements.

Enforcement Leadership Declining Nonessential Wells Meetings

Deputy Director Wadhwa emphasized the Enforcement Division's ongoing efforts to streamline the Wells process and empower front-line staff. Deputy Director Wadhwa confirmed that he and Director Grewal have been declining requests for Wells meetings in cases that did not involve novel legal issues or important policy questions (without providing insight into how they are making these determinations). He insisted the Wells process remains important, but that they are mindful of the investment of time and resources by the Enforcement staff and by respondents and their counsel. Respondents should treat their interaction with front-line staff as the primary method to achieve resolution of their cases; they should not expect a second bite at the apple with officials higher up the chain.

Enforcement Division Litigating More Cases

Chief Litigation Counsel Olivia Choe's comments centered on how the Enforcement Division is not afraid to litigate. This year, the SEC has tried 15 cases in federal court — the most since 2015 and up from just five last year — involving the gamut of alleged violations, including insider trading, investment-adviser frauds, Ponzi and offering schemes and commission splitting. Chief Litigation Counsel Choe touted the SEC's record of success in 2022, noting favorable jury verdicts in 13 cases and nine victories on summary judgment.

Enforcement staff members also offered a reminder that they are continuing to pursue insider trading cases and noted the increase in such litigated actions. Relatedly, Enforcement staff observed an uptick of activity around insiders' family members and other close relations who — due to work-from-home conditions during the pandemic — may have been exposed to insider conversations that previously would have taken place in a company's offices.

In addition to litigating alleged substantive violations, the SEC has also been busy litigating enforcement of subpoenas and other orders. Chief Litigation Counsel Choe discussed unsuccessful efforts by the founder of an electric car manufacturer to quash a subpoena the SEC served after he made Twitter posts that potentially violated a 2018 settlement agreement. She also cited a failed attempt by subpoena recipients to avoid compliance by arguing they had not been properly served through counsel, as an example of the SEC standing its ground to enforce its processes. Lastly, Chief Litigation Counsel Choe detailed the SEC's willingness to pursue civil contempt orders when defendants attempt to evade penalties or hide assets, citing cases resulting in the seizure of a boat and incarceration of an evasive defendant.

Disgorgement Post-*Liu*

Chief Counsel Waldon described how the SEC has continued to seek broad disgorgement awards following the U.S. Supreme Court's 2020 decision in *Liu v. SEC*, in which the Supreme Court held that the SEC has the statutory authority to seek a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for the benefit of victims. (For background, see McGuireWoods' June 24, 2020, analysis of the case.) He stated that the Enforcement Division staff will pursue legal theories supporting disgorgement even where the funds would not be returned to investors and instead would flow to the Department of the Treasury. He noted that in insider trading cases, the SEC will continue seeking disgorgement of trading profits and losses avoided in addition to prejudgment interest and penalties. Further, in insider trading cases not involving disgorgement claims, the SEC will seek "two-times penalties" plus a penalty equal to the amount of prejudgment interest the SEC would have sought had it claimed disgorgement.

SEC Solicitor Michael Conley and Senior Appellate Counsel David Lisitza discussed courts' support for the Enforcement Division's efforts to impose joint-and-several disgorgement post-*Liu*. In *Liu*, the Supreme Court discussed the SEC's practice of holding multiple defendants jointly and severally liable for disgorgement, a practice that was at odds with traditional equitable principles. The Supreme Court acknowledged a general rule against joint-and-several liability at equity but did not set a firm rule prohibiting an order disgorging from one defendant profits that accrued to another. Instead, recognizing the common law permitted liability among partners engaged in "concerted wrongdoing," the Supreme Court left open the door for some flexibility to impose joint-and-several disgorgement. Without articulating a standard for concerted wrongdoing, the Supreme Court left it to lower courts to determine whether joint-and-several disgorgement was warranted on a case-b--case basis, given the "wide spectrum of relationships between participants and beneficiaries of unlawful schemes."

Since the Supreme Court's decision, the SEC has continued to pursue joint-and-several disgorgement and courts have granted it — relying on multiple defendants' active participation in a scheme to satisfy the "concerted wrongdoing" requirement. In *Liu* following remand, the district court found concerted wrongdoing between two individual defendants, finding relevant that they were a married couple, had commingled finances and had both played active roles in the scheme — with one setting up fraudulent businesses and the other helping to secure investors for them and later accepting misappropriated investor funds.

In a 2022 decision, the U.S. Court of Appeals for the Fourth Circuit affirmed joint-and-several disgorgement from a company and its chief executive. Though the executive argued the district court based his joint-and-several liability solely on his status as a control person, the Fourth Circuit made clear that it was mindful of *Liu* and instead looked at his active participation in an illegal scheme with the company. For example, the court noted that he was the "mastermind and architect" of an investment program the company used to lure investors through fraudulent means; also, the executive and the company — together — were alleged to have made misrepresentations to investors, formed shell companies to deceive investors about the program's success and created fake escrow accounts purportedly to hold stock as collateral for investments. Other recent district court rulings likewise have focused on active participation as a basis for finding concerted wrongdoing to support joint-and-several disgorgement.

Senior Counsel Kerry Dingle discussed post-*Liu* decisions from the U.S. Courts of Appeals for the Second, Fifth and Seventh Circuits that addressed the deduction of legitimate expenses when calculating disgorgeable net profits. In each case, the district court ordered disgorgement after finding the SEC met its burden of making a reasonable approximation of the disgorgeable profits. Although the respective defendants sought deductions — for example, arguing that diverted funds had been offset by contemporaneous transfers to the original destinations or disputing the SEC's valuation of certain assets — the district courts found their arguments insufficient to show the SEC's approximation was not reasonable; and in each case, the respective Circuit Courts affirmed.

Senior Counsel Dingle drew three general principles from these cases. First, these decisions maintained the pre-*Liu* practice of placing the initial burden on the SEC to propose a reasonable approximation of profits causally related to the fraud before shifting the burden to the defendant to show the SEC's approximation was not reasonable. Second, to the extent there is uncertainty or ambiguity around making a reasonable approximation — such as how to value an unconventional asset or how to isolate disgorgeable profits within commingled funds — the wrongdoer bears the consequences of the uncertainty. Finally, to meet its burden of reasonable approximation, the SEC does not need to trace particular funds all the way from their source to the defendant's personal accounts or personal expenses. Collectively, these cases speak to the wide latitude courts may be

inclined to give the SEC in making a reasonable approximation of disgorgeable net profits, as well as the high bar a defendant must clear to challenge the SEC's calculation.

Continued Focus on Municipal Securities

Public Finance Abuse Unit Deputy Chief Rebecca Olsen discussed the Enforcement Division's continued focus on the municipal securities market, including on conduct by issuers, broker-dealers and municipal advisers.

The Enforcement Division's spotlight on school district issuers persists, with three such actions involving alleged misrepresentations of financial information in bond offering documents. In one case, the district provided investors and the credit union agency with misleading budget projections. The SEC charged the district for its omission of payroll liabilities from its financial statements included in bond offering documents. In a currently litigated matter against a city, the SEC alleges that the issuer misled investors with outdated financial statements and a failure to disclose that the district was experiencing financial distress due to overspending. In discussing these actions, Olsen emphasized the importance of providing retail investors with accurate financial information in the bond offering documents and with a truthful picture of the financial risk of investments.

Olsen also highlighted several enforcement actions against broker-dealers for unfair dealing. One case involved a financial conflict of interest between a broker-dealer underwriting a municipal bond offering and its affiliate, which purchased nearly all the bonds in a municipal issuer's tender offer. When recommending the purchase price between its affiliate and the issuer, the broker-dealer did not disclose its affiliate's financial interest. This violated the underwriter's obligation to deal fairly with its municipal clients. The SEC also brought a series of actions against broker-dealers for unfair dealing to retail investors. Specifically, in several bond offerings, broker-dealers allocated municipal bonds to "flippers," who purchased bonds to sell to other broker-dealers or to the same firm for its own inventory, rather than the retail investors entitled to priority allocation.

Regarding municipal adviser misconduct, Olsen emphasized the SEC's first-ever case enforcing MSRB Rule G-42 on the duties of non-solicitor municipal advisers. The SEC brought enforcement actions against an advisory firm and its two principals for a failure to disclose their fee-splitting arrangement with an underwriting firm. As a result of this conflict of interest, which was undisclosed to the firm's charter school clients, the firm violated its duties of loyalty and care to its clients.

Focus on Broker-Dealers as Gatekeepers

Assistant Director Stacey Bogert focused her remarks on the gatekeeping function broker-dealers serve and their responsibility to maintain market integrity. She discussed the most significant areas of the Enforcement Division's focus in the last year: Regulation BI and Form CRS, the filing of Suspicious Activity Reports (SARs) and cybersecurity.

In the first action of its kind, the SEC brought a case under Regulation BI regarding a broker-dealer's standards of conduct in four areas: disclosure obligations, care, conflict of interest and compliance. The SEC charged a broker-dealer with a violation of Regulation BI's duty of care obligations as it sold L Bonds, a high risk and illiquid investment, to customers on fixed incomes with moderate risk tolerances. According to the SEC, this was a failure to exercise reasonable diligence regarding the risks and rewards of the investment for its clients and it failed to establish a reasonable basis that the investment was in the clients' best interest. Bogert was clear that with this action, as well as guidance including FAQs and compliance guides, the Enforcement Division is now initiating enforcement actions under Regulation BI.

Similarly, the Enforcement Division brought approximately 40 cases regarding compliance with Form CRS filing requirements. Such actions, which Assistant Director Bogert indicated will remain an enforcement priority, have involved both failure to file Form CRS on a timely basis and failure to include all required information.

Assistant Director Bogert also commented on two cases involving failures to timely file SARs. She emphasized the importance of this tool in detecting fraudulent behaviors; consequently, firms must continue to develop and implement effective policies and procedures reasonably designed to identify suspicious activity and file SARs with FinCEN.

Assistant Director Bogert further spoke about the Enforcement Division's scrutiny of broker-dealers' safeguarding of customer records and information through written supervisory procedures designed to mitigate identity theft, as required by Regulations S-P and S-ID. The Enforcement Division brought 11 cases against broker-dealers in the last year for failure to have reasonable policies and procedures, even though all had identity theft prevention programs. Assistant Director Bogert emphasized that it is insufficient for broker-dealers to merely include an identity theft policy; instead, policies and programs must be tailored to each broker-dealer's specific business and regularly updated.

Enforcement Remains Committed to Whistleblowers

Office of the Whistleblower Chief Creola Kelly reported on the continuing importance of whistleblowers to Enforcement Division efforts, with $1.3 billion awarded to 281 individuals since the program's inception in 2010 and $226 million to 78 individuals so far in 2022. Chief Kelly also reaffirmed the Enforcement Division's commitment to protecting whistleblowers, including vigilant protection of whistleblowers' identities and strong enforcement of violations of Rule 21F-17. Recent enforcement actions reveal the Enforcement Division's expansive interpretation of Rule 21F-17, which prohibits "imped[ing] an individual from communicating directly with the [SEC] about a possible securities law violation."

For example, a recent matter involved an employee of a nonpublic company who submitted a whistleblower tip to the SEC regarding the company's financial data and 30 days later raised similar concerns internally to the company's CIO. The SEC found that the CIO violated Rule 21F-17 by changing the employee's network access rights and surreptitiously accessing and monitoring the employee's personal email and social media accounts — even though the employee did not know about these actions, the CIO did not know about the whistleblower submission, and there was no evidence that the CIO took any steps to impede the employee from communicating with the SEC about a possible securities law violation.

What Lies Ahead

At the 2021 SEC Speaks conference, Director Grewal laid out a plan for a less respondent-friendly enforcement process, with the intent to improve perceptions of the SEC's fairness and to enhance public confidence in financial markets. Remarks at SEC Speaks 2022 uniformly projected an unwavering, if not enhanced, commitment to that course, as well as an emboldened Enforcement staff.

Under Director Grewal, the Enforcement Division — particularly front-line staff — is likely to push aggressive timelines during investigations and not shy away from aggressive settlement and litigation postures armed with full support from senior enforcement officials. Market participants and their counsel should not expect a lengthy Wells process (if any at all) or access up the chain for further advocacy to the extent an impasse is reached with the investigative staff. Thus, ongoing

proactive engagement with the Enforcement staff will be important at every stage of the enforcement process.

McGuireWoods LLP – E. Andrew Southerling, Louis D. Greenstein, Vinu G. Joseph, Jennifer E. LeMoyne and Timothy Whittle

September 28 2022

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.

September 30 2022

Shearman & Sterling LLP

SEC Sanctions Broker for Failure to Register as Municipal Advisor and for Inadequate Procedures to Ensure Registration: A Reminder for Brokers and Fund Managers - Goodwin

On September 14, 2022, the SEC announced a settled administrative order, also dated September 14 ("Order"), imposing penalties, including a $100,000 fine, on a registered broker (the "Broker") for failing to (1) register as a municipal advisor, in violation of Section 15B(a)(1)(B) of the Securities Exchange Act of 1934 ("Exchange Act"), and (2) reasonably supervise its associated persons with respect to the laws and rules applicable to advising municipal entities, in violation of Rule G-27 of the Municipal Securities Rulemaking Board ("MSRB"), and consequently, Exchange Act Section 15B(c)(1). The Order is a reminder that persons that come into contact with municipal entities, including brokers and fund managers, should have written policies and procedures to ensure that they know what activities would cause them to be municipal advisors and whether they need to register or have an available exemption or exclusion.

SEC Findings
Broker provides institutional brokerage services to certain municipal entities, including a Midwest city described in the Order as "Municipal Entity."[1] Broker was temporarily registered as a municipal advisor prior to July 1, 2014 but ceased to be registered as a municipal advisor thereafter.[2] Between 2017 and 2019, a registered representative ("Registered Representative") of Broker provided advice to Municipal Entity regarding securities that were purchased with municipal bond proceeds (generally, proceeds of a municipal bond offering that have not yet been spent or applied to their intended use). The SEC found that Registered Representative recommended that Municipal Entity purchase specific financial products, which were ultimately acquired by the Municipal Entity with municipal bond proceeds. Furthermore, the SEC found that "the communications from [Broker] and Registered Representative included subjective opinions or views, conveying more than mere general information." These communications were sufficient to make Broker a municipal advisor, required to register.

The SEC also found that Broker did not maintain a system to supervise the municipal securities activities of its associate persons that was reasonably designed to achieve compliance with applicable securities laws, regulations, and MSRB rules. During the relevant period, Broker had written supervisory procedures ("WSPs") that required it to "conduct its public finance and municipal securities-related business in a manner so as to not subject the firm to registration and regulation as a Municipal Advisor."[3] However, the SEC found that Broker's supervisory system was inadequate to (1) enable registered representatives to know when communications could require registration as a municipal advisor, (2) train personnel with respect to the municipal advisor training requirements, and (3) conduct electronic communication surveillance to identify potential violations of the municipal advisor registration rules. As a result, Broker failed to reasonably detect or prevent unregistered municipal advisor activities.

Violations
The Order held that the failure to register as a municipal advisor was a violation of Section 15B(a)(1)(B) of the Exchange Act. In addition, it held that Broker's failure to establish and maintain an adequate system to supervise the municipal securities activities of its associated persons reasonably designed to achieve compliance with applicable securities laws, regulations, and MSRB rules was a violation of MSRB Rule G-27(e), which requires appropriate supervisory procedures,

and, therefore, of Section 15B(c)(1) of the Exchange Act. Section 15B(c)(1) provides, in part, that "no broker, dealer, municipal securities dealer or municipal advisor shall make use of the mails or any means or instrumentality of interstate commerce to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products, the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person, in contravention of any rule of the [MSRB]."

There was no finding that Broker was a member of the MSRB. The SEC found Broker to be in "willful" violation of MSRB Rule G-27 even though Broker was not a member and without regard to whether it realized that the rule applied to its activities.[4]

Who Needs to Have Supervisory Procedures Required by Rule G-27?
It may come as a surprise to some readers that they can be in violation with an MSRB rule even if they are not members of the MSRB. If you are a municipal advisor and not registered, you can be in violation not only of the registration requirement but of the MSRB rule requiring you to have adequate supervisory procedures to make sure you are registered. If you are not a municipal advisor, you are not in violation of either the registration requirement or the supervisory procedures rule.

Section 15B(c)(1) says that "brokers" that act as municipal advisors (or municipal securities brokers) are subject to MSRB rules and, therefore, must have supervisory procedures in place to, among other things, ensure that they are registered if they are required to be. However, Section 15B(c)(1) and Rule G-27 do not make it unlawful not to have supervisory procedures to make sure you are registered if you are not actually acting as a municipal advisor or municipal securities broker. If your municipal advisor supervisory procedures are inadequate or even non-existent, but, by good fortune, you never act as a municipal advisor or municipal securities broker, you won't be in violation of G-27. But that's no way to go through life if you do business with municipal entities.

Different exemptions and exclusions apply to different categories of persons, and the need to have procedures to test whether you are a municipal advisor will depend on the nature of your business and whether it could change in the future to include municipal advisory activities. Here are some examples:

- **Brokers.** A broker that executes transactions in securities for a municipal entity investing the proceeds of a municipal securities offering is not a municipal advisor if it does not provide advice or recommendations with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning financial products or issues. "Municipal financial product" is a defined term that includes investment strategies – plans or programs for the investment of the proceeds of municipal securities. Every broker that executes transactions in securities for municipal entities should have policies and procedures to educate associated persons about what activities will require registration as a municipal advisor and a system to test and monitor the communications of associated persons to ensure that they are not providing municipal advisory services.
- **Placement agents.** The definition of "municipal advisor" includes a person who "undertakes a solicitation of a municipal entity." "Solicitation of a municipal entity" is defined, in substance, as communications with a municipal entity, for compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser with whom the solicitor is not affiliated, for the purpose of obtaining or retaining an engagement of such person. In the case of an investment adviser, the definition specifies that the engagement is to provide investment advisory services to or on behalf of a municipal entity [emphasis supplied]. In response to proposed rules interpreting, among other things, the phrase "solicitation of a municipal entity," the SEC received comments that the phrase should not be interpreted to include a placement agent soliciting a

municipal entity to invest in a collective fund, even if advised by an investment adviser. The SEC agreed, stating that a placement agent soliciting an investment by a municipal entity on behalf of a fund is not soliciting on behalf of the investment adviser in order for the municipal entity to retain the services of the investment adviser.[5] However, if a placement agent solicits a municipal entity to open a separate account with an investment adviser so that the investment adviser can advise the municipal entity on the investment of proceeds of a municipal offering (and the placement agent is not affiliated with the investment adviser), the placement agent could be required to register as a municipal adviser to engage in that type of solicitation. Placement agents should have policies and procedures to educate associated persons about the difference between the two types of solicitation and to monitor for and prevent direct solicitation on behalf of investment advisers if the placement agent is not registered as a municipal advisor.

- **Investment advisers.** Exchange Act Section 15B(e)(4)(C) excludes from the definition of municipal advisor "any investment adviser registered under the Investment Advisers Act of 1940, or persons associated with such investment advisers who are providing investment advice." Mere registration as an investment adviser is not sufficient to qualify for the exemption. The investment adviser must be providing investment advice, and the SEC makes clear in Rule 15B1-1(d)(2)(ii) that, for purposes of the investment adviser exclusion, investment advice does not include "advice concerning whether and how to issue municipal securities, advice concerning the structure, timing, and terms of an issuance of municipal securities and other similar matters, advice concerning municipal derivatives, or a solicitation of a municipal entity or obligated person."[6] An investment adviser that provides advice to municipal entities should have policies and procedures to educate associated persons about the difference between investment advice and the other kinds of advice and services that do not provide an exclusion from registration as a municipal advisor, and to test for and prevent the investment adviser from being compensated for providing the other kinds of advice and services without registration as a municipal advisor.
- **Fund managers.** In the Adopting Release, the SEC stated that it would interpret a pooled investment vehicle (e.g., a hedge fund, private equity fund, real estate fund, or commodity pool) "to be an investment strategy and an advisor to such a pool to be a municipal advisor, when the pooled investment vehicle contains proceeds of an issuance of municipal securities, regardless of whether all funds invested in the vehicle are funds of municipal entities."[7] An advisor to a pooled investment vehicle that has at least one municipal entity participant that has invested the proceeds of an issuance of municipal securities must be registered as a municipal advisor, unless it is excluded as a registered investment adviser or registered commodity trading adviser. Some real estate fund advisors are not required to be registered as investment advisers because the funds own real property rather than real estate securities. Whether a real estate fund advisor is required to be registered as a municipal advisor may come down to whether municipal entity investors are investing the proceeds of an issuance of municipal securities or, instead, funds that either were not proceeds of an issuance of municipal securities or have been "spent," i.e., put to the use for which the proceeds were intended.[8] An example of the latter would be proceeds of an issuance of municipal securities that have been used to fund an employee retirement system, and have become the property of the retirement system to use for its purposes. A fund manager may rely on representations in writing made by a knowledgeable official of the municipal entity or obligated person whose funds are to be invested regarding the nature of such funds, provided that the manager has a reasonable basis for such reliance.[9] A fund manager's policies and procedures concerning municipal advisor registration should include, among other things, procedures for obtaining a representation by a knowledgeable official of the municipal entity with respect to the nature of the funds invested, which can be part of the subscription agreement or a separate document.

Having reasonably designed supervisory procedures with respect to activities with municipal entities can prevent a broker or advisor from inadvertently acting as an unregistered municipal advisor and,

if a good faith mistake is still made, can reduce the level of sanctions the SEC may seek.

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[1] Merely providing brokerage services to municipal entities does not require a broker to register as a municipal advisor unless the broker otherwise provides services or advice that would make it a municipal advisor.

[2] Municipal advisors were permitted to register on the temporary form until the permanent rules applicable to registration as a municipal advisor went into effect on July 1, 2014. As a result of new exemptions and exclusions added by the SEC in the permanent rule and related FAQs, some persons temporarily registered as municipal advisors withdrew their registrations.

[3] Apparently verbatim quotation by the SEC from the text of the WSPs.

[4] The SEC cited case law in support of its interpretation of "willfully" in this context to mean "no more than that the person charged with the duty knows what he is doing."

[5] SEC Release No. 34-70462 (Sept. 20, 2013)("Adopting Release"), text preceding n. 461.

[6] This is discussed in the Adopting Release in the text preceding n. 655.

[7] Adopting Release, text preceding n. 398.

[8] Rule 15Ba1-1(m), definition of proceeds of municipal securities.

[9] Rule 15Ba1-1(m)(3); see also Adopting Release, text preceding n. 340.

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by Peter LaVigne

September 29, 2022

Goodwin

SEC Brings First Charges Against Muni Market Underwriters Alleging Failure to Meet Requirements for Limited Offering Disclosure Exemption: Ballard Spahr

Summary

The Securities and Exchange Commission (SEC) recently announced enforcement proceedings against four municipal market underwriters for alleged violations of municipal bond disclosure requirements. Three of the four underwriters have settled with the SEC.

The Upshot

- The four underwriting firms allegedly sold new issue municipal securities in primary offerings intended to meet the limited offering exemption to broker-dealers and investment advisers without a reasonable belief that the entities were making purchases for their own accounts or without a

view to distribute the securities.
- The underwriters allegedly failed to ascertain for whom the broker-dealers and investment advisers were purchasing the securities and were unable to form a reasonable belief that the purchases were for investors who possessed the necessary knowledge and experience to evaluate the investments.
- The three underwriters that settled with the SEC agreed to disgorgement and penalties ranging between $100,000 and $300,000. In pending charges against the fourth underwriter, the SEC alleges the underwriter "made no inquiry to determine if those entities were buying on behalf of their customers and/or clients and, if so, whether such investors met the exemption criteria."

The Bottom Line

The pending complaint identifies certain matters that the SEC believes underwriters should consider in determining compliance with the limited offering exemption requirements. But the SEC provides no guidance on how such inquiries should be undertaken or whether investor letters can be used for this purpose. The SEC said it is investigating whether other firms are properly relying on the limited offering exemption and is encouraging firms that believe they may have not complied with the exemption requirements to self-report possible violations.

On September 13, 2022, the Securities and Exchange Commission (SEC) announced enforcement proceedings against four municipal market underwriters for alleged violations of municipal bond offering disclosure requirements under SEC Rule 15c2-12. The SEC rule establishes certain requirements in connection with primary market and continuing disclosures to be provided to investors, unless an exemption applies. Three of the underwriters settled with the SEC while charges are pending against the fourth underwriter.

Under federal securities law, a limited offering exemption is available for offerings sold in $100,000 authorized denominations if the securities are sold to no more than 35 persons who the underwriter reasonably believes (i) have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the investment (the "sophisticated investor clause") and (ii) are not buying the securities for more than one account or with a view to distributing the securities (the "investment purpose clause").

According to the SEC, the four underwriting firms sold new issue municipal securities in primary offerings intended to meet the limited offering exemption to broker-dealers and investment advisers without a reasonable belief that the entities were making purchases for their own accounts or without a view to distribute the securities, as required by the investment purpose clause. The SEC asserts that, because the underwriters failed to ascertain for whom the broker-dealers and investment advisers were purchasing the securities, the underwriters were unable to form a reasonable belief that the broker-dealers and investment advisers were purchasing the securities for investors who possessed the necessary knowledge and experience to evaluate the investments, as required by the sophisticated investor clause.

The SEC's pending complaint against the underwriter that did not settle provides more details about the alleged violations. In that compliant, the SEC observes that some broker-dealers and investment advisers purchasing securities in the primary offerings from the underwriter shortly thereafter resold the securities to multiple brokerage customers or allocated the securities to multiple advisory clients. The SEC alleges that the underwriter "made no inquiry to determine if those entities were buying on behalf of their customers and/or clients and, if so, whether such investors met the exemption criteria." The SEC argues that the underwriter "did not reasonably believe the broker-dealers were buying the securities for their own accounts because the broker-dealers that were buying the securities were in the business of servicing brokerage customer accounts" and also "did

not reasonably believe the investment advisers were buying the securities for their own accounts because these investment advisers were in the business of managing accounts for their advisory clients."

The SEC notes in the pending complaint that the underwriter did not inquire whether the broker-dealers or investment advisers were purchasing on behalf of their customers or clients. Further, in cases where the broker-dealers or investment advisers may have been purchasing on behalf of their customers or clients, the SEC states that the underwriter "neither requested nor received information from the broker-dealers [or investment advisers] about: how many customers [or clients] would receive the securities; how much each customer [or client] was investing; each customer's [or client's] level of financial experience; or whether each customer [or client] was buying for a single account." The SEC concludes that, without this information, the underwriter could not have formed the requisite reasonable belief that the broker-dealers or investment advisers, or the customers or clients on whose behalf they may have been buying, were sufficiently sophisticated and buying for their own account, as the limited offering exemption requires. The SEC also alleges that the underwriter violated MSRB Rule G-17, which requires fair dealing, by deceptively representing to municipal market issuers that it complied with the limited offering exemption requirements.

While the pending complaint identifies certain matters that the SEC believes underwriters should consider in determining compliance with the limited offering exemption requirements, the SEC provides no guidance on how such inquiries should be undertaken or whether investor letters can be used for this purpose. As a matter of practice, investor letters are often used by municipal market underwriters to confirm the sophisticated status and investment intent of municipal securities purchasers.

The SEC further alleges that the four firms also violated Municipal Securities Rulemaking Board (MSRB) Rule G-27, which requires municipal market underwriters to put in place sufficient supervisory policies and procedures to ensure compliance with federal securities laws.

The three underwriters that settled with the SEC agreed to disgorgement and penalties ranging between $100,000 and $300,000. The case against the fourth underwriter is pending. The SEC stated in its news release that it has started investigating whether other firms are properly relying on the limited offering exemption. The SEC is encouraging firms that believe they may have not complied with the exemption requirements to self-report possible violations to the SEC at: LimitedOfferingExemption@sec.gov. The SEC did not provide a form for self-reporting or standard settlement terms.

by Teri Guarnaccia, Ernesto Lanza, Kimberly Magrini, William Rhodes, Tesia Stanley

September 22, 2022

Ballard Spahr LLP

MSRB Votes to Amend Municipal Advisor Advertising and Registration Rules.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB or Board) met virtually on September 15 for the final Board meeting of the fiscal year. The Board voted to amend MSRB Rule G-40, on advertising by municipal advisors, to allow municipal advisors to use testimonials in advertisements, and MSRB Rule A-12, on registration, to make accompanying changes to Form A-12.

The proposed amendments to Rule G-40 would allow municipal advisors the use of testimonials, subject to limitations in alignment with analogous requirements under the Securities and Exchange Commission's (SEC) new Rule 206(4)-1, on Investment Adviser Marketing, under the Investment Advisers Act of 1940. The proposed rule change is anticipated to be filed with the SEC before the end of the calendar year.

"When the MSRB established advertising standards for municipal advisors in 2018, it sought to enhance the MSRB's fair-dealing provisions by promoting regulatory alignment with other financial regulators," said Patrick Brett, MSRB Board Chair. "In the same spirit, following the SEC's modernization of its advertising rule for investment advisors, which allows investment advisors use of testimonials in marketing materials, the MSRB is proposing to make conforming amendments to Rule G-40."

The proposed amendments to Rule A-12 would include extending the annual affirmation period through January 31 of each calendar year and permitting regulated entities to update optional information on Form A-12 during the annual affirmation period rather than within 30 days of a change. In addition, regulated entities, on a voluntary basis, would be able to identify whether the firm has identified as a women and minority-owned business or veteran-owned small business. The proposed rule change and the enhancements to Form A-12 are anticipated to be operational on January 1, 2023, to coincide with the 2023 annual affirmation period.

At this final board meeting of the fiscal year, MSRB CEO Mark Kim stated, "On behalf of the staff of the MSRB, I would like to thank Board Chair Patrick Brett along with our other departing Board members, Caroline Cruise, Joseph Darcy and Seema Mohanty for their dedication and service." The MSRB's new fiscal year begins on October 1, 2022.

Date: September 16, 2022

Contact: Bruce Hall, Senior Manager, Communications
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GFOA: Modernizing Internal Control Checklists in State and Local Governments

Internal control checklists aren't the most exciting topic to work on in a government. Frequently, they are left alone unless something goes wrong. If used correctly, however, a comprehensive, well-designed checklist can be the first line of defense to notify management that something is wrong. This article outlines the history of the State of Illinois internal control checklist and lessons learned for the future.

Publication date: August 2022

Author: Jack Rakers

DOWNLOAD

Financial Accounting Foundation Relocation.

Norwalk, CT, September 19, 2022 — The Financial Accounting Foundation (FAF) today announced it is moving to a new location in Norwalk, CT, along with the staffs of the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB).

The new offices are located at 801 Main Avenue, Norwalk, CT 06851.

The FAF is the parent organization of the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB).

During a brief transition period, employees will work remotely, remaining fully available to stakeholders. All staff are expected to be working in the new office space by Monday, October 3, 2022.

Financial Services Professionals: Check Your Political Contributions for Compliance to Avoid Pay-To-Play Fines - Nossaman

During these last weeks of the 2022 election season, campaigns are ramping up urgent, last-minute fundraising efforts. Financial services professionals should not let their guard down amid this flurry. Recently published Securities Exchange Commission (SEC) fines are a reminder that a contribution by such individuals could have consequences for their employer and for them, according to the SEC's Rule 206(4)-5, the so-called federal "pay-to-play rule."[1] As seen in the SEC's recently unveiled settlements with four investment advisers, the most common source of a pay-to-play violation stems from an associate contributing to a governor or other chief executive, such as a mayor. With 36 states and three territories electing governors in 2022 (not to mention countless municipal elections), the SEC is holding up the proverbial yield sign with its announcement of these settlements so close to the election. These cases are a reminder that financial services firms should remind their professionals of compliance checks before making political contributions.

The SEC's Pay-to-Play Rule

SEC Rule 206(4)-5 places limits on political contributions made by certain "covered associates" of an investment adviser that has a contract with a government client. However, only contributions to candidates for an office that has the authority to influence the government's award of an investment advisory contract will trigger the pay-to-play rule. If a "covered associate" makes such a contribution, the investment adviser is prohibited from providing investment advisory services for compensation to a government client for two years from the time of that contribution, and if it does engage in those services, it is subject to penalty. It may also need to disgorge previously earned fees.

There are limited ways by which a "covered associate" can make contributions. SEC Rule 206(4)-5 permits certain de minimis contributions by a "covered associate" of up to $350 to a candidate for whom the associate is entitled to vote and contributions of up to $150 for other candidates.

Recent Settlements

With less than 60 days before the November election, the SEC's settlement of pay-to-play allegations

with four investment advisers neither admitted nor denied the violation and contain a total of $300,000 in penalties, ranging from $45,000 to $90,000. Although these violations and fines appear in line with other SEC settlements, there are three key takeaways from a compliance perspective.

- *Statewide and Citywide Offices Pose the Greatest Compliance Risk.*

Notably, three out of the four settlements involved $1,000 contributions to three different 2018 candidates for governor, with the other being contributions to a candidate for Mayor of New York City for the 2021 election.

- *The SEC Rule is one of Strict Liability.*

As Commissioner Hester Pearce points out in her statement critiquing the settlements, the pay-t--play rule is a "blunt" instrument. As a matter of law, there is strict liability under the rule – the intent of the donor does not matter, only the fact that the contribution was made to a certain official above the *de minimis* threshold.

- *There is Limited Opportunity for Remediation.*

The contributor in the case of the $1,000 contribution to the Massachusetts candidate sought and obtained a refund of the contribution, but to no avail. A refund of the contribution will only negate the violation if (1) the contribution does not exceed $350; (2) the adviser discovered the contribution within four months of the date of the contribution; and (3) the contributor obtains a refund within 60 days after learning of the contribution.

Although the SEC's pay-to-play rule applies throughout the year, the months heading into an election present a heightened risk of inadvertent violations, given the push from campaigns and the desire of donors to support the candidates and causes about which they care. As these settlements show, even a contribution as much as $50 over the de minimis limit can trigger a significant penalty, a reminder of the importance of proactive compliance and vetting.

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[1] The SEC pay-to-play rule covers investment advisers, but other financial service providers may be covered by similar rules issued by the Municipal Securities Rulemaking Board (MSRB), the Financial Industry Regulatory Authority (FINRA), and the Commodities Futures Trading Commission (CFTC).

Nossaman LLP – William A. Powers and Frederick T. Dombo, III

09.22.2022

Broker-Dealer Settles Charges for Unregistered Municipal Advisory Operations.

A broker-dealer settled SEC charges for operating as an unregistered municipal advisory firm by providing advice to a municipality regarding securities that were purchased with the proceeds from an issuance of bonds. In a release, the SEC stated that "[t]he action marks the first time the SEC has charged a broker-dealer for violating the municipal advisor registration rule."

The SEC found that a registered representative of the firm made recommendations for specific financial products that included subjective opinions, which the SEC determined constitutes as investment advice. The SEC said that the broker-dealer failed to adequately supervise registered representatives' municipal securities activities. The broker-dealer maintained (i) improper procedures to enable its registered representatives to identify municipal bond proceeds accounts, (ii) inadequate training on the municipal advisor registration requirements and (iii) insufficient electronic communication monitoring to identify potential communications violations.

As a result, the SEC determined the broker-dealer violated Exchange Act Section 15B(a)(1)(B) and 15B(c)(1) ("Municipal securities") as well as MSRB Rule G-27 ("Supervision"). To settle the charges, the broker-dealer agreed to (i) cease and desist, (ii) accept a censure, (iii) pay a civil monetary penalty of $100,000, plus additional disgorgement and prejudgment interest.

Commentary

Firms that provide services to municipalities should be mindful that the definition of "municipal advisor" does not correspond to the definition of "investment adviser," and that it is not intuitive.

Fried Frank Harris Shriver & Jacobson LLP – Steven Lofchie

September 21 2022

US Senate Mulls Onerous, Costly Financial Reporting Standards for Counties.

The Financial Data Transparency Act of 2022 (S. 4295), sponsored by Senator Warner (D-VA) and Senator Crapo (R-ID), would mandate governments and nonprofits to report financial information using uniform reporting categories, or "data standards," which would likely require costly updates or extensive workarounds for county finance systems.

Companion legislation (H.R. 2989), introduced by Reps. Carolyn Maloney (D-N.Y.) and Patrick McHenry (R-N.C.) passed the US House of Representatives on July 14, 2022, as an amendment to the House version of the fiscal 2023 National Defense Authorization Act (NDAA), which is annual must-pass legislation. Like the House, the Senate is actively considering attaching S. 4295 to its version of the fiscal 2023 NDAA.

Section 203 of this legislation would require the Municipal Securities Rulemaking Board (MSRB) to develop data standards for financial reporting related to the municipal bond market.

These data standards include universal reporting standards, and reporting entities would be required to the extent practicable to render fully searchable and machine-readable data with accompanying metadata that clearly defines the semantic meaning of the data. In addition, the legislation would require the MSRB to "scale" reporting requirements for "smaller regulated entities."

If enacted, the legislation requires joint rulemaking for regulated entities that will take place two years after passage, and then it provides two years for implementation. Full implementation and compliance would begin in 2027.

Transitioning to a new uniform reporting system requires significant resources — consultants, software, and reconfiguring county financial systems to account for the new reporting standards.

Moreover, this costly unfunded mandate would fall on the backs of local governments, with no financial support from the federal government.

According to the National Association of Counties (NACo):

> Counties recognize the need for full disclosure of all relevant information concerning a county's financial condition to potential investors, citizens, and other parties interested in municipal bonds. Counties also oppose federally imposed standards for county financial accounting and reporting and supports those principles put forth by the Governmental Accounting Standards Board (GASB). As such, NACo is concerned with the unfunded and federally mandated financial reporting standards included in this bill.
>
> NACo is following this closely and will provide members with updates.

The Local Government Article, Section 16-306 of the Annotated Code of Maryland requires each county, incorporated city or town, and taxing district in Maryland to file audit reports annually or once every four years under specified conditions.

The Office of Legislative Audits, part of the Maryland Department of Legislative Services, reviews the financial statements. The financial statements must be prepared using generally accepted accounting principles and audited per generally accepted auditing standards.

There were 186 local government audit reports are included in OLA's fiscal year 2021 review (23 counties and Baltimore City, 150 other incorporated cities and towns, and 12 taxing areas). The latest report is available here.

Maryland Association of Counties

by Kevin Kinnally

September 21, 2022

BDA Monitoring Legislation Mandating Specific Technologies for Issuer Financial Reporting.

The BDA, working in concert with our partners in the Public Finance Network led by the GFOA, have been monitoring the progress of the Financial Data Transparency Act of 2022. A similar bill recently passed the House of Representatives as part of the National Defense Authorization Act.

The legislation can be viewed here.

Background

The Senate bill sponsored by Senator Warner (D-VA) and Senator Crapo (R-ID) requires the MSRB to "establish data standards." It also needs to "scale" reporting requirements for "smaller regulated entities."

The provisions in question are in Section 203 of the legislation. The Senate version requires joint rulemaking for regulated entities that will take place for two years after passage and then it

provides two years for implementation.

The BDA has flagged concerns about a one-size fits all mandate to the Senate sponsors, as well concerns of the financial burdens this will have on issuers and on how this will be funded at the MSRB – recognizing that dealers pay the majority of the MSRB budget.

The legislation would require identical financial reporting taxonomies across all types of public entities. Given the wide variety of governments the market represents (e.g., states, cities, counties, water systems, public power, public gas, hospitals, etc.), combining all into a single standardized template has the potential to lose valuable information and to reduce transparency by eliminating detail specific to the unique functions or services that governments actually provide.

Full implementation and compliance would be required beginning 2027.

We will continue to provide updates as they become available.

Bond Dealers of America

by Brett Bolton

September 9, 2022

Municipal Bond Market Impact of the SEC's Mutual Fund ESG Proposals: Ballard Spahr

Summary

Two pending proposals could significantly affect how mutual and other funds approach their ESG investments in municipal bonds. If adopted by the Securities and Exchange Commission, the proposals could result in municipal issuers facing ESG-related expectations from mutual funds that are more stringent and less flexible as a precondition of accessing capital from segments of the fund industry that seek to serve the ESG-focused investor base.

The Upshot

- The Fund ESG Proposal would adopt specific disclosure requirements for funds regarding ESG strategies, including requiring some environmentally focused funds to disclose the greenhouse gas emissions associated with their portfolio investments. Municipal ESG holdings may need to conform to these new requirements.
- The Fund Names Proposal would amend existing SEC rules to, among other things, expand the current requirement for certain funds to invest at least 80 percent of their assets in accordance with the investment focus the fund’s name suggests. The proposal raises questions on whether municipal bonds may sometimes be limited to the residual portion of fund assets if the name suggests an ESG focus.
- Some ESG-Focused Funds would be required to disclose the carbon footprints and weighted average carbon intensities of their portfolios, including their municipal holdings.

The Bottom Line

These pending SEC proposals on mutual funds may be the first new ESG rules that have a significant

impact on the municipal market. While municipal issuers may conform their ESG practices to the proposed criteria for ESG fund holdings in structuring new offerings, they may face considerable obstacles applying the newer ESG practices to outstanding bonds that may be held by funds. In addition, issuers may need to choose between meeting heightened expectations or bypassing some ESG-Focused Funds as potential investors.
The municipal bond market is grappling with how best to approach evolving investor demand for environmental, social, and governance (ESG) disclosures and ESG-designated bonds under existing federal anti-fraud and materiality standards and through voluntary industry best practices. These conversations are happening against the backdrop of the Securities and Exchange Commission's (SEC) pending ESG regulatory proposals for the corporate securities1 and mutual fund2 markets. Many market participants look to these pending SEC proposals for clues to what regulators might have in store for the municipal market in the future.3

However, the pending Fund ESG Proposal and Fund Names Proposal could themselves result in significant and more immediate effects on how mutual and other funds – the second largest investor segment for municipal bonds4 – approach their ESG investments in municipal bonds. If adopted by the SEC, the proposals could result in municipal issuers facing a number of ESG-related expectations that are new, more stringent and/or less flexible than the current market as a precondition to continuing to access capital from the fund industry that seeks to serve the ESG-focused investor base. While municipal issuers may seek to conform their ESG practices to these criteria in structuring their new offerings going forward, they would face considerable obstacles in applying the newer ESG practices to outstanding bonds that may be held by funds.

Summary of Recent SEC Fund Proposals

In broad summary, the Fund ESG Proposal would apply to registered investment companies and business development companies (funds), as well as registered investment advisers and certain unregistered advisers (advisers). The Fund ESG Proposal would (i) require specific disclosure requirements regarding ESG strategies in fund prospectuses, annual reports, and adviser brochures; (ii) implement a layered, tabular disclosure approach for ESG funds to allow investors to compare ESG funds at a glance; and (iii) generally require certain environmentally focused funds to disclose the greenhouse gas (GHG) emissions associated with their portfolio investments. In addition, the Fund Names Proposal would amend the SEC's existing fund names rule to (i) improve and expand the current requirement for certain funds to adopt a policy to invest at least 80 percent of their assets in accordance with the investment focus the fund's name suggests; (ii) provide new enhanced disclosure and reporting requirements; and (iii) update the rule's current notice requirements and establish recordkeeping requirements. The provisions of these proposals that are potentially relevant to municipal securities issuers are described below.

Potential Impact of SEC Fund Proposals on Municipal Securities Issuers

Some of the new ESG-related expectations incorporated into the Fund ESG Proposal and Fund Names Proposal, and their potential impacts on municipal issuers, include the following:5

- More Structured Criteria for Consideration of ESG Factors When Making Investment Decisions – For any funds that consider one or more ESG factors in their investment decisions – whether along with other non-ESG factors, with the ESG factors being no more significant than other non-ESG factors (Integration Funds), or as a significant or main consideration in selecting investments (ESG-Focused Funds) – the funds may need to establish more structured criteria than they currently use on how they incorporate ESG factors into the investment selection process, including what factors they consider.
- Municipal issuers may experience less flexibility from funds on how they apply ESG factors in

assessing a potential investment in their bonds given funds' need to comply with their publicly disclosed more structured investment criteria.

- Heightened ESG Investment Criteria for ESG-Focused Funds – In the case of ESG-Focused Funds, the fund proposals would require more detailed criteria for considering ESG factors in making investment decisions, including descriptions of any methods for including or excluding investments (such as any quantitative thresholds or qualitative factors used), any scoring methodologies, methods for evaluating the quality of third-party data used, and the use of any third-party ESG framework (including how funds determine that a portfolio holding is consistent with the framework).

- Municipal issuers may experience heightened expectations from ESG-Focused Funds with respect to the information (potentially including quantitative information) issuers would need to make available concerning applicable ESG factors so that such funds can maintain investment portfolios that are consistent with disclosed criteria. As a result, issuers may need to choose between meeting these expectations or bypassing some ESG-Focused Funds as potential investors.
- In addition, ESG-Focused Funds with names suggesting that investment decisions incorporate one or more ESG factors must meet an investment policy requirement that at least 80 percent of the value of assets in the funds' portfolios consist of the type of investment suggested by their names. It is unclear if municipal bonds that have ESG characteristics but may not meet the formal criteria of a particular ESG-Focused Fund might still be considered within the 80 percent investment policy requirement or would otherwise be limited to the remaining more-flexible portion of the fund's portfolio holdings. If so limited, the level of investor interest in such bonds may be significantly reduced.
- Additional Disclosures for Impact Funds – For ESG-Focused Funds that select investments that seek to achieve one or more specific ESG impacts (Impact Funds), in addition to the requirements described above for ESG-Focused Funds, such Impact Funds would be required to disclose the impacts they are seeking to achieve, how they seek to achieve such impacts, how they measure progress toward the specific impacts (including key performance indicators), the time horizons used to analyze progress, and the relationship between the impacts sought and financial return.
- Municipal issuers seeking investments from Impact Funds would in most cases need to be willing and able to provide ongoing qualitative and/or quantitative data on the achievement of specific goals or similar measures of progress toward the applicable impact. Municipal issuers may need to choose between providing this ongoing information or bypassing Impact Funds as potential investors.
- Methodology When Considering Greenhouse Gas (GHG) Emissions – For Integration Funds that consider GHG emissions of their holdings as one ESG factor in their investment selection process, the funds would be required to describe the methodology used for considering portfolio investment GHG emissions.
- Municipal issuers may need to consider what, if any, information they may be willing and able to generate and disclose with respect to their GHG emissions in light of the various methodologies different Integration Funds may develop. No particular methodology is mandated, nor would Integration Funds be required to use quantitative metrics; however, funds that consider GHG emissions likely would develop more structured criteria for doing so (which may include quantitative measures) and, as a result, may have less flexibility in how they assess GHG emissions tied to a particular investment in a municipal bond for their portfolio in light of these criteria. Municipal issuers may need to choose between meeting such methodologies or bypassing some Integration Funds requiring GHG emissions information as potential investors.
- Quantitative Disclosures of GHG Emissions for Some ESG-Focused Funds – Unless ESG-Focused Funds that consider environmental factors affirmatively disclose that they do not consider issuers' GHG emissions as part of their investment strategy, these ESG-Focused Funds would be required to disclose the carbon footprints and weighted average carbon intensities (WACI) of their

portfolios. Calculation at the fund-level of carbon footprint and WACI would require quantitative measurements of each portfolio security issuer's enterprise value, total revenues and Scope 1 and Scope 2 GHG emissions.6 While such funds would be required to use GHG emission data produced by issuers of portfolio investments if available, they would be permitted to use good faith estimates based on publicly disclosed methods of estimation of the portfolio issuer's Scope 1 and Scope 2 emissions if no such issuer-produced data were available.
- Municipal issuers seeking investments from ESG-Focused Funds that consider GHG emissions would in most cases need to be willing and able to provide significant quantitative data of the type required by the proposal. It is unclear whether such funds would be willing to make good faith estimates for issuers that do not produce the required GHG emissions data. Municipal issuers may need to choose between undertaking to provide requisite GHG emissions data or bypassing ESG-Focused Funds that consider GHG emissions.

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[1] "The Enhancement and Standardization of Climate-Related Disclosures for Investors," Securities Act Release No. 11061 (March 21, 2022).

[2] "Investment Company Names," Securities Act Release No. 11067 (May 25, 2022) (the Fund Names Proposal), and "Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies," Securities Act Release No. 11068 (May 25, 2022) (the Fund ESG Proposal).

[3] The Municipal Securities Rulemaking Board (MSRB) also published MSRB Notice 2021-17 (December 8, 2021) requesting information on ESG practices in the municipal securities market, which generated 52 letters from an array of market participants. Commenters on balance expressed the view that substantive ESG-related regulation with respect to municipal securities, if any, should most appropriately be undertaken by the SEC rather than the MSRB, with the MSRB potentially making certain enhancements to its Electronic Municipal Market Access (EMMA) system to support more efficient and effective dissemination of any ESG-related disclosures.

[4] As of the end of the second quarter of 2022, mutual funds (including money market and closed-end funds) held $1.02 trillion out of the outstanding $4.04 trillion of municipal securities, constituting approximately 25.3 percent of the municipal securities market. Board of Governors of the Federal Reserve, Z.1 Financial Accounts of the United States – Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts – Second Quarter 2022 (September 9, 2022), Table L.212. Only the household sector held more, with approximately $1.61 trillion.

[5] These proposals include a number of other provisions not described herein, and readers should refer to the applicable SEC releases for completes description of each proposal. In addition, the Fund ESG Proposal includes provisions applicable to advisers that may have an impact on their ESG-related investment decisions on behalf of their separately-managed accounts and other clients.

[6] Funds would only be required to disclose Scope 3 GHG emissions of any portfolio issuer that itself discloses Scope 3 emissions.

September 19, 2022

by Ernesto Lanza, Kimberly Magrini, William Rhodes

Ballard Spahr LLP

Municipal Bond Underwriters Settle SEC Charges for "Limited Offering" Disclosure Violations.

Three municipal bond underwriters settled SEC charges for failing to provide sufficient disclosure to investors in connection with the sale of municipal securities (see, here, here and here). The SEC also filed a Complaint against a fourth municipal bond underwriter in the United States District Court for the Southern District of New York based on the same alleged violations. The SEC stated, “these are the first SEC actions addressing underwriters who fail to meet the legal requirements that would exempt them from obtaining disclosures for investors in certain offerings of municipal bonds.”

According to the separate Orders, the underwriters relied on a “limited offering” disclosure exemption in paragraph (d)(1)(i) of SEA Rule 15c2-12 (“Municipal securities disclosure”), which requires that the securities are sold to no more than 35 persons having “such knowledge and experience in financial and business matters” that they are able to understand the product, and were not purchasing for redistribution. The SEC found that the underwriters did not determine if the broker-dealer and investment advisers purchased the securities for investment purposes, nor did the underwriters know for whom the securities were purchased. As a result, the SEC found that the underwriters were unable to reasonably believe that the securities were purchased for investors that fully understood the product. Further, the SEC found that the underwriters failed to adopt supervisory policies.

As a result, the SEC determined that the underwriters violated SEA Rule 15c-12, SEA Section 15B(c)(1) (“Municipal securities”) and MSRB Rule G-27 (“Supervision”).

To settle the charges, the underwriters agreed to (i) cease and desist, (ii) accept a censure and (iii) pay civil monetary penalties plus disgorgement with prejudgment interest. Separately, the SEC charged a fourth municipal bond underwriter with similar violations, also alleging that the fourth underwriter also made materially deceptive statements to investors regarding the securities, in violation of MSRB Rule G-17 (“Conduct of Municipal Securities and Municipal Advisory Activities”).

The Complaint against the fourth underwriter also includes charges for deceptive statements to issuers in violation of Rule G-17 and “seeks permanent injunctions, disgorgement plus prejudgment interest, and a civil money penalty.”

September 14 2022

Fried Frank Harris Shriver & Jacobson LLP

SEC Charges Loop Capital Markets in First Action against Broker-Dealer for Violating Municipal Advisor Registration Rule.

Washington D.C., Sept. 14, 2022 — The Securities and Exchange Commission today charged Chicago-based Loop Capital Markets, LLC for providing advice to a municipal entity without registering as a municipal advisor. The action marks the first time the SEC has charged a broker-dealer for violating the municipal advisor registration rule.

According to the SEC's order, between September 2017 and February 2019, Loop Capital advised a Midwestern city to purchase particular fixed income securities, which the city purchased using the proceeds of its own municipal bond issuances. In addition, the Commission's order found that Loop Capital did not maintain a system reasonably designed to supervise its municipal securities activities and had inadequate procedures, including insufficient methods to identify potential violations of the municipal advisor registration rules.

"The municipal advisor registration rules apply to all market participants and are intended to protect municipal entities from abuse," said LeeAnn Ghazil Gaunt, Chief of the Enforcement Division's Public Finance Abuse Unit. "Registered broker-dealers must either register as municipal advisors or refrain from engaging in municipal advisory activities."

Loop Capital agreed to settle with the SEC and consented, without admitting or denying any findings, to the entry of an SEC order finding that it violated the rules regarding municipal advisor registration and supervision requirements, censuring it, and ordering it to pay disgorgement and prejudgment interest of $5,456.73 and a civil penalty of $100,000.

The SEC's investigation was conducted by Sally Hewitt and Kristal P. Olson of the Public Finance Abuse Unit with assistance from Jonathan Wilcox and Eric Celauro. The investigation was supervised by Brian D. Fagel. The SEC examination that led to the investigation was conducted by Ben Kempton, Catherine Cotey, David Kinsella, Michael Wells, and John Brodersen of the Chicago Regional Office.

SEC Charges Four Underwriters in First Actions Enforcing Municipal Bond Disclosure Law.

Washington D.C., Sept. 13, 2022 — The Securities and Exchange Commission today filed a litigated action against Oppenheimer & Co. Inc. and separately announced settlements with BNY Mellon Capital Markets LLC, TD Securities (USA) LLC, and Jefferies LLC, charging each of the four firms with failing to comply with municipal bond offering disclosure requirements. These are the first SEC actions addressing underwriters who fail to meet the legal requirements that would exempt them from obtaining disclosures for investors in certain offerings of municipal bonds.

According to the SEC's complaint and the settled orders, during different periods since 2017, the four firms sold new issue municipal bonds without obtaining required disclosures for investors. Each of the firms purported to rely on an exemption to the typical disclosure requirements called the limited offering exemption, but they did not take the steps necessary to satisfy the exemption's criteria.

"I applaud the excellent work of the Division's Public Finance Abuse Unit in bringing these first-ever actions in the $4 trillion municipal bond space," said Gurbir S. Grewal, Director of the SEC's Division of Enforcement. "We encourage underwriters to examine their practices and to self-report any failures to us before we identify them ourselves."

"Disclosure helps protect investors from fraud," said LeeAnn G. Gaunt, Chief of the SEC Enforcement Division's Public Finance Abuse Unit. "Underwriters must take seriously their responsibility to ensure municipal bond investors get the information they are entitled to."

The SEC's orders find that BNY, TD, and Jefferies each violated Rule 15c2-12 under the Securities

Exchange Act of 1934, which establishes disclosures that must be provided to investors, as well as Municipal Securities Rulemaking Board (MSRB) Rule G-27 and Section 15B(c)(1) of the Exchange Act. Without admitting or denying the SEC's findings, these three firms agreed to settle the charges, cease and desist from future violations of those provisions, be censured, and pay the following monetary relief:

- BNY: $656,833.56 in disgorgement plus prejudgment interest and a $300,000 penalty;
- TD: $52,955.92 in disgorgement plus prejudgment interest and a $100,000 penalty; and
- Jefferies: $43,215.22 in disgorgement plus prejudgment interest and a $100,000 penalty

The SEC's complaint against Oppenheimer, filed in federal district court in Manhattan, charges the same violations as above in connection with at least 354 offerings. The complaint also alleges that Oppenheimer made deceptive statements to issuers in violation of MSRB Rule G-17, which prohibits deceptive, dishonest, or unfair practices. The complaint seeks permanent injunctions, disgorgement plus prejudgment interest, and a civil money penalty.

As a result of its findings in these investigations, the SEC staff has begun investigations of other firms' reliance on the limited offering exemption. Firms that believe their practices do not comply with the securities laws are encouraged to contact the SEC at LimitedOfferingExemption@sec.gov.

The SEC's investigations were conducted by Laura Cunningham, Sue Curtin, Warren Greth, Brian Knight, Steve Varholik, Cori Shepherd Whitten, and Jonathan Wilcox of the Public Finance Abuse Unit, with assistance from Samir Badalov, and supervised by Kevin B. Currid, Jason H. Lee, Ivonia Slade, and Rebecca Olsen. The SEC's litigation against Oppenheimer will be led by Devon Staren. The SEC appreciates the assistance of the Municipal Securities Rulemaking Board.

Chicago BD to Pay Over $105K for Failing to Register as Muni Advisor.

What You Need to Know

- Loop Capital Markets is the first broker-dealer to be charged for violating the municipal advisor registration rule.
- The SEC ordered the firm to pay disgorgement and prejudgment interest of $5,457 and a civil penalty of $100,000.
- The SEC also recently filed a litigated action against Oppenheimer & Co. and reached settlements with BNY Mellon Capital Markets, TD Securities and Jefferies for failing to comply with municipal bond offering disclosure requirements.

A Chicago-based broker-dealer has agreed to pay more than $105,000 for violating the municipal advisor registration rule, The Securities and Exchange Commission said Wednesday.

Loop Capital Markets earned the dubious distinction of being the first BD to be charged for violating that rule, according to the SEC.

According to an SEC order filed Wednesday, between September 2017 and February 2019, Loop Capital advised a Midwestern city to buy particular fixed income securities, which the city purchased using the proceeds of its own municipal bond issuances.

The firm has been registered with the SEC as a BD since 1997. Loop Capital was temporarily registered as a municipal advisor before July 1, 2014, but has not been registered with the SEC as a

municipal advisor since then, according to the SEC order.

The SEC also found that Loop Capital didn't maintain a system reasonably designed to supervise its municipal securities activities and had inadequate procedures that included insufficient methods to identify potential violations of the municipal advisor registration rules.

"The municipal advisor registration rules apply to all market participants and are intended to protect municipal entities from abuse," according to LeeAnn Ghazil Gaunt, chief of the SEC Enforcement Division's Public Finance Abuse Unit.

"Registered broker-dealers must either register as municipal advisors or refrain from engaging in municipal advisory activities," she said in a statement.

Without admitting or denying the SEC's findings, Loop Capital agreed to settle with the SEC and consented to the entry of an SEC order finding it violated the rules regarding municipal advisor registration and supervision requirements.

The SEC also ordered the firm to pay disgorgement and prejudgment interest of $5,457 and a civil penalty of $100,000. The firm also agreed to be censured.

Loop Capital didn't immediately respond to a request for comment on Thursday.

The SEC said Tuesday it filed a litigated action against Oppenheimer & Co. Inc. and had reached settlements with BNY Mellon Capital Markets LLC, TD Securities LLC and Jefferies LLC for failing to comply with municipal bond offering disclosure requirements.

ThinkAdvisor

By Jeff Berman

September 16, 2022

SEC Risk Alert for Municipal Advisors Highlights Key Compliance Issues: Ballard Spahr

Summary

The Security and Exchange Commission last month released a Risk Alert to notify municipal advisors of key compliance issues. The SEC's Division of Examinations adds client disclosure concerns to the list of most frequently observed compliance failures. Additionally, the Division warns that it intends to have a sharper focus on core standards of conduct and duties required of municipal advisors.

The Upshot

- Municipal advisors are required to register with both the SEC and the Municipal Securities Rulemaking Board. The SEC requires municipal advisor firms to file Form MA as well as a Form MA-I for each natural person engaging in municipal advisory activities. The MSRB requires firms to file Form A-12 as well as to pay an initial and annual fee.
- Municipal advisors should ensure that policies and procedures are up to date and accurately reflect recordkeeping requirements for specific record types.

- Municipal advisors must establish a supervisory system reasonably designed to achieve compliance and, at a minimum, provide for the establishment, implementation, maintenance, and enforcement of written supervisory procedures.

The Bottom Line

The SEC's patience, even with small entities, can decrease after it has issued multiple alerts about a particular area of concern. Municipal advisors should review policies and procedures to avoid negative findings in future examinations.

On August 22, 2022, the SEC's Division of Examinations (the Division) released a Risk Alert to notify municipal advisors of key compliance issues. The alert follows the Division's 2017 release and reiterates old concerns as well as raises new ones. While the 2017 release addressed deficiencies found in the areas of municipal advisor registration, recordkeeping, and supervision, this latest alert adds client disclosure concerns to the list of most frequently observed compliance failures. The Division warned that it intended to have a sharper focus on core standards of conduct and duties required of municipal advisors.

Filings and Fees

Prior to engaging in municipal advisory activities, municipal advisors are required to register with both the SEC and the Municipal Securities Rulemaking Board (MSRB). Registration with the SEC requires municipal advisor firms to file Form MA as well as a Form MA-I for each natural person associated with the municipal advisor who engages in municipal advisory activities. Registration with the MSRB requires firms to file Form A-12 as well as to pay an initial and annual fee. Forms MA and A-12 must be updated annually. In addition, all of the aforementioned registration forms must be updated promptly in the event of a material change to information previously provided, including filing new Forms MA-I for newly associated persons and updating existing Forms MA-I to reflect any departing associated persons. The Division exam staff found that registration forms often were incomplete, inaccurate, and not updated to reflect changes or disclosures as required. Staff also found that some municipal advisors failed to properly pay the initial and annual MSRB registration fees.

Municipal advisors should conduct annual reviews of their filings to ensure accuracy and require associated persons to certify that their personal information is current. Policies and procedures should be updated, as needed, to inform associated persons of their duty to timely provide information on material changes. This annual review should be documented and can be incorporated into the required annual review of the municipal advisor's supervisory system under MSRB Rule G-44. Similarly, payment of filing fees and of the MSRB's annual municipal advisor professional fee under MSRB Rule A-11 should be reviewed annually.

Recordkeeping

Exchange Act Rule 15Ba1-8 and MSRB Rules G-8 and G-9 impose various bookkeeping and record retention requirements with which municipal advisors' compliance was found to be lacking. Failure to maintain the following types of records were specifically noted:

- originals or copies of written communications relating to municipal advisory activities, particularly electronic communications including messages transmitted via personal email, text, and instant messenger;
- financial and accounting documents;
- records concerning compliance with MSRB Rule G-44, discussed below;

- written consents to service of process from associated persons;
- copies of documents created by the municipal advisor that were material to making a recommendation to a municipal entity or obligated person; and
- written agreements entered into by the municipal advisor with municipal entities and their employees, obligated persons, or otherwise relating to the municipal advisor's business.

Municipal advisors should ensure that policies and procedures are up to date and accurately reflect recordkeeping requirements for specific record types. Each item of required information should be easily located in a logical filing system and preserved in an appropriate manner in conformity with applicable MSRB and SEC record retention requirements. Testing and monitoring to ensure that records are correctly made, approved, and retained should be conducted, potentially as part of or in conjunction with the required annual review of the municipal advisor's supervisory system under MSRB Rule G-44.

Supervision

MSRB Rule G-44 requires municipal advisors to establish a supervisory system reasonably designed to achieve compliance and, at a minimum, provides for:

- the establishment, implementation, maintenance, and enforcement of written supervisory procedures (WSPs) that are reasonably designed to achieve compliance with applicable rules; and
- the designation of one or more municipal advisory principals to be responsible for supervision.

Furthermore, municipal advisors must do the following:

- implement processes to establish, maintain, review, test and modify written compliance policies and WSPs and review such supervisory systems at least annually;
- designate a chief compliance officer; and
- have its chief executive officer (or equivalent) certify in writing annually to the presence of these supervisory requirements.

Division staff found that some municipal advisors did not have WSPs in place and, where they did exist, such written policies were ineffective to ensure compliance with applicable rules. The alert also noted that WSPs were often not amended to reflect rule changes, e.g., MSRB Rule G-42, which establishes duties of care and loyalty and governs conflicts of interest, and MSRB Rule G-40 regarding advertising, which became effective in 2019. Failures to test supervisory systems annually or perform chief executive officer certifications were also noted.

Municipal advisors should develop effective supervisory systems that include, among other things, principal supervision, systematic maintenance of approvals, and a process to monitor and implement regulatory change. That supervisory system should be specifically described in the firm's WSPs. On an annual basis, the chief compliance officer should conduct or oversee testing and monitoring of WSPs and produce a report to the chief executive officer to support the required annual certification under Rule G-44(d).

Client Disclosure

MSRB Rule G-42 requires municipal advisors to provide their municipal entity or obligated person client with full and fair disclosure of all material conflicts of interest. Such disclosure must be made in writing and provide sufficient detail of the nature of the conflict, potential consequences, and how the municipal advisor will manage or mitigate each conflict. To the extent that a municipal advisor determines, following reasonable diligence, it has no known material conflicts, it must provide a

written statement to that effect to the client. The municipal advisor must also maintain evidence of each municipal advisory relationship and update such documentation to reflect material changes.

Frequently cited deficiencies included a failure to disclose or to timely disclose conflicts of interest, for example, related to fee-splitting or contingent compensation arrangements. Municipal advisors also were cited for not providing a “no known material conflicts of interest” statement where applicable. Failures to adequately document client relationships also were found.

The client engagement process, which should encompass timely engagement documentation, including an accurate scope of services and any limitations thereto, as well as full and timely disclosure of conflicts, should also be covered in the municipal advisor’s WSPs and be part of the annual compliance review and testing reporting process.

Core Duties and Standards of Conduct

While the Risk Alert did not delineate which of the core standards of conduct and duties required of municipal advisors it intends to focus more sharply upon in future examinations, the SEC’s publicly announced enforcement activities and SEC staff statements at its annual outreach forums and in other venues can provide some sense of where staff priorities may lie. Substantive municipal advisor duties, beyond those described above, discussed during the three most recent joint SEC-MSR--FINRA compliance outreach programs for municipal advisors included documenting and fulfilling the municipal advisor’s scope of services; potential municipal advisor duties during the new issue pricing process; role of municipal advisors in bank loans/direct placements; and the basis for the municipal advisor’s own recommendations or its review of third-party recommendations. Recently filed SEC enforcement actions alleging breach of a municipal advisor’s fiduciary duty involve duties with respect to the municipal advisor’s role in disclosures in the offering document and the municipal advisor’s participation in the preparation of allegedly fraudulent financial projections. Municipal advisors should consider how they address these or similar scenarios in their WSPs and compliance policies.

Key Takeaways

Municipal advisors should note that the SEC’s patience, even with small entities, can decrease when it has issued multiple alerts about a particular area of concern and should take this opportunity to review policies and procedures in order to avoid negative findings in future examinations. As a foundation, municipal advisors should focus on addressing the following questions for each area of concern:

- Who is responsible for compliance?
- How and where are supervisory systems documented?
- How is compliance with documented WSPs evidenced?
- How frequently is compliance tested and monitored?
- Have written supervisory procedures and compliance manual been updated to address these topics?

by Lisa Brice, Scott Diamond, Teri Guarnaccia, Ernesto Lanza, Kimberly Magrini

September 9, 2022

Ballard Spahr LLP

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August Edition of GFR Now Available.

Dive into the August edition of Government Finance Review to learn about bridging political divides, entrepreneurial thinking in local government, internal controls, legal financing, and much more.

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SEC Municipal Advisor Examination Observations: Mayer Brown

SEC risk alert highlights areas of continuing deficiencies and future focus of examinations.

On August 22, 2022, the Division of Examinations (the "Division") of the U.S. Securities and Exchange Commission ("SEC") published a risk alert (the "2022 Risk Alert") to raise awareness of the most frequently cited deficiencies and weaknesses observed in recent municipal advisor examinations.1 Topics include municipal advisor registration and filings, recordkeeping, supervision and disclosure of conflicts of interest. The Division previously highlighted many of these topics in a 2017 risk alert (the "2017 Risk Alert") with respect to newly registered municipal advisors.2 The Division has included examinations of municipal advisors as an examination priority each year since 2019.3

The 2022 Risk Alert, together with two SEC enforcement actions against municipal advisors in June of this year,4 may signal an increase in scrutiny from SEC examination and enforcement staff regarding municipal advisor practices, policies and procedures relating to the topics highlighted in the risk alert. As such, firms should consider reviewing and assessing their compliance with each of the topics. In this regard, we note that the Division indicated that it intends for future examinations "to include a more prominent focus on the core standards of conduct and duties applicable to municipal advisors."5

The following is a brief summary of the Division's key observations in the 2022 Risk Alert.

Registration and Filings
Municipal advisors filed SEC Forms MA and MA-I with inaccurate or incomplete information, including information regarding their associated persons' other business and other required disclosures (e.g., customer complaints, tax liens). Additionally, municipal advisors did not amend, or did not amend timely, SEC Forms MA and MA-I and Municipal Securities Rulemaking Board ("MSRB") Form A-12, such as to reflect changes in ownership of the firm or disciplinary actions involving the firm or its associated persons (e.g., disclosure of judicial actions or judgments/liens, change in employment or other business).

Recordkeeping

Municipal advisors did not make or keep true, accurate and current copies of certain required books and records, or did not preserve such records, including with respect to:

- *Written communications* relating to municipal advisory activities, particularly electronic communications, such as business-related email sent from a personal email address, text messages on mobile devices and instant messages. We note that this topic has been a focus of the SEC with respect to broker-dealers.
- *Financial and account documents*, including cash reconciliations and general ledgers.
- *Written agreements* entered into by the municipal advisor with municipal entities and their employees, obligated persons or otherwise relating to the firm's business.

Supervision
Municipal advisors either did not have any written supervisory procedures ("WSPs") or the WSPs were not sufficient, not implemented and/or not enforced. For example, deficiencies related to gifts, gratuities and expenses, and, as noted above, the preservation of electronic communications and/or the filing and updating of required forms. Moreover, some firms failed to promptly amend their WSPs to reflect the adoption of MSRB Rule G-42 (Duties of Non-Solicitor Municipal Advisors),6 which became effective in 2016, or MSRB Rule G-40 (Advertising by Municipal Advisors),7 which became effective in 2019. Firms also failed to conduct annual reviews of their WSPs pursuant to MSRB Rule G-44(b) and/or their Chief Executive Officers failed to certify annually, in writing, that the firm had in place processes to establish, maintain, review, test and modify WSPs, pursuant to MSRB Rule G-44(d).

Disclosure to Clients
Municipal advisors failed to disclose in writing to clients, or did not disclose timely, their material conflicts of interest, including with respect to the firms' relationships with other parties (e.g., underwriters or other parties providing services to or on behalf of a municipal entity client) or between the municipal advisor and the municipal entity client itself. Other deficiencies involved disclosures relating to fee-splitting arrangements and contingent compensation arrangements. Finally, firms failed to document, or did not document adequately or timely, their municipal advisory relationships.

Footnotes
1 See SEC Division of Examinations, Risk Alert: Observations from Municipal Advisor Examinations (Aug. 22, 2022).

2 See SEC Office of Compliance Inspections and Examinations, Risk Alert: Observations from Municipal Advisor Examinations (Nov. 7, 2017) ("In sum, the staff observed that [municipal advisors] were generally unfamiliar with many of their regulatory obligations."). The 2017 Risk Alert noted that "[s]ome firms were referred to the [SEC's] Division of Enforcement." Id. at 2.

3 See Examination Priorities for 2019, 2020, 2021 and 2022.

4 These cases involve municipal advisors who, among other things, breached their fiduciary duties to their municipal clients and, in one case, failed to disclose to nearly 200 municipal clients that the firm had material conflicts of interest arising from its compensation arrangements.

5 Risk Alert at 1.

6 Among other things, MSRB Rule G-42 establishes core standards of conduct, including duties of care and loyalty, and provides for the disclosure of conflicts of interest for municipal advisors that engage in municipal advisory activities, other than municipal solicitation activities.

7 MSRB Rule G-40 establishes requirements for advertisements by municipal advisors, including a requirement that each advertisement be approved in writing by a municipal advisor principal prior to first use.

SEC Continues Scrutiny of Municipal Bond Offerings: Goodwin Proctor

The SEC recently brought fraud charges against Sterlington, Louisiana and its former mayor and separately against Rochester, New York and its former executives and Rochester's municipal advisors and principals/owners for misleading investors related to their respective bond offerings.

At a high level, the SEC alleged (collectively between the two matters):

1. Investors were misled because offering documents included false or outdated financials and city officials and municipal advisors failed to disclose material facts related to the offerings.
2. Claims against city officials for misleading a credit rating agency by failing to disclose a projected budget shortfall, failing to further inquire about financial conditions despite knowledge of financial distress, and failing to apprise investors of the associated risks.
3. Activity by an unregistered municipal advisor as well as substantive claims of misleading investors, breaching fiduciary duty, and failing to disclose material conflicts of interest.

These cases are only the latest in a string of SEC settlements with municipalities and their advisors, including those resulting from the agency's 2016 "MCDC" Initiative against dozens of municipal issuers and underwriters related to their failure to satisfy continuing disclosure obligations under Exchange Act Rule 15c2-12. Unlike the MCDC actions, the Sterlington and Rochester cases did not implicate the underwriters of the bond offerings (at least not yet).

Lapses in disclosures in the municipal securities market has been, and will continue to be, an area of SEC focus. This should come as no surprise given that the Division of Examinations included municipal securities as an area of focus in its 2022 examination priorities. A recent risk alert from the Division of Examinations also summarized staff's observations from municipal advisor examinations, including noting deficiencies in registration, conflicts disclosures, and recordkeeping.

Other noteworthy takeaways from the Sterlington and Rochester cases include:

- The SEC made its usual assertions of violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.
- The SEC also alleged that Rochester's municipal advisors and its principals violated MSRB Rules G-17, G-42, and G-44 and Exchange Act Section 15B(c)(1).
- The SEC settled with the town of Sterlington and, interestingly, imposed no fines or other penalties against the city. The SEC took into account Sterlington's corrective measures to enhance its internal controls and financial oversight (establishing a committee to oversee and approve borrowing, applying, and disbursements of funds).
- Sterlington's former mayor is contesting the charges against him, in which the SEC is seeking a fine and a ban from engaging in future municipal securities offerings.
- Sterlington's municipal advisor and its owner settled with the SEC and agreed to pay ill-gotten gains, accrued interest, and fines, which are yet to be determined by the court (advisory fees for the bonds sold totaled $26,303).
- In the Rochester case, the city and its municipal advisors and owners are contesting the SEC's allegations. The SEC is seeking fines and payment of ill-gotten gains and accrued interest by the

municipal advisor based on the alleged violations.
- Rochester's former CFO settled with the SEC and consented to a $25,000 fine and a ban from engaging in future municipal securities offerings.

Goodwin Procter LLP – Nick Losurdo and Lauren A. Schwartz

August 31 2022

SEC Approves MSRB Amendments to CUSIP Application Process.

The SEC approved an MSRB proposal to amend MSRB Rule G-34 ("CUSIP Numbers, New Issue, and Market Information Requirements") to better align the requirements for applying for a CUSIP number with the actual process for obtaining one.

As previously covered, the MSRB proposed (i) requiring that CUSIP applications be submitted only to a board's designee, (ii) allowing municipal advisors a more flexible timetable to apply for a CUSIP and (iii) authorizing the board's designee to determine the necessary information required in a CUSIP application. The final rule was adopted with minimal changes and the SEC stated that the proposal does not pose a threat to the facilitation of capital formation.

Fried Frank Harris Shriver & Jacobson LLP

August 25 2022

Proposed Changes to FINRA Expungement Rules: SIFMA Comment Letter

SIFMA provided comments to the U.S. Securities and Exchange Commission (SEC) on FINRA's proposed rule changes to the Code of Arbitration Procedure relating to requests to expunge customer dispute information from the Central Registration Depository (CRD) and FINRA BrokerCheck.

View the SIFMA Comment Letter.

Regulation Implementing the Adjustable Interest Rate LIBOR Act: SIFMA Comment Letter

SIFMA provided comments to the Federal Reserve Board on their proposed rule that would implement the Adjustable Interest Rate (LIBOR) Act.

Click here to view the SIFMA comment letter.

In the Muni Market, Financial Disclosures DO Matter to Investors.

The usefulness of municipal bond issuers' financial disclosures is a source of considerable debate. Our paper, "*The Information Content of Municipal Financial Statements: Large-Sample Evidence*," provides evidence that disclosure matters to municipal bond investors, particularly the retail investors who dominate the market. Using the entire universe of annual financial disclosures from 2009 to 2020, collected by the Municipal Securities Rulemaking Board—412,947 in all—we find that trading activity in the secondary market for municipal bonds increases after disclosures are filed. We find that trading activity increases by 2 percent to 3 percent around filings of annual financial statements, a small but meaningful increase.

Both institutional and retail trades increase around disclosure filing, but the effect is pronounced for retail investors, for whom the reports are more likely to provide new information. Moreover, trading increases more after timelier disclosures, consistent with regulators' views that untimely disclosures are less likely to provide new information. We also examine variation in investors' responsiveness to disclosure, based on the content of the disclosures. In general, disclosures that indicate the bond is risky are associated with a pronounced response.

Our results contrast with earlier research and provide the first large-scale evidence that participants in the U.S. market for municipal bonds perceive financial disclosures to have informational value.

Download the full paper.

The Brookings Institution

by Christine Cuny, Ken Li, Anya Nakhmurina, and Edward Watts

August 23, 2022

MSRB Elects New Board Leadership and Announces New Members for FY 2023 at Quarterly Meeting.

Washington, DC – The municipal market's self-regulatory organization (SRO) met July 27-28, 2022 for its final quarterly Board of Directors meeting of Fiscal Year 2022. The Municipal Securities Rulemaking Board (MSRB) elected new officers and announced four new members who will join the Board in FY 2023.

Also at its meeting, the Board discussed current and forthcoming initiatives to advance its mission of protecting and strengthening the $4 trillion market that enables access to capital, economic growth, and societal progress in tens of thousands of communities across the country.

"The work of an SRO is never more important than at a time of profound evolution and modernization of financial markets," said MSRB Chair Patrick Brett. "I am proud and grateful to have served alongside a dedicated Board of experts steeped in the characteristics of our unique market, who have not shied from advancing an ambitious agenda. With engagement from a broad universe of market stakeholders, the MSRB has taken meaningful steps to enhance the efficiency and transparency of municipal market structure, to deepen our own and the broader market's understanding of how market practices are evolving, and to create opportunities for collaboration that will yield powerful new technology platforms and data analytics capabilities."

Board Leadership and New Members for FY 2023

Brett's term as Chair and Board member ends September 30, 2022. The Board announced today that it has elected public member Meredith L. Hathorn, Managing Partner, Foley & Judell, L.L.P. in Baton Rouge, LA, to serve as FY 2023 Chair of the Board. Public member Carol Kostik, the retired former deputy comptroller for public finance for the City of New York, will serve as Vice Chair. Officer terms are one year. The Board also announced the incoming class of four new Board members whose terms will begin October 1, 2022.

Chair-elect Hathorn, the FY 2022 Vice Chair and head of the Board's Nominating Committee said, "Each year, we cast a wide net to identify a new class of market experts to join us on the Board. We thank each applicant for their willingness to give back to our market, and we could not be more pleased to welcome four new members who each bring a distinct perspective, a wealth of experience and an outstanding commitment to overseeing the execution of the MSRB's long-term strategic goals."

New public members joining the MSRB Board in Fiscal Year 2023 are institutional investor representative David F. Belton, Director, American Family Insurance; and municipal issuer representative Horatio Porter, Chief Financial Officer, North Texas Tollway Authority. Joining the Board as regulated members are: bank representative Patrick O. Haskell, Managing Director and Head of Municipal Securities and Co-Head of Fixed Income Retail Capital Markets, Morgan Stanley; and municipal advisor representative Jill Jaworski, Managing Director and Partner, PFM Financial Advisors. The new Board members were selected from more than 70 applicants this year.

For FY 2023, the Board will have 15 members, including eight independent public members and seven members from MSRB-regulated broker-dealers, banks and municipal advisors. The size of the Board was reduced as part of a series of governance enhancements that also tightened standards of independence for public members and established a lifetime service limit for Board members. To implement the transition plan to a smaller Board, the terms of a current public member on the Board, Donna Simonetti, and one regulated member, Francis "Frank" Fairman, have been extended one year. Board member Daniel Kiley's term also has been extended one year to complete the final year of a vacancy created by the 2021 resignation of a regulated representative on the Board.

Market Regulation

The Board discussed the status of the ongoing retrospective rule review to holistically consider its rules and interpretive guidance and identify opportunities to streamline, update and promote consistency with rules of other regulators. The Board authorized staff to prepare a new request for comment on MSRB Rule G-47 to seek feedback on a proposal to codify interpretive guidance and specify certain additional information that may be material and require time of trade disclosures to customers. The MSRB plans to engage with stakeholders prior to the release of the request for comment.

In coordination with the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA), the MSRB is preparing to issue a request for comment in the coming week on proposed amendments to shorten MSRB Rule G-14 's time of trade reporting requirements as part of an initiative to enhance post-trade transparency across fixed income markets.

Market Transparency

The Board received a demonstration of continued work to develop the future-state MSRB.org website. The MSRB website is being redesigned to make MSRB rules, compliance resources,

educational materials and other information easier and more intuitive to find, and to complement the ongoing work to modernize the Electronic Municipal Market Access (EMMA®) website and related market transparency systems.

Market Structure and Data

The Board continued its ongoing discussions about market structure, including the potential implications for the MSRB's rules of the SEC's proposal to bring more Alternative Trading Systems (ATSs) under the regulatory umbrella. Additionally, the Board discussed working with staff to develop coordinated proposals with fellow regulators on the collection of pre-trade data in the fixed income markets. The Board also discussed potential new opportunities to support the market's use of structured data by leveraging EMMA Labs, the MSRB's innovation sandbox, to advance transparency and the quality and comparability of data in the municipal securities market.

"A common theme in our long-term strategic plan is the objective of advancing market efficiency, improving price transparency, and enhancing overall market liquidity, especially in light of the opportunities presented by evolving technology and market practices across the fixed income markets," said MSRB CEO Mark Kim.

Public Trust

The Board approved a $45 million operating budget to fund the operations of the MSRB for FY 2023, beginning October 1, 2022. A budget summary detailing the MSRB's projected expenses, revenues and reserve levels will be published at the beginning of the fiscal year. The Board recently proposed amendments to its fee setting process to ensure the MSRB collects only the revenue needed to fund its operations without accumulating excess reserves. Based on comments received on its proposal, the MSRB has advanced a revised proposal for filing with the SEC. The proposed amendments will be available for further public comment and would become operative on October 1, 2022.

Additionally, the Board discussed releasing a summary report in the coming weeks on comments received in response to its request for information on environmental, social and governance (ESG) practices in the municipal securities market, published in December 2021.

About the New MSRB Board Members

David Belton is Director at American Family Insurance, where he provides credit research and portfolio management for the company's municipal bond holdings, both tax-exempt and taxable. Prior to joining American Family, Mr. Belton was Senior Vice President and Head of Municipal Bond Research at Standish Mellon Asset Management, where he was also portfolio manager of several Dreyfus municipal bond funds. Mr. Belton began his career at Van Kampen Merritt and subsequently held positions at Stein Roe & Farnham and Federated Investors. He has been active in the National Federation of Municipal Analysts at both the local and national levels. Mr. Belton holds a bachelor's degree in political science from Haverford College and an MBA from the University of Chicago. He is a Chartered Financial Analyst.

Patrick O. Haskell *is Managing Director and Head of Municipal Securities and Co-Head of Fixed Income Retail Capital Markets at Morgan Stanley. Prior to this role, Mr. Haskell was Head of Credit Complex Trading, Americas, which included the Securitized Products Group, Corporate Credit and Municipal Securities. Prior to joining Morgan Stanley, Mr. Haskell was Chairman and CEO of diversified water technology company Ecosphere Technologies. Mr. Haskell began his career in municipal bond sales at Credit Suisse First Boston and went on to become Head of U.S. Government Bond Trading before joining HSBC as a Managing Director and Head of North American Rates Sales*

and Trading. He previously served as Board Chair of Tradeweb and as Chairman of the Primary Dealer Committee of SIFMA. He currently serves as the Board Chair for Boy's Hope/Girl's Hope NYC. Mr. Haskell earned a bachelor's degree in economics from Union College.

Jill Jaworski is Managing Director and Partner at PFM Financial Advisors, where she manages the Chicago financial advisory practice, serving a range of clients in Chicago and the Midwest, as well as transit and transportation clients nationally with a focus on the South and Mid-Atlantic regions. Ms. Jaworski began her career as an analyst in public finance investment banking at First Albany Capital, eventually rising to Vice President. She also worked at Jefferies & Company prior to joining PFM Financial Advisors. Ms. Jaworski holds a bachelor's degree in political science from the University of Chicago.

Horatio Porter *is Chief Financial Officer and Assistant Executive Director of Finance at the North Texas Tollway Authority, where he is responsible for executing the company's financial strategies. In this role, he leads the accounting, business diversity, procurement and treasury functions. Mr. Porter was previously Chief Financial Officer for the City of Fort Worth and an Assistant Vice President at AmeriCredit, Corp. (now GM Financial). He is a certified public accountant and holds a bachelor's degree in accounting and a master's of business administration in finance from Texas Christian University.*

Date: July 29, 2022

Contact: Leah Szarek, Chief External Relations Officer
202-838-1300
lszarek@msrb.org

SEC Staff Identifies Compliance Deficiencies Uncovered in Muni Advisor Examinations: Fried Frank

The SEC Division of Examinations identified common compliance deficiencies found during examinations of municipal advisors.

In a Risk Alert, SEC staff listed deficiencies related to registration, recordkeeping, supervision and disclosures. Highlighted areas included:

- **Registration:** Incomplete, inaccurate filings; failure to amend promptly; failure to pay fees;
- **Recordkeeping:** Failure to keep electronic communications, including emails sent from personal email addresses and text messages; poor financial records; failure to certify compliance as required under MSRB Rule G-44 ("Supervisory and Compliance Obligations of Municipal Advisors"); failure to keep written agreements;
- **Supervision:** Failure to have adequate written supervisory procedures; failure to conduct annual reviews of compliance; and
- **Disclosures:** Inadequate disclosure of conflicts; poor documentation of advisory relationships.

SEC staff said the deficiencies in the report were similar to those identified in its 2017 Risk Alert, a reminder that those areas continue to be the most vulnerable (*see* previous coverage).

The SEC staff encouraged municipal advisors to review the deficiencies identified in the alert and consider implementing programs to improve compliance.

Fried Frank Harris Shriver & Jacobson LLP

August 23 2022

Summer 2022 MSRB Update.

The MSRB discusses market perspectives on ESG, new board leadership and members plus more in the latest MSRB Update.

View the MSRB Update.

MSRB Publishes Summary of Responses to its Request for Information on ESG Practices in the Municipal Securities Market.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) today published a summary of comments received on its request for information (RFI) to solicit public input on environmental, social and governance (ESG) practices in the municipal securities market.

The MSRB issued the RFI in December 2021 to further understanding of how ESG practices are being integrated in the municipal securities market and to engage in information-gathering to fulfill its statutory mandate to protect investors, issuers and the public interest. The summary synthesizes the diversity of viewpoints expressed by the 52 commenters according to three broad themes:

- The evolving nature of ESG practices in the municipal securities market
- Challenges associated with ESG integration in the municipal securities market
- Opportunities to improve market transparency through the MSRB's Electronic Municipal Market Access (EMMA®) website.

"The MSRB acknowledges and appreciates the robust level of stakeholder engagement from across the municipal market," said MSRB CEO Mark Kim. "The 52 commenters provided a broad range of perspectives on ESG that achieved our goal of advancing our own and the broader market's understanding of the current challenges and opportunities presented by two distinct and evolving market trends: disclosure of ESG-related information and the marketing of municipal securities with ESG designations."

The MSRB will continue to monitor and engage with the broader market on understanding emerging ESG practices and their implications for market fairness, efficiency and transparency.

All comment letters are available to read in full on the MSRB's website here.

Date: August 9, 2022

Contact: Leah Szarek, Chief External Relations Officer
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SIFMA Playbook for the Move to T+1

In 2024, the current trade settlement timeframe will be halved, moving from the current trade date plus two days (T+2) to trade date plus one day (T+1). Taking 24 hours out of the settlement cycle will require a myriad of significant changes. The list of impacted areas is long: global settlements, documentation, corporate actions, securities issuance, and coordination for mutual fund portfolio securities and investor shares. Some areas—allocations, affirmation and disaffirmation processes, clearinghouse process timelines, and securities lending—will require fundamental changes. Other areas that will require significant change include prime brokerage, delivery of investor documentation, foreign currency exchange (FX), global movement of securities and currency, batch cycle timing, and exchange-traded fund (ETF) creation and redemption. It will also be imperative to analyze current settlements to identify the reasons behind settlement errors and fails and ensure that the error and fail rates do not increase under a newly compressed timeline.

How will the industry prepare for such a significant change?

To assist market participants in the move to T+1, SIFMA, the Investment Company Institute (ICI), and The Depository Trust & Clearing Corporation (DTCC), together with Deloitte LLP (Deloitte), have published The T+1 Securities Settlement Industry Implementation Playbook. This guide outlines a detailed approach to identifying the implementation activities, timelines, dependencies, and risk impacts that market participants should consider as they prepare for the transition to T+1 settlement.

SIFMA, DTCC and ICI are committed to leading the industry's collaboration on accelerating the settlement cycle. We know from our work together on the move from T+3 to T+2 in 2017 that this undertaking pulls in each sector of the industry and spans multiple operations, functions, and regulations. Unlike the move to T+2, the move to T+1 is a wholesale change to the processes which take place between execution and settlement.

What is the Playbook designed to do?

The Playbook was developed as a guide for market participants to identify areas impacted by shortening the settlement cycle and considerations that should be addressed. Every firm has different infrastructure, businesses, and clients, as well as operational processes and geographies that need to be taken into account. It is important to note that, because the SEC's proposal to shorten the settlement cycle is not yet final, the Playbook serves as a guide to assist with the many complex steps involved in the move to T+1. The Playbook assumes a third quarter 2024 transition date to a T+1 settlement cycle, subject to final regulatory approval, and it may be updated at a later time should regulators select a different transition date.

It consists of 14 sections. Two sections provide overviews of the previous move to a T+2 settlement cycle and the approach being taken with the move to T+1. Eight sections explore specific areas of the trade lifecycle, including Trade Processing, Asset Servicing, Documentation, Securities Lending, Prime Brokerage, and Funding and Liquidity Considerations. The remaining sections outline matters related to Regulatory Changes, Global Impacts, Primary Offerings, Buy-Side Considerations, Industry Testing and Migration Plans, as well as the associated resources needed for market participants to prepare for the transition to T+1.

What other considerations are there as we move to T+1?

The move to T+1 requires changes to securities regulations. The Securities and Exchange

Commission (SEC) issued a proposal to adopt rules and rule amendments to shorten the standard settlement cycle earlier this year. In a comment letter on the proposal, SIFMA supported the SEC providing regulatory clarity on SEC Rule 15c6-1, the rule that covers T+1 settlement and outlined recommendations and comments with respect to the proposal which would foster the policy goals of the proposal while reducing potential adverse consequences. SIFMA also noted the proposal reflects many of the recommendations included in the report, "Accelerating the U.S. Securities Settlement Cycle to T+1," which SIFMA drafted in partnership with DTCC, ICI, and Deloitte in December 2021.

To expedite delivery of required documentation to better align with T+1 settlement, SIFMA strongly believes e-Delivery should be the default mechanism for prospectus and confirmation delivery. In an E-delivery default world, retail investors will receive their trade confirmations on the trade date as opposed to the typical mail delivery of 3-5 days post settlement. This will allow retail investors the opportunity to review the terms of the trade before settlement and manage any discrepancies in the trade details before the trade is finalized. Overall, e-Delivery systems allow for improved methods of communication with investors and a more efficient process for delivering confirmations for broker-dealers in accordance with their obligations under Rule 10b-10. SIFMA recently sent a letter encouraging the SEC to modernize its rules to make e-delivery the default mechanism for transmitting investor communications and disclosures.

What's next in the move to T+1?

We encourage all impacted market participants to start using the Playbook to put the foundations of their programs in place. The Playbook is a user-friendly, living document and users can expect updates throughout the process of shortening the settlement cycle, especially as it relates to the final SEC rule.

Tom Price is a managing director and head of technology, operations, and business continuity for SIFMA.

August 4, 2022

US Regulators Move on Plan to Cut Bond Reporting to 1 Minute.

- **Current reporting window for transactions is 15 minutes**
- **Reduction had been suggested by SEC Chair Gensler in April**

US financial regulators are moving ahead with a plan that could slash the amount of time that traders have to report many bond transactions to just one minute.

The Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board sought comments on the possible reduction from the current time frame of 15 minutes. It's an initial step in a lengthy rule-change process that also involves the Securities and Exchange Commission.

Finra, which oversees brokerages and dealers, said the plan would apply to trading in corporate bonds, asset-backed securities and certain mortgage-backed securities. The industry-backed regulator said it would create "a qualitative increase in market transparency."

Continue reading.

Bloomberg Markets

By Lydia Beyoud and Jack Pitcher

August 2, 2022

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e-Delivery in a T+1 Environment: SIFMA Comment Letter

SUMMARY

SIFMA provided comments to the U.S. Securities and Exchange Commission (SEC) on the need to modernize its rules to make e-delivery the default mechanism for transmitting investor communications and disclosures in a T+1 environment.

View the comment letter.

MSRB Seeks Comment on Potential Benefits and Challenges of Shortening Trade Reporting to Within One Minute.

Washington, D.C. – The Municipal Securities Rulemaking Board (MSRB) today opened a 60-day comment period to re-examine time of trade reporting requirements first established in 2005 and last considered in 2013. The MSRB's request for comment, released in coordination with a parallel proposal by the Financial Industry Regulatory Authority (FINRA), is part of the MSRB's broad retrospective review of the entire body of MSRB rules and interpretive guidance to identify opportunities to modernize the rule book in light of evolving market practices and to align its rules, as appropriate, with those of other regulators.

Specifically, the MSRB is seeking public comment on the potential benefits and challenges of a proposed amendment to MSRB Rule G-14 to generally require that transactions in municipal securities are reported as soon as practicable, but no later than within one minute of the time of trade, down from the long-standing 15-minute reporting requirement. Trades reported to the MSRB through its Real-Time Transaction Reporting System (RTRS) are made transparent to the public on the free Electronic Municipal Market Access (EMMA®) website, providing investors, dealers, municipal advisors and other market participants with the information they need to make informed decisions about the pricing of municipal securities.

"In the 17 years since the 15-minute trade reporting timeframe was first established, our market has seen significant advances in technology and an evolution of market structure that includes electronic trading venues," said MSRB CEO Mark Kim. "Although the majority of trades are already being reported within one minute today, it is also clear from the data that certain types of trades are taking longer to be reported. The Board is requesting information from market participants to inform our thinking on the path forward to modernize Rule G-14."

In developing the proposed amendments and framing the questions in the request for comment, MSRB staff analyzed current trade data to compare the time of trade execution to the time the trade was reported to the MSRB. This analysis is included in the request for comment.

"Although 77% of trades required to be reported in 15 minutes were reported within one minute, this only represented 44% of the par amount reported," said MSRB Chief Market Structure Officer

John Bagley. “Coupled with our analysis of same-day trade activity for individual securities, we believe a significant volume of trades could have had the benefit of additional information if trades were required to be reported within one minute.”

Comments should be submitted no later than October 3, 2022.

Read the request for comment.

Date: August 2, 2022

Contact: Leah Szarek, Chief External Relations Officer
202-838-1300
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MSRB Publishes ATS Research Paper.

MSRB data shows a significant and relatively steady increase in customer transactions with ATSs since 2016, with a dramatic acceleration in the first half of 2022.

Read the paper.

Muni Market Transaction Costs Remain High, Despite Customer Protection Rules, Study Says.

Researchers find dealers mark up prices when customers are less likely notice

Municipal bond dealers set prices well above what they pay for the securities, reaping windfalls at the expense of individual investors despite recent regulation aimed at curbing so-called markups, according to an academic study of trading data released Thursday.

“Dealers appear to use their pricing discretion to charge higher markups to small customers when investors are less likely to notice,” wrote the study’s authors, John Griffin and Samuel Kruger of the University of Texas at Austin, and Nicholas Hirschey of the Universidade NOVA de Lisboa.

State and local governments sell bonds in the roughly $4 trillion municipal market to finance infrastructure such as roads, sewers and high schools. Most of the debt is held by households, either directly or through mutual or exchange-traded funds. The interest is typically exempt from federal and often state taxes, attracting high net worth individual investors.

Continue reading.

The Wall Street Journal

By Heather Gillers

Aug. 4, 2022

MSRB Elects New Board Leadership and Announces New Members for FY 2023 at Quarterly Meeting.

Washington, DC – The municipal market's self-regulatory organization (SRO) met July 27-28, 2022 for its final quarterly Board of Directors meeting of Fiscal Year 2022. The Municipal Securities Rulemaking Board (MSRB) elected new officers and announced four new members who will join the Board in FY 2023.

Also at its meeting, the Board discussed current and forthcoming initiatives to advance its mission of protecting and strengthening the $4 trillion market that enables access to capital, economic growth, and societal progress in tens of thousands of communities across the country.

"The work of an SRO is never more important than at a time of profound evolution and modernization of financial markets," said MSRB Chair Patrick Brett. "I am proud and grateful to have served alongside a dedicated Board of experts steeped in the characteristics of our unique market, who have not shied from advancing an ambitious agenda. With engagement from a broad universe of market stakeholders, the MSRB has taken meaningful steps to enhance the efficiency and transparency of municipal market structure, to deepen our own and the broader market's understanding of how market practices are evolving, and to create opportunities for collaboration that will yield powerful new technology platforms and data analytics capabilities."

Board Leadership and New Members for FY 2023

Brett's term as Chair and Board member ends September 30, 2022. The Board announced today that it has elected public member Meredith L. Hathorn, Managing Partner, Foley & Judell, L.L.P. in Baton Rouge, LA, to serve as FY 2023 Chair of the Board. Public member Carol Kostik, the retired former deputy comptroller for public finance for the City of New York, will serve as Vice Chair. Officer terms are one year. The Board also announced the incoming class of four new Board members whose terms will begin October 1, 2022.

Chair-elect Hathorn, the FY 2022 Vice Chair and head of the Board's Nominating Committee said, "Each year, we cast a wide net to identify a new class of market experts to join us on the Board. We thank each applicant for their willingness to give back to our market, and we could not be more pleased to welcome four new members who each bring a distinct perspective, a wealth of experience and an outstanding commitment to overseeing the execution of the MSRB's long-term strategic goals."

New public members joining the MSRB Board in Fiscal Year 2023 are institutional investor representative David F. Belton, Director, American Family Insurance; and municipal issuer representative Horatio Porter, Chief Financial Officer, North Texas Tollway Authority. Joining the Board as regulated members are: bank representative Patrick O. Haskell, Managing Director and Head of Municipal Securities and Co-Head of Fixed Income Retail Capital Markets, Morgan Stanley; and municipal advisor representative Jill Jaworski, Managing Director and Partner, PFM Financial Advisors. The new Board members were selected from more than 70 applicants this year.

For FY 2023, the Board will have 15 members, including eight independent public members and seven members from MSRB-regulated broker-dealers, banks and municipal advisors. The size of the Board was reduced as part of a series of governance enhancements that also tightened standards of independence for public members and established a lifetime service limit for Board members. To implement the transition plan to a smaller Board, the terms of a current public member on the

Board, Donna Simonetti, and one regulated member, Francis “Frank” Fairman, have been extended one year. Board member Daniel Kiley’s term also has been extended one year to complete the final year of a vacancy created by the 2021 resignation of a regulated representative on the Board.

Market Regulation

The Board discussed the status of the ongoing retrospective rule review to holistically consider its rules and interpretive guidance and identify opportunities to streamline, update and promote consistency with rules of other regulators. The Board authorized staff to prepare a new request for comment on MSRB Rule G-47 to seek feedback on a proposal to codify interpretive guidance and specify certain additional information that may be material and require time of trade disclosures to customers. The MSRB plans to engage with stakeholders prior to the release of the request for comment.

In coordination with the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA), the MSRB is preparing to issue a request for comment in the coming week on proposed amendments to shorten MSRB Rule G-14 ’s time of trade reporting requirements as part of an initiative to enhance post-trade transparency across fixed income markets.

Market Transparency

The Board received a demonstration of continued work to develop the future-state MSRB.org website. The MSRB website is being redesigned to make MSRB rules, compliance resources, educational materials and other information easier and more intuitive to find, and to complement the ongoing work to modernize the Electronic Municipal Market Access (EMMA®) website and related market transparency systems.

Market Structure and Data

The Board continued its ongoing discussions about market structure, including the potential implications for the MSRB’s rules of the SEC’s proposal to bring more Alternative Trading Systems (ATSs) under the regulatory umbrella. Additionally, the Board discussed working with staff to develop coordinated proposals with fellow regulators on the collection of pre-trade data in the fixed income markets. The Board also discussed potential new opportunities to support the market’s use of structured data by leveraging EMMA Labs, the MSRB’s innovation sandbox, to advance transparency and the quality and comparability of data in the municipal securities market.

“A common theme in our long-term strategic plan is the objective of advancing market efficiency, improving price transparency, and enhancing overall market liquidity, especially in light of the opportunities presented by evolving technology and market practices across the fixed income markets,” said MSRB CEO Mark Kim.

Public Trust

The Board approved a $45 million operating budget to fund the operations of the MSRB for FY 2023, beginning October 1, 2022. A budget summary detailing the MSRB’s projected expenses, revenues and reserve levels will be published at the beginning of the fiscal year. The Board recently proposed amendments to its fee setting process to ensure the MSRB collects only the revenue needed to fund its operations without accumulating excess reserves. Based on comments received on its proposal, the MSRB has advanced a revised proposal for filing with the SEC. The proposed amendments will be available for further public comment and would become operative on October 1, 2022.

Additionally, the Board discussed releasing a summary report in the coming weeks on comments

received in response to its request for information on environmental, social and governance (ESG) practices in the municipal securities market, published in December 2021.

About the New MSRB Board Members

David Belton *is Director at American Family Insurance, where he provides credit research and portfolio management for the company's municipal bond holdings, both tax-exempt and taxable. Prior to joining American Family, Mr. Belton was Senior Vice President and Head of Municipal Bond Research at Standish Mellon Asset Management, where he was also portfolio manager of several Dreyfus municipal bond funds. Mr. Belton began his career at Van Kampen Merritt and subsequently held positions at Stein Roe & Farnham and Federated Investors. He has been active in the National Federation of Municipal Analysts at both the local and national levels. Mr. Belton holds a bachelor's degree in political science from Haverford College and an MBA from the University of Chicago. He is a Chartered Financial Analyst.*

Patrick O. Haskell *is Managing Director and Head of Municipal Securities and Co-Head of Fixed Income Retail Capital Markets at Morgan Stanley. Prior to this role, Mr. Haskell was Head of Credit Complex Trading, Americas, which included the Securitized Products Group, Corporate Credit and Municipal Securities. Prior to joining Morgan Stanley, Mr. Haskell was Chairman and CEO of diversified water technology company Ecosphere Technologies. Mr. Haskell began his career in municipal bond sales at Credit Suisse First Boston and went on to become Head of U.S. Government Bond Trading before joining HSBC as a Managing Director and Head of North American Rates Sales and Trading. He previously served as Board Chair of Tradeweb and as Chairman of the Primary Dealer Committee of SIFMA. He currently serves as the Board Chair for Boy's Hope/Girl's Hope NYC. Mr. Haskell earned a bachelor's degree in economics from Union College.*

Jill Jaworski *is Managing Director and Partner at PFM Financial Advisors, where she manages the Chicago financial advisory practice, serving a range of clients in Chicago and the Midwest, as well as transit and transportation clients nationally with a focus on the South and Mid-Atlantic regions. Ms. Jaworski began her career as an analyst in public finance investment banking at First Albany Capital, eventually rising to Vice President. She also worked at Jefferies & Company prior to joining PFM Financial Advisors. Ms. Jaworski holds a bachelor's degree in political science from the University of Chicago.*

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Date: July 29, 2022

Contact: Leah Szarek, Chief External Relations Officer
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Arizona Charter School Financed With Muni Bonds Files Bankruptcy.

- **Park View School issued $7.6 million of muni bonds in 2016**
- **SEC sued school in 2020 for misleading investors on bond sale**

An Arizona charter school north of Phoenix, sued by the US Securities and Exchange Commission for allegedly misleading investors in an 2016 municipal bond offering, filed bankruptcy Tuesday.

Park View School Inc., a non profit, listed $9.4 million in liabilities, mostly due to bondholders, and $9.7 million in assets. Bondholders have a lien on the school, which had recurring losses, according to a June 2021 financial statement.

On July 15, $10,000 of Park View bonds with a 6% coupon and maturing in 2050 traded at about 21 cents on the dollar.

In 2020, the SEC alleged Park View and …

Continue reading. **(Subscription required.)**

Bloomberg Law

by Martin Z. Braun

July 20, 2022

Orrick: Lessons From Recent SEC Municipal Enforcement Actions

The Public Finance Abuse Unit of the U.S. Securities and Exchange Commission (the "SEC") had a busy first half of 2022, bringing forth four enforcement cases alleging substantial violations of federal securities laws. Unlike the previous two years, when most of the SEC's enforcement activity focused largely on financial advisers and underwriters, all of these four actions directly involved municipal issuers, their employees and in most cases, their financial advisers as well.

While each case is unique, and though several cases are still pending, there are important takeaways that can be derived from the allegations set forth by the SEC, which can serve to inform municipal issuers and private obligors of watchouts regarding potential violations of securities laws. In addition to these key takeaways, summaries of each case are provided below.

Continue reading.

by Robert Feyer, James Hernandez, Jerry Kyle Jr., Alison Radecki, Christine Reynolds

July 19, 2022

Orrick, Herrington & Sutcliffe LLP

MSRB 2022 Mid-Year Market Update.

View the update.

July 2022 MSRB Board of Directors Meeting Discussion Items.

The Board of Directors of the Municipal Securities Rulemaking Board (MSRB) will meet in Washington, D.C. on July 27-28, 2022, where it will discuss the following topics:

Market Regulation

The Board will discuss the status of its ongoing retrospective rule review and consider authorizing a new request for comment on MSRB Rule G-47 to codify interpretive guidance and reflect additional market practices.

Key retrospective reviews currently underway include: preparing to issue a request for comment to shorten MSRB Rule G-14's time of trade reporting requirements, which were first established in 2005 and last considered in 2013; the filing of modernized MSRB Rule G-34, on obtaining CUSIP numbers, which has been published for comment; and the forthcoming filing of proposed new Rule G-46 that would establish and codify certain core standards of conduct and duties of "solicitor municipal advisors."

The Board also previously authorized seeking comment on modernizing rules on dealer supervision and streamlining the timeframe for underwriters to provide primary market information through MSRB Form G-32.

Market Transparency

The Board will receive a demonstration of continued work to develop the future-state MSRB.org website. The MSRB website is being redesigned to make MSRB rules, compliance resources, educational materials and other information easier and more intuitive to find, and to complement the ongoing work to modernize the Electronic Municipal Market Access (EMMA®) website and related market transparency systems.

Market Structure and Data

The Board will discuss market structure topics. The Board also will discuss potential new opportunities to collaborate with market participants in EMMA Labs, the MSRB's innovation sandbox, to advance transparency and the quality and comparability of data in the municipal securities market.

Public Trust

As part of its essential oversight responsibilities of the organization's governance and financial stewardship, the Board will consider the comments received on its proposed amendments to its fee setting process, adopt the FY 2023 budget and elect new leadership. The Board will announce the FY 2023 chair, vice chair and four new members of the Board following its meeting. Additionally, the Board will discuss a draft summary report on comments received in response to its request for information on environmental, social and governance (ESG) practices in the municipal securities market, published in December 2021.

Texas Fought Against ESG. Here's What It Cost.

When states boycott financial institutions over their ESG policies, it can have a chilling and costly effect on competition in the bond market, according to a new paper from Wharton's Daniel Garrett.

Texas law that bans its municipalities from doing business with banks that have ESG policies against fossil fuels and firearms is driving down competition for borrowing and costing taxpayers millions in extra interest, according to a new study from Wharton.

In their paper, Wharton assistant finance professor Daniel Garrett and Ivan Ivanov, an economist with the Board of Governors of the Federal Reserve System, documented the financial impact of Senate Bills 13 and 19, which took effect Sept. 1, 2021. The legislation is aimed at protecting Texas' reliance on the oil and gas and firearms industries by prohibiting local jurisdictions from contracting with banks that have adopted environmental, social, and corporate governance policies against those industries. That means cities can no longer use those banks as underwriters for municipal bonds, which are one of the main ways that cities raise money.

After Texas passed the law, five of the largest underwriters exited the market: JPMorgan Chase, Goldman Sachs, Citigroup, Bank of America, and Fidelity.

Continue reading.

Knowledge at Wharton

by Angie Basiouny

July 12, 2022

Municipal-Bond Issuers Fall Behind on Disclosures.

S&P last month withdrew ratings for 30 cities, counties and other municipalities because of filing delays

U.S. states, cities and counties are taking longer to file regular financial reports, leaving bondholders in the dark and adding to pressure on prices.

S&P Global Ratings last month withdrew its ratings for 30 cities, counties and other municipalities because they haven't yet filed their 2020 financial statements. The ratings company also placed New Orleans on credit watch in April for late reporting, the largest city analysts can recall incurring that sanction in more than a decade.

S&P said it could lift New Orleans' credit watch in the coming weeks after the city, with nearly 400,000 residents and more than half a billion dollars in outstanding bond debt, finally made its 2020 financial information publicly available on June 29, a year and a half after the fiscal year ended.

Continue reading.

The Wall Street Journal

By Heather Gillers

July 13, 2022

Navigating the Disclosure Labyrinth in Municipal Finance: A Practical Approach

One of the primary purposes of the Securities and Exchange Commission (the "SEC") is to ensure that the investing public obtains accurate, timely and comprehensive information with respect to publicly-traded securities. The SEC regulates the release of such information through the antifraud provisions of the federal securities laws, particularly Section 17(a) of the Securities Act of 1933 and SEC Rule 10b-5 (established under Section 10(b) of the Securities Exchange Act of 1934) ("Rule 10b-5"). Like public companies, governmental issuers of municipal bonds must comply with these antifraud provisions when making public statements that are reasonably expected to reach investors and the trading market. In recent years, the SEC has undertaken unprecedented enforcement activity relative to such disclosures, both in terms of the number of actions and the enforcement tools at its disposal. Significantly, recent SEC enforcement actions have involved not only governmental issuers, but also their individual officials.

As a result, issuers are taking a fresh look at their disclosure practices relative to their public finance transactions, paying particular attention to the individuals tasked with: (i) assuring that the issuer's disclosure documents for a particular bond issue comply with federal securities law requirements and (ii) assisting the issuer with its post-issuance disclosure obligations. Often, the issuer's bond counsel and financial advisor take the lead in overseeing these matters. Alternatively, in situations involving unique or complicated disclosure questions, separate disclosure counsel may be engaged to advise the issuer on its disclosure obligations.

The involvement of legal counsel notwithstanding, the issuer is ultimately responsible for complying with its disclosure obligations under the federal securities laws. This blog is intended to help issuers in navigating these considerations, focusing on: (i) the preparation of the issuer's offering circular, commonly known as the official statement (the "Official Statement"), in connection with the public sale of its municipal bonds; (ii) the issuer's ongoing disclosure requirements once the bonds are issued, including the effect of the issuer's other financial obligations on these requirements; (iii) the impact of the issuer's other public statements in relation to the antifraud provisions; (iv) guidelines for preparing effective disclosure policies and procedures to facilitate these requirements; and (v) a brief word on environmental, social and governance ("ESG") matters as they relate to the issuer's disclosure obligations.

Continue reading.

by Neal Pandozzi

July 15, 2022

Adler Pollock & Sheehan P.C.

Fingers in the Till: SEC Charges Texas City Administrator with Falsified Financial Statements to Conceal Embezzlement

Johnson City, Texas, is a city in the very middle of the Texas Hill Country, with a 2020 population of 1627. Johnson City was incorporated in 1879 and named after its founder, Sam E. Johnson, a Texas rancher. It lies amid the so-called "Texas-German" Belt, which originated due to the many German immigrants arriving from 1830 on. (1830 was a time of political unrest in the various German states due to instability in the Habsburg Empire.) German immigration grew especially after 1842 with the establishment of a recruiting and welcoming center for German immigrants in the Texas Hill Country. So, there are Texas towns with names like New Braunfels, and rather good German style beer, throughout the Texas Hill Country.

Johnson City, the County Seat of Bianco County, is located 12 miles west of the Lyndon B. Johnson National Historical Park. Texas Hill Country is, of course, where President Johnson began his career in politics. In 2013, a 27-year-old named Anthony M. Holland, who had worked for at least eight years in administrative positions for several Texas cities and one school district, landed the job of Chief Administrative Officer and City Secretary for Johnson City. In that position, according to the June 16, 2022, Complaint brought by the U.S. Securities and Exchange Commission ("SEC") in the U.S. District Court for the Western District of Texas, Austin Division (the "Complaint"), Holland was "responsible for the administration and operation of all municipal departments, projects, and oversight of the City's finances and records. Holland's responsibilities included directing and maintaining the central accounting system, preparing financial statements, and preparation of information for annual audits and reviewing audit reports."

The Complaint charged Holland with embezzling approximately $1.12 million from the city over the period of 2015 to 2020, including $107,137 during the 2016 fiscal year. Holland delayed the annual independent audit of the City's 2016 financial statements. Finally, in 2018, under pressure to release the delayed 2016 financials, he "created the Falsified Documents [the SEC's term] by changing dates on the City's 2015 financial statements and audit report." He then provided the Falsified Documents to the City's mayor and its municipal advisor, "knowing that the material would be posted to the City's public website and the EMMA system and made available to investors."

Continue reading.

Norris McLaughlin P.A.

July 18, 2022

MSRB Compliance Corner.

Read the latest Compliance Corner newsletter to learn why compliance professionals should check out the MSRB's updated Investor's Guide to 529 Plans and much more.

GASB Requests Input on Proposal to Require Disclosures About Certain

Governmental Risks.

Norwalk, CT, June 30, 2022 — The Governmental Accounting Standards Board (GASB) issued a proposal today that would require governments to disclose information about certain risks they face that could affect the level of services they are able to provide or their ability to meet obligations as they come due.

Although governments are required to disclose information about their exposure to some risks, essential information about certain other risks that are prevalent among state and local governments is not routinely disclosed because it is not explicitly required. The proposed Statement would provide financial statement users with an early warning that governments are susceptible to the financial effects of those risks.

The Exposure Draft (ED), *Certain Risk Disclosures*, would require governments to disclose essential information about risks related to a government's current vulnerabilities due to:

1. Certain concentrations, and
2. Certain constraints common in the governmental environment.

The proposed Statement defines a *concentration* as a lack of sufficient diversity related to an aspect of a significant revenue source or expense—for example, a small number of companies that represent a majority of employment in a government's jurisdiction, or a government that relies on one revenue source for most of its revenue. It defines a constraint as a limitation imposed on a government by an external party or by formal action of the government's highest level of decision-making authority—such as a voter-approved property tax cap or a state-imposed debt limit. Concentrations and constraints may limit a government's ability to acquire resources or control spending.

Disclosure Criteria

This proposal would require a government to disclose information about a concentration or constraint if all of the following criteria are met:

1. It is known to the government prior to issuing the financial statements
2. An associated event either has occurred or is *more likely than not* to occur or begin to occur within 12 months of the financial statement date or shortly thereafter, and
3. It is *at least reasonably possible* that within three years of the financial statement date the event will cause a *substantial effect* on the government's ability to (1) continue to provide services at the level provided in the current reporting period or (2) to meet its obligations as they come due.

Note Disclosures

If a government determines that those criteria have been met, it would disclose information in notes to financial statements in sufficient detail to allow users of financial statements to understand the general nature of the circumstances disclosed and their potential effect on the government's ability to provide services or meet its obligations.

Stakeholders are asked to review the proposal and provide input to the Board by September 30, 2022. Comments may either be submitted in writing or through an electronic input form.

More information about commenting on the ED can be found in the document, which is available on

the GASB website, www.gasb.org.

GASB Issues Enhanced Concepts for Notes to Financial Statements.

Norwalk, CT, July 7, 2022 — The Governmental Accounting Standards Board (GASB) today issued a Concepts Statement to guide the Board when establishing note disclosure requirements for state and local governments. The document is part of the GASB's response to the results of its research reexamining existing note disclosure requirements.

The concepts contained in the document are primarily intended to provide the GASB with criteria to consistently evaluate future requirements for notes to financial statements in the standards-setting process. They also may help stakeholders to understand the fundamental concepts underlying note disclosure requirements contained in future GASB pronouncements.

Concepts Statement No. 7, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements: Notes to Financial Statements*, details concepts including:

- The purpose of notes to financial statements
- The intended users of note disclosures
- The types of information that should be disclosed in notes>
- The types of information that are not appropriate for note disclosures, and
- The degree of importance that information disclosed in notes to financial statements should possess.

A key element of the Concepts Statement is the concept of essentiality. The document establishes that notes to financial statements are essential to making economic, social, or political decisions or assessing accountability. The Concepts Statement also identifies the characteristics of essential information:

- The information has or is expected to have a meaningful effect on users' analyses for making decisions or assessing accountability.
- A breadth or depth of users utilize or are expected to utilize the information in their analyses for making decisions or assessing accountability.

The concepts included in Concepts Statement 7 establish that information disclosed in notes to financial statements should correspond to the reporting units presented in the financial statements.

The GASB issued an Exposure Draft (ED) on this topic in early 2020. The Board issued a Revised Exposure Draft in July 2021 to incorporate feedback received from stakeholders on the previous ED and to seek feedback on the resulting proposed revisions.

Concepts Statement No. 7 is available for download at no charge on the GASB website, www.gasb.org.

MSRB Notice 2022-03 – Amendments to Certain Fees for Dealers and Municipal Advisors and Proposing an Annual Rate Card Process: SIFMA

Comment Letter

SUMMARY

SIFMA provided comments to the U.S. Securities and Exchange Commission (SEC) on the Municipal Securities Rulemaking Board's Notice 2022-03 and its Filing of a Proposed Rule Change to Amend Certain Rates of Assessment for Rate Card Fees Under MSRB Rules A-11 and A-13, Institute an Annual Rate Card Process for Future Rate Amendments, and Provide for Certain Technical Amendments to MSRB Rules A-11, A-12, and A-13.

View the SIFMA Comment Letter.

SIFMA, BDA and NAMA on MSRB Proposed Changes to its Fee Setting Process.

SUMMARY

SIFMA, BDA and NAMA provided comments to the U.S. Securities and Exchange Commission (SEC) on the Municipal Securities Rulemaking Board's (MSRB) Proposed Changes to its Fee Setting Process.

View the Comment Letter.

MSRB Fee Proposal Causes Backlash Among Market Participants.

The Municipal Securities Rulemaking Board's proposed fee amendments submitted to the Securities and Exchange Commission are catching backlash from muni industry leaders over a perceived failure to address the discrepancy between fees collected from dealers and municipal advisors, in addition to a lack of transparency over the budgeting process.

That's according to letters submitted to the SEC by representatives from the Bond Dealers of America, National Association of Municipal Advisors and the Securities Industry and Financial Markets Association, urging the Commission to reject the proposal.

"Dealers pay 90-plus percent of the industry-derived revenue that the MSRB collects and that's consistent over many years since the MSRB has been regulating MAs post-Dodd-Frank," said Michael Decker, senior vice president for public policy at the Bond Dealers of America. "That's just unfair and inequitable and inappropriate and this project of reviewing and revising their fee structure should have provided an opportunity for the board to consider and address that issue and find a way to adjust the lopsided burden that applies to broker-dealers relative to municipal advisors."

"Because they didn't address this issue, we were not supportive of the proposal," he added.

The MSRB started looking at relative contributions between MAs and broker-dealers in 2014, and has made some moves to address the financial burden imposed on dealers by temporarily reducing underwriting, transaction and technology fees and increasing the professional fee for MAs to $1,000

from $500 in Sept. 2019.

MSRB estimated that broker-dealers accounted for around 80% of its fees in 2019 and hoped to continue to bring that down as a step in the direction of fairness and equity. But now, BDA estimates that they make up 92% of fees, a proportion that places too much of the burden on that side of the market.

The board's proposed Annual Rate Card Process will determine the fees the board charges based on the total amount of revenue each fee was expected to contribute, expected volume of activity of each fee, in addition to the amount of revenue generated from the fee in the previous fiscal year compared with its corresponding budget.

But the proposed measures haven't done much to quell the concerns of both MAs and broker-dealers, who both feel the fee arrangement doesn't work well for their segment of the market.

"Neither the narrative nor the amendment language includes the proportionate ratio amounts, the Annual Rate Card Process, or the updated Funding Policy," the NAMA letter said.

In addition to the details of the Annual Rate Card Process and Updated Funding Policy not included in the SEC filing, NAMA feels that the caps thresholds could cause significant fee increases over time.

"NAMA is troubled by the significance of the word 'generally' in the discussion about the Rate Card Process and in the Amendment language to Rule A-11," the NAMA letter said. "It begs the question – are these caps actually in place as stated or are they to be 'generally' observed (which we read as meaning the caps could change and still be consistent with the filing)," NAMA added. "The compounding of these increases would create an undue burden on small MA firms."

From conversations with the MSRB, NAMA said that the MA portion of fees is 8% of the total fees it collects but provides no rationale for how those proportions are derived.

"Without specific ratios, or a detailed, clear process for how those ratios are calculated, the filing offers us no specificity as to fees," the NAMA letter said.

Others joined NAMA in condemning the lack of transparency the board continues to exhibit in its budgeting process.

"The members of our organizations have expressed ongoing concern that some of the MSRB's funded initiatives are not germane to its statutory authority," the joint letter from BDA, NAMA and SIFMA said. "We continue to request that the MSRB provide greater transparency regarding expenditures, especially with regard to expenses that do not support the important and necessary work the MSRB is authorized to execute."

The concerns over individual fees and the inability of the board to provide a rationale for why they need a certain amount of operating money gets to the heart of many concerns that the MSRB is overstepping its Congressional mandate, whether on ESG or other technology projects.

"In recent years, the MSRB has undertaken projects that many of our members think are at best on the fringes of their core mission," Decker said. "The MSRB's mission is to regulate the industry for the benefit of issuers and investors and some of the technology projects that they've undertaken seem a few steps away from that."

But the muni market leaders do agree on some aspects of the proposal. SIFMA agrees that an

annual rate setting process can be beneficial to the board's efforts in managing reserve levels, BDA agrees with the board on amending the process based on the MSRB's anticipated budget and projections for market activity, and NAMA had hoped to support the amendments that would establish a new framework for assessing fees on regulated entities.

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 07/07/22

SEC Issues Proposed Rule Amendments Regarding Fund Naming Conventions: Dechert

Overview

The U.S. Securities and Exchange Commission, by a vote of three-to-one, proposed for public comment on May 25, 2022, amendments to the rule governing naming conventions of funds1 subject to the U.S. Investment Company Act of 1940. The "names rule" generally requires a fund to invest, under normal circumstances, at least 80% of its assets in the investments suggested by its name. The proposed amendments would (among other items):

- expand the scope of funds subject to Rule 35d-1 under the Investment Company Act (Names Rule); address certain funds that use environmental, social and/or governance (ESG) investment practices and
  ESG and related terms in their names;
- limit the circumstances under which a fund may temporarily depart from its 80% investment policy and
  include time frames for returning to compliance with its 80% investment policy; and
- include certain form changes and new disclosure requirements.2

As further discussed below, these proposed amendments have the potential to meaningfully impact fund names,
strategies, management and operations.

Continue reading.

by Johnson, Mark Perlow, Corey Rose, Anthony Zacharski, Nicholas DiLorenzo, Matthew Barsamian, Claire Hinshaw and
Tyler Payne

July 6, 2022

Dechert LLP

GFOA Government Finance Review June Edition Now Available.

The June edition of Government Finance Review focuses on Rethinking Strategic Planning. Other articles include unlocking new revenue, streamlining the budget process, organizational

collaboration, and more.

READ ONLINE

2022 Update for Investment Advisers: Important Annual Requirements, Recent Proposed Rulemaking, and Recent SEC Enforcement Initiatives: Sidley Austin

Investment advisers registered with the U.S. Securities and Exchange Commission (SEC or Commission) (each, an RIA) are subject to certain annual requirements under the Investment Advisers Act of 1940 (Advisers Act); some of these requirements also either apply to exempt reporting advisers (each an ERA) or warrant consideration as best practices for ERAs. This Sidley Update reminds investment advisers of the annual and other periodic regulatory and compliance reporting cycles, including a number of significant 2022 reporting or filing deadlines.

This Sidley Update also reminds advisers that are registered as commodity pool operators (CPOs) or commodity trading advisers (CTAs) with the Commodity Futures Trading Commission (CFTC) and members of the National Futures Association (NFA) of certain CFTC and NFA reporting requirements.

This Sidley Update provides important information regarding

This Update does not purport to be a comprehensive summary of all of the compliance obligations to which advisers are subject; please contact your Sidley lawyer to discuss these and other requirements under the Advisers Act, the Commodity Exchange Act, and other regulations that may apply to RIAs, CPOs, and/or CTAs, as well as applicable non-U.S. regulatory developments.

Continue reading.

Sidley Austin LLP – Laurin Blumenthal Kleiman, Nathan A. Howell, Chuck Daly, Jonathan B. Miller and Victoria A. Anglin

June 23 2022

Serving the Public? SEC Charges Two Municipalities and Their Leaders with Bond Fraud.

I have written previously about the recurring problem of fraudulent financial information used to market and sell municipal securities. See my Sept. 22, 2020, Blog “SEC Focus on Municipal Securities: Disclosure and Enforcement – the Peculiar Structure of the Municipal Securities Disclosure Regime”; my March 2, 2021, Blog “Being Held Accountable: The ‘Education’ of KPMG at the College of New Rochelle”; and by April 28, 2022, Blog “Failing Grades: School District and Auditor Earn SEC Discipline.”

Indeed, the problems in municipal finance had proven so endemic by the first decade of the 21st century that in 2010, the U.S. Securities and Exchange Commission (“SEC”) created a specialized group within its Division of Enforcement to deal with these matters. The work of the Public Finance

Abuse Unit has become key to the commission's overall efforts to regulate capital markets and protect investors. On Oct. 13, 2016, the then director of the SEC's Division of Enforcement, Andrew J. Ceresney, gave the keynote address at the 2016 Securities Enforcement Forum, focusing entirely on problems arising in the then $ 3.7+ trillion municipal securities market and emphasizing the importance of the Public Finance Abuse Unit in dealing with them. There is a tendency, as noted in my "Failing Grades" Blog, to see municipal finance as low risk, because) it does not offer the same sort of outsized earnings and personal gains as do other parts of the capital market, and ii) the people involved are typically "ordinary citizens" on school boards or government councils. Unfortunately, that misplaced optimism frequently proves to be insufficiently skeptical. Both of the following cases were brought by the Public Finance Abuse Unit when optimism failed.

On Thursday, June 2, 2022, the SEC charged the town of Sterlington, Louisiana, a population of approximately 2,600, and its former mayor, as well as the town's unregistered municipal advisor, with misleading investors in the sale of $5.8 million of municipal revenue bonds in 2017 and 2018. The bond proceeds were to finance the development of a water system and the improvement of the existing sewer system. As required by law, Sterlington applied to the Louisiana State Bond Commission ("SBC") for approval of the offerings, including both detailed information about the costs of the projects and projections of revenue from the improved system. Those projections foresaw usage by some 2,200 customers when actual use was only a little over 1000. They also claimed an existing customer base of some 1,500, when in fact there were only 960 customers prior to the improvements. Absent the fraudulent projections, the system would not bring in enough revenue to support the bond payments. In addition, submissions to the SBC failed to disclose that some $3 million from earlier bond issues was used to fund improvements to a sports complex, municipal legal fees, and municipal payroll, notionally to the political benefit of the former mayor. Sterlington cooperated with the Public Finance Abuse Unit investigation and agreed to a cease-an--desist order. The unregistered municipal advisor and its principal consented to judgments enjoining them from future violations, disgorgement of all fees received together with interest, and a civil penalty to be set by the court. The former mayor resigned on Oct. 1, 2018, and is litigating the SEC's charges against him.

On Tuesday, June 14, 2022, the SEC filed charges in the U.S. District Court for the Western District of New York against the City of Rochester, its former finance director, and the former Rochester School District CFO, as well as the city's municipal advisor, with misleading investors in an August 2019 $119 million bond offering consisting of a $69 million bond anticipation note ("BAN") and a $50 million revenue anticipation note ("RAN"). The purpose of the BAN was to provide financing for the School District and for other city projects. The RAN was to finance cash flow for the District for the 2020 fiscal year. The former finance director and the district CFO failed to disclose, in the financial information used to inform a credit rating agency and to market the $119 million bond offering, that the district was facing at least a $25 million shortfall in its existing budget, primarily due to overspending on teacher salaries.

In fact, things turned out to be much worse. In September 2019, 42 days after the bond offering was sold, the district's outside auditors informed district leadership that the district had overspent its budget by some $30 million. This, in turn, led to a rating downgrade for the city's bonds and a voluntary disclosure filing on Oct. 3, 2019, on the Municipal Securities Rule Making Board's Electronic Municipal Market Access system. The district's CFO resigned on Oct. 10, 2019. When outside auditors completed the audit of the district's 2019 financial report on Dec. 3, 2019, it showed a $42 million operating deficit ($27.6 million more than had been budgeted), which consumed all the district's financial reserves. In May of 2020, the State of New York granted the district a $35 million, 30-year, interest-free loan and appointed a State Commission of Education monitor for three years to provide oversight of the district's finances. The former district CFO

consented to the entry of a court order barring him from future violations and from participating in future municipal securities offerings and requiring him to pay a $25,000 civil penalty. The SEC charges remain pending against the other parties.

These cases reveal both greed (for political approval, especially by the former mayor) in small-town Louisiana and willful blindness in a major New York City. In both, the investing public, seeking the supposed safety (and tax benefits) of putting money in municipal securities, was deceived to its detriment. The work of the Public Finance Abuse Unit continues.

Peter D. Hutcheon

Monday, June 27, 2022

Norris McLaughlin P.A.

Ratings Firm Egan-Jones Sanctioned by SEC.

Conflicts of interest are often the predicate for a finding of liability under the securities laws. For example, many of the cases brought against investment advisers are based on the failure to fully disclose a conflict of interest by the adviser. This happens, for example, in the share class selection cases where a broker affiliate of an advisory will receive a fee in connection with the choice of which mutual fund shares to recommend to a client.

Those involved with ratings, such as firms registered with the Commission as Nationally Recognized Statistical Rating Organizations or NRSRO, may also become involved with matters that center on a conflict of interest. In 2008, Congress specifically found that credit rating agencies face conflicts of interest "that need to be carefully monitored, according to Section 932(a) of the Dodd-Frank Act. In view of this fact, the Commission was directed to issue rules to prevent sales and marketing considerations from influencing ratings. To implement this directive the Commission adopted Rule 17g-5(c)(8), for example, to insulate those registered as NRSROs from business pressures by separating the business development function from the analytical function of the firm. It is this mandated separation of functions that is at the center the Commission's most recent case involving a NRSRO, *In the Matter of Egan-Jones Ratings Company*, Adm. Proc. File No,. 3-20902 (June 21, 2022).

Named as Respondents are Egan-Jones Ratings and Sean Egan. The firm is a well-known ratings agency. It registered with the Commission and became an NRSRO for financial institutions, insurance companies, corporate issuers, government and municipal securities and those of foreign governments. Sean Egan, the founder and CEO of the privately held company, is also a Respondent.

In 2013 Egan-Jones was found to have violated Exchange Act Sections 15E(a)(1) and related provisions by making a material misstatement in its form NRSRO and causing violations of Sections 15E and 17(a). The action was resolved with the entry of a cease-and-desist order as to Egan-Jones and the revocation of its registration regarding ratings for asset-backed securities and government securities with a right of reentry after eighteen months. A cease-and-desist order based on Rule 17g-5 was also entered as to Mr. Egan,.

The action here centered on alleged violations of Rule 17g-5(c)(8)(i) regarding the issuance of a rating when there is a conflict of interest and Rule 17(g)-5(c)(1) which is concerned with maintaining a rating for a client that is responsible for 10% or more of the firm's revenue under certain

circumstances. First, Egan-Jones issued a rating in 2019 at a time when Respondent Egan had participated in determining the credit rating for the client. The firm founder engaged in sales and marketing activities with respect to the client. This breached the divide between sales and marketing and the issuance of a rating mandated by the Dodd-Frank Act.

Second, Egan-Jones violated the 10% rule. Specifically, in 2017 the firm solicited business from a client that it was aware might contribute over 10% of its revenue for the year. This is contrary to Rule 17g-5(c)(1) of the Exchange Act. While $538,000 was recorded in the year end financial statements in a footnote and labeled as “excess revenue refundable” – the exact amount by which the 10% level was exceeded — the loss contingency was not accrued in accord with GAAP. There was thus no reason for not tabulating the sum for purposes of the 10% rule.

Respondent firm also failed to establish, maintain and enforce policies and procedures reasonably designed to manage conflicts of interest as required by Rule 15E(h)(1).

Respondent firm agreed to implement certain undertakings, including conducting a training program regarding the matters at issue here and retaining an Independent Consultant. The firm will also develop and implement policies and procedures prohibiting Mr. Egan from participating in the development or approval of any ratings.

The Order alleges violations of Sections 15E(h)(1) and 15E(f)(2) and Rules 17g-(5)(c)(8)(i), 17(g)(5(c)(8)(ii) and 17(g)-5(c)(1). In resolving this action, the firm consented to the entry of a cease-and-desist order based on each of the three Rules citer above and a censure. It will also pay disgorgement of $129,000 along with prejudgment interest of $17,592. In addition, the firm will pay a penalty of $1.7 million.

Respondent Egan also consented to the entry of a cease-and-desist order based on Rules 17g-(5)(c)(8)(i) and 17(g)(5(c)(8)(ii). He will pay a penalty of $300,000.

SEC Actions – Thomas O Gorman

June 23 2022

SIFMA AMG on SEC Climate-Related Disclosures for Investors.

SUMMARY

SIFMA AMG provided comments to the U.S. Securities and Exchange Commission (SEC) on the Commission’s proposal to enhance and standardize climate-related disclosures.

View the SIFMA comment letter.

The Enhancement and Standardization of Climate-Related Disclosures for Investors: SIFMA

SUMMARY

SIFMA provided comments to the U.S. Securities and Exchange Commission (SEC) on the

Commission's proposal to enhance and standardize climate-related disclosures. The Proposing Release states that the Commission is proposing new disclosure requirements to elicit "[c]onsistent, comparable, and reliable disclosures on the material climate-related risks."

View the SIFMA comment letter.

GASB Improves and Clarifies Standards for Accounting Changes and Error Corrections.

Norwalk, CT, June 13, 2022 — The Governmental Accounting Standards Board (GASB) today issued guidance designed to improve the accounting and financial reporting requirements for accounting changes and error corrections.

GASB Statement No. 100, *Accounting Changes and Error Corrections*, provides more straightforward guidance designed to lead to information that is easier to understand and more reliable, relevant, consistent, and comparable across governments for making decisions and assessing accountability.

The Board's previous standards on accounting changes and error corrections—in GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* – were based on guidance established in the 1970s. The GASB's pre-agenda research identified diversity in applying the existing standards in practice, including issues with selecting the appropriate category of accounting change or error correction.

Statement 100 defines the following categories:

- Changes in accounting principles
- Changes in accounting estimates
- Changes to or within the financial reporting entity
- Corrections of errors in previously issued financial statements.

Statement 100 prescribes accounting and financial reporting for (1) each category of accounting change and (2) error corrections. It requires that:

- Changes in accounting principle and error corrections be reported retroactively by restating prior periods.
- Changes in accounting estimate be reported prospectively by recognizing the change in the current period.
- Changes to and within the financial reporting entity be reported by adjusting beginning balances of the current period.

The Statement also addresses how accounting changes and error corrections should be displayed in financial statements, disclosed in notes, and presented in required supplementary information and supplementary information.

Statement 100 carries forward some of the requirements of Statement 62 but with clearer explanations. Regarding classification, a notable change relates to changes to or within the financial reporting entity, which previously did not encompass changes within the reporting entity, such as a change from discrete presentation of a component unit to blended presentation or vice versa. Regarding note disclosures, Statement 100 requires that governments disclose the effects of each

accounting change and error correction on beginning balances in a tabular format.

“Governments and other stakeholders should find many of the requirements of Statement 100 familiar,” said GASB Chair Joel Black. “But they should find the understandability of the guidance greatly improved, and financial statement users should benefit from the new tabular disclosure.”

The requirements of Statement 100 are effective for accounting changes and error corrections made in fiscal years beginning after June 15, 2023, and all reporting periods thereafter. Earlier application is encouraged.

GASB Provides Unified Accounting Model for Compensated Absences and Eases Disclosure Burden.

Norwalk, CT, June 16, 2022 — The Governmental Accounting Standards Board (GASB) today issued new guidance that enhances the recognition and measurement requirements for compensated absences and refines related disclosure requirements.

Statement No. 101, *Compensated Absences*, supersedes the guidance in Statement No. 16, Accounting for Compensated Absences, which was issued in 1992. The new guidance is in keeping with the Board’s commitment to periodically reexamine its standards to ensure their continued effectiveness.

State and local governments often provide paid leave benefits to their employees, such as vacation leave and sick leave. Some benefits have evolved since Statement 16, such as the use of a paid-tim--off model that has characteristics of both vacation and sick leave. Statement 101 aligns recognition and measurement guidance for all types of compensated absences under a unified model. The new model will result in governments recognizing a liability that more appropriately reflects when they incur an obligation for compensated absences. The model also will lead to greater consistency in application and improved comparability across governments.

Statement 101 details the circumstances under which governments will be required to recognize a liability for compensated absences and provides guidance for measuring that liability. The general approach for measurement is to use an employee’s pay rate as of the financial reporting date.

Generally, a liability for leave that has not been used would be recognized if the leave:

(a) Is attributable to services already rendered
(b) Accumulates, and
(c) Is more likely than not to be used for time off or otherwise paid or settled.

There are some exceptions—such as parental leave and military leave—for which a liability would not be recognized until the leave commences.

The guidance eliminates or makes optional certain existing disclosures that GASB research found did not provide essential information to financial statement users. The Statement provides an alternative to the existing requirement to disclose the gross annual increases and decreases in long-term liability for compensated absences, allowing governments to disclose only the net annual change in the liability as long as it is identified as such. The Statement also removed the disclosure of the government funds used to liquidate the liability for compensated absences.

The requirements of Statement 101 are effective for fiscal years beginning after December 15, 2023, and all reporting periods thereafter. Earlier application is encouraged.

SEC Charges Rochester, N.Y., Misled Investors.

Case centers on $119 million municipal-bonds offering on behalf of school district

In charges detailed Tuesday, the Securities and Exchange Commission says municipal-bond offering documents for the Rochester, N.Y., schools included outdated financial statements.

The city of Rochester, N.Y., former city and school-finance officials and a municipal advisory firm misled investors about the school system's distressed finances, the Securities and Exchange Commission alleged Tuesday.

The agency alleges that Rochester in 2019 sold $119 million of municipal bonds on behalf of its school district without informing investors that the schools were in financial trouble because of overspending on teacher salaries. Former city finance director Rosiland Brooks-Harris, and former school finance chief Everton Sewell and city municipal adviser Richard Ganci of Capital Markets Advisors all knew about the trouble, the SEC said, but the bond offering documents included outdated financial statements.

An audit revealed the overspending, which amounted to nearly $30 million, less than two months after the bond sale and the city's debt rating was downgraded, the SEC said.

Rochester officials "disagree vehemently with this filing and will take all appropriate legal steps to defend the City and its former financial director," the city said.

"We have made it clear that the City does not have access to or authority over the finances of the Rochester City School District, and therefore cannot be responsible for the district withholding financial information," the statement said.

In a settlement subject to court approval, Mr. Sewell, without admitting or denying the SEC's findings, agreed to pay a $25,000 fine and not participate in future municipal bond deals. "Mr. Sewell has resolved his differences with the SEC," his attorney, David Rothenberg, said when reached by phone.

Ms. Brooks-Harris, Mr. Ganci, and Capital Markets Advisors are facing allegations that they violated antifraud provisions of securities laws in U.S. District Court for the Western District of New York.

Mr. Ganci, his colleague Richard Tortora, and Capital Markets Advisors are also facing allegations they violated their fiduciary duty as municipal advisers as well as laws around deceptive practices and fair dealing. An attorney for Mr. Ganci, Mr. Tortora and the firm couldn't be reached for comment.

The Wall Street Journal

By Heather Gillers

June 14, 2022

SEC Charges Rochester, NY Former Officials with Misleading Investors on Bond Offering.

The Securities and Exchange Commission (SEC) recently charged the City of Rochester, N.Y., some former city officials, and an advisor with misleading investors in a $119 million bond offering.

Specifically, former Rochester finance director Rosiland Brooks-Harris and former Rochester City School District CFO Everton Sewell were charged, as were Rochester's municipal advisor Capital Markets Advisors (CMA), and its principal Richard Ganci. CMA, Ganci, and CMA co-principal Richard Tortora were also charged with failing to disclose conflicts to municipal clients.

The SEC alleges that the defendants misled investors in 2019 with bond offering documents that included outdated financial statements for the Rochester City School District and did not indicate that the District was experiencing financial distress due to overspending on teacher salaries. Sewell was allegedly aware that the District was facing at least a $25 million budget shortfall, but he misled a credit rating agency on the magnitude of the expected shortfall, the SEC alleges.

The SEC alleges that Brooks-Harris and Ganci were also aware of the Rochester City School District's increased financial distress. However, the SEC says they made no effort to inquire further about the District's financial condition prior to the bond offering, nor did they inform investors of the risks that the overspending posed to the District's finances. In September 2019, 42 days after the offering, the District's auditors found that the District had overspent its budget by nearly $30 million, resulting in a downgrade of the city's debt rating.

"We allege that the Rochester City School District's financial health was important to investors, who were counting on the district as the expected source of repayment," LeeAnn Ghazil Gaunt, chief of the Enforcement Division's Public Finance Abuse Unit, said. "As described in our complaint, these defendants failed to inform investors of the serious financial difficulties the district was experiencing at the time of the offering."

In addition, the SEC's complaint also alleges that CMA, Ganci, and Tortora failed to disclose to nearly 200 municipal clients that CMA had material conflicts of interest arising from its compensation arrangements.

Brooks-Harris, CMA, and Ganci were charged with violating the antifraud provisions of the securities laws. Also, CMA, Ganci, and Tortora were with violating the municipal advisor fiduciary duty, deceptive practices, and fair dealing provisions of the federal securities laws. The Commission is seeking injunctive relief and financial remedies against all parties.

Sewell agreed to settle the SEC's charges by consenting, without admitting or denying any findings, to a court order prohibiting him from future violations of the antifraud provisions and from participating in future municipal securities offerings. He also agreed to pay a $25,000 penalty.

FINANCIAL REGULATION NEWS

BY DAVE KOVALESKI | JUNE 16, 2022

SEC Sues City of Rochester, Says Investors Not Informed of 'Serious Financial Difficulties'

The U.S. Securities and Exchange Commission Tuesday announced a major complaint against the city of Rochester, former Finance Director Rosiland Brooks-Harris and former Rochester City School District Chief Financial Officer Everton Sewell, accusing them of misleading investors during a $119 million bond offering in 2019.

The bond offering came after the finance officials allegedly knew of a massive budget shortfall in RCSD, but before it became public.

“We allege that the Rochester City School District’s financial health was important to investors, who were counting on the district as the expected source of repayment,” LeeAnn Ghazil Gaunt, chief of the Enforcement Division’s Public Finance Abuse Unit, said in a statement. “These defendants failed to inform investors of the serious financial difficulties the district was experiencing at the time of the offering.”

The SEC is also charging Rochester’s municipal advisor, Capital Markets Advisors, LLC, and principals Richard Ganci and Richard Tortora with false statements and misleading investors.

The city immediately objected to the SEC action.

“We have made it clear the city does not have access to or authority over the finances of the Rochester City School District, and therefore cannot be responsible for the district withholding financial information,” it said in a statement.

RCSD is fiscally dependent on the city, meaning the city is ultimately responsible for approving its budget and seeking loans when necessary. The question is whether Brooks-Harris or other city officials were aware of RCSD’s pending budget crisis when they went out for the bond.

Sewell resigned in October 2019. According to the SEC, he has already settled the charges against him, including by paying a $25,000 fine.

Brooks-Harris pleaded guilty to a misdemeanor campaign finance-related charge in 2021 in a case related to former mayor Lovely Warren’s re-election campaign.

After the RCSD budget shortfall became public in 2019, Warren sought unsuccessfully to sever the city’s financial ties from the school district.

Within the school district, the budget shortfall led ultimately to hundreds of mid-year layoffs, the abrupt resignation of Superintendent Terry Dade and the appointment of a state academic and fiscal monitor, Shelley Jallow.

The lawsuits

The lawsuits from the SEC — Sewell is also sued independently — paint a picture of a city school district awash in overspending as officials tried to disguise the facts of a steadily deteriorating financial condition. In 2018, the court papers say, the district’s overspending accelerated to keep pace with salaries. The costs led to a $63 million drop in cash for the 2019 fiscal year.

The district turned to short-term loans from the city to try to establish some financial stability.

The lawsuit alleges that Sewell knew of the district’s precarious financial conditions in June and July

of 2019, with budget deficits estimated between $25 million and $50 million, but did not diligently inform others of the troubles.

“Sewell did not inform anyone outside of the District’s finance department of the projected budget deficits until late August 2019, after the bonds had been issued,” the lawsuit alleges.

The lawsuit also maintains that Sewell was not forthright with a credit rating agency at a June 2019 meeting.

“Sewell also misrepresented the reason for the District’s $63 million cash decline,” the lawsuit states, “When the ratings analyst asked Sewell to explain how the District was predicting using only the budgeted $15 million in fund balance when cash had declined by $63 million, Sewell said the decline was due to accounting treatment and timing issues in the receipt of cash.

“In fact, as Sewell was aware, the cash decline was due to the District’s overspending on salaries, among other things..”

by Justin Murphy & Gary Craig

June 14, 2022

Rochester Democrat and Chronicle

SEC Charges Rochester, NY, and City’s Former Executives and Municipal Advisor with Misleading Investors.

City sold $119 million of bonds to investors without disclosing financial distress

Washington D.C., June 14, 2022 — The Securities and Exchange Commission today charged the City of Rochester, New York, its former finance director Rosiland Brooks-Harris, and former Rochester City School District CFO Everton Sewell with misleading investors in a $119 million bond offering. The SEC also charged Rochester’s municipal advisor Capital Markets Advisors, LLC (CMA) and its principal Richard Ganci with misleading investors and breaching their fiduciary duty to Rochester. CMA, Ganci and CMA co-principal Richard Tortora were also charged with failing to disclose conflicts to municipal clients.

The SEC alleges that in 2019 the defendants misled investors with bond offering documents that included outdated financial statements for the Rochester City School District and did not indicate that the district was experiencing financial distress due to overspending on teacher salaries. Sewell was allegedly aware that the district was facing at least a $25 million budget shortfall, but he misled a credit rating agency regarding the magnitude of the expected shortfall. The SEC alleges that Brooks-Harris and Ganci were also aware of the Rochester City School District’s increased financial distress, including overspending on teacher salaries, yet they made no effort to inquire further about the District’s financial condition prior to the bond offering, nor did they inform investors of the risks that the overspending posed to the district’s finances. In September 2019, 42 days after the offering, the district’s auditors revealed that the district had overspent its budget by nearly $30 million, resulting in a downgrade of the city’s debt rating and requiring the intervention of the state of New York.

The SEC’s complaint also alleges that CMA, Ganci and Tortora failed to disclose to nearly 200

municipal clients that CMA had material conflicts of interest arising from its compensation arrangements. In many cases, CMA, Ganci and Tortora falsely stated that CMA had no undisclosed material conflicts of interest.

“We allege that the Rochester City School District’s financial health was important to investors, who were counting on the district as the expected source of repayment,” said LeeAnn Ghazil Gaunt, Chief of the Enforcement Division’s Public Finance Abuse Unit. “As described in our complaint, these defendants failed to inform investors of the serious financial difficulties the district was experiencing at the time of the offering.”

The SEC’s complaint against the city, Brooks-Harris, CMA and Ganci, filed in the U.S. District Court for the Western District of New York, charges them with violating the antifraud provisions of the securities laws. The complaint also charges CMA, Ganci and Tortora with violating the municipal advisor fiduciary duty, deceptive practices, and fair dealing provisions of the federal securities laws. The Commission is seeking injunctive relief and financial remedies against all parties.

Sewell agreed to settle the SEC’s charges by consenting, without admitting or denying any findings, to a court order prohibiting him from future violations of the antifraud provisions and from participating in future municipal securities offerings, and to pay a $25,000 penalty. The settlement is subject to court approval.

Cori Shepherd, Warren Greth, Laura Cunningham, Jon Wilcox, and Creighton Papier of the Enforcement Division’s Public Finance Abuse Unit conducted the investigation under the supervision of Ivonia Slade and Rebecca Olsen. The SEC’s litigation will be led by James Carlson and Eugene Hansen.

Finding More Clarity in State Blue Sky Laws: Shedding Light on Exclusions from Municipal Bond Exemptions

Summary:
Some states exclude from the municipal exemption the registration of municipal securities that are paid from a non-governmental industrial or commercial enterprise, unless the payments and insured are guaranteed by a person whose securities are exempt from registration under certain other enumerated sections of the law.

Issue:
There is substantial disagreement among these states as to whether conduit 501(c)(3) bonds, student loan bonds and single family mortgage revenue bonds constitute bonds payable from revenues to be received from a non-governmental industrial or commercial enterprise.

Sub-Issue:
One state allows for the municipal exemption to apply to municipal securities that paid from revenues derived from a non-governmental industrial or commercial enterprise if the securities being offered obtain a rating high enough so as to not require any registration or notice filing. However, the guidance is ambiguous, which can cause differences in interpretation.

For example, in Washington, a regulation indicates that an exemption from registration for bonds payable from a non-governmental industrial or commercial enterprise is available if either:

- the security receives a rating of “AA” or better from S&P or an equivalent rating from Moody’s,

- the security is issued to fund a single-family mortgage program established and operated by a state housing finance agency and the security receives a rating of at least" A+" from S&P or an equivalent rating from Moody's

The problem is that there is no guidance as to what constitutes an "equivalent" rating from Moody's (or any other rating agency for that matter). Though it might seem obvious that a Moody's rating of Aa2 would be an equivalent rating to an S&P rating of AA, the lack of formal guidance means that one is forced to make an assumption that Securities Division has not commented on; and if that assumption is incorrect, the issuance of the securities may be subject to an enforcement action.

Bottom line:
State opinions can sharply differ regarding exclusions from municipal bond exemptions. The lack of guidance and uniformity can make practicing in this area confusing — which is why it's key to rely on experienced consultants.

by Christopher Andreucci

June 8, 2022

Harris Beach PLLC

GASB Posts Paper on Intersection of ESG Matters with Governmental Accounting Standards.

View the GASB paper.

5/31/2022

The SEC's Proposed New Climate-Related Disclosure Requirements for Public Companies: What Do They Mean for Municipal Issuers and Borrowers? - Orrick

Summary Statement

- In March 2022, the U.S. Securities and Exchange Commission ("SEC") released proposed rules that would require public companies to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements.
- While the SEC's recently proposed disclosure rules for public companies regarding climate-related disclosures do not apply to municipal issuers and borrowers (unless the borrower is a public company) and are not final, they do provide helpful context and guidance for how the SEC may view climate-related disclosures in the municipal market.
- In light of these considerations, issuers and borrowers in the municipal market should:
  – Review the SEC's proposed climate-related disclosure rules and their implications for the municipal market, specifically as it relates to disclosure of climate-related risk and governance and

management of such risks in offering documents and continuing disclosure filings.
– Assess climate-related risks to their organization and consider whether improvements need to be made to the governance and management of such risks and whether it is advisable to establish climate-related goals and policies.

Current Climate [PUN INTENDED!]

In March 2022, the SEC released proposed rules that would require public companies to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. The required information about climate-related risks also would include disclosure of a public company's greenhouse gas emissions, which have become a commonly used metric to assess a public company's exposure to such risks.

In May 2022, the SEC released proposed amendments to enhance and modernize the Investment Company Act "Names Rule" to address changes in the fund industry and compliance practices that have developed in the approximately 20 years since the rule was adopted. According to a statement by SEC Commissioner Allison Herren Lee, the SEC's proposed changes to the "Names Rule" have implications for funds using terms like "ESG" or "sustainable" or "green" or "social" in their names to ensure that such concepts truly align with a fund's investment decisions. While the May 2022 proposed amendments to the "Names Rule" are not the topic of this article, they illustrate the SEC's current focus on promulgating guidance that impacts the ESG investment community.

The SEC does not have the authority to adopt similar climate-related disclosure rules for issuers and borrowers (unless the borrower is a public company), and the proposed rules relating to such climate-related disclosures **do not** apply to issuers and borrowers. They do, however, provide helpful context and guidance as to how the SEC may view climate-related disclosures in the municipal market.

Orrick's corporate ESG group published an article summarizing the proposed rules as applied to public companies generally and proposing steps public companies could consider taking now. Our public finance team has prepared this supplement to that article, summarizing the key takeaways for issuers and borrowers. **We encourage you to read this supplement together with the underlying article.**

Applying the SEC's Proposed Rules to the Municipal Market

There are some key takeaways from the SEC's proposed rules for issuers and borrowers as it relates to disclosure of climate-related risks and governance and management of such risks in offering documents and continuing disclosure filings.

Climate-Related Disclosure

Proposed Rules:

In its registration statements and annual reports, a public company would be required to disclose climate-related risks, including information about:

- how any climate-related risks identified by the public company have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term;
- how any identified climate-related risks have affected or are likely to affect the public company's

strategy, business model, and outlook;
- the public company's processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the public company's overall risk management system or processes;
- the impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the public company) and transition activities (including transition risks identified by the public company) on the line items of a public company's consolidated financial statements and related expenditures, and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities;
- the oversight and governance of climate-related risks by the public company's board and management; and
- the public company's climate-related targets or goals, and transition plan, if any.

The proposed rules would also require a public company to provide greenhouse gas ("GHG") emissions metrics for investors to assess those risks, and in certain instances the GHG emissions metrics disclosures would be subject to third-party verification requirements. Further, the proposed rules would allow for disclosure regarding a public company's climate-related opportunities.

Application to Municipal Market:

A registration statement for public companies is similar to an offering document like an official statement or offering memorandum for issuers and borrowers in the municipal context. Issuers and borrowers often have a practice of disclosing risks factors relevant to the security for and sources of payment of the securities being issued and, in many cases, risks relevant to an issuer's or borrower's operations and finances. It is not uncommon to see risk factors in an offering document for municipal securities relating to climate change, like global warming and even GHG emissions, or climate-related events like earthquakes, wildfire, floods, and tsunami, as and if relevant.

For issuers and borrowers that do not routinely include climate-related risk disclosure in their offering documents, the SEC's proposed rules suggest the time has come to start doing so.

For issuers and borrowers that already have a practice of disclosing climate-related risks in their offering documents, the SEC's proposed rules provide more detailed and focused considerations for developing their existing climate-related risk disclosure. Issuers and borrowers should partner with their disclosure counsel to think through each of the bullets above and consider if relevant and how to best disclose and address. The bulk of the disclosure points summarized above from the proposed rules are valuable guidance as to what issuers and borrowers should consider and discuss in developing their climate-related risk disclosure.

The annual reports prepared by a public company could be analogized to the annual reports prepared by issuers or borrowers for continuing disclosure purposes. While issuers and borrowers are only obligated to provide information in annual reports that they have contractually agreed to provide at the time of issuance of the debt instrument (often in the form of a continuing disclosure agreement or continuing disclosure certificate), there may be a push by ESG investors for issuers and borrowers to start including updates to their climate-risk disclosure as part of their annual reporting obligations going forward. Annual updates regarding climate-related risks are relevant to the secondary market – especially to ESG investors – who are buying and selling securities long after the publication of the related offering document.

Whenever an issuer or a borrower makes a public disclosure in the form of an offering document or an annual report, it is speaking to the municipal market and such statement is subject to SEC Rule 10b-5. SEC Rule 10b-5 states in relevant part: "It shall be unlawful for any person, directly or

indirectly … *to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.”*

SEC Rule 10b-5 sets a high bar for public disclosures, including climate-related disclosure; there can be no errors or omissions of material facts. Materiality is the primary tool that issuers and borrowers have to guide disclosure practices. However, materiality is not based on what is material to the issuer or borrower making the disclosure; instead, it is based on what would be **material to the investment decision of a reasonable investor**.[1] What is material to a reasonable investor as it relates to climate-related risks and disclosure will require issuers and borrowers to have conversations with disclosure counsel, underwriters, and other professionals to ensure they are not omitting any aspect of their climate-related story that may be relevant to a reasonable investor – not just an ESG investor.

It is important to note that if an investor is specifically choosing to be an ESG investor, then an issuer’s or borrower’s climate-related policies and risks would be a top-of-mind factor when such investor is making investment decisions.

Audited Financial Statements

Proposed Rules:

Public companies would be required to include certain climate-related financial statement metrics and related disclosure as a note in their audited financial statements. The proposed financial statement metrics would consist of disaggregated climate-related impacts on existing financial statement line items. As part of the audited financial statements, the climate-related financial statement metrics would be subject to audit by an independent registered public accounting firm.

Application to Municipal Market:

Most issuers prepare their audited financial statements in accordance with standards and guidance promulgated by the Governmental Accounting Standards Board (“GASB”). It will be important to watch GASB closely in the coming years to see if it issues any proposals relating to the incorporation of climate-related metrics in audited financial statements for governmental agencies. To understand the risks imposed by climate-related conditions and events and adequately disclose them, it may be useful or even necessary for an issuer or borrower to quantify the climate-related costs incurred and reserves available to address climate-related risks should they occur. If such quantification of climate-related risks gains traction, GASB may decide to provide guidance on how to undertake this effort in a governmental agency’s audited financial statements and in doing so subject an issuer’s quantification to independent audit.

Implications for ESG Investing

Investor interest in ESG investments has grown significantly in recent years. According to one estimate, the “U.S. sustainable investment universe” has grown to over $17 trillion, which represents an increase of over 42% since 2018. Despite the growing interest in ESG investing and demand for ESG investments, there is no clear definition or description of what constitutes ESG investments, and ESG investors look for different markers, indices and evidence in their assessment of whether an investment qualifies as an ESG investment. Further, rating agencies are increasingly analyzing ESG factors as part of their credit analysis, with some agencies releasing “scorecards” for certain sectors of the municipal market, but there is no clear guidance on the factors considered and the importance in a given issuer’s or borrower’s credit analysis.

In light of the SEC's proposed rules, some of the looming questions for ESG investing include:

- How will the expectations from the ESG investor community develop concerning climate-related disclosures?
- How will ESG investors and rating agencies and other third-parties utilize the proposed rules when evaluating the ESG quality of municipal securities and making an investment decision?
- Will the ESG investing community coalesce around more standardized approach to ESG at least as it relates to assessing environmental and climate-related governance issues?
- To what extent will ESG information become material to the reasonable investor and will the omission of it run afoul of SEC Rule 10b-5?

As noted earlier, the ESG investment market is sizable and growing, and may at some point drive a change in the municipal market even though the proposed rules if adopted would not be applicable to issuers and borrowers. Issuers or borrowers who fail to carefully assess climate-related risks and fail to take actions to manage and improve such risks and then are not able to provide the climate-related disclosure that the ESG community expects may face a more limited set of investors, which could in turn impact borrowing costs.

The question will be if the loss of ESG investors will be enough of a detractor for issuers and borrowers to change their approach and practices related to climate issues. Even more, if such climate-related practices and disclosures become more prevalent in the municipal market, the expectation may extend to investors outside the ESG market.

Dave Sanchez, Director of the Office of Municipal Securities at the SEC, seems to suggest things might come to that in statements made at the National Federation of Municipal Analysts' 2022 Annual Conference: "It's not a violation of securities laws to say you're not going to do anything [on ESG], that you are going to stick your head in the sand…maybe nobody will buy your bonds."[2]

What's Next

The SEC's proposed rules for public companies regarding climate-related disclosures are not yet final. Orrick will continue to monitor the proposed rules and any related enforcement actions by the SEC, along with potential implications for issuers and borrowers in the municipal market.

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[1] *See Basic Inc. v. Levinson*, 485 U.S. 224, 224 (1988) (holding that for purposes of SEC Rule 10b-5, an omitted fact is material if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor).

[2] See "SEC's Sanchez offers Guidance on ESG," by Connor Hussey, published on May 18, 2022 in *The Bond Buyer*, available at https://www.bondbuyer.com/news/secs-sanchez-offers-guidance-on-esg.

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by Marc Bauer & Andrea Nicole Greenwald

June 9, 2022

Orrick, Herrington & Sutcliffe LLP

SEC Charges Louisiana Town and Former Mayor with Fraud in Two Municipal Bond Deals.

Town's Municipal Advisor and its Owner also charged

Washington D.C., June 2, 2022 — The Securities and Exchange Commission today charged the town of Sterlington, Louisiana and its former mayor, Vern A. Breland, as well as the town's unregistered municipal advisor, Twin Spires Financial LLC, and its owner, Aaron B. Fletcher, with misleading investors in the sale of $5.8 million in municipal bonds across two offerings in 2017 and 2018.

According to the SEC's complaints, the town of Sterlington issued the revenue bonds to finance the development of a water system and improvements to its existing sewer system. As required by state law, Sterlington applied to the Louisiana State Bond Commission (SBC) for approval of the two offerings. The SEC alleges that Sterlington submitted false financial projections, created by Fletcher and Twin Spires, with then-Mayor Breland's active participation and approval, substantially overstating the number of historical and projected sewer customers in order to mislead the SBC as to the town's ability to cover the debt service for the proposed bonds. The town and Breland allegedly did not disclose to investors that SBC approval of the bonds was based on the false projections or that Breland had directed the misuse of more than $3 million from earlier bond offerings intended for sewer system updates to instead pay for sports complex improvements, town legal fees, and payroll. The SEC further alleges that Twin Spires and Fletcher provided municipal advisory services to Sterlington without Twin Spires being registered as a municipal advisor with the Commission.

"Investors in Sterlington's bonds had a right to know that the town had obtained approval of the bond offerings based on false projections and had misused proceeds from prior offerings." said LeeAnn Ghazil Gaunt, Chief of the SEC Enforcement Division's Public Finance Abuse Unit. "Further, it is long past time for financial advisors to municipal issuers to comply with the requirement that they must be registered with the Commission before they provide municipal advice, and we will vigorously pursue advisors who continue to flout those requirements."

The SEC charged Sterlington, Breland, Twin Spires, and Fletcher with violating the antifraud provisions of the Exchange Act and the Securities Act. Fletcher and Twin Spires also were charged with failing to register as municipal advisors and with violating fiduciary duty and fair dealing rules. Without admitting or denying the SEC findings, Sterlington has agreed to a cease-and desist order against future violations, whereas Twin Spires and its owner Fletcher have consented to the entry of judgments enjoining them from future violations and agreed to pay disgorgement, prejudgment interest, and civil penalties in amounts to be determined at a later date by the court. Breland is litigating the SEC's allegations against him.

Robbie L. Mayer and Creighton Papier of the Public Finance Abuse Unit conducted the investigation under the supervision of Peter J. Diskin and Deputy Unit Chief Rebecca J. Olsen. The litigation against Breland will be conducted by William P. Hicks and M. Graham Loomis of the SEC's Atlanta Regional Office. The SEC acknowledges the assistance of the Investigative Audit Staff of the Louisiana Legislative Auditor.

FAF Issues 2021 Annual Report.

Norwalk, CT—June 1, 2022 — The Financial Accounting Foundation (FAF) today posted its 2021 Annual Report to its website. The report is available as a printable PDF file and as an enhanced digital version.

The annual report theme is “Standards That Work from Main Street to Wall Street,” and it commemorates the 50th anniversary of the creation of the Financial Accounting Foundation. The report provides a snapshot of the major milestones over the last 50 years of the Foundation’s work to enable the independent standard-setting process of the Financial Accounting Standards Board (FASB) and Governmental Accounting Standards Board (GASB).

The report also offers an overview of how the FASB and GASB focus on obtaining and incorporating stakeholder input during standards-setting activities. This feedback has recently led the FASB to add project topics on digital assets; intangibles; government grants; and accounting for financial instruments with environmental, social, and governance (ESG)-linked features and regulatory credits. It has also informed the GASB’s work on three major projects, the Financial Reporting Model Reexamination, Revenue and Expense Recognition, and the Disclosure Framework.

The 2021 Annual Report includes:

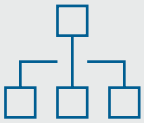
- Letters from FASB, GASB, and FAF leaders
- Milestones of the FAF’s 50-year history
- Highlights of 2021 FASB and GASB standards and Exposure Drafts
- Complete 2021 management’s discussion and analysis and audited financial statements (MD&A) (previously posted to the FAF website).

The annual report is available online as a downloadable PDF file, along with a mobile-friendly version at accountingfoundation.org. The online version also includes complete lists of all FASB and GASB advisory group members, including the Emerging Issues Task Force and the Private Company Council.

S&P Credit FAQ: Will LIBOR’s Expiration Adversely Affect U.S. Public Finance Issuers?

The London Interbank Offered Rate (LIBOR) as we know it has about a year left. The one-year countdown until the cessation of one-, three-, six-, and 12-month U.S. dollar LIBOR publication by the ICE Benchmark Association begins July 1, 2022. While the one-week and two-month LIBOR ceased to be published effective Jan. 1, 2022, the remaining tenors cover the vast majority of LIBOR-based exposure for U.S. Public Finance (USPF) issuers.

What We Are Watching



Limited credit exposure

Although risks remain, LIBOR exposure within USPF is small.
We believe risk to credit exists on three fronts: regulatory, cost, and management.

Regulatory protection

New legislation and regulatory developments have provided clarity and guidance. We expect issuers to afford themselves of these in order to amend existing contracts without triggering a reissuance.

Unexpected costs

Rate turnover will likely result in manageable cost increases. However, some strategies that involve debt issuance costs or payments associated with unwinding swaps could have greater impact.

Management

Key to ensuring credit exposure is management's preparedness to identify and cushion.

Source: S&P Global Ratings.

USPF issuers service most debt by applying cash available from total operating revenues, net of expenses. Because the notional amount of LIBOR exposure tends to be modest relative to USPF issuers' overall debt service obligations, it is our view that substituting a successor benchmark for LIBOR-exposed instruments will not impair an issuer's capacity to meet debt service payments. Even adjustment factors to reconcile LIBOR with its successor benchmarks are imperfect and contribute to modestly higher interest rates. We view the USPF sector's use of cash available for debt service across all instruments as distinguishing it from some other sectors, in which the capacity to meet obligations is specific to the debt issue's cash flows and not to the issuer's broader cash flows. In the former structure, cash flows tend to be tightly aligned with debt service obligations, and even small changes in interest rates can have consequences, which we do not view as an exposure for USPF issuers.

In our ongoing due diligence calls, issuers across USPF sectors have afforded us insights into preparatory and transitional trends as they continue to work with their counterparties to migrate to a new benchmark or rely on newly established legislation to enact SOFR as the replacement benchmark. There is belief among issuers that the cost increase as a result of imperfect harmonization between LIBOR and SOFR will be inconsequential to overall operating performance and subsequent debt service obligations. Below we answer some frequently asked questions to address these issues.

Frequently Asked Questions

What credit risks remain for USPF issuers?

Although we believe recently passed legislation will aid the municipal bond market in achieving a smooth transition from LIBOR to an alternative benchmark, in certain circumstances management's adoption and execution of a strategy that limits financial exposures could be key to credit stability. Most issuers within public finance that have LIBOR exposure exists predominately in the form of variable rate debt which are often hedged with fixed payer swap instruments. Risks could remain acute for some issuers if management fails to identify and address exposure adequately, resulting in elevated basis risks and increased costs through untimely or unmatched transition between their debt obligations and hedging instruments. Alternatively, fixing variable-rate portfolios through reissuance in unfavorable market conditions could subsequently weaken an issuer's budgetary

performance, flexibility, and liquidity. In our view, a credit-sound strategy by management includes the identification of an issuer's complete LIBOR exposure with proactive measures already in place to amend any existing documentation with fallback language, while budgeting for some increased costs. We believe there is risk associated with strategies that have not yet identified which obligations need to be amended and/or will not assume increased cost of capital as part of their annual expenses.

Further limiting any credit exposures that USPF issuers might face as they transition to benchmarks that succeed LIBOR are federal legislative and regulatory developments that define the replacement benchmark as the Secured Overnight Financing Rate (SOFR), where financing documents are silent on the question of substitution. Nevertheless, the parties to the financing need to agree on a spread adjustment to reconcile the differences in these measures of interest rates. While time still remains, many USPF issuers have indicated that they have already assessed potential exposure to LIBOR across all obligations and are either in or have completed discussions with their counterparties.

What recent regulatory developments have provided guidance for USPF issuers?

The Federal Reserve, the Federal Deposit Insurance Corp., and the Office of the Comptroller of the Currency prohibited new contracts to use LIBOR as of Jan. 1, 2022, and S&P Global Ratings believes that transition risk for USPF issuers would exist mainly in legacy contracts that have proven difficult or problematic to amend. The recent passing of the federal Adjustable Interest Rate (LIBOR) Act has created a safe harbor for those who select SOFR as the replacement benchmark, and they will not be subject to legal liability. The law also provides that the Federal Reserve can select a SOFR-based replacement for LIBOR in contracts where there is no fallback language that specifies LIBOR or where any fallback language is not sufficient, maintaining an active rate for those contracts. This federal law supersedes the New York State law that provided similar fallback language. While many issuers have already worked with their lenders to adopt fallback language, some cited legislation as their preferred method of transition.

Clarity on avoiding a taxable event was published on Jan. 4, 2022, when the IRS provided guidance on the transition from LIBOR. The guidance states that the IRS will not consider the transition a taxable reissuance if the LIBOR replacement includes any rate recommended by the Alternative Reference Rates Committee or the Federal Reserve. While these new rules have a 12-month grace period beyond the cessation of LIBOR, the additional timing affords issuers the confidence to transition from LIBOR without the concern of a forced reissuance in a rate environment that could be detrimental to their overall cost of capital.

What risks associated with derivatives remain for USPF issuers?

For swaps and other derivative instruments, similar protocols are in place to facilitate a smooth transition that provides robust fallbacks for those parties who elect to adopt the protocols. The International Swaps and Derivatives Association (ISDA) has published the IBOR Fallbacks Protocol and Supplement, effective Jan. 25, 2021, which identifies SOFR as the successor to LIBOR, but leaves open to negotiation between the issuer and its counterparty the spread adjustment for reconciling SOFR's interest cost to LIBOR's, which can define financial capacity to meet debt service requirements.

While not affecting all sectors in USPF, the Financial Accounting Standards Board (FASB) has proposed an update to accounting standards on April 20, 2022, to include flexibility regarding hedge accounting qualifications during the LIBOR transition period. Previously, in the event a hedge was deemed no longer highly effective, and hedge accounting was discontinued, issuers would have reported the change in fair value of the non-hedged interest rate swaps as an interest expense,

inflating their recorded expenses and possibly affecting debt service coverage requirements that may be required by individual indentures and other covenants. Should FASB adopt these proposed changes, the risk is mitigated as long as management applies for relief through Dec. 31, 2024.

What risks do USPF issuers face if they transition to another benchmark that is not SOFR?

Although the prospects for transitioning to benchmarks other than SOFR are remote, transition to an index that results in higher interest rates relative to current interest rates, or that triggers a taxable reissuance under the tax code, might negatively pressure credit ratings if the costs are material to cash available for debt service and debt service. While there are other replacement rates available, only SOFR being a substitute for LIBOR will enable a safe harbor protection under the new regulations.

What does S&P Global Ratings expect the transition from LIBOR to look like from here?

Based on our polling of issuers across USPF sectors, we have found that there is considerable variability among issuers in their preparation for LIBOR's expiration. Although many have completed discussions with counterparties surrounding the selection of replacement benchmarks and adjustment factors, there are also many whose discussions remain in the preliminary stages. We do not expect negative credit consequences among the latter group because their LIBOR exposure tends to be small and any basis differential between LIBOR and its successor after applying an adjustment factor should be inconsequential. Moreover, the modest ratio of LIBOR instruments relative to total debt instruments, when viewed against the backdrop of debt payments that come from cash available for debt service from all revenue sources, rather than those dedicated to a specific issue, further limits the potential for negative financial pressures attributable to the transition. Legislative and regulatory guidance that will facilitate the transition should further insulate credit quality. We believe that there will be additional costs associated with the transition and surveyed issuers believe these additional costs to be nominal to their budgetary performance.

31 May, 2022

First Circuit Affirms Dismissal Of Putative Securities Class Action Against Bank For Alleged Failure To Disclose Deteriorating Bond Market Conditions.

On May 20, 2022, the United States Court of Appeals for the First Circuit affirmed the district court's dismissal of claims under Section 10(b) of the Securities Exchange Act (the "Exchange Act") and Rule 10b-5 thereunder against a bank and its affiliates (the "Bank"). *Ponsa-Rabell v. Santander Sec. LLC, et al.*, No. 20-01857 (1st Cir. May 20, 2022). Plaintiffs alleged the Bank devised a scheme to defraud investors into purchasing Puerto Rican government bonds by omitting material information about the state of the market and about its own alleged program to rid itself of those securities. The appeal did not pertain to the district court's dismissal of claims under Section 17(a) of the 1933 Securities Act or Plaintiffs' claims brought under Puerto Rican law for which the district court declined to exercise supplemental jurisdiction after dismissing plaintiffs' securities claims.

According to the Complaint, the Bank acted as broker to plaintiffs who allegedly purchased Puerto Rico Municipal Bonds, Puerto Rico Closed End Funds, and Puerto Rico Open End Funds (collectively the "PRMB securities") from December 1, 2012 to October 31, 2013 (the "Putative Class Period"). Plaintiffs alleged that the PRMB securities were marketed to the public via fund-specific prospectuses that disclosed the fund's investment objectives, risk factors, and tax consequences,

along with investment risks associated with each particular fund. According to the Complaint, the PRMB securities were "attractive investments" that offered relatively high interest and were exempt from Puerto Rican and Federal income and estate taxes. Shortly before the Putative Class Period, however, the Complaint alleges that Puerto Rico began experiencing an economic recession, which made investments in the PRMB securities particularly risky. Plaintiffs alleged that during the recession, Puerto Rico issued billions of dollars in PRMB securities and used the proceeds to pay off existing debts rather than to stimulate the Puerto Rican economy. Puerto Rico's deficit allegedly increased to approximately $2.2 billion and became unpayable.

According to the Complaint, in 2012, various public sources began warning about the increased risks of holding PRMB securities, including a March 2012 published report that warned that Puerto Rico was "flirting with insolvency", and an August 2012 report from Moody's Investor Service ("Moody's") lowering Puerto Rico's bond credit rating to Baa1 and advising that "[c]onservative investors . . . should pursue portfolio diversification." Plaintiffs' alleged that on December 13, 2012, Moody's again downgraded Puerto Rico's credit rating to Baa3, "just above junk bond status." The Complaint alleges that the bond market "crashed" in the fall of 2013, resulting in financial losses for all those who invested in PRMB securities. Plaintiffs alleged that leading up to this crash, the Bank actively tried to rid itself of its PRMB securities inventory "at an accelerated pace," which, according to plaintiffs, motivated the Bank to sell the securities to plaintiffs. Plaintiffs filed their initial complaint against the Bank four years after the crash, alleging that they never would have purchased the PRMB securities if the Bank had disclosed the risk of the crash. The district court dismissed the federal securities claims with prejudice and the state law claims without prejudice, and plaintiffs appealed the dismissal of the Section 10(b) claims—specifically, whether plaintiffs sufficiently pled (i) a material misrepresentation or omission, and (ii) scienter.

The First Circuit first considered the misstatement or omission element of plaintiffs' Section 10(b) claim. Plaintiffs alleged that two disclosures in the fund prospectus were "fatally defective" because of information the Bank omitted. In the disclosures, the Bank allegedly disclosed that "there is no Assurance that a Secondary Market for the Offered Bonds will Develop," and that "the Underwriters are not obligated to do so [meaning to guarantee a secondary market] and any such market making may be discontinued at any time at the sole discretion of the Underwriters." Plaintiffs contended that these disclosures did not include material facts which were necessary to make them not misleading; namely, that market conditions were deteriorating in Puerto Rico and that the Bank was selling off its own inventory of PRMB securities for that very reason. Plaintiffs further alleged that even if the omitted information was public, it did not relieve the Bank of its duty to disclose the information at the time plaintiffs allegedly purchased the PRMB securities, or of its ongoing obligation to update its prospectuses.

In affirming the district court's decision, the Court rejected plaintiffs' argument that the Bank should have disclosed information regarding the deteriorating market conditions, holding that the Bank "was simply not under any duty to repeat information already known or readily accessible to investors." In so holding, the Court maintained that "it is not a material omission to fail to point out information of which the market is already aware" and added that "plaintiffs' own complaint points to public statements about the deteriorating economy in Puerto Rico."

Turning to plaintiffs' allegation that the Bank should have disclosed that it was divesting itself of the PRMB securities, the Court similarly affirmed the district court's dismissal. In particular, the Court distinguished *Tutor Perini Corp. v. Banc of Am. Sec. LLC*, 842 F.3d 71, 90 (1st Cir. 2016), a case in which a bank allegedly knew the market for a particular security was "on the brink of collapse" when it allegedly encouraged plaintiff to purchase more of the securities while rapidly selling the same securities. The Court distinguished Tutor on the basis that the bank there had a "special

relationship" with plaintiff as its investment advisor; whereas, in contrast here, plaintiffs made no allegations that they had a special relationship or had given any particularized investment instructions to the Bank that would support a duty to disclose. The Court determined that plaintiffs merely alleged that the Bank "solicited" (or recommended) they purchase the PRMB securities, and that their investment objectives were to "preserve capital" and "current fixed income." Further, the Court held that, unlike in Tutor, plaintiffs made no allegation that the Bank promised to outline the risks of their investment or failed to inform plaintiffs of a market crash they knew was occurring. Therefore, the Court affirmed the district court's holding that plaintiffs failed to sufficiently allege an actionable omission. After making his finding, the Court noted that it was able to avoid a lengthy analysis concerning whether plaintiffs sufficiently pled scienter.

Shearman & Sterling LLP

June 2 2022

Municipal CFOs: Be Careful of Your Bond Disclosures; The SEC is Gunning for You.

The Securities and Exchange Commission (SEC) recently charged two chief financial officers of school districts with misleading investors in municipal bond offerings. This should be a warning to municipal CFOs to be very careful to make appropriate disclosures when involved in their public entities' bond issues. An SEC official recently stated that "the SEC is committed to holding bad actors in municipal securities offerings accountable for their misconduct." Don't be the CFO bad actor that the SEC targets!

Sweetwater (California). The first situation involved Sweetwater Union High School District, near San Diego, California, and its CFO, Karen Michel. The school district issued general obligation bonds in April 2018. In September 2021, the SEC charged that the district and CFO Michel provided inaccurate information in connection with the sale of the 2018 Bonds. The district settled with the SEC and agreed to a consent order. CFO Michel also settled with the SEC, was banned from participating in future municipal bond offerings, and agreed to pay a $28,000 penalty. The SEC also required the district to engage an outside financial professional (who was not involved in the bond issue) to clean up the district's financial operations.

What went wrong in Sweetwater? Before the district's FY 2017-18 started, the district agreed to 3.75% raises for its employees. CFO Michel failed to include the full cost of the salary increases in the FY 2017-18 budget. The budget projected an ending general fund balance of $19.5 million. But if the 3.75% increase were factored into the budget, it would have shown an ending general fund balance of NEGATIVE $7.2 million. Even though internal analyses by her office recognized the problem, CFO Michel took many steps to cover up the actual deficit.

How did the CFO hide the ball in Sweetwater?
CFO Michel was in charge of all aspects of the district's finances. She oversaw the budget process. She prepared all periodic financial reports to the five person school board. And she oversaw the debt issuance process for the district. In addition, in its resolution approving the issuance of $28 million of general obligation bonds in 2018, the school board authorized CFO Michel to enter into all agreements and sign all documents related to the bonds. And she did so; she negotiated and signed all documents related to the bonds.

Who did the CFO mislead?

- Her school board.
- The State of California. The CFO filed periodic year-to-date budget information with the state that included the false information.
- The rating agency that gave an “A” rating to the bonds.
- The underwriter and other professionals working on the bond issue.
- Through the preliminary and final official statements, the bond purchasers.

To each of these entities, CFO Michel provided inaccurate information and hid the truth. CFO Michael then signed the closing certificates that said there were no misstatements or material omissions in the official statement. The bonds were issued in April 2018. CFO Michel retired in September 2018. The new CFO figured out the problem quite quickly, as did the auditor working on the FY 2017-18 audit. The rating agency then downgraded the district from “A” to “BBB+” with a negative outlook.

What are the lessons of Sweetwater?

- For CFOs: Don’t hide the truth and lie about the financial condition of the issuer. The truth will eventually come out!
- For the school board: Don’t give power over all aspects of the finances to one person. Have some sort of checks and balances in the financial operations.
- For bond professionals: When conducting due diligence, be careful to analyze what you are being told, particularly when it comes to projections of future results.

Crosby (Texas). The second situation involved the Crosby Independent School District, near Houston, Texas, and its CFO Carla Merka. The school district issued $20 million of general obligation bonds in 2018. In 2022, the SEC charged the district, CFO Merka and the district’s auditor with providing inaccurate information in connection with the 2018 Bonds. The district settled with the SEC and agreed to a consent order. CFO Merka was fined $30,000 and is prohibited from participating in future municipal bond offerings. The auditor was suspended from practicing before the SEC for at least three years.

What went wrong in Crosby?
The district’s FY 2016-17 financial statements (a) failed to report $11.7 million in payroll and construction liabilities, and (b) falsely reported $5.4 million in reserves. CFO Merka was aware of these problems but did not inform the auditor who prepared the FY 2016-17 financial statements. She then provided the FY 2016-17 financial statements to be included in the official statement for the January 2018 Bonds.

Does this case involve Texas high school football?
Yes, it does! The district issued bonds in 2013 to fund various capital projects, including improvements to the football stadium. The district’s superintendent became actively involved in the stadium project, and he directed the contractors to perform project enhancements outside the original scope of work. As a result, the stadium project blew through its budget, and $12 million from the general fund would be needed to finish the stadium (the district did not have $12 million available in the general fund). CFO Merka convinced the primary contractor to defer payment until the district could undertake a new bond issue.

Did the district then double down?
Yes, it did! As a way of dealing with the $12 million problem, the district changed its fiscal year end in FY 2016-17 from August 31 to June 30. The district traditionally paid its teachers their annual

salaries over the course of 12 months. The auditor assumed the teachers were fully paid for FY2016-17 by June 30, 2017, but the final two months for FY 2016-2017 were still owing and unpaid – that amount was $3.8 million. CFO Merka did not tell the auditor of this problem.

As with the Sweetwater situation, CFO Merka in Crosby was in total control of the bond process on behalf of the district, and she did not inform the underwriter or the disclosure counsel of the problems of which she was aware.

Things then hit the fan. The bonds were issued in January 2018. Also in January 2018, the football-loving superintendent resigned. In May 2018, CFO Merka resigned and took a CFO job at another school district. In June 2018, the district's new CFO discovered the problems. In August 2018, the district went public with the problems. In September 2018, one rating agency downgraded the 2018 Bonds from "A1" to "A3" with a negative outlook. A second rating agency also downgraded the 2018 Bonds from "AA-" to "A-" with a negative outlook.

What are the lessons of Crosby?

- Don't let superintendents anywhere near football projects.
- If the superintendent messes up, the CFO should not cover for him. It could cost the CFO $30,000 and her career.
- An underperforming auditor can cause real problems. The SEC said the auditor failed to "exercise professional judgment" and "maintain professional skepticism."

Obviously, most people reading this article would not make the mistakes that the CFOs in Sweetwater and Crosby made, but these cases are a good reminder that CFOs, public officials and public finance professionals all need to be very careful and diligent to provide full and accurate information when bond issues are being sold to the public.

by Ryan Gonder & David Unkovic

June 1, 2022

McNees Wallace & Nurick LLC

MSRB Files Proposal with SEC to Implement Structural Changes to Its Fee Setting Process.

Washington, D.C. – The Municipal Securities Rulemaking Board (MSRB) announced today that it filed with the Securities and Exchange Commissions (SEC) a proposal to restructure how the organization will assess fee revenue and manage reserve levels going forward. The filing describes an annual rate setting process that will annually adjust fee rates to account for prior year results. This "Annual Rate Card Process" is designed to ensure the organization has sufficient annual revenue to fund operations, while also more effectively and efficiently managing its reserve levels. Consistent with the new approach, the proposal would also amend certain fees for dealers and municipal advisors as of October 1, 2022. The additional revenue generated from these amendments will fund anticipated operating shortfalls and other near-term funding priorities of the self-regulatory organization (SRO) responsible for protecting and strengthening the $4 trillion municipal securities market.

"Among the highest responsibilities of an SRO is prudent stewardship of the revenue from regulated

entities," said MSRB Chair Patrick Brett. "Following an intensive evaluation by our Finance Committee and a careful review of input from our stakeholders, we have developed a more nimble and sustainable approach that positions us to continue to advance our mission of protecting investors, issuers and the public interest, and our long-term strategic goals of modernizing our rules, technology and data."

Proposed Annual Rate Card Process
The MSRB's proposal to establish a new Annual Rate Card Process would determine certain MSRB fees based on the total amount of revenue each fee was expected to contribute, the expected volume of activity underlying the fee, and the amount of revenue actually generated by the fee in the prior fiscal year as compared to budget.

"With the majority of the MSRB's revenue coming from market volume-based fees, market volatility has contributed to a cycle of excess reserve building and temporary fee reductions that has understandably frustrated many of our regulated stakeholders," said Frank Fairman, Chair of the Board's Finance Committee. "Our proposed rate card process provides a more timely and predictable mechanism for mitigating the impact of market volatility, allowing us to effectively manage reserve levels while adequately funding future expenses needed to deliver on our long-term strategic plan."

The new approach is designed to maintain a fair and equitable balance of fees among regulated entities while also ensuring that the MSRB has sufficient revenue and organizational reserves to operate without interruption even in economic downturns and other unforeseen circumstances.

Proposed FY 2023 Fee Rates
The MSRB's proposal would increase the rates of assessment for the MSRB's market-based fees, including the Underwriting Fee, Transaction Fee and Trade Count Fee (currently known as the Technology Fee) described in MSRB Rule A-13, for the first time in over a decade. The proposal also would increase slightly the rate of assessment for the MSRB's Municipal Advisor Professional Fee described in MSRB Rule A-11. The proposed rates of assessment would become operative on October 1, 2022, and are currently expected to remain operative through December 31, 2023, when the next set of rates determined under the Annual Rate Card Process would take effect.

"I am pleased to report that we remain on track to fulfill our commitment to return approximately $19 million in excess reserves to the industry by the end of September," said MSRB CEO Mark Kim. "We strive to uphold the public trust and ensure accountability to our stakeholders by more effectively managing our operational reserves and by providing transparency in how we allocate our resources."

The MSRB publishes detailed information about its revenues, expenses and reserves in its annual budget each fall, in addition to providing full audited financial statements in its annual report each January.

- See FAQs about Proposed Amendments to MSRB Rules Establishing Fees for Dealers and Municipal Advisors.
- Read the MSRB Notice.
- Read the filing.

Date: June 2, 2022

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GFOA Debt Committee Launches 'Wholesale Review' of Best Practices.

The Government Finance Officers Association's debt committee Saturday recommended repealing a decades-old policy position against taxable debt and revamping a swath of best practices ranging from issuing variable-rate debt to hiring underwriters as part of a wider updating of its best practices and policy statements.

Meanwhile, the GFOA's next debt-focused best practice is likely to focus on designated green bonds, debt committee members said Saturday.

At its meeting Saturday ahead of the GFOA's 116th conference in Austin, Texas, the debt committee spent hours recommending updates to the association's best practices, which guide tens of thousands of local and state governments across the country. It's the first time in 10 years that the committee has undertaken a comprehensive review of all its best practices, which the association's website says "aim to promote and facilitate positive change or recognize excellence."

The recommendations will be sent to the executive board, which will vote on the measures in September. Changes to policy statements need to be voted on by the entire membership, which won't happen until the 2023 annual conference at the soonest.
With all eyes on ESG, the association's upcoming best practice recommendation will likely focus on designated ESG bonds, said committee member David Erdman, Wisconsin's capital finance manager.

"I think we're pretty close to doing a best practice on designated bonds," Erdman said. "The market is starting to hear more, as a result of MRSB discussions, about what people are looking for with designated bonds," he said. "There's been no consistency out there for investors, but now we are starting to see that a little."

On the policy side, the GFOA's decades-old position that the association "does not support the taxable bond option" dates all the way back to 1977, where it was written in response to a specific congressional situation, members said.

"That was in response to a very specific situation almost 50 years ago," said debt committee chair Tim Ewell, chief assistant county administrator of Contra Costa County, California.

The position is "clearly at odds with our position now," Ewell said.

Taxable bonds have become a growing part of the municipal market in recent years amid low interest rates and the 2017 Tax Cuts and Jobs Act ban on tax-exempt advance refundings. In 2020, taxable debt totaled nearly $150 billion – up from around $30 billion in 2019 – though that number declined in 2021 to just over $100 billion.

Because the full membership needs to vote on policy statements, the committee recommended that the GFOA review the position ahead of the next annual conference, and "mute" the policy in the meantime.

A best practice that warns issuers about floating variable-rate debt may be softened to reflect both the potential usefulness of short-term variable rate notes and shifting market conditions, members said.

After years of low interest rates rendered variable-rate bonds uncommon, rates are back on the rise, Erdman noted. “As interest rates go up, you’re going to see more issuers consider variable-rate debt,” he said, noting that Wisconsin is floating $130 million of variable rate notes this week.

Also on the variable-rate debt practice, the debt committee recommended updating language to reflect that the most common interest rate index, the London Interbank Offered Rate, is being phased out. The GFOA will not recommend a new index in its updated best practices.

On the market side, current best practice recommends issuers use an RFP to select an underwriter. The committee suggested broadening the recommendation to include hiring a previously retained underwriter who may already be familiar with the issuer’s “story” without a new RFP.

Through all the best practices, the committee suggested weaving language highlighting diversity, equity and inclusion as well as ESG principles.

After the meeting, Ewell thanked the committee for its work, noting that it was the first in-person annual conference since the pandemic. The debt committee has, he said, embarked on such tasks as a suite of ESG best practices, an ESG white paper, voluntary disclosure and a “wholesale review of the vast majority of our best practices,” he said. “It proves once again that this is the committee that rolls up its sleeves and works on behalf of our membership.”

By Caitlin Devitt

June 6, 2022

BY SOURCEMEDIA | MUNICIPAL

‘Woke’ ESG Scores From Credit Raters Draw GOP Ire to Muni Market.

- **Arizona’s Yee weighs avoiding raters’ ‘political scorecard’**
- **Firms say ESG applied to rating only when relevant, material**

Republicans’ growing opposition to the ESG movement is targeting a corner of Wall Street less accustomed to controversy — the credit rating companies.

S&P Global Inc. unveiled a scoring system for governments on categories like human rights, social integration and low-carbon strategies in March. Moody’s Corp. released its own scoring system, and Fitch Ratings Inc. in a May report said environmental, social and governance concerns factor into 7% of their U.S. public finance ratings.

Complaints quickly followed from Republican governors and treasurers, who said the companies have no business wading into an area that lawmakers see as politics, not finance. At stake could be some of the millions of dollars in fees paid by borrowers in the $4 trillion municipal market for ratings required by many institutional investors.

“We are leery of the whole ESG rating system for states,” South Carolina Treasurer Curtis Loftis, whose state received a ‘neutral’ grade in S&P’s new process, said in an interview. “We may be in perfect harmony with their goals and their methods, but they’re not going to order us, like children, to do what they’d like us to do.”

Growing Market

ESG-labeled bonds constitute a small but expanding part of the municipal market. Borrowers sold some $48 billion of such bonds in 2021, about 10% of all issuance and almost quadruple the share from five years earlier, according to Bloomberg data.

While Moody's Investors Service, S&P Global Ratings and Fitch are the biggest credit assessors, some state officials say their ratings aren't mandatory. Already, issuers increasingly are opting for a rating from just one of the companies, with single-rated sales totaling 28% of issuance year-to-date, up from 19% in 2008, according to a report from Municipal Market Analytics.

"We have the ability to go to companies that stand for the values that we believe in," Arizona Treasurer Kimberly Yee said in a phone interview. "ESG policies and woke corporations are moving in a direction that I believe is dangerous."

Yee added, "It's a political scorecard, and not a financial scorecard."

It's relatively rare for municipalities to publicly criticize credit rating companies. In 2017, former Chicago Mayor Rahm Emanuel asked Moody's to pull its rating on Chicago's debt, saying that the company failed to recognize the steps he took to shore up the city's finances.

Raters Respond

The rating companies maintain that ESG has long been part of their evaluation process, and the reports are an effort to make the data more transparent. Gregg Lemos-Stein, chief analytical officer at S&P, said the company incorporates ESG factors when it believes they are "relevant and material to creditworthiness."

For its ESG credit indicator report card, S&P said states typically have tools to mitigate risks and scored the majority neutral or moderately negative.

The three firms' approach to ESG differ slightly and comes amid an investor push for such information.

"There is financial materiality to a lot of these factors," said Lauren Kashmanian, director of portfolio management and responsible investing at Parametric Portfolio Associates, citing the effects of rising sea levels and weather events as examples.

The rating companies themselves argue that issues like climate risk can affect a government's financial outlook. For example, erosion of waterfronts or the danger of massive fires or social unrest can be costly for cities and states.

Earlier this month, S&P released a follow-up report about its ESG indicators, answering questions such as, "How is ESG relevant to credit ratings?" (S&P's answer: When it's material to creditworthiness and sufficiently visible.) "Can ESG credit indicators cause upgrades or downgrades?" (No.)

Utah Showdown

The dispute is getting heated in Utah, where S&P said Utah's environmental factors are a moderately negative consideration and the state faces elevated natural capital risk due to long-term challenges regarding water supply.

State officials in April slammed S&P for its scorecard, with Governor Spencer Cox and lawmakers sending the company a letter calling it an undue politicization of the ratings process. State

Treasurer Marlo Oaks labeled it “corporate cancel culture,” and asked S&P to rescind the ESG metric.

S&P refused. Eden Perry, head of the firm’s U.S. public finance practice, last week sent Oaks a letter stating the company “will not allow any issuer to inappropriately influence our analytical processes or our credit rating opinions,” according to a copy of the letter obtained by Bloomberg News.

In an interview, Oaks said Perry’s letter didn’t address his concerns, and the shift to more ESG assessments is a way of “weaponizing capital.” Oaks said investors he meets with don’t see any value in ESG analysis, but declined to name any because he said there is fear of being “canceled.”

“ESG will essentially fundamentally change how we do business in the U.S.,” he said.

In fact, regulators including the U.S. Securities and Exchange Commission and the Municipal Securities Rulemaking Board are taking a look at ESG issues in financial markets. The MSRB earlier this year concluded a request for information around ESG disclosure, with some respondents pointing to a lack of clear data from issuers.

“We have heard a lot of investors say, ‘When I see an ESG score, I’m not quite sure what to make of that,’” said Patrick Welch, head of ESG at Kroll Bond Rating Agency, a smaller company.

Welch said Kroll focuses only on factors with a clear tie to the underlying credit’s risk of default. The company called ESG scoring confusing and “a disservice to market participants” in a report published May 12.

While no state officials have said they will stop working with any of the rating companies, they’re keeping their options open. “We’re carefully monitoring who we do business with,” Arizona’s Yee said.

Bloomberg Markets

By Nic Querolo and Skylar Woodhouse

May 25, 2022, 6:30 AM PDT

— With assistance by Joseph Mysak Jr

SEC to Crack Down on Misleading ESG Claims With Fund Rules.

- **Agency seeks to eliminate names that critics call greenwashing**
- **Wall Street regulator proposed plan at meeting on Wednesday**

The US Securities and Exchange Commission is taking its biggest step yet to stop money managers from misleading investors when they claim their funds are focused on environmental, social or governance issues.

The agency proposed a slate of new restrictions Wednesday aimed at ensuring ESG funds accurately describe their investments. Some would also need to disclose the aggregated greenhouse gas emissions of companies they’re invested in, according to the SEC.

Concerns are mounting over a lack of consistent standards for investments claiming to be

sustainable, with the ESG label slapped on everything from exchange-traded funds to complex derivatives. During the Biden administration, the SEC has been focused on the issue, and has signaled a clampdown was looming.

“It is important that investors have consistent and comparable disclosures about asset managers’ ESG strategies so they can understand what data underlies funds’ claims and choose the right investments for them,” SEC Chair Gary Gensler said in a statement.

In one proposed change, the SEC would expand an existing rule to ensure funds labeled ESG invest at least 80% of their assets in a way that lines up with that strategy.

The agency is also weighing more standardized disclosures about their investment strategies. Those changes could help investors get a better understanding of the underlying investments in a fund and its overall strategy for addressing climate change or social issues like diversity, equity and inclusion.

Republicans oppose the SEC’s focus on ESG, and say the agency shouldn’t play a role in rating municipal debt and or in making decisions about provide financing to oil, gas and coal companies.

“These proposals are designed to manufacture activism by funds on ESG issues,” said Republican Commissioner Hester Peirce, who opposed the proposal.

In a separate move, the SEC announced on Monday that Bank of New York Mellon Corp. unit agreed to pay $1.5 million to settle claims that it falsely implied some mutual funds had undergone an ESG quality review. BNY, which didn’t admit or deny the allegations, said that it had taken steps to improve communications with investors.

Globally, some $2.7 trillion is parked in ESG-labeled exchange-traded funds and mutual funds, according to data from research firm Morningstar Inc. This stratospheric growth has fueled concerns about greenwashing — when companies exaggerate their environmental benefits — and prompted criticism for having limited real-world impact on large problems such as climate change and income inequality.

While institutional players are already highly attuned to ESG considerations and can often get the information they need about what’s in a fund, retail investors are less able to dig into a portfolio’s underlying assets and are “naturally more at risk of greenwashing,” said Quinn Curtis, a professor at University of Virginia School of Law.

The proposals are the second set of major ESG-related policy changes that the agency is considering under Gensler. In March, the SEC announced plans to require companies to reveal detailed information about their greenhouse gas pollution and to outline the risks a warming planet poses to their operations.

Asset managers’ ability to comply will depend on how much information they can get from the companies they invest in, said Sandra Peters, head of financial reporting policy at the CFA Institute.

The investment industry will spend the coming weeks pouring over the details. The SEC will take public comment for as long as 60 days, and may revise the proposal before holding a second vote to finalize the regulation.

Bloomberg Green

By Lydia Beyoud and Saijel Kishan

May 25, 2022

Fitch: ESG in Credit - Exposure to Social Impacts Report

Related Fitch Ratings Content: ESG in Credit – Exposure to Social Impacts Report

Fitch Ratings-London/Hong Kong-26 May 2022: Social issues are rising in prominence for investors and other stakeholders and as such the exposure issuers have on shifting consumer preferences or social pressures and resistance can manifest as a credit risk in certain situations, Fitch Ratings says in the latest of its 'ESG in Credit' series.

These shifts are captured as part of Fitch's ESG Relevance Scores (ESG.RS) under the Exposure to Social Impacts (SIM) general issues. This category captures credit issues arising from shifting consumer preferences driven by a desire to avoid harm or do good. These shifts are largely outside issuers' direct control and can be highly dynamic over time. They can affect demand for products and services, impair operations and alter market shares.

Mitigation of risks associated with elements under social impacts, such as strikes, boycotts and shifting consumer preferences, therefore rests heavily on the level of awareness on the part of the issuers of these underlying shifts, and actions to manage their operations to limit their exposure.

The pharmaceuticals, energy and natural resources and tobacco sectors have historically been at the forefront of either regulatory action to manage social impacts, or face various levels of social resistance. With the proliferation of social media, the technology sector is also becoming increasingly exposed to regulatory and consumer shifts in attitudes. Some non-bank financial institutions (NBFIs), as well as certain pools of RMBS transactions, have a higher concentration of higher ESG.RS that indicate medium and high impact from SIM.

The ESG in Credit series provides insights on the credit relevance and materiality of sector-specific ESG credit issues.

'ESG in Credit – Exposure to Social Impacts Report' is available at fitchratings.com or by clicking the link above, It focuses on the SIM general issue within Fitch's ESG.RS framework and scoring templates.

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The SEC's Proposed New Cybersecurity Disclosure Requirements for Public Companies: What Do They Mean for Municipal Issuers and Borrowers? - Orrick

- Governmental entities have increasingly experienced cybersecurity incidents impacting their operations and finances over the last few years, with some breaches costing upwards of $40 million.
- Many issuers and borrowers of municipal bonds are taking steps to defend themselves against such attacks, and may also need to determine how and when to disclose such efforts and any material cybersecurity incidents to the municipal market.
- While the SEC's recently proposed disclosure rules for public companies regarding cybersecurity incidents and related policies do not apply to municipal issuers and borrowers (unless the borrower is a public company) and are not final, they do provide helpful context and guidance for how the SEC may view cybersecurity disclosures in the municipal market.

In light of these considerations, issuers and borrowers in the municipal market should:

- Review the SEC's proposed cybersecurity disclosure rules and their implications for the municipal market, specifically around incident reporting and periodic disclosure of risk management, strategy, and governance.
- Focus on their own cyber defenses and mitigation strategies, since this has been a particular focus of rating agencies on public companies when assessing the strength of a particular credit.

A Growing Problem

In recent years, governmental entities have increasingly experienced cybersecurity incidents impacting their operations and finances. According to a white paper published by KnowBe4 in 2020, the median cost of a data breach for a state was $1.87 million, with some breaches costing upwards of $40 million. Many issuers and borrowers of municipal bonds ("issuers and borrowers") are taking steps to defend themselves against such attacks. They may wonder how and when to disclose such efforts and any material cybersecurity incidents to the municipal market.

The SEC has proposed new disclosure rules for public companies regarding cybersecurity incidents and related policies and procedures. Since the SEC does not have the power to adopt similar rules for issuers and borrowers (unless the borrower is a public company), the proposed rules **do not** apply to issuers and borrowers. They do, however, provide useful context and guidance for how the SEC may view cybersecurity disclosures in the municipal market, specifically around incident reporting and periodic disclosure of risk management, strategy, and governance.

Our governance and data privacy teams published an article summarizing the proposed rules as applied to public companies generally and proposing steps public companies could consider taking now. Our public finance and data privacy teams have prepared this supplement to that article, summarizing the key takeaways for issuers and borrowers. **We encourage you to read this supplement together with the underlying article.**

Applying the SEC's Proposed Rules to the Municipal Market

The SEC's proposed rules fall into two categories: (1) incident reporting; and (2) periodic disclosure of cybersecurity risk management, strategy, and governance. We will treat each category separately.

Incident Reporting

Public Company Rules: The SEC's proposed rules reveal its focus on timely disclosure of material cybersecurity incidents on a public company's Form 8-K by requiring that material cybersecurity incidents are reported within four business days from the materiality determination.

The SEC's proposed rules do not provide specific guidance for what constitutes a material cybersecurity incident. They do provide that the required timing of a public company's Form 8-K filing is tied to the company's determination that the incident is material rather than to its discovery of the underlying incident.

Additionally, the requirement applies to compromises of the company's "information system," which includes systems owned or used by the public company and may include third-party information resources such as cloud infrastructure and service providers.

Finally, the SEC's proposed rules require periodic updates reflecting material changes or additions to previously disclosed incidents. That would include information regarding remediation.

Application to the Municipal Market: In the municipal market context, the disclosure analogue for a public company's Form 8-K is an issuer or borrower's material event notice filed pursuant to its continuing disclosure undertakings and SEC Rule 15c2-12.

Rule 15c2-12 does not specifically require issuers and borrowers to disclose material cybersecurity incidents. Such entities may disclose incidents through voluntary event notices on the MSRB's Electronic Municipal Market Access ("EMMA") website.

In addition, when issuers and borrowers speak to the market through offering documents,[1] quarterly and/or annual continuing disclosure reports, or other communications, they may want to consider disclosing recent material cybersecurity incidents. Issuers and borrowers may also want to consider focusing on developing and/or improving internal reporting systems to facilitate the discovery of and determinations of materiality regarding internal and third-party cybersecurity incidents.

Issuers and borrowers may want to consider the following questions when developing and/or improving reporting systems relating to cybersecurity incidents:

- Do you have a current and tested incident response plan?
- Do you have cybersecurity policies and procedures in place that require employees to quickly escalate cybersecurity incidents to those empowered to make materiality and disclosure determinations?[2]
- Do you have a process in place to assess the range and magnitude of financial impacts of a cybersecurity incident, as they become available, and memorialize materiality determinations?
- Do your contracts with third parties that make up your "information system" provide for incident reporting and the cooperation necessary to make materiality and disclosure determinations regarding third-party cybersecurity incidents?
- Do you have a process in place to track updates regarding previously disclosed cybersecurity incidents and provide such updates to those empowered to make materiality and disclosure determinations?

- Have you discussed with bond or disclosure counsel the implications of any cybersecurity incidents and possible voluntary disclosures?

Periodic Disclosure of Risk Management, Strategy, and Governance

Public Company Rules: The SEC's proposed rules also reveal a focus on public companies' internal risk management, strategy, and governance. Specifically, the proposed rules include changes to Regulation S-K, and corresponding changes to Form 10-K and Form 10-Q to require additional disclosures.

The proposed rules would require a public company to periodically disclose information about the processes of its board of directors and key management relating to cybersecurity issues. Specifically, the SEC proposes disclosure relating to "whether or how the board or board committee considers cybersecurity risks as part of its business strategy, risk management, and financial oversight." The agency would also require disclosure of whether or not a company has a Chief Information Security Officer (including that person's background and reporting line). In addition, the SEC's proposed rules require a public company to periodically disclose whether any members of its board have expertise in cybersecurity, and to provide detail regarding the nature of that expertise. The SEC's proposed rules reveal its increasing desire to obtain detailed and specific disclosures regarding a public company's internal processes and expertise relating to cybersecurity.

Application to the Municipal Market: In the municipal market context, the disclosure analogue for a public company's Form 10-K and Form 10-Q is an issuer or borrower's annual report and quarterly report (if any), respectively, filed pursuant to its continuing disclosure undertakings. As with cybersecurity incident reporting, there is no specific requirement that issuers and borrowers include in annual or quarterly reports information regarding internal risk management, strategy, and governance. However, given the SEC's marked focus on cybersecurity-related disclosure (including the two SEC enforcement actions in 2021 relating to data privacy incidents referenced in footnotes 1 and 2), issuers and borrowers may want to evaluate the quality of their disclosures in this area whether through voluntary event filings, annual and/or quarterly continuing disclosure reports, offering documents, or other communications to the market.

More broadly, issuers and borrowers should review and update their cybersecurity policies and disclosure procedures. They may also want to focus on developing disclosures relating to existing cybersecurity policies and procedures they can update and adapt for quarterly and annual reports and offering documents. Given the SEC's focus on the expertise of individual directors or employees, issuers and borrowers may also consider collecting information regarding cybersecurity expertise that members of their governing bodies and key staff members possess and consider whether an internal Chief Information Security Officer position exists or can be created. In undertaking such efforts, we recommend that issuers and borrowers consider the following questions:

- Do you have comprehensive information security policies
- Have you had any privacy or security incidents that involve confidential or personal data?
- How does your governing body evaluate cybersecurity risk and what role does cybersecurity risk play in its decision-making process?
- Do you have a Chief Information Security Officer, or other individual designated as responsible for information security?
- Which members of your governing body and staff, including the Chief Information Security Officer, if any, possess expertise relating to cybersecurity matters?
- Do you have cyber insurance, and if so, what does it cover and what are the retention and limits?
- Do you conduct periodic risk assessments, and if so, have any identified risks been remediated or added to a security roadmap?

- Have there been any third-party security assessments, and if so, have the identified issues been remediated or added to a security roadmap?

Additional Considerations for the Municipal Market

National Federation of Municipal Analysts

The National Federation of Municipal Analysts published a white paper in November 2020 calling for municipal bond issuers to "conduct a cybersecurity assessment to start the process of addressing cybersecurity risks as soon as possible" and recommending best practices for cybersecurity risk disclosures. Issuers and borrowers may want to review the paper to understand the views of municipal investors in this area.

Rating Agencies

While the SEC's proposed rules focus on enhancing and standardizing cybersecurity disclosure for public companies, rating agencies remain focused on public companies' cyber defenses and mitigation strategies when assessing the strength of a particular credit. A recent Moody's survey revealed that approximately 93% of organizations surveyed have a cybersecurity manager, and approximately 57% of North American organizations surveyed maintain cyber insurance.[3] To remain competitive, issuers and borrowers may want to consider implementing a cybersecurity manager, maintaining cyber insurance, and instituting cyber defenses and mitigation strategies to maintain their relative credit strength.

What's Next?

The SEC's proposed disclosure rules for public companies regarding cybersecurity incidents and related policies are not yet final. Orrick will continue to monitor the proposed rules and any related enforcement actions by the SEC, along with potential implications for issuers and borrowers in the municipal market.

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[1] In *In re Pearson plc* (2021), the SEC imposed a penalty of $1,000,000 against Pearson plc because its risk factor disclosure implied only that the company faced a hypothetical risk of a data privacy incident and failed to disclose that the company had in fact already experienced such a data breach.

[2] In *In re First American Financial Corporation* (2021), the SEC imposed a penalty of $487,616 against First American Financial Corporation because, despite an employee's discovery of a security vulnerability, the company's reporting system was insufficient to ensure that the fact of the vulnerability was communicated to senior executives responsible for disclosure.

[3] *See* Cyber risk survey of issuers finds growing investments, but gaps in preparedness, Moody's Investors Service (March 31, 2022).

by Joseph Santiesteban, Sean Yates

May 17, 2022

Orrick, Herrington & Sutcliffe LLP

Fitch: ESG Relevance Limited for Most US Public Finance Ratings

Fitch Ratings-New York-16 May 2022: A small portion, 7%, of US public finance ratings (USPF) are affected by environmental, social and governance (ESG) considerations, Fitch Ratings says. Fitch's ESG Relevance Scores (ESG.RS) communicate the extent to which ESG factors affect ratings but do not provide commentary on the ESG practices or qualities of issuers. ESG factors are manageable for most USPF issuers. Fitch's report Where ESG Matters for U.S. Public Finance reviews 12 case studies that illustrate how ESG issues can affect ratings and highlights current ESG focus areas, including issuer disclosure, the transition to a lower-carbon economy and cybersecurity.

Governance is the most important factor, on a singular basis, assessed to have a medium or high relevance for 3% of issuer ratings. This reflects the influence of governance structure and effectiveness, policy formation, and financial performance on credit quality.

Social factors have become more prominent with the assignment of ESG.RS in the community development and social lending (CDSL) sector, conveying the positive rating effect for certain credits of federal agencies' support of housing agencies and the negative effects of unsafe environmental conditions among some housing providers. Overall, social factors influence 2% of Fitch's USPF ratings.

Continue reading.

America's Political Right Has a New Enemy No. 1: ESG Investors

The popular investing strategy is drawing new partisan attacks ahead of the US midterm elections

Heading into the hotly contested midterm elections, the American political right has a new rallying cry: Down with ESG.

Conservatives have identified the popular investing strategy, which accounts for environmental, social and governance risks, as part of a broader narrative about left-wing overreach and " wokeness" run amok. Utah Treasurer Marlo Oaks calls it "corporate cancel culture." Behind the rhetoric lie policies designed to sap the momentum of one of Wall Street's most successful initiatives in recent years, now worth $35 trillion globally. If it works, it will firmly ensconce ESG in the culture wars, galvanize voters and weaken the resolve of big asset managers to act on climate change and other big, societal issues.

West Virginians are already all too familiar with ESG, according to state treasurer Riley Moore. He's preparing a list of banks that, he says, will lose the state's business unless they declare they aren't boycotting the coal industry and other fossil fuels. "Certainly 'woke capitalism' is something they are very familiar with," he said. "We're facing threats from that in my state, right now."

The attacks on ESG escalated last week when former Vice President Mike Pence made the strategy a key theme in an energy-policy speech in Houston. A potential candidate for the 2024 Republican presidential nomination, Pence said large investment firms are pushing a "radical ESG agenda" and took aim at BlackRock Inc., whose Chief Executive Officer Larry Fink is a champion of sustainable investing, and others who have pressed for progress on climate change.

Pence added to the growing public attacks on ESG. On Wednesday, Tesla Inc. founder and libertarian influencer Elon Musk told his 94 million Twitter followers that " ESG is a scam," building on a March tweet in which he labeled the practice "the Devil incarnate." Republican megadonor Peter Thiel called ESG a "hate factory for naming enemies" in a speech at a Bitcoin conference in April, and the Twitter bio of right-wing pundit Glenn Beck now reads, "Against ESG before it was cool."

With gas prices rising and energy a key factor in Russia's invasion of Ukraine, it's becoming easier for Republicans to tie ESG to pocketbook issues of their constituents. Just as Critical Race Theory grew from a catchall for parents unhappy or worried about what their children were learning in public schools to successful efforts to seize control of local school boards, ESG opponents see an opportunity to aim voters' fears of inflation at the finance industry's efforts to combat global warming and other social ills.

It's also a new front in a longstanding battle against further restrictions on fossil-fuel industries, which give generously to Republican party candidates, and more corporate accountability. At the state level, Republican governors and other officials are finding new ways to block major Wall Street firms from state business, including managing pension funds and bond issues, if they apply ESG principles to other parts of their portfolios.

Nationally, the broadsides against ESG bolster calls to abandon, or at least relax, environmental standards in favor of "energy independence." It's also a partisan issue at the US Securities and Exchange Commission, which is trying to require companies to report on their greenhouse gas emissions. In a virtual meeting on the plan in March, the agency's only Republican commissioner, Hester Peirce, turned off her camera in protest, saying that she was trying to reduce her carbon footprint.

Republicans are increasingly using banks and "woke" companies as cudgels for their base voters, said Reed Galen, a co-founder of the anti-Trump group, The Lincoln Project. "If you're taking on a company who has environmental and social justice goals, you don't have to explain ESG to the voters. All you have to do is say 'woke corporation.'"

In the past few years, as the world became more aware of the risks posed by global warming and social unrest, financial firms have rushed to offer investments that promise to account for those risks — and maybe even minimize them. With an ESG slant on everything from loans to complex derivatives, assets are set to balloon to $50 trillion worldwide by 2025, according to estimates from Bloomberg Intelligence.

In the US, a big proportion of that is via public pension funds, which are overseen by state or local officials, or in private sector retirement plans, and receive preferential tax treatment. In response to new federal rules that would allow pension funds to consider ESG alongside traditional fiduciary factors in making investing decisions, almost two dozen states registered their objection, saying the rules would allow investments to be guided by "social causes and corporate goals, even if it adversely affects the return to the employee."

Those states are increasingly considering legislative action. State lawmakers and treasurers have for years been concerned that politically motivated investing strategies reduce long-term profits, said Jonathan Williams, chief economist at the American Legislative Exchange Council. The conservative group, which writes model legislation, is looking to prevent public pensions from making investments using ESG.

Credit ratings agency S&P Global Inc. also has come under fire for using ESG information to

evaluate municipal debt. In West Virginia, Moore joined several state treasurers last month to demand the ratings agency drop ESG factors from its rating system. His state got a negative social score and a moderately negative environmental score, signaling higher risk than the vast majority of states, which are rated neutral.

“The ESG movement is nothing but a slippery slope,” Moore said, cautioning that states will be forced to “bend the knee to the woke capitalists or suffer financial harm.”

S&P Global declined to comment on specific states and instead referred to a paper it published May 9 explaining how its ESG credit indicators work.

Kentucky, Texas and West Virginia have passed legislation that requires financial firms to say whether they have policies that limit doing business with oil, gas and coal companies, a common practice for firms that have made pledges to reduce their own carbon footprint. Banks that demur could lose their licenses in those states. Another 12 states are considering similar measures.

“Once ESG becomes commingled with corporate wokeness, it can become a powerful way for anti-corporate right wingers to talk about it and galvanize voters,’’ said Chris Stirewalt, an expert in US politics, voting trends and public opinion at free-market think tank American Enterprise Institute.

In addition to shunning oil, gas and coal producers as part of climate change policies, investors and employees have encouraged companies in recent years to take positions on LGBTQ rights, gun control and other issues that add to rancor among Republican voters.

Most recently, companies have begun to address the third rail of political issues: abortion. In March, Citigroup Inc. made waves when it said it would cover the travel and medical costs for any of its employees who needed to cross state lines to seek an abortion or other reproductive health care. In response, a Texas lawmaker said the bank could face criminal charges under that state’s abortion law, and Republican members of Congress called for the cancellation of US government contracts with Citigroup, which provides the credit cards that members of the US House of Representatives use to pay for flights, supplies and other goods.

Spokespeople for Citigroup and BlackRock declined to comment. A spokesman for Thiel didn’t respond to messages, nor did representatives for Tesla, run by Musk.

Few expect the Republican attacks on ESG to vaporize the industry. As of now, roughly $3.4 trillion of public retirement money is invested in line with ESG strategies of some sort, according to the sustainable-investing industry group US SIF. Some of the bigger, more liberal states like California and New York are pushing for more restrictive ESG screens for state funds, not less. What’s more, many of the world’s biggest financial institutions have their own goals to cut emissions, which include reducing the amount of business they do with heavy polluters — whether they bill it as ESG or not. Many also have set targets for workforce diversity and elevating women in management, neither of which are politically popular among the right.

Still, the political pressure seems to be taking a toll. BlackRock sent a letter this week to the Texas state comptroller, rebutting the assertion that the firm boycotts the oil and gas industries, and Fink has made it clear he opposes divesting from fossil-fuel companies. The firm also said this year that it won’t back as many shareholder efforts to push companies to reduce their emissions compared with 2021. JPMorgan Chase & Co. is also taking steps to re-establish itself in Texas’s muni-bond market, about eight months after a new law forced that bank out of most deals because of its policies on guns and fossil fuels.

And if Wall Street's usual suspects can't be persuaded, others are eager to step in. With the backing of hedge fund manager Bill Ackman and Thiel, Vivek Ramaswamy, a pharmaceutical investor and author of "Woke Inc.," has started an investing firm that attempts to be an antidote to the "political agendas" and "stakeholder capitalism" of bigger money managers.

In Utah, state treasurer Oaks pointed to real pain points for his constituency. Dixie Power, for example, which delivers power to roughly 25,000 customers, recently learned its longtime auto insurer wouldn't renew coverage. The utility owns a coal-burning power plant and has stakes in two others, and the insurance company is phasing out business with companies that derive profits from coal, according to Colin Jack, the firm's chief operating officer. The co-op is also set to lose insurance coverage for its coal mine from Lloyd's of London for the same reason.

Fueled by frustration with that and what he sees as other government intrusion into the energy sector, Jack is running as a Republican for a seat in the Utah state legislature.

He may be in line for a powerful endorsement. On Wednesday, less than three hours after tweeting that ESG is a scam, Musk wrote that although he'd voted Democrat in the past, "I can no longer support them and will vote Republican."

Bloomberg

By Jeff Green and Saijel Kishan

May 20, 2022

— With assistance by Benjamin Bain, and Mark Niquette

Ducking the Culture Wars Isn't an Option for Companies Anymore. Fighting Back Is.

The culture wars are heating up for U.S. businesses. Many will duck. But those who want to stand their ground should look to Citigroup, the company that messed with Texas and lived to tell the tale.

In March 2018, after a gunman killed 17 people at Marjory Stoneman Douglas High School in Parkland, Fla., then Citigroup CEO Michael Corbat announced a new firearms policy for the bank. The policy, with some caveats, prohibits retailers that are customers of the bank from offering bump stocks or selling guns to people who haven't passed a background check or are younger than 21.

As reported by Bloomberg News, the national gun lobby went into overdrive, accused Citi of being "woke" and lobbied for a law passed last year by Texas Republicans that forbid the state from working with any companies that "discriminate" against the firearms industry.

At stake for Citi and other banks that adopted similar policies was $58 billion in debt underwriting fueled by population growth and infrastructure needs. Citi's ranking as the largest Texas munis manager plummeted while the bank hashed out a recognition from the state attorney general that the policy did not discriminate.

In December, Citi, without making any change to its gun policy, finally resumed business with the state of Texas. It is now leading underwriting for a $1.2 billion bond sale for the Dallas Fort Worth International Airport.

Citi quickly found itself fighting on another front in Texas. Corbat's successor, CEO Jane Fraser, in response to a Texas law banning abortions after six weeks of pregnancy, announced that Citi would pay travel expenses for employees needing to travel out of state to have access to adequate medical resources. "What we did here was follow our past practices. We respect everyone's view on this subject," Fraser said.

Texas state Rep. Briscoe Cain warned Citi that employees who travel outside Texas for an abortion could face criminal charges. He said he would introduce legislation to bar Citigroup from underwriting municipal bonds—again.

Citi has not issued any comments in response. But by standing up to Texas on guns Citi has set a precedent for ignoring the grandstanding and carrying on business as usual. For all the companies that want to demonstrate social purpose and care for employees' needs, but worry about alienating government stakeholders, breaking through the political noise to stand up for values isn't too hard.

In 2019, 181 CEOs of America's biggest companies signed on to a commitment by the Business Roundtable redefining the purpose of the corporation to serve all stakeholders, including workers, as well as shareholders.

The commitment covered rewarding hard work and helping workers adjust to the rapid pace of change in the economy. "We foster diversity and inclusion, dignity and respect," the statement says.

The statement was a reversal of economist Milton Friedman's popular view that shareholders are the only ones who count. It invited debate as to whether companies really should think about their stock price less and pay more attention to their employees. Perhaps without realizing it, the statement also placed them squarely in the middle of the so-called culture wars.

Advocates have pointed out that many of the signatories to the statement have fallen short in their pledges to uphold the interests of all stakeholders. Companies have faced pressure to engage on voting rights, Black Lives Matter, abortion, LGTBQ issues, climate, and #MeToo. Covid-19 vaccination requirements also entered the debate.

This has set companies up to enter politics in a way they studiously avoided before, and not just in Texas. Republican governors in Florida and Georgia are now policing business, as the columnist Heather Cox Richardson puts it.

Disney's confrontation with Gov. Ron DeSantis over education legislation his opponents have labeled the "Don't Say Gay" law put CEO Bob Chapek to the test. He signed the Roundtable commitment. But he first tried to avoid getting involved, saying he didn't want the controversy to become a political football.

His workforce revolted and forced him to apologize to them and stand up to Gov. DeSantis.

Now Chapek is fighting Florida to retain tax breaks and governance of the special district created for Disney, the state's largest employer, since its inception.

The abortion fight has raised the stakes even higher.

The draft under consideration by the Supreme Court to overturn Roe v. Wade has turned the social purpose debate upside down. The landmark ruling in 1973 gave women the freedom to decide if they wanted an abortion. If the ruling takes away that right on a federal level, states like Texas, Georgia, Alabama, Arkansas and Florida have strong anti-abortion laws that will kick in. Other states that would also have the power to decide may follow.

For companies that offer healthcare plans that cover abortion and follow federal guidelines of offering equal healthcare to all their employees, this is a practical problem, as much as a moral one. Many operate in states were abortion would become illegal. Companies such as AT&T, which signed the Business Roundtable statement, may not believe it obligates them to take a stance on abortion. The company has stayed with a policy of public silence on the topic.

But nearly 200 CEOs have recognized that the right of women to make their own decision about abortion rights is good for business. It's an important part of Americans deserving a life of "meaning and dignity," as the Business Roundtable statement put it. Like Citi, Amazon, Starbucks and Tesla have all announced they would help their Texas employees travel for out-of-state abortion services.

For companies that don't live up to their social-purpose commitments, there's a good chance their employees will hold them accountable. Ducking is no longer an option. Citi's experience shows they can put their money where their mouth is and live another day.

Barron's

By Laurie Hays

May 20, 2022

'Woke Bond Rating'? The Muni Finance Fight Over ESG Scores.

Utah officials recently lashed out at a rating agency's use of environmental, social, governance rankings. Investors have an appetite for the metrics, but critics say they're too subjective.

Welcome back to another edition of Route Fifty's Public Finance Update! I'm Liz Farmer and this week, I'm looking at the latest squabble over ESG evaluation—assessing governments' long-term environmental, social or governance risks. As always, send feedback and tips to: publicfinance@routefifty.com.

ESG evaluation has always been a somewhat contentious issue in the investment community because data on those metrics are not standardized. But a recent move by S&P Global to assess states' ESG exposure is sparking new debate, and has conservative lawmakers and interest groups fighting back in one of the most concerted efforts yet to discredit the practice.

At issue are new "ESG credit indicators" S&P released in late March. Each state was given a report card on its environmental, social and governance factors and assigned a ranking of 1 (positive) to 5 (very negative) on each factor. States all generally scored twos and threes for each category. "ESG credit indicators," said S&P in a recent FAQ, "provide additional transparency on what's already incorporated into our credit rating analysis."

Continue reading.

Route Fifty

By Liz Farmer

MAY 17, 2022

SEC’s Sanchez Offers Guidance on ESG.

Issuer fears that ESG regulation will lead to disclosure trouble are overblown, the Securities and Exchange Commission’s muni office chief said Wednesday.

Dave Sanchez’s comments were part of the National Federation of Municipal Analysts’ 2022 Annual Conference, where panelists spent considerable time discussing the recent ESG initiatives underway at the SEC and Municipal Securities Rulemaking Board.

Sanchez addressed industry concerns that any disclosure regime centered around ESG will be an exercise in over-disclosure.

The SEC’s 2020 guidance on voluntary disclosures related to COVID-19 has received mostly positive marks from the market, but the Commission may be considering expanding some of the provisions on cautionary language going forward.

“We lean heavily on the 2020 SEC statement from the chair and the director of the Office of Municipal Securities talking about cautionary language about your disclosure,” said Emily Brock, director of the federal liaison center at the Government Finance Officers Association. “Always very glad to hear Dave mention that there is thinking at the SEC about maybe expanding that information beyond COVID-19 disclosures.”

Panelists also used their time to work through how regulators, investors and issuers handle materiality.

“As a practitioner, I kind of always thought of it as like you’re trying to cross a river from the information you’re holding to disclosing it and there’s really one rock in the middle and that’s materiality,” Sanchez said. “Part of the job of the SEC really is to provide additional touch points in different contexts that help people get across the river to actually disclose this information.”

Panelists agreed that some issuers feel they have the right to define materiality on their terms, which is not the standard as defined by the SEC.

“As a former issuer myself, I actually think I suffered from a misunderstanding of securities law as I thought I got to define materiality,” said Mark Kim, chief executive at the MSRB. “It’s the investors decision to make.”

The Supreme Court has ruled that information is material if it would matter in the investment decision of a reasonable investor.

“It’s not really in the eye of the beholder,” Sanchez said. “There is a standard, it has to be reasonable investors, it’s not any investor.”

But Sanchez ultimately believes that ongoing dialogue with underwriters, bond counsel or others around materiality, and if it’s well-documented, will provide some protection from the SEC.

“If you have a good-faith discussion about whether something is material or not, that ends up providing a lot of protection under securities laws,” Sanchez said.

The MSRB’s controversial request for information on ESG also served as an important pillar for the discussion. Kim expressed that he was surprised by comments that questioned why the MSRB was

asking these sorts of questions, when he thought market participants would be asking why the board didn't do this sooner.

Kim compared the ESG RFI to the RFI issued in 2018 on third-party yield curves, which is still a concern that persists today.

"While I'll be the first to admit that we have absolutely no regulatory authority over third-party vendors that are offering yield curves and benchmarks to the industry, we do have the responsibility to ask that question," Kim said.

SOURCE MEDIA

By Connor Hussey

May 18, 2022

A Muni Minute: Tit-for-Tat

Municipal investors often sift through various issues that include underfunded pensions, a lack of market liquidity, and inconsistent financial disclosure. However, there is a new area of concern that is causing indigestion among market participants: political and corporate agendas.

On April 22, Florida Governor Ron DeSantis signed a bill dissolving a handful of special taxing districts created prior to 1968, most notably the Reedy Creek Improvement District (Reedy Creek). The move was significant since Reedy Creek allows The Walt Disney Company to exert considerable governmental autonomy over the area within and around its nearly 25,000-acre theme park. Interestingly enough, the legislation was introduced not to provide any sort of societal or economic benefit, but to penalize Disney for denouncing a controversial gender bill that was signed into law earlier this year.

While the ability of the special district legislation to withstand legal challenges remains uncertain, questions still remain regarding the treatment of nearly $1 billion of municipal bonds issued by Reedy Creek. State law dictates that outstanding bonds from a dissolved special district will be transferred to overlapping municipalities, which in this case largely includes Orange County, FL. However, whether the county chooses to honor the bonds is unclear, potentially creating a larger issue for the state and more importantly, for investors.

More troubling is that this is not the first instance in which politics have collided with the municipal market. In 2018, multiple large financial institutions began implementing policies that restricted business relationships with certain firearms manufacturers. In response, Texas Governor Greg Abbott, along with the governors of several other states that derive a material amount of economic activity from the firearms industry, signed laws that prohibited municipalities from having contractual relationships with companies that discriminate against the firearms industry. The Texas bill effectively prevented Citi Group, the largest municipal underwriter in the state, from doing business with local municipalities. Both actions caused concern in the capital markets, with the former showing the power that major financial institutions can wield to effectively cut off financing to certain sectors of the market, and the latter effectively reducing competition amongst municipal underwriters, possibly resulting in increased borrowing costs for public finance issuers.

Legislation and corporate actions fueled by political agendas that unnecessarily rile the capital

markets represent a policy mistake, in our opinion, especially when the measures effectively restrict consumer choice. Investors can abstain from investing in securities that do not meet their investment criteria, and issuers have the ability to work with whichever financial institution that they believe will help them best accomplish their objectives. However, corporate policies and legislation that instead make these choices for the end user generally do more harm than good in that they tend to limit competition, push higher costs onto consumers, and are typically met with retaliatory measures.

While it is nearly impossible to predict the next target of a political attack, investors should be wary of municipalities with an overreliance on any one specific industry or company, potentially leaving them in the crosshairs of political battle between corporate America and state legislatures. We do not foresee any related issues with municipal sectors that rely on state appropriations for a significant portion of their funding, including K-12 schools and public higher education institutions. This is because education-related funding cuts are typically politically unpalatable, and generally are only utilized in the event of a state budget shortfall. Nevertheless, we view these politically charged disruptions as one-off events, and municipal bonds remain an excellent option for investors looking for tax-exempt income with very limited credit risk.

SAGE ADVISORY

By Brett Adelglass, Sage Portfolio Management

MAY 10, 2022

How to Avoid Political Jockeying With ESG Bond ETFs.

374Like so many current issues, environmental, social, and governance (ESG), at least in the eyes of some experts, has an element of political polarization to it.

That situation is amplified by lack of clarity and uniformity pertaining to how index providers score securities on the basis of ESG, prompting some experts to speculate that this could be a legitimate issue to contend with as the universe of fixed income assets aiming for ESG consideration grows.

As reflected by exchange traded funds like the newly minted SPDR Nuveen Municipal Bond ESG ETF (MBNE), there is demand for fixed income strategies that combine bonds and ESG principles. In fact, despite its rookie status, MBNE could be at the right place at the right time because issuance of green munis is soaring, while some state financial regulators are clamoring for more clarity on exactly what constitutes ESG.

For example, Utah recently clashed with index giant and credit ratings agency Standard & Poor’s (S&P) over ESG ratings, asserting that the firm’s standards are too ideological.

“In addition to rating governments on meaningful financial criteria, in March the biggest of the top three credit-rating firms began to apply an environmental, social and governance, or ESG, rating system. But Utah isn’t about to submit to these subjective standards. State officials, including myself, recently wrote a letter to S&P objecting to the ESG indicators and ratings it has assigned to Utah and calling for the company to withdraw them,” writes Utah Treasurer Marlo Oaks in an op-ed for the Wall Street Journal.

Regarding MBNE, the ETF can allay concerns on both sides of the aisle. For starters, Utah isn’t one

of the top 10 state exposures in the new ETF, and that group combines for about 70% of the fund's roster.

Second, MBNE is actively managed, indicating that it can skirt some of the thorny political issues associated with some parts of ESG investing while focusing on the business of identifying the best opportunities among green municipal bonds.

That's not to say MBNE doesn't have standards — it does. Bonds entering the fund must meet certain ESG traits. However, as an actively managed fund, MBNE has flexibility in a space that needs it.

Markets "encapsulate many different views of the future and their organic structure allows for quick adaptation. ESG scores, by contrast, rigidly hold to one viewpoint and are slow to pick up on changes in the world," adds Oaks.

ETF TRENDS

by TOM LYDON

MAY 12, 2022

Fitch: Where ESG Matters for U.S. Public Finance

View the Fitch Special Report.

Mon 16 May, 2022

MSRB Analysis Finds Notable Shift in Trading Volumes in Municipal Market Over Last 15 Years.

Washington, D.C. — A new MSRB analysis reveals a significant decrease in trading volumes in the municipal securities market over the 15 years from 2007 through 2021, mainly due to a dramatic decline in the variable rate market. The report also identified spikes in trading volumes and unique trading activity during periods of market disruption or dislocation.

Over the 15-year period studied, the market saw a 67% decline in par amount traded and a 16% decrease in the number of trades, with the declining trend in number of trades most apparent in recent years. While yields also have declined significantly over the last 15 years, during periods of market disruption or dislocation, such as the global financial crisis and the start of the COVID-19 pandemic, trading volumes and yields generally tended to spike amid a notable rise in customer sales—both in terms of par traded and number of trades—and decline in customer purchases as compared to other trade types.

"Of all the periods of market disruption during the last 15 years, the global financial crisis of 2008 had the most lasting impact on the municipal securities market," said John Bagley, chief market structure officer. "In particular, the sudden and dramatic decline in trading of variable-rate municipal securities in 2008 led to a fundamental shift in the municipal market structure over the

subsequent years."

The number of trades of variable-rate securities fell from 25% of the overall market in 2007 to an average of just 4% by 2009, while par traded fell from 70% of the overall market in 2007 to 44% in 2009, following a significant decrease in trading associated with tender option bond programs and the auction rate securities market. The variable-rate market has never recovered, with the number of trades averaging between 1% and 4% of overall trades between 2009 and 2021 and par amount traded declining further to 23% of total par traded in 2021.

Meanwhile, trading in the fixed-rate municipal market has not seen the same level of change as the variable-rate market. While trade sizes have increased, particularly in the tax-exempt market, the overall number of trades and par amount traded in the fixed-rate market remained relatively steady for the 10 years between 2007 through 2017, though they declined significantly starting in 2018, with 2021 volumes reaching the lowest levels in terms of number of trades and the second lowest in terms of par amount traded since 2007.

Date: May 11, 2022

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S&P Hits U.S. States With Politicized Credit Scores: WSJ Opinion

The ratings agency seeks to penalize fossil-fuel producers. Its 'ESG' push is unlikely to end there.

Ideological criteria will now influence the credit ratings of state and local governments, thanks to S&P Global Ratings. In addition to rating governments on meaningful financial criteria, in March the biggest of the top three credit-rating firms began to apply an environmental, social and governance, or ESG, rating system. But Utah isn't about to submit to these subjective standards. State officials, including myself, recently wrote a letter to S&P objecting to the ESG indicators and ratings it has assigned to Utah and calling for the company to withdraw them.

ESG is sometimes dressed up to look objective with quantitative "metrics" and complex "analytical frameworks." But this blurs the distinction between subjective judgments and objective financial assessments.

S&P Global says it "incorporates [ESG] risks and opportunities into the credit rating analysis" of public issuers. This includes ambiguous and open-ended categories such as how a state scores on "managing carbon," "political unrest stemming from community and social issues" and "adverse publicity that results in reputation risk." Leaving no doubt as to the measurement's subjectivity, S&P notes, "reflecting ESG risks and opportunities within our credit rating analysis will require a qualitative view of an entity's capacity to anticipate and plan for a variety of emerging risks." Unlike quantifiable financial metrics, this qualitative view depends entirely on the beliefs of whoever constructs it.

It's easy to see that those beliefs are left-wing. S&P assigns a lower ESG score to states that have both "physical risks" like earthquakes and natural disasters and a larger percentage of their economy tied to natural resource extraction, such as Texas, Alaska and Louisiana. S&P's

Environmental category, after noting federal-state partnerships' financial mitigation of natural disasters, focuses its assessment on the costs of making the transition to "net zero" and the policy changes it predicts will be necessary to "curtail" greenhouse-gas emissions.

Certainly, if a state's finances are overly concentrated on any one particular industry this will affect its financial outlook because of the risk that revenue could decline should that industry's fortunes contract. But a traditional credit rating takes into account the diversity of industry in a state already, so why create an ESG metric that could be politicized? Instead of focusing on the financial risk associated with economic concentration, the ESG metric highlights if a state or local government allows what S&P thinks is too much oil, gas or coal extraction.

Further, there are national security, economic and even environmental benefits for U.S. states to produce traditional energy. Many countries are searching for sources of natural gas and oil so they can lower their dependence on Russia after its invasion of Ukraine. In that environment, states like Texas, Alaska and Louisiana have a tremendous market advantage and could see improved cash flows. Not only are their fossil fuel revenues benefiting a free democracy, Russia's natural gas exports to Europe burn 41% dirtier than American natural gas. Exporting U.S. natural gas would create a significant environmental benefit. Authoritarian regimes like Russia threaten, among other things, the environment, human rights, free societies and democratic government—all factors that should be important to ESG proponents. That S&P's ESG metrics completely ignored or missed these variables exposes some of the major flaws of ESG ratings. Such scores place a value judgment on political issues that do not have one right or wrong answer, are highly complex, and are impossible to predict.

As the Russian situation has shown, ESG assessments depend on variables that can change rapidly. Before Russia attacked Ukraine, Europe was moving away from fossil fuels and military spending. That changed almost overnight. This is why markets are so valuable; they encapsulate many different views of the future and their organic structure allows for quick adaptation. ESG scores, by contrast, rigidly hold to one viewpoint and are slow to pick up on changes in the world. The minds behind S&P's ESG metrics seem to believe that a transition to green energy is inevitable and therefore punish states that produce traditional energy for "climate transition risk." But no one really knows what this "climate transition" will look like. There are no widely accepted, economically viable alternatives to fossil fuels in the market. No one knows where they'll come from, what they'll be or when they'll arrive.

ESG metrics' false certainty about future events, and consequent inability to keep up with unanticipated current events, causes capital to be misallocated. They create bubbles in favored industries while starving others that could be profitable.

The solutions to our most difficult challenges—such as climate change—can come only through innovation. Foisting rigid ESG factors onto the market discourages innovation by mandating conformity, penalizing creativity and punishing the industry with the greatest incentive to find alternatives—the energy sector. Fracking has reduced U.S. carbon emissions immensely, but it could cost you under S&P's ESG metrics.

Utah has prudently managed its finances over decades and as a result maintains the highest possible credit rating from all major firms, allowing the state to borrow money at the lowest rates and save taxpayer dollars. But under the new ESG regime, those financial factors may be supplanted by subjective, political ones.

These metrics also threaten Utah and other states' democratic sovereignty. The ESG disclosures many corporations have felt compelled to release have also led to frivolous legal action and

shareholder resolutions, an additional fiscal drag on businesses. Extending this regime into the municipal sphere is an invitation to litigation and other coercive tactics that will sabotage states' self-determination and independence.

States like Utah value our constitutional republic, which has ensured freedom, and free markets, which have fostered innovation and generated prosperity for generations. Any states, governmental jurisdictions, corporations, individuals, and investors who also hold those beliefs should join us in standing against ESG.

The Wall Street Journal

By Marlo Oaks

May 8, 2022 5:22 pm ET

Mr. Oaks is treasurer of Utah.

State Blue Sky Laws: Shedding Light on Exclusions from Municipal Bond Exemptions

We continue our series exploring the lack of uniformity – and sometimes lack of guidance – that makes it challenging to interpret state Blue Sky laws. Today's example addresses the exclusion from the use of the municipal issuer exemption if the securities being issued are paid from a non-governmental source.

Summary:

Some states exclude from the municipal exemption the registration of municipal securities that are paid from a non-governmental industrial or commercial enterprise, unless the payments and insured are guaranteed by a person whose securities are exempt from registration under certain other enumerated sections of the law.

Issue:

There is substantial disagreement among these states as to whether conduit 501(c)(3) bonds, student loan bonds and single family mortgage revenue bonds constitute bonds payable from revenues to be received from a non-governmental industrial or commercial enterprise.

Sub-Issue:

What is a non-governmental industrial or commercial enterprise? Most states do not include a formal definition, leaving practitioners having to interpret those state's laws with little or no guidance. One state that does define non-governmental industrial or commercial enterprise includes non-profit corporations in the definition, but another state excludes non-profit corporations within the definition of what is a non-governmental industrial or commercial enterprise. This is confusing to say the least – making one struggle to reconcile these polar opposite approaches.

Bottom line:

State opinions can sharply differ regarding exclusions from municipal bond exemptions. The lack of

guidance and uniformity can make practicing in this area confusing, which is why it's key to rely on experienced consultants.

by Christopher Andreucci

May 12, 2022

Harris Beach PLLC

GASB Issues Omnibus Statement Addressing Wide Range of Practice Issues.

Norwalk, CT, May 9, 2022 — The Governmental Accounting Standards Board (GASB) today issued guidance addressing various accounting and financial reporting issues identified during the implementation and application of certain GASB pronouncements or during the due process on other pronouncements.

The issues covered by GASB Statement No. 99, *Omnibus 2022*, include:

- Accounting and financial reporting for exchange or exchange-like financial guarantees
- Certain derivative instruments that are neither hedging derivative instruments nor investment derivative instruments
- Clarification of certain provisions of:
  - Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*
  - Statement No. 87, *Leases*
  - Statement No. 94, *Public-Private and Public-Public Partnership and Availability Payment Arrangements*
  - Statement No. 96, *Subscription-Based Information Technology Arrangements*
- Replacing the original deadline for using the London Interbank Offered Rate (LIBOR) as a benchmark interest rate for hedges of interest rate risk of taxable debt, with a deadline of when LIBOR ceases to be determined by the ICE Benchmark Administration using the methodology in place as of December 31, 2021
- Accounting for the distribution of benefits as part of the Supplemental Nutrition Assistance Program (SNAP)
- Disclosures related to nonmonetary transactions
- Pledges of future revenues when resources are not received by the pledging government
- Updating certain terminology for consistency with existing authoritative standards.

The requirements of Statement 99 that relate to the extension of the use of LIBOR, accounting for SNAP distributions, disclosures for nonmonetary transactions, pledges of future revenues by pledging governments, clarifications of certain provisions in Statement 34, and terminology updates are effective upon issuance. The requirements related to leases, PPPs, and SBITAs are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. The requirements related to financial guarantees and the other requirements related to derivative instruments are effective for fiscal years beginning after June 15, 2023, and all reporting periods thereafter. Earlier application is encouraged and is permitted by individual topic to the extent that all requirements associated with an individual topic are implemented simultaneously.

Muni Audit Reporting Times Worsened Over Last Decade.

Municipal bond issuers took an average of 164 days from the close of their fiscal years to complete their comprehensive annual audits in 2020, up from 147 in 2009, a worsening trend that is beginning to affect issuers' credit ratings.

That's according to Merritt Research Service and the University of Illinois Chicago's Government Finance Research Center's new report comparing municipal bond issuers' audit times.

"In the interest of good governance and transparency and having adequate information to properly price these issues in the market, we felt that this is really important in terms of bringing attention to this issue," said Deborah Carroll, director of the Government Finance Research Center at the University of Illinois Chicago. "Unfortunately, the trend is going the wrong way."

Corporate bond issuers have median audit times of 60-90 days due to Securities and Exchange Commission requirements. Municipal bond issuers report audit times which are two to three times longer, averaging 140 to 160 days.

Late audits do weigh on ratings. S&P Global Ratings put New Orleans and 12 other local governments on a negative watch last week over failed filings.

"The withdrawal of the affected ratings could follow if we do not receive fiscal 2020 financial statements within 30 days," the agency said. "We consider the financial statements necessary to maintain and assess our ratings on these issuers. Accordingly, the ratings are now at risk of being withdrawn, preceded by any change to the rating we consider appropriate given available information."

If issuers provide their 2020 financial statements within 30 days, S&P said it would conduct a full review and take a rating action within 90 days of the negative watch action.

Both co-authors of the report stressed the timeliness of the report considering such recent actions by S&P.

"We think that's an appropriate action by the rating agencies and it's really needed from the marketplace itself in order to recognize that there's greater risk where there's not timely disclosure," said Rich Ciccarone, president of Merritt Research Services.

The report divides muni bond issuance into categories of revenue bonds, which includes hospitals and healthcare systems, community colleges, private higher education, public higher education, airports, retail electric, toll roads, water and sewer and wholesale electric. The report also includes government bonds, which are split up by cities, counties, dedicated tax, school districts and states and territories. All categories' audit times have increased in the period from 2009-2020.

The report cites community colleges as having the largest increase in median audit time, 24 days, but notes a potential cause in the significant growth in the number of issuers between 2009 and 2020, which increases the variation in audit completion times among individual issuers.

Issuers in the hospital and healthcare sector increased their median audit time by 10 days, water and sewer issuers by 9 days, and retail electric sector issuers increased by 8 days. Public higher education fared better, increasing a median of 1 day and toll road issuers increased by just 2 days in the period 2009-2020.

For what is designated governmental bond sectors, school districts increased their audit time by 22 days, counties increased by 16 days, the dedicated tax sector 11 days, cities by 10 days and states and territories worsened their audit time by 2 days.

But some audit times were affected significantly during the 2019-2020 period as a result of COVID-19, especially in the revenue bond category of health and higher education sectors.

“During this time, when staffs were short and people were becoming accustomed to remote work, we certainly expected audit times for all sectors to become slower,” the report said.

But that isn’t exactly how it turned out. Community colleges continued their lag in 2019-2020, worsening their median audit time by 13 days but issuers in public higher education increased their audit times by 5 days, followed by issuers of hospitals and healthcare systems which increased their reporting time by 4 days.

For government issuers during 2019-2020, issuers in the retail and wholesale electric and toll roads sectors maintain audit times that are considerably faster than all other sectors combined.

But states and territories are among the most affected by COVID-19, as the median audit time increased by 11 days between 2019 and 2020. The audit time for cities only increased by 2 days in the same time frame.

“Between 2019 and 2020 in most of the sectors, we do see an increase in audit times, as we would expect, because COVID-19 sort of screwed everything up for this time period,” Carroll said. “But we’re not seeing a huge increase in the timeliness of these audit completions.”

But not all issuers wait years to complete their audits. The report also ranks the top 3 issuers in each category, as Port Authority of New York & New Jersey comes in first for airports, Sioux Falls, South Dakota comes in first for cities and Santa Barbara County, California wins for counties, all completing their audits in under 90 days.

“Generally speaking, that puts them very much on par with the private sector corporate bond issuers, which I think is a really great sign,” Carroll said.

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 05/03/22 02:12 PM EDT

Which Municipal Bond Issuers Have the Speediest Audit Times?

Compared with corporate bond issuers, municipal bond issuers typically take two to three times longer — 140 to 160 days — to complete their audits between fiscal year-end and the date of the Independent Auditor’s Report signature, according to data research from Merritt Research Services.

This year the Government Finance Research Center at the University of Illinois Chicago partnered with Merritt, which has been tracking and reporting the time it takes for municipal bond-related audits to be completed and signed after fiscal year-end since 2007, to develop its latest analysis.

The new report includes an overview of audit time trends since 2009 and identifies the timeliest audits for the 2020 fiscal year, grouped by municipal credit sector. The analysis covers the nearly

10,000 municipal bond audits in the Merritt database found in CreditScope.

Median audit times for municipal bond issuers have generally been increasing since 2009, especially between 2019 and 2020, most likely due to the onset of the COVID-19 pandemic.

Among the revenue bond sectors, wholesale electric, hospitals and health care systems, and private higher education had the fastest audit times for FY2020. For the governmental bond sectors, school districts and dedicated tax had the fastest audit times in FY2020.

Revenue bond sector issuers are generally faster in completing their audits than issuers in the governmental bond sectors, the analysis found.

Among the top performers in FY2020, all issuers except for states and territories completed their audits in 90 days or less, putting them on par with corporate bond issuers.

Interest groups ranging from bond investors to government watchdogs to regulators have regularly called for faster audit times from municipal bond issuers, said Deborah Carroll, director of the Government Finance Research Center at UIC.

“Timely audit reporting is essential for credit evaluation and proper pricing in the municipal bond market and is an important indicator of good governance and stewardship,” said Carroll, UIC associate professor of public administration.

While there are several newcomers highlighted in this year’s report, many of the top performers in FY2020 were also recognized in FY2019 suggesting consistent leadership in debt management, according to Richard A. Ciccarone, president of Merritt Research Services, an Investortools Company.

“All of the 2020 audit time exemplars and audit firms deserve commendation, particularly those that remained among the fastest to complete their audits from last year,” Ciccarone said.

University of Illinois Chicago

3-May-2022

Seventh Circuit Provides Rare Guidance On “Statutory Liens” - Cadwalader

On April 21, 2022, the U.S. Circuit Court of Appeals for the Seventh Circuit issued a decision interpreting the Bankruptcy Code’s definitions of “statutory lien” and “judicial lien,” holding that a lien imposed by the Chicago Municipal Code was “judicial” rather than “statutory” because it arose partly as the result of a “quasi-judicial” process rather than “solely by force of a statute.” *In the Matter of Mance*, No. 21-1355, 2022 WL 1182416 (7th Cir. April 21, 2022). In the Seventh Circuit’s view, the fact that a “quasi-judicial” process functioned as an “essential prerequisite” to the imposition of the lien and determined the amount of the lien was sufficient for it to qualify as a “judicial” rather than a “statutory lien,” notwithstanding that the lien was ultimately imposed automatically by operation of a municipal ordinance rather than directly by a court order.

Statutory liens are an important tool in municipal finance, because unlike some other types of liens, they are not cut off by Section 552 of the Bankruptcy Code in the event of a municipal issuer’s bankruptcy.1 Whether a municipal investor will qualify as a “secured” or “unsecured” creditor in a

municipal bankruptcy therefore may depend on whether that investor's lien qualifies as a "statutory lien." Notwithstanding the importance of "statutory liens" to municipal finance, however, judicial decisions on the nature of "statutory liens" are relatively rare, particularly at the federal appellate court level. The Seventh Circuit's *Mance* decision now adds to the relatively small library of appellate court decisions that can offer issuers and investors guidance on the nature of "statutory liens."

Background

The *Mance* appeal arose out of a long-running series of cases—including the U.S. Supreme Court's 2021 decision in *Chicago v. Fulton*2 —in which the City of Chicago (the "City") impounded motor vehicles for various parking- and driving-related infractions. The Chicago Municipal Code provides that any vehicles so impounded "shall be subject to a possessory lien in favor of the City in the amount required to obtain release of the vehicle." M.C.C. § 9-92-080(f). The issue in this particular appeal was whether the City's possessory lien on a vehicle that it had impounded should be deemed a "judicial lien" or a "statutory lien" under the Bankruptcy Code. If the lien was found to be "judicial" rather than "statutory," then it would be avoidable pursuant to a provision of the Bankruptcy Code authorizing individual debtors to avoid liens on motor vehicles. See 11 U.S.C. §§ 522(f), (d)(2).

Definitions and Examples of "Statutory" and "Judicial" Liens

The Seventh Circuit concluded that the lien under the Chicago Municipal Code was "judicial," not "statutory." In doing so, it applied the Bankruptcy Code's definitions of "judicial lien" and "statutory lien."

Specifically, the Bankruptcy Code defines a "judicial lien" as one "obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. § 101(36). By contrast, a "statutory lien" is defined as a lien "arising solely by force of a statute on specified circumstances or conditions . . . , but does not include security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute." 11 U.S.C. § 101(53). The Seventh Circuit noted that, under these definitions, the classification of a lien depends on the events that must occur before the lien attaches, with a "statutory lien" arising "solely by force of a statute," and a "judicial lien" resulting from some type of "legal or equitable process or proceeding."

As an example of a "statutory lien," the Seventh Circuit cited a mechanics' lien, which by statute attaches to improved property once payment for a mechanic's work on the property is due and goes unpaid. Such a mechanics' lien may require a filing with a county clerk in order to be perfected, but this filing requirement, in the Seventh Circuit's view, did not constitute the type of "legal or equitable process or proceeding" that would convert the lien from a "statutory" to a "judicial lien."

By contrast, the "textbook" example of a "judicial lien," in the Seventh Circuit's view, was a court-ordered money judgment, where a court must enter judgment for the winning creditor before the lien can arise.

"Quasi-Judicial" Proceedings Give Rise to a Judicial Lien

With these definitions and examples in mind, the Seventh Circuit next turned to the specific procedures required in order for the City to obtain a lien on an impounded vehicle. The Court acknowledged that these procedures fell "somewhere in between" the easy examples of a mechanics' lien and a money judgment, but ultimately determined that the "quasi-judicial" nature of

the required procedures placed the impoundment lien on the "judicial" rather than the "statutory" side of the line.

Among other things, before an impoundment lien can be imposed, the Chicago Municipal Code requires the underlying traffic violations to undergo an administrative process through which they become "final determinations of liability." As part of this administrative process, the vehicle owner can contest the charged violation in an in-person proceeding or by writing. If the vehicle owner is unsuccessful in this first phase of the process, the vehicle owner can also file an appeal under the Illinois Administrative Review Law. Only after the owner has lost the appeal does the traffic violation become a "final determination."

Following a "final determination," more legal process is required in order for the City to impound the vehicle if the fines go unpaid. The City must issue a notice to the vehicle owner, and the owner has the right to petition for a hearing to prove that she is not liable for the fines. Only after the owner failed to prevail at such a hearing would the City be able to impound the vehicle, at which point the impoundment lien would attach.

Notably, the Seventh Circuit acknowledged that the last step of lien attachment was "automatic," with the lien attaching automatically by operation of the ordinance upon impoundment of the vehicle, "without further action by a judge or quasi-judicial official." The City therefore had some basis to argue that the impoundment lien was a "statutory lien." The Seventh Circuit concluded, however, that it could not simply "ignore all the prior legal process that must occur before the City's possessory lien arises." In light of this prior legal process, the Court concluded that the impoundment lien did not arise "solely by statute," and instead was dependent on a "legal . . . process or proceeding." Therefore, the lien was a "judicial" rather than a "statutory lien."

Distinguishing the Third Circuit's *Schick* Case

In response to an argument by the City that the position ultimately adopted by the Seventh Circuit would create a circuit split, the Seventh Circuit attempted to distinguish the Third Circuit's decision in *In re Schick*, 418 F.3d 321 (3d Cir. 2005). The *Schick* case had some superficial similarities to *Mance*, because it addressed a New Jersey statute that imposed a lien on a motorist's property in the event the motorist failed to pay certain surcharges related to underlying traffic violations, including for reaching a certain number of violation points.

The Seventh Circuit nonetheless identified what it viewed as a "critical difference" between the processes leading to the liens in *Schick* and in *Mance*. Specifically, the New Jersey statute in *Schick* pertained only to surcharges, not to the underlying vehicle violations that were subject to judicial proceedings. The Third Circuit therefore concluded that "the underlying traffic proceeding charging the driver with a motor vehicle offense [was] too remote to constitute the required judicial process or proceeding necessary to find a judicial lien." On that basis, the Third Circuit concluded that the resulting lien was a "statutory lien."

In *Mance*, by contrast, the Seventh Circuit concluded that the statutory structure did not separate the underlying vehicle violation that was subject to quasi-judicial proceedings from any related fees (analogous to the "surcharges" at issue in *Schick*). Indeed, in *Mance* the amount of the lien itself was determined in the underlying quasi-judicial proceedings, and this lien amount included additional fees and penalties incurred in the course of those proceedings, whereas in *Schick* the amount of the surcharges was dictated separately by "statute and administrative regulations" and not determined by the underlying proceeding against the driver. The Seventh Circuit therefore concluded that in *Mance*, unlike in *Schick*, the quasi-judicial proceedings were "essential prerequisites for a valid impoundment lien," and were "not too far removed from the impoundment lien" for it to qualify as a

"judicial lien."

The Seventh Circuit's method of distinguishing *Schick* suggests that, in determining whether a particular lien is "statutory" or "judicial," it may not be sufficient to perform a binary analysis of whether or not judicial proceedings play a role in the creation of the lien. Instead, it is necessary to analyze the precise relationship between any judicial proceedings and the creation of the lien, including how far "removed" the judicial proceedings are from the ultimate creation of the lien.

It will be interesting to see whether the City accepts the Seventh Circuit's attempt to distinguish *Mance* from *Schick*, or instead seeks review by the U.S. Supreme Court on the theory that *Mance* has created a circuit split between the Seventh and Third Circuits.

Tax Liens as Statutory Liens

In response to another argument by the City, the Seventh Circuit sought to reconcile its interpretation of the distinction between "judicial" and "statutory liens" with legislative history indicating that Congress intended for tax liens to qualify as "statutory liens." The City pointed out that federal tax liens result from judicial and quasi-judicial processes, such that under the Seventh Circuit's analysis in *Mance* they should technically qualify as "judicial" rather than "statutory liens," contrary to Congressional intent.

In a somewhat puzzling analysis, the Seventh Circuit conceded that "[t]ax liens are unquestionably statutory," but then suggested that the status of tax liens as statutory was not really a function of the definitions in the Bankruptcy Code and instead resulted from Congress's prerogative to "single out a particular category of liens and classify it." The Seventh Circuit's analysis on this point is arguably in tension with the general principle that statutory text should control over legislative history, because Congress "singled out" tax liens and "classified" them as statutory only in the legislative history. As such, the Seventh Circuit's interpretation of the Bankruptcy Code's statutory definitions of "judicial lien" and "statutory lien" should arguably override that Congressional classification. Given that the status of tax liens was not directly at issue in *Mance*, however, the Seventh Circuit's statements on this issue are arguably not binding, and the exact status of tax liens in light of the *Mance* analysis may need to await a future decision.

Takeaways

In bankruptcy, holding a "statutory lien" can make all the difference between being a secured creditor entitled to payment in full and being an unsecured creditor entitled only to pennies on the dollar (if that). And yet, as *Mance* illustrates, whether a particular lien qualifies as a "statutory lien" can be a surprisingly fact-intensive question, notwithstanding the deceptive simplicity of the Bankruptcy Code's definitions. In particular, the fact that the final step in imposing the lien occurs by operation of statute may not be sufficient for the lien to qualify as a "statutory lien" if judicial or quasi-judicial proceedings preceded this final, statutory step.

Mance therefore serves as a reminder that municipal issuers and investors alike should engage in a careful and nuanced analysis of exactly what type of lien is likely to be created by a particular transaction before issuing or investing in municipal debt. *Mance* helpfully provides some additional guidance on this issue, but is likely far from the final word on the matter.

FOOTNOTES

1 See 11 U.S.C. § 552(a) ("[P]roperty acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered

into by the debtor before the commencement of the case”).

2 See Ingrid Bagby, Michele C. Maman, Casey John Servais, & Eric G. Waxman, Stand Pat, Don’t Act: U.S. Supreme Court Holds that Mere Retention of Debtor Property Does Not Violate Bankruptcy Code Section 362(a)(3), Pratt’s Journal of Bankruptcy Law (April/May 2021), available at https://www.cadwalader.com/uploads/media/Pratt_reprint_cadwalader.pdf.

Tuesday, May 3, 2022

Financial Accounting Foundation Board of Trustees: Notice of Meeting

Meeting Notice

05/03/22

Puzzling Pieces: Component Unity Identification, Classification, Disclosure, and Display - GFOA

Although the basic shape of the financial reporting entity for state and local governments has been around for nearly 30 years, the Governmental Accounting Standards Board (GASB) has made many incremental changes over time. Most recently, GASB Statements No. 84, *Fiduciary Activities*, No. 90, *Majority Equity Interests*, and No. 97, *Certain Component Unit Criteria*, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans have introduced such changes. So, it is not terribly surprising that governments sometimes struggle to determine which entities should be included in a set of basic financial statements prepared in accordance with generally accepted accounting principles (GAAP), how they should be reported, and how both determinations should be explained.

DOWNLOAD

Government Finance Officers of America

Publication date: April 2022

Author: Michele Mark Levine

West Virginia Blasts S&P ESG Scoring as ‘Politically Subjective’

- **The rating company’s ESG scorecard debuted at end of March**
- **Republicans, industry groups have opposed more ESG oversight**

West Virginia’s Republican treasurer called on S&P Global Ratings to scrap a new system scoring U.S. states on their environmental, social and governance efforts, calling the ratings scale a

“politically subjective” scheme that will force states to yield to “woke capitalists.”

“This new ESG rating system is just the beginning of a new wave of judging states – and their people – not by valid financial metrics, but by the preferred political views and outcomes of a select global elite,” West Virginia State Treasurer Riley Moore said in a statement released earlier this week. “The ESG movement is nothing but a slippery slope whereby our states and our people will be forced to bend the knee to the woke capitalists or suffer financial harm.”

Moore’s condemnation follows a similar rebuke from Utah officials and comes amid a broader culture-war brawl between Republicans and corporate America. Texas has threatened to ban state investments in businesses that cut ties with oil and gas companies because of ESG initiatives. Florida has stripped Walt Disney Co. of some of its self-governance privileges after the company objected to a new law that limits school instruction about gender identity and sexual orientation.

S&P’s new system scores governments on categories like human rights, social integration, low-carbon strategies, climate measures and sustainable finance. The company released its first scorecard March 31.

S&P declined to comment.

West Virginia, a Republican-controlled state, received a negative social score and a moderately negative environmental score. The vast majority of states’ ratings were neutral. West Virginia has an AA- bond rating from S&P, its fourth-highest.

“So despite our state’s excellent financial position, our taxpayers could now be punished with higher borrowing costs simply because S&P doesn’t like our state’s industries and demographic profile,” Moore said. “This ratings scheme will affect our state and its municipalities, and begs the question: at what point will this stop? Will individuals soon get ESG ratings as part of their credit scores? Where will it end?”

Institutional investors like BlackRock Inc. and pension funds are demanding greater clarity from companies on their efforts to diversify their workforces and address a changing climate. Meanwhile, GOP lawmakers and powerful industry groups, including the U.S. Chamber of Commerce, have opposed increased activity by financial watchdogs on ESG issues.

Bloomberg Markets

By Skylar Woodhouse

April 27, 2022

Some States’ Anti-ESG Push Garners Support In Congress.

Republican Congress could use riders to block SEC actions

Republican state lawmakers are berating U.S. financial institutions for increased reliance on environmental, social and governance metrics to screen investments and analyze credit risk factors, with some of the critics attracting support in Congress.

Utah state Treasurer Marlo Oaks coordinated a response to S&P Global Inc., blasting the financial

services firm's credit rating division for plans to supplement its analysis of states with a score on certain ESG indicators, such as exposure to climate risk and demographic trends.

While S&P notes the ESG analysis is added only after it issues the credit rating, the move nonetheless sparked backlash from the state's GOP lawmakers, who say the inclusion of those factors stray from traditional financial factors.

"To call them 'credit indicators' attempts to legitimize a dubious and unproven exercise in developing a political ratings system that is based on indeterminate factors," the letter said. "Traditional public finance entity credit ratings already incorporate financially material factors, including ESG factors."

Notably, Oaks was joined by Gov. Spencer J. Cox, other state officials, and Utah's entire congressional delegation: Republican Sens. Mitt Romney and Mike Lee and Reps. John Curtis, Blake D. Moore, Burgess Owens and Chris Stewart.

Stewart said he and his colleagues are encouraging other GOP members to have similar conversations with their state treasurers and financial regulators on the proliferation of ESG metrics.

If Republicans take back control of the House at the midterm elections, they will look to utilize appropriation riders to curb additional ESG regulations. This would be akin to the long-standing rider that prevents the Securities and Exchange Commission from pursuing rulemaking on corporate political spending disclosure, he said in an interview Tuesday.

"We're going to be able to put some limits on this, precluding the Securities and Exchange Commission, for example, from using their regulatory authority to implement policies that are really out of bounds of their actual authority," said Stewart, who sits on the House Appropriations Committee. "We'll have some ability to push back on that starting next winter."

The letter and Stewart's remarks underscore the latest effort from Republican politicians who are pushing back against the financial sector's embrace of ESG metrics in credit analysis and investment decisions.

In particular, leaders in fossil fuel producing states have pursued policies to bar officials from dealing with businesses that are moving to ditch fossil fuels or considering climate change in their own investments.

Last month, Texas Comptroller Glenn Hegar sent letters to nearly 20 banks and financial services providers asking if their funds either limit or block fossil fuel investments in light of a law to boycott investment vehicles divesting from oil, gas and coal firms — ultimately affecting Texas' pension funds. In West Virginia, the state dropped BlackRock Inc. funds from its portfolio over the asset manager's embrace of ESG investing.

Model policy

Earlier this month, the American Legislative Exchange Council released a model policy titled the State Government Employee Retirement Protection Act that's aimed to "protect pensioners from politically driven investment strategies."

The conservative organization — whose members consist of nearly one-quarter of the country's state legislators representing more than 60 million Americans — says ESG-oriented strategies in investments shrink investment returns over the long run, hurting retirees and taxpayers.

Under the policy framework, plan sponsors for state and local pension funds must evaluate investments only on pecuniary issues, defined as a factor with a material effect on financial risk or returns on investments. ESG factors and “similarly oriented considerations” are considered pecuniary factors “only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories.”

Investor advocacy groups and ESG supporters say that Republicans’ criticisms and actions to fight the movement are misplaced, particularly on climate risk.

“We fundamentally reject the argument that ESG is not materially impactful,” said Steven Rothstein, managing director of the Ceres Accelerator for Sustainable Capital Markets. Ceres is a nonprofit organization for investors concerned with sustainability and other ESG issues.

“There is lots of data that shows” ESG is material, he said in an interview. “There is also data that shows that companies that address these issues over the long term do better financially. Because they think about these constituencies.”

While Rothstein said not every ESG issue has the same level of materiality, investors’ sentiment shows physical and transitional risks from climate change and other topics will have an impact on the returns of their portfolios. State and federal officials who choose to exclude or ignore ESG factors may put pension funds and investments of Americans’ money at risk.

“I wouldn’t put this in the context of being supportive of ESG. It’s supportive of their fiduciary responsibility to look at the range of financial risks,” Rothstein said. “As someone had said three years ago, is the pandemic an ESG issue? Is it a public health issue? Or is it a financial risk issue? Well, it’s all of them. And I don’t think anyone would argue the pandemic hasn’t had a dramatic impact on our economy, in lots and lots of ways.”

Bryan McGannon, director of policy and programs at US SIF: The Forum for Sustainable and Responsible Investment, echoed similar sentiments that some states’ pension plans may be misguided by blatantly ignoring certain ESG factors. US SIF is composed of advisers, firms and banks that support sustainable investing.

Depending on midterm results, Republicans may push for more oversight on what the SEC does on ESG regulations and bring forward more bills that challenge the inclusion of non-traditional financial metrics, McGannon said in an interview.

Such actions would be similar to what Republicans pursued in previous sessions of Congress when they controlled both chambers. Moreover, he said they would do little to change investors’ overall sentiment that ESG factors are on equal footing with other financial factors.

“Frankly, it’s more a political move,” he said in an interview. “The marketplace is so far down the road that there is no going back.”

Roll Call

By Ellen Meyers

April 28, 2022

SEC Chief Floats Slashing Bond-Trade Reporting to 1 Minute.

- **Gensler sees benefit in cutting current 15-minute window**
- **Transaction data sent to Trace should also be broader, he says**

U.S. Securities and Exchange Commission Chair Gary Gensler wants to slash the amount of time that traders have to report many bond transactions as part of a bid to increase visibility into fixed-income markets.

Gensler on Tuesday said that more transparency was needed across global bond markets, and that disclosures had generally failed to keep up with technological changes. In remarks for City Week in London, the SEC chief said data should be sent faster to the Financial Industry Regulatory Authority's Trace reporting system and cover more types of securities.

"Currently, a trade has to be reported as soon as practicable but no later than within 15 minutes of the time of execution," he said, also referring to how transactions involving municipal securities are reported to regulators. "Why couldn't the outer bound be shortened to no later than, for example, 1 minute?"

The amount of time that traders have to report fixed-income transactions has been a hot-button issue for regulators since before Gensler took over the last April. During the Trump era, a controversial plan to test whether delaying disclosure of the biggest corporate bond trades would boost market liquidity was eventually shelved after strong industry opposition.

Gensler said there could also be value in broadening Trace reporting to include sovereign debt transactions. The market impacts of Russia's invasion of Ukraine "have shown the value that regulatory reporting and public dissemination of foreign sovereign bonds would offer."

A Finra spokesman said the watchdog was supportive of Gensler's plans. However, financial firms will still have a chance to weigh in as any proposal would have to wind through a byzantine rule-making process that includes approval by the SEC, which oversees the industry-backed regulator.

Other potential measures for boosting transparency could include making public Trace data on individual Treasury transactions, Gensler suggested. Authorities could look into reporting trading protocols and fees paid for transactions, as well as the "spread" to Treasuries when the trade is agreed upon, he said.

Shortening the reporting time for fixed-income securities would involve a transition that "could take quite a bit of time," said Gennadiy Goldberg, a U.S. rates strategist at TD Securities.

"The timing of trade reporting is a delicate balancing act between creating sufficient transparency and creating so much transparency that buyers and sellers have trouble executing their positions without being revealed to markets in the process," Goldberg added.

Bloomberg Markets

By Lydia Beyoud

April 26, 2022

— With assistance by William Shaw, and Tom Metcalf

MSRB Votes to Seek Public Comment on Enhancing Post-Trade Transparency at Quarterly Board Meeting.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) met April 26-28, 2022 for its quarterly Board of Directors meeting, where the Board determined to seek public comment on enhancing post-trade transparency and to continue to foster dialogue on environmental, social and governance (ESG) practices in the $4 trillion municipal market, among other initiatives to advance the four goals outlined in its long-term strategic plan.

The Board met with Securities and Exchange Commission (SEC) Chair Gary Gensler. The Board regularly meets with SEC officials and the leadership of other self-regulatory organizations in support of regulatory coordination and communication.

“As we fully expected at the start of the fiscal year, this Board has worked thoughtfully and collaboratively to advance one of the most impactful and consequential agendas in our history,” said MSRB Chair Patrick Brett. “At our third meeting of the year, we were honored to speak with Chair Gensler about how the policy priorities of the Commission intersect with our work to engage constructively with municipal market stakeholders to further our mission to strengthen and protect the municipal market.”

Regulatory Initiatives

The Board will seek public comment on a retrospective review of MSRB Rule G-14, the rule that since 2005 has ensured investors and the public have access to trade prices within 15 minutes of the time of trade on the free Electronic Municipal Market Access (EMMA®) website.

“As part of our focus on modernizing our rule book in light of evolving market practices and technology, we are interested in exploring whether the time might be right to consider shortening what constitutes ‘real-time’ trade reporting in our unique market,” said MSRB CEO Mark Kim. “We plan to solicit public comment from dealers, investors and other stakeholders about the benefits and challenges of potential rule amendments to enhance post-trade transparency.”

Transparency Initiatives

The Board previewed the future-state MSRB.org website, which is being redesigned with the benefit of extensive input from stakeholders to make MSRB rules, compliance resources, educational materials and other information easier and more intuitive to find. The new MSRB.org, which is planned to be implemented this year, also is designed to complement the ongoing work to modernize the EMMA website and related market transparency systems.

To help keep stakeholders informed of upcoming and longer-term EMMA enhancements, the MSRB publishes a forward roadmap of its transparency and technology initiatives on its website.

Market Structure and Data

Also at its meeting, the Board was briefed on structured data, including pending federal legislation and the emerging use of structured data in the municipal market.

“The Board was briefed on legislation and activities at the federal, state and local level to move toward open data, and we discussed the potential to showcase state and local leadership on this front, and innovate collaboratively on our EMMA Labs platform,” Brett said.

The MSRB this year launched EMMA Labs as an innovation sandbox to collaborate with market participants to advance transparency and the quality and comparability of data in the municipal securities market.

Public Trust

In support of its commitment to uphold the public trust and stay engaged with the market about evolving trends, the Board in December invited the public to share information and perspectives on environmental, social and governance (ESG) practices in the municipal securities market.

As a next step, the MSRB plans to prepare and publish a summary of the diverse comments received on its request for information on ESG practices in the municipal market. The MSRB also plans to host a series of virtual town halls to further explore the various themes raised by commenters.

“We are pleased that so many different organizations and individuals took advantage of our 90-day comment period to share their perspectives on this evolving and growing area of our market,” said MSRB Vice Chair Meredith Hathorn. “As the Board continues to synthesize the wealth of information provided, we have many threads to pull, including specific suggestions to enhance the EMMA website. We look forward to continuing to provide forums to bring different viewpoints together for more dialogue.”

Date: April 29, 2022

Contact: Leah Szarek, Chief External Relations Officer
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MSRB Proposes to Extend SEC’s Regulation Best Interest to Bank Dealers.

The Municipal Securities Rulemaking Board today proposed a rule change that would amend an existing rule on the suitability of recommendations and transactions. The proposed changes would promote regulatory parity between bank dealers and broker-dealers with regard to Regulation Best Interest and the recommendation of municipal securities transactions or investment strategies involving municipal securities.

The MSRB also proposed changes to another rule related to transactions with sophisticated municipal market professionals. The changes are subject to approval by the Securities and Exchange Commission.

In previous comments, the American Bankers Association has urged the MSRB to consider the compliance costs of including bank dealers in the SEC’s Regulation Best Interest Rule, noting that bank dealers in municipal securities do not have a significant retail customer base to warrant a new regulatory compliance regime.

ABA BANKING JOURNAL

APRIL 19, 2022

April 2022 MSRB Board of Directors Meeting Discussion Items.

The Board of Directors of the Municipal Securities Rulemaking Board (MSRB) will meet in Washington, D.C. on April 26-28, 2022, where it will discuss the following topics:

Market Regulation

The Board will discuss seeking public comment on a retrospective review of MSRB Rule G-14 to modernize trade reporting requirements with a view to enhancing post-trade transparency.

Market Transparency

The Board will preview the future-state MSRB.org website, which is being redesigned to make MSRB rules, compliance resources, educational materials and other information easier and more intuitive to find, and to complement the ongoing work to modernize the Electronic Municipal Market Access (EMMA®) website and related market transparency systems.

Market Structure and Data

The Board will discuss potential new opportunities to collaborate with market participants in EMMA Labs, the MSRB's innovation sandbox, to advance transparency and the quality and comparability of data in the municipal securities market.

Public Trust

As part of its commitment to uphold the public trust and serve as a forum for conversation about evolving municipal market matters, the Board published a request for information on environmental, social and governance (ESG) practices in the municipal securities market in December 2021. Following the end of the 90-day comment period in March, the Board began its review of comments received and will discuss preliminary themes at its meeting.

April Edition of GFOA Government Finance Review Now Available.

The April edition of GFR is now available to read digitally. Rethinking Local Government Revenue is among the many articles this month. We know changes to the revenue systems in local government are necessary, but how do local governments evaluate options and initiate transformation?

READ GFR ONLINE

MSRB to Discuss ESG Request for Information at Quarterly Meeting.

The Municipal Securities Rulemaking Board intends to discuss the preliminary themes in the comments it received as part of its request for information on environmental social and governance factors, in its first meeting since the comment period closed in March.

The board will discuss that along with the efforts to update trade reporting rules in its Rule G-14, as

well as updates to its websites during the board's quarterly meeting on April 26-28.

The board's request for information on ESG has provoked concern from many market participants, with some saying the MSRB overstepping its reach. But the response has varied from criticizing the way in which the board framed its questions to accusations that the board is politicizing public finance.

The meeting marks the first time since the board closed its comment period in March that the members will discuss the comments and their preliminary themes.

The board will continue its efforts to improve transparency in the municipal securities market, whether through its own systems or through rules for other market participants, according to its agenda.

"The board will discuss seeking public comment on a retrospective review of MSRB Rule G-14 to modernize trade reporting requirements with a view to enhancing post-trade transparency," the MSRB said.

The MSRB.org website is being redesigned in order to make "MSRB rules, compliance resources, educational materials and other information easier and more intuitive to find," the MSRB said, in addition to making it a more seamless complement to its EMMA website.

The MSRB launched its EMMA Labs platform at the top of this year to enhance and accelerate the use of data analytics in the municipal securities market, and the board will use its upcoming meeting to discuss new opportunities for collaboration with market participants.

The efforts surrounding EMMA Labs will hope to "advance transparency and the quality and comparability of data in the municipal securities market," the board said.

By Connor Hussey

BY SOURCEMEDIA | 04/21/22

Utah Officials Blast S&P Over ESG Credit Indicators.

Utah's top elected officials demanded on Thursday that S&P Global Ratings cease applying environmental, social, and governance factors to the state through the use of what they called a politicized rating system based on indeterminate factors.

A letter to S&P signed by Gov. Spencer Cox, Treasurer Marlo Oaks, other state constitutional officeholders, legislative leaders, and Utah's Congressional delegation, stated their objection "to any ESG ratings, ESG credit indicators, or any other ESG scoring system that calls out ESG factors separate from, in addition to, or apart from traditional credit ratings."

S&P, which rates Utah AAA with a stable outlook, declined to comment about the letter.

In an ESG credit indicator report card for all 50 states that S&P released on March 31, Utah was assigned "a moderately negative" score for environmental factors, due largely to long-term water supply challenges. Cox declared a state of emergency on Thursday due to "dire drought conditions affecting the entire state."

The state received neutral scores for social and governance factors.

The letter demanded that S&P withdraw those credit indicators and stop publishing any ESG factors for the state.

“Considering recent global events, the current economic situation in the U.S., and the unreliability and inherently political nature of ESG factors in investment decisions, we view this newfound focus on ESG as politicizing the ratings process,” the letter stated. “It is deeply counterproductive, misleading, potentially damaging to the entities being rated, and possibly illegal.”

It added that “no financial firm should substitute its political judgments for objective financial analysis, especially on matters that are unrelated to the underlying businesses, assets and cash flows it evaluates.”

The elected officials also expressed concern “the disclosure of ESG factors will unfairly and adversely affect Utah’s credit rating and the market for Utah’s bonds, especially where the alleged indicators are not indicative of Utah’s ability to repay debt.”

Oaks, who spearheaded a response signed by officials from 23 states to the Municipal Securities Rulemaking Board’s request for information on ESG considerations in the municipal market, called Utah’s AAA rating an important asset to the state.

“I’m grateful for the unified approach our leaders have taken in pushing back against S&P’s move to politicize the ratings process, which ultimately threatens our outstanding credit and, more broadly, our pluralistic systems of free-market capitalism and democracy,” he said in a statement.

A Bond Buyer survey last year showed 56% of respondents rated ESG as important to the municipal industry, although only 42% said it is important for rating agencies to take ESG into consideration for ratings. Two-thirds of respondents said it was very important or critical for issuers to disclose ESG risks and opportunities.

Matt Fabian, a partner at Municipal Market Analytics, said the “genie is out of the bottle.”

“Because few state and local governments have decided to provide solid data on their credit exposure to climate change, investors are relying on data from third party providers that, by definition, the states don’t control,” he said. “As the science gets better, and third-party data changes, gets smarter, and becomes more predictive and invasive, it’s only going to get worse for states trying to manage what investors see.”

In its March report card, S&P said the ESG credit indicators “provide additional disclosure and transparency at the entity level and reflect our opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are applied after the credit rating has been determined.”

ESG ratings criteria published by S&P in October noted it was looking at factors that can materially influence an issuer’s creditworthiness and that if factors are sufficiently material they can influence credit ratings.

The Utah letter, which was addressed to S&P Global Ratings President and CEO Douglas Peterson and President Martina Cheung, included a list of detailed questions regarding S&P’s consideration of ESG factors in public finance credit ratings, as well as a description of any communications it has had with the U.S. Securities and Exchange Commission, the MSRB, the U.S. Treasury Department, or any other governmental agency regarding the use of ESG factors for credit ratings.

Brittany Griffin, Oaks' spokeswoman, said other rating agencies have not gone as far as S&P in their use of ESG credit indicators.

Fitch Ratings, Moody's Investors Service, and Kroll Bond Rating Agency also look at ESG factors in their ratings. Moody's and Fitch have scoring systems, while KBRA has an ESG Management System that does not provide scores, but if an ESG factor is relevant to credit, the factor is incorporated into its analysis in the same manner as all other relevant factors across KBRA's rated sectors.

By Karen Pierog

BY SOURCEMEDIA | 04/22/22

SEC Charges School District, the District's Former Chief Financial Officer and the District's Auditor with Violations of Federal Securities Laws in a 2018 Bond Offering.

On March 16, 2022, the Securities and Exchange Commission ("SEC") entered an order against a school district (Crosby Independent School District (the "District"), located in a suburb of Houston, Texas) and against the District's auditor (the "Auditor") and charged the school district's former chief financial officer ("CFO") with misleading investors who purchased $20 million of the District's 2018 bonds (the "Bonds").

In its actions, the SEC noted that the District, the CFO and the Auditor included false and misleading audited financial statements in the official statement for the Bonds. Specifically, the FY2017 financial statements underreported construction liabilities (by $7.9 million) and payroll expenses (by $3.8 million) resulting in the financial statements overstating the general fund balance by $11.7 million. The District submitted the FY2017 financial statements for use with the offering document, the District and the CFO reviewed the offering document prior to its use in marketing the Bonds, and the school board's president signed the offering document. The District changed its fiscal year end as part of a plan to address the District's financial condition prior to offering the Bonds, and the change in fiscal year end should have prompted a heightened level of scrutiny on the Auditor's part. The SEC determined that the Auditor's audit procedures were deficient.

The District. The charges against the District were brought under the Securities Exchange Act of 1934 ("1934 Act") Section10(b) and Rule 10(b)(5) thereunder and the Securities Act of 1933 ("1933 Act") Section 17(a). Violations of 1933 Act Section 17(a) do not require intentional wrongdoing on the part of the actor and can be established on the basis of negligence. The SEC's order against the District found that it violated 1934 Act Section 10(b) and Rule 10b-5 thereunder and 1933 Act Section 17(a). The District was ordered to cease and desist from committing or causing any violations and any future violations of 1934 Act Section 10(b) and Rule 10b-5 and 1933 Act Section 17(a).

The CFO. The SEC alleged the CFO violated 1933 Act Section 17(a)(1) and (3) and 1934 Act Section 10(b) and Rule 10b-5. The CFO has agreed to settle with the SEC, including paying a $30,000 penalty and not participating in any future municipal securities offerings. The settlement is pending court approval.

The Auditor. The SEC's order against the Auditor found that she engaged in improper professional conduct pursuant to 1934 Act Section 4C(2) and SEC Rules of Practice Rule 102(e)(1)(ii). The SEC's

order was effective immediately and denied the Auditor the privilege of appearing or practicing before the SEC as an accountant.

A similar recent case. This set of cases follows SEC actions from September 2021 involving a California school district and its CFO wherein that California school district included misleading budget projections in its offering documents for its bonds due to the budget's failure to reflect salary increases. Despite reports showing actual expenses were higher than projected, the California school district used the stale information and the CFO attested to the accuracy of the information in the offering document. The SEC order against the California school district found that it violated 1933 Act Section 17(a)(2) and (3) by "making misleading statements and omissions to investors, as well as to the bonds' credit rating agency and other municipal industry professionals on the transaction." The California school district was ordered to cease and desist violating 1933 Act Section 17(a)(2) and (3), implement various written policies and procedures, conduct staff training, retain an independent consultant to review the policies and procedures, implement recommendations of the independent consultant, disclose this settlement in future bond offerings, and provide certifications of compliance to the Staff of the SEC regarding these settlement conditions. The SEC charged the former CFO with violating 1933 Act Section 17(a)(3).

Dorsey & Whitney LLP

April 15, 2022

SEC Proposes Significant Expansion of Firms That Must Register as Dealers: Sidley

On March 28, 2022, the U.S. Securities and Exchange Commission (SEC) unanimously proposed rules to further define activity that requires registration as a "dealer" or "government securities dealer" with the SEC (the Proposal).1 The Proposal would generally require any person, which would include a natural person or legal entity, that engages in a routine pattern of buying and selling securities (or government securities) that has the effect of providing liquidity to other market participants to have to register as a dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act) (or as a government securities dealer pursuant to Section 15C of the Exchange Act).

Specifically, the SEC is proposing two rules — Proposed Rules 3a5-4 and 3a44-2 under the Exchange Act — to further define what it means to trade securities or government securities for one's own account "as part of a regular business" in a manner that would require a person to register as a "dealer" or a "government securities dealer," respectively, absent an exception or exemption (other than the so-called "trader" exception/exemption from such definitions).2

According to the SEC, the impetus for the Proposal is advancements in electronic trading and technology across securities markets that have given rise to unregistered market participants (referred to as "proprietary trading firms") playing an increasingly significant "liquidity providing role" in overall trading and market activity.3 Alleging that certain of these unregistered liquidity-providing firms are performing traditional "dealer" activity, the SEC is concerned that an uneven playing field has developed where some market participants are subject to regulation and others are not. This uneven application of regulatory oversight, according to the SEC, makes it difficult for regulators to detect, investigate, and understand significant market events, such as the "flash rally" in the Treasury markets in October 2014.

Hedge fund managers that actively trade will need to carefully consider whether they fall within the scope of the proposed rules and would therefore have to register as a dealer (or government securities dealer). If so, such hedge funds would face immensely greater regulatory scrutiny and compliance costs as they would become subject to SEC rules (e.g., net capital requirements, increased recordkeeping, risk management), self-regulatory organization rules (e.g., trade reporting, self-reporting of rule violations), and increased examinations and enforcement investigations.

The Proposal's comment deadline is the later of (i) Friday, May 27, 2022 (60 days after issuance of the Proposal), or (ii) 30 days after publication of the Proposal in the *Federal Register*.

Background

Section 3(a)(5)of the Exchange Act generally defines the term "dealer" to mean "any person engaged in the business of buying and selling securities … for such person's own account through a broker or otherwise" but excludes "a person that buys or sells securities … for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business."4 This statutory exclusion from the definition of "dealer" is often referred to as the "trader" exception.5

According to the SEC, while traders and dealers engage in the same core activity — buying and selling securities for their own account — their level of activity varies in absolute terms and in regularity. For example, the SEC has stated that dealers often buy and sell contemporaneously and quickly enter into offsetting transactions to minimize the risk associated with a position.6 In contrast, the SEC has said that traders are "market participants who provide capital investment and are willing to accept the risk of ownership in listed companies for an extended period of time" and that "it makes little sense to refer to someone as 'investing' in a company for a few seconds, minutes, or hours."7

The SEC last indicated that it might consider a rulemaking related to distinguishing a dealer from a trader in 2014 when the then-Chair of the SEC announced, as part of a number of other market structure initiatives, that she had asked the staff to recommend a rulemaking to "clarify the status of unregistered active proprietary traders to subject them to [SEC] rules as dealers."8 However, the SEC did not promulgate a proposal until now.

Further Definition of "As Part of a Regular Business"

The operative concept in the definitions of "dealer" and "government securities dealer" that distinguishes the regulated entity from the unregulated trader is that the dealer is engaged in buying and selling securities for its own account "as part of a regular business." Accordingly, the Proposal is designed to further define what "as part of a regular business" means by defining three qualitative standards intended to more precisely identify activities of certain market participants who assume dealerlike roles. Specifically, the proposed new rules seek to identify persons whose trading activity in the market "has the effect of providing liquidity" to other market participants.

Under the proposed rules, a person would be engaged in buying and selling securities (or government securities)9 for its own account "as a part of a regular business" if that person engages in a "routine pattern" of buying and selling securities (or government securities) that has the effect of providing liquidity to other market participants by

1. Routinely10 making roughly comparable11 purchases and sales of the same or substantially similar12 securities in a day;13
2. Routinely expressing trading interests14 that are at or near the best available prices on both sides of the market and that are communicated and represented in a way that makes them

accessible to other market participants; or
3. Earning revenue primarily from capturing bid-ask spreads, by buying at the bid and selling at the offer, or from capturing any incentives offered by trading venues to liquidity-supplying trading interests.15

For persons buying and selling government securities, there would be an additional quantitative standard that, if met, would automatically deem the person to be engaging in the activity "as part of a regular business," irrespective of whether the person meets any of the other qualitative criteria. Under this standard, a person engaged in buying and selling more than $25 billion of trading volume in government securities in each of four of the last six calendar months would be deemed to be doing so "as part of a regular business."16

Notably, the proposed rules relate only to the interpretation of the Exchange Act's "dealer" and "government securities dealer" definitions under Sections 3(a)(5) and 3(a)(44) of the Exchange Act, respectively. The SEC is not proposing a comparable rule with respect to the Exchange Act's "municipal securities dealer" definition under Section 3(a)(30) of the Exchange Act or "security-based swap dealer" under Section 3(a)(71) of the Exchange Act.

There would not be a presumption that a person is not a dealer (or government securities dealer) solely because that person does not satisfy (1), (2), or (3) above.17

Exclusions From the Proposed Rules; Intersection of the Proposed Rules With Other Exceptions and Exemptions

The proposed rules would exclude two specific categories of persons from their coverage — meaning that if a person meets the criteria noted above but falls within an exclusion, such person's activities would not — by virtue of these criteria alone — be deemed to be "part of a regular business." The exclusions are for a person that

1. Has or controls total assets of less than $50 million or
2. Is an investment company registered under the Investment Company Act of 1940.18

Because there is no presumption under the proposed rules that a person is not a dealer (or government securities dealer) if not meeting the relevant criteria described above, market participants would still need to analyze their activity under prior SEC guidance and precedent, and applicable case law, to determine whether the activities may otherwise implicate the dealer and/or government securities dealer definitions.19

The proposed rules also would not change other available statutory or regulatory exceptions or exemptions that may be available to a particular person. For example, banks would continue to enjoy the various bank-specific exceptions and exemptions from the "dealer" and "government securities dealer" definitions.20 Moreover, even if a person is deemed to implicate the "dealer" and/or "government securities dealer" definitions, an exemption from the requirement to register may remain available — such as the exemption for foreign broker-dealers complying with Rule 15a-6 under the Exchange Act.21

Aggregation of Accounts Under the Proposal

To account for variations in corporate structure and ownership among different persons, and to prevent possible circumvention of the proposed rules, the Proposal would also define the terms "own account" and "control." The proposed definitions are designed to determine which accounts must be considered for purposes of evaluating whether a person meets the criteria described above.

Specifically, a person's "own account" would be defined to mean any account

1. held in the name of that person,
2. held in the name of a person over whom that person exercises control or with whom that person is under common control (subject to certain exceptions, as discussed below), or
3. held for the benefit of those persons identified in (i) and (ii).

Exception for Certain Accounts

The Proposal sets forth certain exceptions under prong (ii). Specifically, an account held in the name of a person over which the person exercises control or with whom the person is under common control would not be considered for purposes of determining whether the person may be a dealer/government securities dealer if the account meets one of the following exceptions:

(A) Broker-Dealer and Investment Company Accounts — The account is in the name of a registered broker, dealer, or government securities dealer or an investment company registered under the Investment Company Act of 1940.

(B) Investment Advisory Accounts for Clients That Are Not Controlled by the Adviser — With respect to an investment adviser registered under the Investment Advisers Act of 1940 (Advisers Act), the account is held in the name of a client of the adviser (unless the adviser controls the client as a result of the adviser's right to vote or direct the vote of voting securities of the client, the adviser's right to sell or direct the sale of voting securities of the client, or the adviser's capital contributions to or rights to amounts upon dissolution of the client).22

(C) Accounts for Shared Clients of an Adviser (Other than Parallel Account Structures) — With respect to any person, the account is held in the name of another person that is deemed under common control with that person solely because both persons are clients of an investment adviser registered under the Advisers Act (an RIA), unless the accounts constitute a "parallel account structure."

Under the Proposal, the term "control" would have the same meaning as prescribed in Rule 13h-1 (Large Trader Reporting) under the Exchange Act, which generally presumes control at a level of 25% interest.23

The term "parallel account structure" would be defined to mean "a structure in which one or more private funds (each a 'parallel fund'), accounts, or other pools of assets (each a 'parallel managed account') managed by the same investment adviser pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions as another parallel fund or parallel managed account."24

Investment Advisers Under the Proposal

RIAs would be subject to the proposed rules.25 The SEC states that an RIA could become subject to the proposed rules with respect to trading for its own proprietary account, as well as the accounts of clients the RIA controls, unless an exclusion or exemption applies. Importantly, the fact that the RIA has discretionary authority over a client's account would not itself cause the account's trading activity to be aggregated with the activity for the RIA's own proprietary account. Rather, aggregation would be required only if the RIA controls the client itself.26

If the Proposal is adopted in its current form, RIAs will need to carefully consider which advisory clients are considered under their control and hence which clients' advisory accounts must be aggregated with the RIA's own proprietary account for purposes analyzing the RIA's activities under

the proposed rules.

Dealer Registration With the SEC and Self-Regulatory Organizations

If adopted, any person deemed to be acting as a dealer (or government securities dealer) under the proposed rules would, absent an available exception or exemption or "no-action" position, have to register with the SEC and become a member of a national securities exchange and/or FINRA and comply with applicable SEC and exchange/FINRA rules within one year of the effective date of any final rules.27 Compliance with certain of these rules could prove challenging for some firms based on their current business model. For example, the SEC generally requires all registered broker-dealers to comply with its net capital rule under Rule 15c3-1 of the Exchange Act. The SEC's net capital rule, as well as certain FINRA rules, imposes substantial limitations/restrictions on the ability to withdraw capital from such broker-dealer, and FINRA or an exchange could impose limits/restrictions on the amount of leverage used by a broker-dealer. This could restrict liquidity for investors in a private investment/hedge fund that seeks to trade principally through a wholly owned subsidiary that is a registered broker-dealer.

While it is currently possible for certain exchange-member dealers to avoid FINRA membership, market participants would be wise to not expect the current exemption from FINRA membership to last. Section 15(b)(8) of the Exchange Act generally requires that a broker-dealer become a member of a national securities association (i.e., FINRA, as the sole-registered securities association), unless the broker-dealer effects transactions solely on an exchange of which it is a member.28 Rule 15b9-1 provides a further exemption from FINRA membership, generally allowing an exchange-member dealer that carries no customer accounts and effects all of its trades with or through other registered broker-dealers to avoid FINRA membership.29

In 2015, however, the SEC proposed amendments to significantly narrow the Rule 15b9-1 exemption from FINRA membership.30 It seems reasonable to expect that the SEC might repropose the narrowing of this exemption in the coming months to ensure that dealers captured by the Proposal are subject to regulatory oversight by FINRA, as the primary regulator of the over-the-counter (OTC) markets. Exchanges are not well positioned to regulate and oversee the trading activity of, for example, a government securities dealer that transacts almost exclusively in the OTC treasury markets. Accordingly, we anticipate that proposed changes to Rule 15b9-1 may be forthcoming.

State "Blue Sky" Law Provisions Would Continue to Apply

The Proposal relates only to the interpretation of the Exchange Act's "dealer" and "government securities dealer" definitions. Individual state "Blue Sky" law provisions would continue to apply, although many states' Blue Sky laws contain provisions that require such laws to be interpreted to promote uniformity with other states' laws and the "related federal regulation." As such, generally, a person that is not deemed to be a dealer (or government securities dealer) under the Exchange Act should, as a general matter, not be subject to separate registration under state Blue Sky laws. However, to the extent that a person is required to be registered as a dealer (or government securities dealer) under the Exchange Act, the state Blue Sky laws do not separately regulate securities "dealers" versus "government securities dealers" but rather regulate "broker-dealers." In this regard, a broker-dealer could include both a securities dealer and a government securities dealer.

As a general matter, a person registered as a dealer or government securities dealer under the Exchange Act and which (i) does not maintain a place of business in a particular state and (ii) effects securities transaction in a state solely with certain enumerated categories of institutional investors (including one or more state-registered broker-dealers) would not be required to be separately

registered as a broker-dealer under the applicable state's Blue Sky law. Even if a person is required to become registered under a state's Blue Sky laws, Section 15(i)(1) of the Exchange Act preempts the states from imposing requirements on an Exchange Act–registered dealer with respect to, among other things, capital, margin, keeping records, and financial and operational reporting requirements that "differ from, or are in addition to, the requirements in those areas established under [the Exchange Act]."31

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April 11, 2022

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1 Exchange Act Release No. 94524 (March 28, 2022), https://www.sec.gov/rules/proposed/2022/34-94524.pdf.
2 The Proposal does not address the definitions of "municipal securities dealer" in Section 3(a)(30) of the Exchange Act or "security-based swap dealer" in Section 3(a)(71) of the Exchange Act.
3 The SEC estimates that the Proposal would require approximately 51 persons to register as dealers and 46 persons to register as government securities dealers. Proposal at 171-172.
4 15 U.S.C. 78c(a)(5)(A) and (B). Similarly, Section 3(a)(44) of the Exchange Act provides, in relevant part, that the term "government securities dealer" means "any person engaged in the business of buying and selling government securities for his own account, through a broker or otherwise" but does not include "any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business." 15 U.S.C. 78c(a)(44).
5 Exchange Act Release No. 46745 (Oct. 30, 2002), 67 FR 67496, 67498–67500 (Nov. 5, 2002) (explaining that "a person that is buying securities for its own account may still not be a 'dealer' because it is not 'engaged in the business' of buying and selling securities for its own account as part of a regular business" and that "[t]his exclusion is often referred to as the dealer/trader distinction").
6 The SEC has identified a number of other indicators of dealer activity, including, among other things, (1) acting as a market maker or specialist on an organized exchange or trading system, (2) acting as a de facto market maker or liquidity provider, and (3) holding oneself out as buying or selling securities at a regular place of business.
7 Proposal at 21.
8 Former SEC Chair, Enhancing Our Equity Market Structure (June 5, 2014), https://www.sec.gov/news/speech/2014-spch060514mjw.
9 The SEC notes that the proposed rules would apply to any security or government security (as defined in Sections 3(a)(10) and 3(a)(42) of the Exchange Act, respectively), "including any digital asset that is a security or a government security within the meaning of the Exchange Act." See Proposal at n.36.
10 The Proposal states that "routinely" means "more frequent than occasional but not necessarily continuous" and that this interpretation of the term "will separate persons engaging in isolated or sporadic securities transactions from persons whose regularity of participation in securities transactions demonstrates that they are acting as dealers." Proposal at 48-49.
11 The Proposal states that "roughly comparable" means "similar enough, in terms of dollar volume, number of shares, or risk profile, to permit liquidity providers to maintain near market-neutral positions by netting one transaction against another transaction." Id. at 50. The SEC offers no bright-line test for "roughly comparable" but additionally states that "a person that closes or offsets, in the same day, the overwhelming majority of the positions it has opened, has likely made 'roughly

comparable purchases and sales.' " Id.
12 With respect to the meaning of "the same or substantially similar," the Proposal states that securities are the "same" if they are "securities of the same class and having the same terms, conditions, and rights," such as securities with the same CUSIP. Id. at 52. Whether securities are considered to be "substantially similar" would be a facts and circumstances analysis, taking into account such factors as whether "(1) the fair market value of each security primarily reflects the performance of a single firm or enterprise or the same economic factor or factors, such as interest rates; and (2) changes in the fair market value of one security are reasonably expected to approximate, directly or inversely, changes in, or a fraction or a multiple of, the fair market value of the second security." Id. at 53.
13 This category would encompass "day trading" activity meeting this criteria — activity that has historically been regulated by self-regulatory organization margin rules, such as, Rule 4210(f)(8)(B) of the Financial Industry Regulatory Authority, Inc. (FINRA).
14 The Proposal states that the term "trading interest" is intended to capture "traditional quoting engaged in by dealer liquidity providers, new and developing quoting equivalents, and the orders that actually result in the provision of liquidity" that the SEC intends the proposed rules to address. Id. at 57.
15 See proposed Rules 3a5-4(a)(1) and 3a44-2(a)(1).
16 See proposed 3a44-2(a)(2).
17 See proposed Rules 3a5-4(c) and 3a44-2(c). See also Proposal at 35-37 and 94-95.
18 See proposed Rules 3a5-4(a)(2) and 3a44-2(a)(3).
19 For example, an entity that is acting as an underwriter would still be required to register as a dealer. Proposal at 94.
20 See, e.g., Exchange Act Sections 3(a)(5)(C) and 3(a)(44)(C).
21 17 CFR 240.15a-6. See Proposal at 29. Rule 15a-6 under the Exchange Act provides a "foreign broker or dealer" (as defined in the rule) a limited exemption from the registration requirements of Sections 15(a)(1) and 15B(a)(1) of the Exchange Act (that is, with respect to securities dealers and municipal securities dealers, but not government securities dealers). Treasury Regulation 401.7, however, provides a substantially similar exemption with respect to the registration requirements in Section 15C(a) of the Exchange Act. 17 CFR 401.7.
22 Put another way, the fact that a registered investment adviser (RIA) has discretionary authority over a client's account would not itself cause the account's trading activity to be attributed to the investment adviser for purposes of the proposed rules. On the other hand, if the investment adviser is deemed to control the client, then the trading activity for that client account would be attributed to the investment adviser.
23 17 CFR 240.13h-1. Rule 13h-1(a)(3) provides that "the term control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of securities, by contract, or otherwise. For purposes of this section only, any person that directly or indirectly has the right to vote or direct the vote of 25% or more of a class of voting securities of an entity or has the power to sell or direct the sale of 25% or more of a class of voting securities of such entity, or in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that entity."
24 See proposed Rules 3a5-4(b)(4) and 3a44-2(b)(4).
25 Although there is an exclusion from the definition of "investment adviser" for any broker or dealer whose performance of advisory services is solely incidental to the conduct of such person's business as a broker or dealer, and who receives no special compensation therefor (see Section 202(a)(11)(C) of the Advisers Act), there is no comparable exception from the definition of "dealer" (or "broker") under the Exchange Act for an RIA.
26 See also note 22, supra.
27 The compliance period would apply only to persons captured by the proposed rules as of the

effective date of any final rules but would not cover market participants whose activities are captured by the final rules only after the effective date. Proposal at 34-35. This compliance period could prove challenging as, for example, it can take six months or longer to become a FINRA member.
28 15 U.S.C. 78o(b)(8).
29 17 CFR 242.15b9-1. Rule 15b9-1 generally exempts a broker-dealer from the requirement to become a member of a national securities association if it is a member of a national securities exchange, carries no customer accounts, and has annual gross income of no more than $1,000 that is derived from securities transactions effected otherwise than on a national securities exchange of which it is a member. Under the rule, income derived from transactions for the dealer's own account with or through another registered broker-dealer does not count toward this $1,000 de minimis threshold.
30 Exchange Act Release No. 74581, 63 FR 18036 (Apr. 2, 2015).
31 15 U.S.C. 78o(i)(1)

Q1 2022 Update on LIBOR Transition Developments: McGuireWoods

Since passing the December 31, 2021 "no new LIBOR" line-in-the-sand drawn by regulators, the pace of new developments in LIBOR transition has slowed as various markets have adapted to pricing transactions at SOFR or some other alternative to LIBOR. As we close out Q1 2022, here are some of the highlights in events and trends we've seen since our last post.

Federal LIBOR Legislation: On March 15, 2022, President Biden signed the Consolidated Appropriations Act, 2022, which contains as part of its many provisions the Adjustable Interest Rate (LIBOR) Act. The LIBOR Act is largely unchanged from the legislation passed by the U.S. House of Representatives in December 2021, which the U.S. Senate also passed earlier this month as part its approval of The Consolidated Appropriations Act. Some of the highlights:

- As discussed in a previous post on the House bill, the LIBOR Act is intended to provide a transition from LIBOR to a SOFR based rate for "tough" legacy contracts which lack adequate fallback provisions and would be difficult to amend.
- The LIBOR Act does not affect contracts which already contain benchmark replacement or alternate interest rate provisions, so the work in the business loan market (which typically contain some version of fallback language even in credit documents that pre-date LIBOR sunset announcements) will need to continue apace.
- The LIBOR Act also amends the Trust Indenture Act of 1939 to resolve potential conflicts between the provisions of that legislation and changes authorized under the LIBOR Act.
- The Board of Governors of the Federal Reserve System (the Fed) is charged with adopting

regulations to implement the LIBOR Act and establish a replacement rate based on SOFR (including establishing spread adjustments for the one, three and six month interest period tenors).
- Perhaps most importantly, the LIBOR Act establishes safe harbor from claims and liability for administrators, trustees or agents which utilize Fed selected benchmark replacements and procedures.

The LIBOR Act will provide important relief for CLOs, bonds and similar widely held and difficult to amend debt instruments, and protection for the trustees and agents which administer those products in dealing with LIBOR transition, but will have little direct impact for the business loan market.

No New LIBOR and its Nuances: As to business loans, throughout the end of Q42021 and early Q12022, we've seen banks methodically implementing the joint OCC and Fed regulatory guidance dictating "no new LIBOR" after December 31, 2021. This has been clearly understood to mean no new LIBOR deals or facility size increases for LIBOR deals after that date, and no extensions of maturity for existing LIBOR deals beyond June 30, 2023 (the final termination date for the publication of LIBOR). The meaning of "no new LIBOR" for other credit actions on and after January 1, 2022 is less clear and much discussed: For instance:

- *Committed delayed draw term loans:* like a committed revolver, probably OK to fund at LIBOR (but probably not OK to extend the draw period)
- *Uncommitted facilities:* some credit facilities are "discretionary", and without an ***obligation*** to lend at LIBOR, the weight of interpretation has settled on – move away from LIBOR absent compelling circumstances
- *Material Credit Actions / Waivers:* some banks have decided to use any material credit action as a basis to move away from LIBOR, e.g., a waiver, forbearance or other action requiring credit committee approval

Regulators have avoided issuing specific bright line guidance on these and other "grey area" questions in an effort to push the market away from LIBOR as quickly as possible – if you're uncertain whether a funding or credit action crosses the "no new LIBOR" line, ask your examiner, with a preference for moving off LIBOR wherever possible.

Term SOFR Adoption: An open question early in Q42021 was whether CME Term SOFR would be widely adopted. That questions has been clearly answered "yes", and CME Term SOFR (now expanded to offer twelve month tenors, along with the original one, three and six month tenors), has become commonplace in syndicated loan transactions. Lower middle market bilateral lending transactions have been showing a variety of alternative approaches, including SOFR varieties (e.g., one month SOFR resetting monthly), BSBY, Ameribor and in some cases, "Prime minus" formulations. ARRC and LSTA model SOFR language has been widely adopted particularly in syndicated transactions, with some negotiation around a few topics:

- *Spread Adjustments:* As previously noted, LIBOR-to-SOFR fallback language recommended by ARRC and industry groups (e.g. the LSTA) included a "spread adjustment" to approximate LIBOR values in a SOFR-based rate calculation, i.e., Term SOFR + Spread Adjustment + Applicable Margin, and on March 5, 2021, the ARRC published recommended spread adjustments for one, three and six month tenors based on the average spread between SOFR and LIBOR during the 5 year period leading up to that date. However throughout 2021 Q2 – Q4, the spread between the SOFR and LIBOR spot rates was lower than the 5 year average, leading to frequent negotiation around those spread adjustment values. That dynamic turned around in 2022 Q1, with international and market turmoil driving LIBOR up (recall LIBOR is more sensitive to credit market shocks than SOFR), and pushing the spot spreads back up to, or even slightly above, the ARRC

recommended SOFR spreads.

- *Beyond Spread Adjustments:* While spread adjustments made sense for fallback language designed to kick in at a future "Benchmark Replacement Date", a two part calculation (Term SORF + Applicable Margin, with any additional credit risk built into the Applicable Margin) seems like the better approach for new day-one Term SOFR loans. That approach hasn't yet been widely adopted in our experience, and the "Adjusted Term SOFR" three-part construct described above (with the attendant fluid negotiations around the proper spread adjustment) has become something of the norm, at least through February 2022. However we have seen some movement recently toward the simpler two part construct as lenders have become more comfortable with how to price SOFR based loans.
- *Most Favored LIBOR Transition:* We've seen borrowers occasionally ask for, and lenders occasionally agree to, most favored nation treatment on benchmark replacement setting.
- *Break Funding:* We've seen borrowers regularly ask to remove break funding make-whole language on the theory that SOFR loans are not match-funded, so that there should never be any break funding exposure for lenders. There continues to be debate in the market around the practical utility and application of such provisions, but we have generally seen them retained in credit agreements.

Remediation of Existing LIBOR Contracts: While the market evolves around new day-1 SOFR transactions, lenders are actively working to remediate their shrinking, but still very significant, back-book of LIBOR linked business loans. Although new syndicated debt linked to SOFR outpaced LIBOR in January and February, the total outstanding value of debt products linked to LIBOR is still significant, so with only 5 quarters until the last day of LIBOR publication, much remediation work remains.

By Donald A. Ensing, Susan Rodriguez, James Gelman & Kent Walker on March 31, 2022

McGuireWoods, LLP

When Are CCOs on the Hook? FINRA Offers Guidance on CCO Liability - Latham & Watkins

Guidance clarifies assessment of liability under Rule 3110, including designation as supervisor, application of reasonableness standard, and factors for and against charging compliance officials.

On March 17, 2022, the Financial Industry Regulatory Authority, Inc. (FINRA) published Regulatory Notice 22-10 (Reg. Notice 22-10), reminding broker-dealers of the scope of liability for chief compliance officers (CCOs) under FINRA's Supervision Rule (Rule 3110). The role of compliance, and that of the CCO in particular, which is often characterized as "vital" in helping to prevent, detect, and remediate potential violations of internal policies and procedures and the securities laws, has been the subject of policy debate for some time.[1] In Reg. Notice 22-10, FINRA outlines a blueprint to assess the potential liability of CCOs under Rule 3110.

Rule 3110 imposes various supervisory obligations on member firms, such as the obligation to "establish and maintain a system, including written procedures, to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules." Firms are also required to designate registered principals as supervisors for these responsibilities. The express or implied designation of supervisory

authority is the basis for individual liability under Rule 3110.

Assessing Supervisory Responsibility

FINRA clarifies a CCO will be subject to liability under Rule 3110 only when the firm designates the CCO as having supervisory responsibility. The starting point of the analysis is not the title[2] but the designation of supervisory responsibility. The ultimate responsibility for a broker-dealer's compliance rests with its chief executive officer and senior management, not compliance officials.[3]

A CCO can be "designated" as having supervisory responsibility via express designation or, the firm's CEO or other senior business manager can "expressly or impliedly designate the CCO as having specific supervisory responsibilities on an ad hoc basis."

Per Reg. Notice 22-10, CCOs can be "designated" as having supervisory responsibility in the following ways:

1. **Written CCO Supervisory Designation to Establish, Maintain, and Update WSP:** The broker-dealer's written procedures might assign to the CCO the responsibility to establish, maintain, and update written supervisory procedures (WSPs), both generally and in specific areas (e.g., electronic communications).
2. **Written CCO Supervisory Designation to Enforce WSP:** The broker-dealer's written procedures might assign to the CCO the responsibility for enforcing the broker-dealer's WSPs or other specific oversight duties usually reserved for line supervisors.
3. **Ad Hoc Express or Implied CCO Supervisory Designation:** The broker-dealer's president or other senior business manager might also expressly or impliedly designate the CCO as having specific supervisory responsibilities on an ad hoc basis.
4. **CCO Supervisory Designation as Exigencies Demand:** The CCO may be asked to take on specific supervisory responsibilities as exigencies demand, such as the review of trading activity in customer accounts or oversight of associated persons.

FINRA clarifies in Reg. Notice 22-10: "Only in circumstances when a firm has expressly or impliedly designated its CCO as having supervisory responsibility will FINRA bring an enforcement action against a CCO for supervisory deficiencies."

The Reasonableness Standard

CCOs are not subject to strict liability. Even when a CCO has been designated as having supervisory responsibilities, FINRA would seek to discipline a CCO under Rule 3110 if the CCO failed to discharge those designated supervisory responsibilities in a reasonable manner. The determination of reasonableness in a CCO's performance of these supervisory responsibilities depends upon the facts and circumstances of each particular situation. FINRA will assess reasonableness in terms of whether the CCO's conduct was tailored toward achieving compliance with the federal securities laws, regulations, or FINRA rules.

Factors for and Against Charging a CCO under Rule 3110

In assessing potential liability under Rule 3110, FINRA weighs the facts and circumstances of each case to determine whether the CCO's conduct in performing designated supervisory responsibilities was reasonable in terms of achieving compliance with the federal securities laws, regulations, or FINRA rules.

Not every violation under Rule 3110 results in formal disciplinary charges. FINRA weighs various aggravating and mitigating factors to determine, based on the facts and circumstances of each

particular case, whether to bring formal or informal disciplinary action (e.g., a Cautionary Action Letter).

Aggravating factors include awareness of multiple red flags or actual misconduct and failure to take steps to address them, as well as failure to establish, maintain, update, or enforce a firm's WSPs. FINRA would also assess whether the CCO's supervisory failure resulted in violative conduct, and whether that conduct caused or created a high likelihood of customer harm.

Mitigating factors include whether the CCO was given insufficient staffing, budget, and training; whether the CCO was unduly burdened in light of competing functions and responsibilities; whether the supervisory responsibilities were poorly defined or designated; whether the firm underwent structural changes; and whether the CCO attempted to escalate such red flags to firm leadership in a good-faith effort to reasonably discharge supervisory responsibilities.

The SEC Standard for CCO Liability

Rule 3110 differs in some key respects from the application of Rule 206(4)-7 (Compliance Rule) under the Advisers Act, or Section 15(b) of the Securities Exchange Act of 1934.

Under the Compliance Rule, an investment adviser subject to SEC jurisdiction must adopt and implement written policies and procedures reasonably designed to prevent violation of the Investment Advisers Act of 1940 (Advisers Act) by the investment adviser or any of its supervised persons. The CCO must be designated to administer these policies and procedures and should also have sufficient seniority and authority within the organization to compel others in the organization to adhere to the compliance policies and procedures.

Under Section 15(b)(6) of the Securities Exchange Act of 1934, the SEC may take action against an individual associated with a broker-dealer if someone under that person's supervision violated the federal securities laws, the Commodity Exchange Act, the rules or regulations under those statutes, or the rules of the Municipal Securities Rulemaking Board; and the individual failed reasonably to supervise that person to prevent the particular violation.

The issue was central to *In the Matter of Theodore W. Urban*, an administrative proceeding decided on September 8, 2010. The order in the proceeding relied on an earlier proceeding decided in December 1992 (*In the Matter of John H. Gutfreund, et. al.*), which noted that, "[D]etermining if a particular person is a "supervisor" depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." (emphasis added).

On September 30, 2013, the SEC's Division of Trading and Markets published a set of eight Frequently Asked Questions (FAQs) concerning supervisory liability for compliance and legal personnel at broker-dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act. These FAQs stated that the Urban decision was considered "of no effect" (and therefore not adverse precedent). Liability under Section 15(b) continues to be a facts-and-circumstances determination regarding "the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." SEC staff clarify, in the FAQs, that certain facts on their own are not sufficient to turn legal or compliance personnel into supervisors. These facts include:

- Holding a compliance or legal position
- Providing advice or counsel concerning compliance or legal issues to business line personnel or even senior management
- Assisting in the remediation of an issue

- Participating in, providing advice to, or consulting with a management or other committee

For the SEC, the real question is not necessarily whether a CCO has been explicitly or implicitly designated a supervisor, but whether the person clearly has been given, or otherwise assumed, the requisite degree of responsibility, ability, or authority to affect the conduct of another employee.

In a November 4, 2015 speech, Andrew Ceresney, then-Director of the Division of Enforcement, further outlined the SEC's "longstanding careful and measured approach" to liability for CCOs of investment advisers, but also to broker-dealers and dual registrants. He noted that "after a thorough analysis of the facts and circumstances and consideration of fairness and equity," the SEC has charged CCOs primarily when the CCO directly participated in misconduct unrelated to compliance duties, such as fraud; obstructed or misled SEC Staff; or has exhibited wholesale failures in carrying out clearly assigned responsibilities, such as developing and implementing WSPs.

In one notable case that he described, a large money manager did not have any written policies and procedures regarding the outside business activities of its employees. Despite awareness of this gap and numerous red flags among employees, "the CCO failed to develop and implement written policies and procedures to assess and monitor the outside activities of the firm's employees and to disclose related conflicts of interest to the funds' boards and to advisory clients." The CCO, however, was not charged with failure to disclose the conflicts of interest; he was charged with failure to adopt written policies regarding outside business activities.

While the SEC's standard remains a fact-intensive inquiry, the SEC clearly does not consider a CCO's provision of counsel to the business (whether effective or ineffective) as grounds for supervisory liability without further analysis of the CCO's degree of responsibility, ability, or authority.

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[1] See, e.g., Securities and Exchange Commission, Commissioner Luis A. Aguilar, The Role of Chief Compliance Officers Must be Supported (June 29, 2015), available at https://www.sec.gov/news/statement/supporting-role-of-chief-compliance-officers.html.

[2] According to FINRA, "The CCO's role, in and of itself, is advisory, not supervisory." Reg. Notice 22-10; Likewise, SEC staff has noted, "Compliance and legal personnel are not 'supervisors' of business line personnel for purposes of Exchange Act Sections 15(b)(4) and 15(b)(6) solely because they occupy compliance or legal positions." Securities and Exchange Commission, Division of Trading and Markets, Frequently Asked Questions about Liability of Compliance and Legal Personnel at Broker-Dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act, at question 1 (Sept. 30, 2013), available at https://www.sec.gov/divisions/marketreg/faq-cco-supervisi-n-093013.htm; According to a statement by Jessica Hopper, FINRA Head of Enforcement, a CCO's role within a firm does not "automatically make them supervisors" subject to the requirements under Rule 3110.

[3] Id. at Background and fn 4, citing to Sheldon v. SEC, 45 F.3d 1515, 1517 (11th Cir. 1995); FINRA Regulatory Notice 22-10 ("The responsibility to meet these obligations rests with a firm's business management, not its compliance officials.").

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March 31 2022

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Reminder: SEC Requires Disclosure of Rating Changes and Financial Obligations - Dinsmore & Shohl

When it comes to continuing disclosure, two of the more common “material events” to occur are rating changes and the incurrence of a “financial obligation.” As a general matter, these are reportable events that should be posted to Electronic Municipal Market Access (EMMA). However, as a practical matter, these material events are frequently overlooked.

Whether a rating change involves an upgrade or a downgrade, it is necessary to post such changes to EMMA pursuant to SEC Rule 15c2-12 (the SEC Rule) for those issuers who are subject to the SEC Rule, even though municipal ratings are usually considered public knowledge. Typically, a change in outlook (such as stable, positive, or negative) is not considered a rating change for the purpose of the SEC Rule, although there is no prohibition in voluntarily posting a notice of such a change on EMMA.

On March 18, 2022, Moody’s Investors Service upgraded the “insurance financial strength” rating of bond insurer Assured Guaranty Municipal Corp. (AGM) and Assured Guaranty UK Limited (AGUK) to A1 from A2. A number of holding companies of Assured Guaranty were also upgraded. For those issuers, and other obligated persons, having issued bonds or other municipal obligations utilizing the credit of Assured Guaranty in the form of bond insurance or other credit enhancement, and who have continuing disclosure responsibilities under the SEC Rule, consideration should be given to disclosing this upgrade.

In the absence of an exception, the SEC Rule mandates underwriters of municipal securities ensure issuers or other obligated persons undertake to provide to the public continuing disclosure information presumed to be important to investors by filing that information with EMMA. Among other things, the SEC Rule requires issuers or obligated persons who have agreed to a continuing disclosure undertaking must provide the MSRB notice of: (a) payment delinquencies and defaults; (b) unscheduled draws on debt service reserves or credit enhancements; (c) substitution of credit or liquidity providers; (d) adverse opinions or notices from the Internal Revenue Service (IRS); (e) bond calls or tender offers; (f) defeasances; (g) bankruptcy; (h) ratings changes; and (i) a default, event of acceleration, termination event, modification of terms or similar event. Although there are other material events, those material events are qualified by a “materiality” standard, such as the disclosure of the incurrence of “financial obligations.” Any issuer or obligated person who has agreed to a continuing disclosure undertaking must notify the MSRB of the forgoing events within 10 business days.

Dinsmore & Shohl LLP – Bradley N. Ruwe and Joshua D. Grossman

March 25 2022

Hawkins Advisory: The Federal Adjustable Interest Rate (LIBOR) Act

The attached Hawkins Advisory discusses recent federal legislation that addresses a variety of legal issues arising from the anticipated June 30, 2023 phase-out of the use of United States dollar denominated LIBOR.

Read the Hawkins Advisory.

President Biden Signs Bill Expanding Cybersecurity Reporting Obligations.

President Biden signed the Consolidated Appropriations Act, 2022 into law on March 15, 2022. Section Y of the new omnibus appropriations bill is titled The Cyber Incident Reporting for Critical Infrastructure Act of 2022 ("the Act"). Importantly, the Act significantly expands federal cybersecurity incident and ransom demand reporting requirements for critical infrastructure entities. In light of these new requirements, critical infrastructure entities who suspect that they may be subject to the Act should begin investigating how the Act will impact their business and consider establishing protocols which may be necessary to ensure compliance.

Notably, the Act does not directly define many necessary terms and obligations. Instead, the Department of Homeland Security's Director of the Cybersecurity and Infrastructure Security Agency ("CISA") has been tasked with promulgating a final rule finalizing these definitions and obligations. Within 24 months of the Act's enactment, CISA is required to begin the notice-an--comment rulemaking process. The final rule must then be published within the 18 months following the start of the rulemaking process. Interested stakeholders will want to review the proposed rule promptly when it is released and consider submitting comments as appropriate.

Incident Reporting Obligations

With respect to incident reporting, the Act requires covered entities to comply with new and expanded obligations when they experience a "covered cyber incident." The term "covered entity" means a critical infrastructure entity—as defined by Presidential Policy Directive 21 ("the Directive")—that satisfies the criteria established in CISA's final rule. Although CISA's criteria will remain unknown until the final rule is promulgated, the Directive clarifies the types of entities that may be subject to the expanded requirements.

Under the Directive, critical infrastructure entities are those operating in the following sectors:

- **Chemical sector.** Including manufacturing, storing, using, or transporting potentially dangerous chemicals.
- **Commercial facilities sector.** Includes a range of sites that are open to the public and draw large crowds for shopping, business, entertainment or lodging.
- **Communications sector.** Includes satellite, wireless and wireline providers, which depend on each other to carry and terminate their traffic.
- **Critical manufacturing sector.** Encompasses the production of primary metals; machinery; electrical equipment, appliances and components; and transportation equipment that may be susceptible to man-made and natural disasters.
- **Dams sector.** Delivers water retention and control services in the United States, including hydroelectric power generation, municipal and industrial water supplies, agricultural irrigation,

sediment and flood control, river navigation for inland bulk shipping, industrial waste management and recreation.

- **Defense industrial base sector.** Encompasses research and development, as well as the design, production, delivery and maintenance of military weapons systems, subsystems and components to meet U.S. military requirements. The sector provides products and services for mobilizing, deploying and sustaining military operations. It does not include the commercial infrastructure of those who provide services such as power, communications, transportation or utilities, which are covered under other sectors.
- **Emergency services sector.** Includes law enforcement, fire and rescue services, emergency medical services, emergency management and public works.
- **Energy sector.** Includes entities that focus on electricity, oil and natural gas.
- **Financial services sector.** Includes depository institutions, providers of investment products, insurance companies, and other credit and financing organizations, as well as the providers of the critical financial utilities and services that support these functions.
- **Food and agriculture sector.** Includes farms, restaurants, and registered food manufacturing, processing and storage facilities.
- **Government facilities sector.** Includes general-use office buildings and special-use military installations, embassies, courthouses, national laboratories and structures.
- **Healthcare and public health sector.** Focuses on protecting all sectors of the economy from terrorism, infectious disease outbreaks and natural disasters.
- **IT sector.** Covers hardware, software, and IT systems and services, along with the communications sector and the internet.
- **Nuclear reactors, materials and waste sector.** Encompasses most aspects of America's civilian nuclear infrastructure, such as nuclear facilities, materials and waste, as well as any cybersecurity related to these facilities.
- **Transportation systems sector.** Focuses on safely, securely and efficiently moving people and goods through the country and overseas. Subsectors include aviation, highway and motor carrier, maritime transport system, mass transit and passenger rail, pipeline systems, freight rail, postal and shipping.
- **Water and wastewater systems sector.** Concentrates on ensuring the supply of drinking water and wastewater treatment.

Similar to the definition of "covered entity," the full definition of "covered cyber incident" will not be available until CISA publishes the final rule. However, the Act establishes that the definition of "covered cyber incident" will contain certain key elements. Pursuant to the Act, the final rule's definition of "covered cyber incident" must require, at minimum, the occurrence of:

- A cyber incident that leads to substantial loss of confidentiality, integrity or availability of such information system or network, or a serious impact on the safety and resiliency of operational systems and processes;
- A disruption of business or industrial operations, including due to a denial of service attack, ransomware attack or exploitation of a zero-day vulnerability against 1) an information system or network, or 2) an operational technology system or process; or
- Unauthorized access or disruption of business or industrial operations due to loss of service facilitated through, or caused by, a compromise of a cloud service provider, managed service provider or other third-party data hosting provider, or by a supply chain compromise.

CISA's final rule will also outline many substantive requirements such as incident reporting obligations and ransom reporting obligations. In each instance, the final rule shall require a covered entity to report the following within 72 hours of the covered entity's reasonable belief that a covered cyber incident has occurred:

- A description of the "covered cyber incident including i) identification and a description of the function of the affected information systems, networks, or devices that were, or are reasonably believed to have been, affected by such cyber incident, ii) a description of the unauthorized access with substantial loss of confidentiality, integrity, or availability of the affected information system or network or disruption of business or industrial operations, iii) the estimated data range of such incident, and iv) the impact to the operations of the covered entity;"
- A description of the vulnerabilities exploited and the security defenses that were in place, as well as the tactics, techniques, and procedures used to perpetrate the "covered cyber incident;"
- Any identifying or contact information related to each actor reasonably believed to be responsible for such cyber incident;
- The category or categories of information that were, or are reasonably believed to have been, subject to unauthorized access or acquisition;
- Identification information of the impacted entity; and
- Contact information for the impacted entity or an authorized agent of the entity.

In the event that a covered entity makes a ransom payment, the final rule will also require the covered entity to make the following disclosures to CISA within 24 hours of such payment:

- A description of the ransomware attack, including the estimated date range of the attack;
- A description of the vulnerabilities, tactics, techniques, and procedures used to perpetrate the ransomware attack;
- Any identifying or contact information related to the actor or actors reasonably believed to be responsible for the ransomware attack;
- The name and other information that clearly identifies the covered entity that made the ransom payment or on whose behalf the payment was made;
- The contact information of the covered entity or authorized agent that made the ransom payment;
- The date of the ransom payment;
- The ransom payment demand, including the type of virtual currency or other commodity requested;
- The ransom payment instructions; and
- The amount of the ransom payment.

Additionally, the Act also requires a covered entity to submit updated reports to supplement previously provided information when substantial new information is discovered. Once a report is submitted, all data relevant to the "covered cyber incident" or ransom payment must then be preserved by the covered entity pursuant to procedures yet to be established through the rulemaking process.

Exceptions to Reporting Obligations

The exceptions to these reporting obligations are fairly narrow. For instance, while a covered entity would otherwise be required to make two reports to cover both a covered cyber incident and a ransom payment, the Act allows such an entity to combine all required information into a single report. Similarly, in the event that a covered entity is subject to certain reporting requirements to other Federal agencies, the report to the other agency may satisfy the entity's reporting obligations to CISA provided that a sharing agreement between the agencies exists.

Using a Third Party to Submit a Required Report or Make a Ransom Payment

A covered entity may either submit a required report itself or use a third party to do so. Such a third party can include an entity such as an "incident report company, insurance provider, service provider, Information Sharing and Analysis organization, or law firm." In the event that a covered

entity utilizes a third party, it must be aware that the use of such a third party does not relieve the covered entity from its reporting requirement. Rather, a covered entity utilizing a third party is subject to the same reporting obligations and timelines as it would be had it submitted the report or made the ransom payment itself.

Notably, third parties are largely exempt from independent obligations under the Act. Importantly, where a third party submits a report or makes a ransom payment on behalf of a covered entity, that third party is not obligated to submit a separate report on its own behalf. However, such a third party does have an obligation to advise the covered entity of their responsibilities regarding the covered entity's reporting obligations. Thus, businesses who act as third parties and provide reporting services to covered entities should remain apprised of all reporting requirements and prepare to advise their clients.

Incident Report Sharing and Data Use

Though the Act establishes substantial reporting obligations, it also limits CISA's ability to use and share the information provided by covered entities in the reports. Importantly, such information may only be used by the Federal Government for:

- Cybersecurity purposes;
- Identifying a cyber threat or security vulnerability;
- Purposes of responding to, "or otherwise preventing or mitigating, a specific threat of death, a specific threat of serious bodily harm, or a specific threat of serious economic harm;"
- Purposes of "responding to, investigating, prosecuting, or otherwise preventing or mitigating, a serious threat to a minor;" or
- Purposes of "preventing, investigating, disrupting, or prosecuting an offense arising out of a reported cyber incident."

In addition to the limitations on use, similar to other cyber threat information-sharing opportunities provided by the Federal Government, information contained in required reports is afforded further protections. Importantly, information obtained by CISA via a required report may not act as the basis for any cause of action. Similarly, such information is also protected from admission into evidence in any future proceeding. Thus, any information contained in a required report may not be received into evidence, subjected "to discovery, or otherwise used in any trial, hearing, or other proceeding in or before any court, regulatory body, or other proceeding."

In providing these protections, the Act intends to enable covered entities to fully disclose all relevant information regarding a covered cyber incident without incurring the risk of potentially exposing itself to liability due to the content of the report. Additional protections establish that information disclosed to CISA pursuant to the Act:

- Is considered to be the "commercial, financial, and proprietary information of the covered entity when so designated by the covered entity;
- Is exempt from disclosure under the Freedom of Information Act (FOIA);
- Is exempt from disclosure required by any "State, Tribal, or local freedom of information law;"
- Is not considered to be a waiver of any "applicable privilege or protection provided by law, including trade secret protection;" and
- May be shared externally only when the victim's identity is anonymized.

Enforcement

In the event that a covered entity fails to comply with the new cyber incident reporting obligations,

CISA's director may request information if it suspects the entity of noncompliance. If the covered entity fails to respond within 72 hours, CISA may then issue an administrative subpoena. Should the covered entity subsequently fail to comply with the subpoena, CISA may turn the matter over to the U.S. Attorney General for civil enforcement and covered entity may potentially held in contempt of court.

However, prior to exercising their enforcement authority, the CISA director must first consider i) the complexity of determining whether a covered cyber event has occurred as well as ii) the covered entity's previous interactions with the agency and the likelihood that the entity is aware of its reporting obligations.

Other Notable Provisions

In addition to expanding reporting obligations, the Act also creates several entities and programs intended to improve the state of cybersecurity in the U.S. These additional provisions call for the creation of:

- The Cyber Incident Reporting Council, led by the Secretary of Homeland Security, which will be responsible for coordinating, deconflicting, and harmonizing Federal incident reporting requirements;
- A ransomware vulnerability warning pilot program intended to "leverage existing authorities and technology to specifically develop processes and procedures for . . . identifying information systems that contain security vulnerabilities associated with common ransomware attacks, and to notify the owners of those vulnerable systems of their security vulnerability;" and
- The "Joint Ransomware Task Force to coordinate an ongoing national campaign against ransomware attacks, and identify and pursue opportunities for international cooperation."

Key Takeaways

Though there is much that will remain unclear until CISA promulgates the final rule, businesses should, at the very least, be aware of the following:

To whom does the Act apply? The Act applies to covered entities as defined by CISA.

What does the act mandate? Reports must be made to CISA when the covered entity makes a ransom payment or experiences a covered cyber incident.

When must the report be made? Reports must be made to CISA within 72 hours of a business's reasonable belief that a covered cyber incident has occurred and 24 hours of any ransom payment.

How is the information contained in the reports protected? CISA may only use the information in the reports for very limited purposes outlined above. Such information is further protected from disclosure via discovery, FOIA requests, or other open records requirement, etc.

How is the Act enforced? The CISA may request information in the event that it believes a covered entity may be noncompliant. If the entity fails to respond to the request within 72 hours, the CISA may issue a subpoena. If the entity fails to respond to the subpoena, the CISA may turn the matter over to the U.S. Attorney General who may enforce the subpoena.

Crowell & Moring LLP – Sarah Rippy, Matthew B. Welling, Evan D. Wolff, Maida Oringher Lerner, Alexander Urbelis and Michael G. Gruden

March 24 2022

SEC Settles Municipal Bond Fraud Case Against Texas School District and Former CFO, and Suspends External Auditor.

On March 16, the SEC filed a municipal bond fraud case against Crosby Independent School District and its former CFO in a $20 million bond offering.1 Crosby is a suburb of Houston, Texas. The SEC also charged the district's outside auditor with improper professional conduct and suspended her from appearing or practicing before the Commission with a right to reapply after three years.

A review of the allegations reveals that the case involved classic financial reporting fraud. The SEC alleged that Crosby ISD's year-end 2017 financial statements seriously understated its payroll and construction liabilities by failing to report some $11.7 million of such liabilities. Those same audited financial statements also contained false claims that the district had $5.4 million in general fund reserves, thereby substantially overstating its assets. According to the Commission, the district and the then-CFO knew that the financial statements were false but issued them anyway. The CFO also allegedly signed false management representation letters. The false statements also appeared in the offering documents for the municipal bond sale.

The fraud allegedly came to light in June 2018 when the successor CFO discovered the misstatements. In August 2018, seven months after the offering, the district disclosed significant financial distress, including that it had a negative general fund balance. The following month, ratings agencies downgraded the district's bonds.

The audit partner agreed to a suspension from appearing or practicing before the Commission under Rule 102(e) of the Commission's Rules of Practice.2 The Commission charged her with improper professional conduct, including failure to obtain sufficient audit evidence, improper supervision of the audit, and lapses in professional judgment and professional skepticism.

The settlements with the district and the former CFO, which were made on a neither-admit-nor-deny basis, involve alleged violations of the antifraud provisions of the federal securities laws, including Exchange Act Section 10(b) and Exchange Act Rule 10b-5.3 The former CFO agreed to pay a $30,000 penalty and not participate in any future municipal securities offerings.

The case is a reminder that the SEC is the cop on the beat in municipal securities offerings and will enforce the securities laws when violations occur.

Footnotes

1. SEC Press Release, *SEC Charges Texas School District and its Former CFO with Fraud in $20 Million Bond Sale* (Mar. 16, 2022), available here.

2. Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions, Securities Exchange Act Release No. 94426 (Mar. 16, 2022), available here.

3. Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing A Cease-and-Desist Order, Securities Act Release No. 11039 (Mar. 16, 2022), available here.

by Toby M. Galloway

23 March 2022

Winstead PC

The Curious Story of How CUSIP Numbers Became a Wall Street Battleground.

CUSIP numbers are like a Dewey Decimal System for stocks and bonds. They're also a source of illegal monopoly power, according to investor lawsuits.

They may not be the most exciting part of the securities markets, but CUSIP numbers are indispensable.

The arcane nine-digit ID numbers, issued by the Committee on Uniform Securities Identification Procedures, show up on everything from stocks, bonds, exchange-traded securities and mutual funds. They're also not free. In at least two class-action lawsuits, investors are alleging that the cost of CUSIPs has been artificially inflated for decades, as a result of monopolistic control by data providers including the American Bankers Association, FactSet and S&P Global.

Investors, who are seeking injunctions and damages, allege the CUSIP system's owners and exclusive licensees aggressively sought to dampen competition from other services offering free or lower-cost alternatives.

"The motive for their exclusion of competition is simple," says one of the complaints filed recently in Manhattan federal court, "CUSIPs are worthless except for the fact that they are the standard."

How the CUSIP system began

CUSIPs have been standard since the 1960s for identifying securities for clearing and settlement of trades. The system is owned by the ABA and a subsidiary of S&P's Global Market Intelligence, now called Factset Research Systems, which completed its purchase of the business from S&P this month for $1.925 billion.

The numbering system was originally a subscription service that provided physical books containing information on every financial instrument linked to a CUSIP and were updated quarterly or annually. But in the 1980s, vendors like Bloomberg began distributing the data directly and electronically to financial institutions, making it unnecessary to pay a fee to S&P.

To counter the loss of revenue, S&P changed its business model from a subscription service to a licensing one, and required financial firms using CUSIPs to pay substantial fees. S&P inserted language in its contracts with data vendors requiring them to cut off access to the CUSIPs for any financial institution that did not enter into a license agreement with S&P.

At about the same time, according to the lawsuits, ABA and S&P became more aggressive in trying to maintain their stranglehold on the system.

"Monopolies are rarely good for business," said Ronald J. Aranoff, a partner in the Litigation & Dispute Resolution Group at Wollmuth Maher & Deutsch LLC, which represents plaintiff Hildene

Capital Management. “We trust the court to decide whether the exercise of monopoly power here was unlawful. We believe it is.”

Flexing monopoly power

CUSIP was designated as a financial standard by a committee of the American National Standards Institute (ANSI), dubbed X9. But X9 is hardly an independent body, at least according to the class action suits. The ABA established X9 during the 1970s and it, as well as S&P’s CUSIP Global Services, are still connected to X9 through voting positions on the committee’s board of directors.

Hildene is an institutional asset manager headquartered in Stamford, Conn. Like all other investment managers and traders, it requires access to financial information for managing, monitoring, buying, and selling financial instruments. The company typically pays Bloomberg for access to data that includes CUSIP numbers. For Hildene, the cost of getting the data with CUSIP numbers ends up being about $10,500 a year.

“Hildene…[is] then left with two unenviable options: pay S&P’s supracompetitive subscription rates or have CUSIP numbers stripped from their data feed and suffer, at a minimum, significant disruption to their businesses,” the lawsuit states.

Hildene once balked at paying the licensing fees, and was sent “a series of increasingly hostile letters” and threats that it must pay the fee or face a debilitating lock out from access to CUSIP numbers, according to the suit. With no alternative, Hildene eventually signed the subscription agreement.

Making money by owning CUSIPs

The CUSIP owners generate revenue in at least three ways. First, S&P, now Factset, charges securities issuers a fee, typically about $280 per CUSIP number, to obtain CUSIP numbers for its securities. Second, S&P charges data providers, like Bloomberg, licensing fees for using CUSIPs in its databases. Third, and more recently, S&P demands that end users, like Hildene, enter their own subscription agreements with S&P under the threat of having the numbers stripped from their data feeds.

“Defendants have a clear interest in requiring that all data users use only the CUSIP identifier system,” according to the suit. “That is because…the ABA retains 30% of CGS’s licensing fees from all data users and the remainder is kept by S&P.”

An earlier class-action complaint by Dinosaur Financial Group LLC further alleges that ABA and S&P are violating copyright laws, on the premise that ID numbers like CUSIP numbers can’t be protected by copyrights.

“A CUSIP is a number that has been known to humanity literally for millennia,” the complaint says. “Mathematicians, scientists, teachers, and financial markets’ participants use numbers every day that happen to coincide with CUSIP numbers. Yet, defendants assert that the ABA has copyrighted those numbers and therefore can control the use of those numbers. That assertion is legally baseless.”

Attempts to reach the ABA and S&P for comment about the suits were unsuccessful.

Past antitrust complaints

Complaints about the CUSIP system and allegations that it unfairly restrains competition have

surfaced multiple times throughout its history.

In November 2009, the European Commission accused S&P of abusing its position as the sole provider of ISIN codes – the international version of the CUSIP – by requiring European financial firms and data vendors to pay licensing fees for their use. The European Commission noted that there are no acceptable alternatives for traders and financial institutions.

Although it disagreed with the commission's findings, S&P offered to create a lower-cost alternative feed of certain ISINs for market participants in Europe.

The Center for Municipal Finance, a U.S.-based nonprofit dedicated to improving the municipal bond market, has come out in support of a free alternative to CUSIPs, developed by Bloomberg, called Financial Instrument Global Identifiers. It's unclear however, whether the FIGI will gain traction in the market because it is not recognized as an industry standard.

"CUSIP is not the United States' financial instruments identifier standard because of any special technology or knowledge by S&P or ABA," Hildene said in its complaint. "After all, a CUSIP is just a string of numbers and letters. S&P is not uniquely capable of issuing and maintaining alphanumeric strings."

businessofbusiness.com

by Doug Bailey

3.25.22

MSRB Fair Dealing Solicitor Municipal Advisor Obligations and New Draft Rule G-46: SIFMA Comment Letter

SUMMARY

SIFMA provided comments to the Municipal Securities Rulemaking Board (MSRB) on their Notice (MSRB Notice 2021-18) on fair dealing solicitor municipal advisor obligations and new draft Rule G-46.

View the MSRB Comment Letter.

March 15, 2022

Groups Raise Concern about Recordkeeping in MSRB Draft Rule.

Comments on the Municipal Securities Rulemaking Board's second request for comment on its draft solicitor muni advisor rule highlight concerns over recordkeeping expectations, harmonization with the Securities and Exchange Commission's "Pay-to Play" rule and whether oral or written disclosures are the most effective for municipal advisors.

The board received comments from The Securities Industry and Financial Markets Association, The National Association of Municipal Advisors and The Third Party Marketers Association. The rule

would codify interpretive guidance from 2017 on MSRB Rule G-17 and align obligations under MSRB Rule G-42, the duties of non-solicitor MAs. The board had previously floated a draft of the rule about a year ago.

Susan Gaffney, executive director of NAMA, initially called the efforts to improve draft Rule G-46 a step forward but expressed “extreme concern” over the books and records discussion detailed in the board’s second proposal.

In its second RFC, the MSRB proposed including recordkeeping expectations int the text of the rule itself, rather than including it in MSRB Rule G-8 on books and records. The board would then take a similar approach with respect to future MSRB rules or rule amendments with the goal of including books and records obligations to each MSRB rule in the text of each rule itself.

“Finding a proposed change that impacts the entirety of MSRB recordkeeping rules within a rule about solicitors, and without specifically highlighting the larger implications of such a change, is very surprising,” the NAMA letter said. “As a matter of principle, proposed broad changes to MSRB rulemaking should not be tucked away in unrelated proposed rulemaking.”

NAMA doesn’t necessarily disagree that a new rule would be out of place, but wants to emphasize that MSRB rulemaking should be clear and avoid “confusion between inter-and intra- agency rulemakings,” the NAMA letter said.

NAMA also supports the MSRB’s efforts to have disclosures provided in writing instead of given orally, an issue that the Third Party Marketers Assocation’s letter also discussed.

NAMA emphasized the need to not burden small firms with additional requirements, a cause the group stressed to the MSRB many times in recent years.

SIFMA’s comment letter applauded the MSRB’s efforts in this area but outlined a number of areas where there could be confusion.

“We do, however, still have certain concerns with the (1) lack of solicitation prohibition for solicitor municipal advisors, (2) inconsistency with the SEC’s Pay-to-Play Rule (as defined herein), (3) lack of safe harbor for inadvertent solicitation, and (4) recordkeeping requirements,” the SIFMA letter said.

The SIFMA letter went on to recommend that Rule G-46 should include a broad solicitation prohibition for solicitor municipal advisors; that the updated rule should include a narrow solicitation prohibition for solicitor municipal advisors if the board doesn’t adopt a broad one; alignment with the SEC’s Pay-to-Play Rule in addition to a uniform approach for dealers and solicitor municipal advisors.

SIFMA’s concerns went deeper to express a lack of safe harbors for inadvertent solicitation, which the group detailed in its original response to the G-46 RFC, concerns around recordkeeping requirements, and a streamlining of future MSRB rules and rule amendments.

“The MSRB stated that it is proposing to take a similar approach with respect to future MSRB rules or rule amendments,” the SIFMA letter said. “The MSRB stated that the eventual goal would be to include recordkeeping requirements applicable to each rule in the text of each rule itself instead of Rule G-8.”

“We think the overall approach for future MSRB rules and rule amendments is a substantial change to the structure of the MSRB Rulebook and should be open for public comment,” the SIFMA letter said.

The Third Party Marketers Association took issue with the “prohibition added to prevent a solicitor municipal advisor from receiving ‘excessive compensation’ will be problematic,” their letter said.

“Although we believe the rationale behind the prohibition to prevent a solicitor municipal advisor from receiving ‘excessive compensation’ is sound, the determination of what is considered ‘excessive compensation’ is left open to interpretation,” the Third Party Marketers Association letter said. “For non-solicitor municipal advisors and underwriters, the marketplace in which these firms operate is much more robust than the one that exists for solicitor municipal advisors.”

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 03/16/22 11:25 AM EDT
