Regulatory

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
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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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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

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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

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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

[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
lszarek@msrb.org

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.*

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
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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.

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

Contact: Leah Szarek, Chief External Relations Officer
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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

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

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[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

[ESG Risks for Financial Institutions Operating in the United States: What to Expect in 2022 - Jones Day]

In Short

The Background: Demand for ESG-aligned companies and investment products are likely to continue to accelerate transformation of the investing landscape in 2022.

The Issues: Although investor demand for ESG-related transactions continues to grow, these opportunities, along with the markets' and regulators' focus on ESG-related issues, can create significant legal uncertainty and risk for financial institutions. The conflict in Ukraine has only further complicated these considerations, although the direction and scope of its impact on ESG considerations is very much an open question.

Looking Ahead: The prominence of ESG-related issues in both the financial markets and the public discourse will present opportunities, but also create significant risks, for financial institutions in 2022, which may be magnified in light of the current broader geopolitical context.

ESG considerations will continue to play an ever-increasing role in financial markets in 2022. ESG-related transactions will continue to present significant opportunities for financial institutions as they respond to and support the needs of the market. However, these opportunities, along with the markets' and regulators' focus on other ESG-related issues, can create significant risk. ESG-focused concerns for financial institutions generally arise in two broad contexts: (i) disclosure-related risks and (ii) conduct-related risks.

This Commentary updates our prior observations concerning potential litigation and regulatory risks for financial institutions, including risks posed by governmental and private actors. We will provide additional updates, including as the impacts of the conflict in Ukraine continue to take shape.

Increased Engagement from Regulators

Last year saw frequent engagement by financial regulators focused on ESG issues, including following President Biden's May 2021 Executive Order directing multiple federal agencies to assess climate-finance risks. The Executive Order singled out financial institutions, noting: "The failure of financial institutions to appropriately and adequately account for and measure [climate-related financial risks] threatens the competitiveness of U.S. companies and markets … and the ability of U.S. financial institutions to serve communities."

This trend likely will continue in 2022 with regulators, led in some respects most visibly by the SEC, poised to enact new reporting requirements focused on climate risk and other ESG themes. SEC Chair Gary Gensler has made clear that a new climate risk disclosure rule likely is forthcoming. Reports indicate that a proposed rule could be issued as early as March 21, 2022, and we will provide further updates as appropriate in the coming days. In the meantime, the Climate and ESG Task Force created by the SEC in 2021 continues its work on ESG-related enforcement initiatives, which can proceed even in the absence of any new formal rulemaking process. These developments are of particular significance to financial institutions both in connection with their preparation of disclosures concerning their own corporate activities as well as any disclosures they may be required to make concerning lending or investing activity.

Other financial regulators are similarly expected to place greater emphasis and focus on climate change and broader ESG issues in the coming months. And, in November 2021, the Acting Comptroller of the Currency urged large bank boards to consider five climate change-related questions to "help put into motion the concrete steps that banks need to prudently manage climate risk." The Consumer Financial Protection Bureau has also announced that it will take action focused on racial equity, suggesting that it could even look beyond fair-lending violations in charging unlawful discrimination. Market participants await further announcements from the Department of Labor regarding the October 2021 proposals regarding the extent to which investment manager fiduciaries may consider sustainability factors when assessing investment opportunities.

Although it remains to be seen what the ultimate regulatory framework and reporting requirements for financial institutions will look like and how they will operate in practice, the question of regulatory reporting and disclosures on ESG-alignment is no longer one of "if," as opposed to "when" and "how."

Increased Engagement by NGOs

Financial institutions' ESG-alignment and mitigation of related risks will also likely continue to be a major focal point for non-governmental organizations ("NGOs") and other private stakeholders, including in light of the broader geopolitical context involving the conflict in Ukraine and the increased focus on world energy markets. Financial institutions must balance pressure from NGOs to reduce financing activities of so-called "fossil fuel" companies with the practical reality that such companies outside of Russia will need increased financing to meet the global demand for energy.

In 2021, numerous NGOs scrutinized companies' net-zero commitments and other climate-related statements both inside and outside of the courtroom, and that trend is expected to continue. In December 2021, for instance, the Sierra Club and Center for American Progress jointly issued a report noting that "the U.S. financial sector has not yet responded in a manner that suggests an understanding of either the scale of the crisis or the sector's role in causing it." That report is just one of several issued in 2021 that critically examine the role financial institutions can and should play in climate change. And these efforts are attracting the attention of lawmakers. For example, Representative Katie Porter (CA), teaming up with "Stop the Money Pipeline," a coalition of environmental groups targeting asset managers and banks with net zero pledges, asserted that: "Banks have bankrolled the climate crisis … And they continue to do it today."

NGOs are also actively considering litigation theories or other public pressure tactics against multinational companies in connection with the conflict in Ukraine. For example, the French affiliates of Friends of the Earth and Greenpeace are reported to have sent a letter to a major French energy company requesting it to end business activities connected to the Russian energy market that may "contribute to the commission of serious violations of human rights."

It is likely that financial institutions and large, multinational organizations will continue to be a primary target of NGOs and other activist organizations pursuing traditional litigation proceedings and less-traditional dispute resolution mechanisms to advance their agendas. The majority of this litigation activity has thus far proceeded outside of the United States, with NGOs and other organizations pursuing companies and financial institutions that they believe are not sufficiently aligned with ESG objectives. In 2021, for example, five NGOs brought a complaint to the SEC alleging misstatements by the Japan International Cooperation Agency regarding "coal-free" bonds, the proceeds of which allegedly could flow to coal-fired power stations in Bangladesh.

More may be on the way. Indeed, the lead lawyer for Milieudefensie, the Dutch wing of the environmental organization Friends of the Earth, which obtained a ruling against Shell in the Netherlands requiring emissions reductions by 2030 (the ruling is on appeal), recently stated: "I think that the next step is to start also litigating against financial institutions who make these emissions and fossil fuel projects possible."

The Materiality Debate Continues

One area that should continue to receive attention is the ongoing debate surrounding what types of ESG information are actually "material" to investment decisions. In securities litigation, where large financial institutions are likely to remain attractive targets in light of the scope of their operations and perceived "deep pockets," liability can turn on the specificity and materiality of the alleged misstatement. Typically, if a statement is deemed vague or aspirational, then courts have found that it cannot have been material to a reasonable investor, and is therefore not actionable. On the other hand, if the statement is concrete enough and would alter the total mix of information that an investor would consider in making an investment decision, then it can potentially support a claim for securities fraud.

Notably, on June 21, 2021, the U.S. Supreme Court issued its decision in Goldman Sachs v. Arkansas Teacher Retirement System, holding that, at the class certification stage, a court may consider whether a company's alleged misstatements were too generic to have impacted its stock price. In advance of the ruling, amicus briefs filed in support of the plaintiff investors argued that generic statements regarding ESG may be material to investment decisions because "investors now incorporate information about a company's ESG performance into their decision-making." As more companies tout their ESG commitments in public disclosures—and as more investors claim to consider such factors when making investment decisions—legal arguments around materiality of these statements should be monitored.

The Debate Over Who Should Police ESG—From Environmental Issues to Human Trafficking

A financial institution's role as a financer, investor, or financial intermediary for a transaction that has ESG-related goals can create the risk of an expectation that a financial institution is responsible for policing those goals, even if that expectation is unreasonable, unwarranted, or unsupported by the transaction documents. Private citizens already have brought claims against banks as financers of third-party projects with negative environmental consequences. A group of residents of Flint, Michigan, for example, sued the underwriters of a municipal water development bond offering, alleging that they knew that the project would cause water contamination in violation of an asserted duty of care owed by the banks to those affected.

Private financial institutions face growing scrutiny in connection with their financing activities in collaboration with international development banks. At least one plaintiffs' lawyer has suggested that banks are a potential target for claims asserting that they have ignored human trafficking-related violations by their customers and derived benefits from facilitating illicit conduct by these customers. Similar claims may also give rise to follow-on shareholder class action cases in the United States and abroad asserting violations of securities laws and/or shareholder derivative claims. As described above, NGOs have already emerged as a formidable constituency seeking to use litigation as a tool to move financial institutions toward a role in policing ESG.

Politicization of ESG: Backlash and the Catch-22 for Financial Institutions

We also continue to monitor efforts by some parties to challenge existing and proposed ESG-related government action, and the partisan nature of these issues. Some state attorneys general may be poised to challenge through litigation various efforts contemplated at the federal level to advance climate and other ESG initiatives, and some have committed to doing so. For example, West Virginia Attorney General Patrick Morrisey sent a letter to the SEC in 2021 describing potential new regulations requiring ESG-related disclosures as unconstitutional. Similarly, in May 2021, the West Virginia treasurer, on behalf of the treasurers of 15 states, wrote to federal Climate Envoy John Kerry to express concern that the Biden administration is reportedly "pressuring U.S. banks and financial intuitions to refuse to lend to or invest in" fossil fuel companies. Separately, in a recent op-ed published in The Wall Street Journal, Arizona Attorney General Mark Brnovich, who is a candidate in the Republican primary for Arizona's U.S. Senate election to be held this November, argued that coordinated efforts to divest from conventional energy resources may amount to an antitrust violation that he and other state attorneys general might pursue.

In 2021, Texas took the lead by enacting two laws targeting financial institutions and other companies that were perceived to economically “boycott” oil and gas businesses. One of the new Texas laws prohibits state pension fund investment in companies deemed by the state comptroller to be boycotting oil and gas companies. Other resource-rich states have passed or are considering similar legislation. Texas has subsequently required financial institutions to submit “anti-boycott” certifications as prerequisites to engage in underwriting of municipal debt offerings.

In West Virginia, the state legislature recently passed a bill, expected to be signed into law by the governor, that would allow the state treasurer to refuse to enter into or remain in banking contracts with financial institutions that take any action “intended to penalize, inflict economic harm on, or limit commercial relations with a company” because the company engages in fossil fuel-based energy activity. In Kentucky, legislation that would require the state treasurer to maintain a list of financial companies engaged in energy company “boycotts” has passed the Senate and awaits input from the House. Under the proposed legislation, the treasurer’s list would be shared with state government entities making investments of more than $1 million annually, which then would be required to cease business with the listed firms.

Highlighting the tensions financial institutions will continue to face in this politically fraught area, recent media reports indicated that the SEC’s Fort Worth regional office has opened a preliminary investigation that may be targeting financial institutions that made certifications in connection with the Texas statute. The investigation may involve comparing the certifications against the companies’ climate disclosures, emphasizing the challenges to financial institutions trying to navigate in this area. In addition, in June 2021, Maine passed legislation requiring its pension funds to divest from fossil fuels by 2026.

Conclusion

As ESG considerations continue to drive transformative change in the financial markets, they present significant opportunities for financial institutions to support market needs in green finance and elsewhere. The prominence of these issues in industry and in public and political discourse, including in light of the conflict in Ukraine and its impact on world energy markets, however, will continue to bring sustained scrutiny from public and private parties, including regulators, market participants, and NGOs. We will provide updates concerning these issues as they continue to unfold.

Three Key Takeaways

1. Regulators, including the SEC and OCC, are poised to enact new reporting requirements focused on climate risk, among other ESG themes, in the coming months. An increase in enforcement actions is also likely to follow.
2. Financial institutions’ ESG-alignment and mitigation of related risks will likely continue to be a major focal point for NGOs and other private stakeholders with increased vigor, given the broader focus on world energy markets in light of the current geopolitical crisis.
3. As more companies tout their ESG commitments in public disclosures—and as more investors claim to consider such factors when making investment decisions—legal arguments around materiality of these statements should be closely monitored.

Jones Day – Jayant W. Tambe, Lizanne Thomas, Mahesh V. Parlikad, Howard F. Sidman, Joseph B. Sconyers and Lauri W. Sawyer

March 21 2022

[2nd Suit Targets 'Abusive' CUSIP Licensing Fees, Tactics.]

Another suit has been filed in federal court challenging long-standing practices regarding licensing fees regarding the use of CUSIP numbers.

The latest suit was filed March 7 in the Southern District of New York by Hildene Capital Management LLC. As did the suit filed earlier this month, this one involves CUSIPs—those unique identifiers that are used to identify U.S. and Canadian registered stocks, U.S. government and municipal bonds, exchange traded funds and mutual funds. And like the first suit, it alleges that S&P Global, Cusip Global Services (CGS) and the American Bankers Association (ABA)—not to mention an entity called FactSet, which recently took over as GS' new operator—conspired to eliminate competition in the use of CUSIP numbers, or to bring alternatives online.

The suit here also asserts—as did the one filed before it—that "there is nothing original, unique, or special about CUSIP numbers; they are trivial except for the fact they are the standard for identifying financial instruments. Hildene's use of the CUSIP numbers is both necessary and fair because CUSIPs are the designated standard."

The suit, which alleges several violations of federal law,[i] says the essence of the problem is "S&P's abuse of its monopoly power in the financial instruments identification market, and Defendants' conspiracy to maintain S&P's (and now FactSet's) monopoly power and unreasonably restrain trade in the financial instruments identification market, in order to extract artificially inflated payments from investors and other users of financial data through subscription agreements to access CUSIP numbers."

'Hold Up'

The suit explains that these particular plaintiffs "receive no financial data services from Defendants; but rather obtain financial data from other sources that necessarily include CUSIP numbers"—a dependency that the suit says means that the defendants can "hold up" users of the data "to pay prices unilaterally determined by Defendants not because there is anything special or valuable about the string of numbers and letters they generate, but simply because CUSIPs have been designated as the standard."

The suit also alleges that the defendants "have conspired to prevent competition from, and the implementation of, alternative free, or far more cost-friendly financial instruments identifiers of equal or superior efficiency and quality"—motivated by the reality that "CUSIPs are worthless except for the fact that they are the standard."

Fee 'Fie'

It's not as though there isn't already money changing hands here—the suit notes that S&P charges securities issuers a fee (typically about $280 per CUSIP) in order to obtain CUSIP numbers for its securities, and S&P also charges data providers (like Bloomberg), licensing fees for using CUSIPs in its databases (a.k.a. "Data Providers"). However, the sticking point here—and the subject of the suit—is S&P's demand that Data Providers' end users (such as the plaintiffs here)—or "entities that otherwise download CUSIP numbers as part of financial data for their own use" to enter their own subscription agreements with S&P under duress—more specifically, the threat of stripping the

CUSIP numbers from their data feeds "if the unilaterally determined licensing fee is not paid."

The suit argues that the ABA retains 30% of CGS's licensing fees from all Data Users and the remainder is kept by S&P (and now FactSet). Meanwhile, the plaintiffs argue that S&P claims that through its CGS division it provides administrative services to Data Users to justify these fees. "However, Data Providers (like Bloomberg), not Defendants, provide these administrative services to Data Users," while—as noted above—the defendants already receive fees for CUSIP numbers twice: first from issuers of securities, and then from the Data Providers. "Defendants' extraction of fees for a third time from Data Users merely because they download financial data that necessarily includes CUSIPs, does not constitute compensation for administrative services," they note. "Rather, they are demands for payments for a valueless alphanumeric string as part of hold ups monetizing the monopoly power held by virtue of being the standard."

Pressure Tactics

The suit outlines how this impacts data users (like Hildene). Noting first that in Hildene's case this subscription payment amounts was $10,500 annually, the suit goes on to note that "under the threat of stripping CUSIP numbers from the users' data feed. Hildene and the members of the Class are then left with two unenviable options: (i) pay S&P's supracompetitive subscription rates or (ii) have CUSIP numbers stripped from their data feed and suffer, at a minimum, significant disruption to their businesses." Now, when Hildene "balked" at paying these licensing fees, the suit notes that "S&P sent a series of increasingly hostile letters, and eventually constant threats that Hildene must pay the unilaterally set fee or face a debilitating lock out from access to CUSIP numbers. Hildene, with no legitimate business alternative, like other members of the Class, eventually signed the subscription agreement."

But that, as it turns out, is not the end of things. The suit goes on to explain that "S&P's pressure tactics do not end with the signing of a subscription agreement. The form subscription agreement includes a 'Usage Review' provision to inspect a Data User's records concerning the level of usage of the CUSIP identifiers to determine whether additional fees and charges should be imposed." Moreover, there is apparently even a clause that provides S&P with the right to seek reimbursement for the cost of any such inspection if, "in its discretion, the Data User is underpaying by five percent or more."

Beyond that, the suit alleges that S&P reserves the right to increase its fees and change the terms of the subscription agreement. "Without any reasonable choice, the Data User is forced to accept these unfair and deceptive terms," the suit notes. "In sum, S&P is using CUSIPs' designation as the standard and the threat of depriving market participants access to the standard to collect enormous sums of money (and share the money with ABA) from Hildene and members of the Class. It's an abuse of monopoly power, anticompetitive, and simply unfair."

By way of lending support to their arguments (and related attempts to either resolve the current practices and/or to provide alternatives), the suit outlines several attempts to bring the matter (and related concerns) to the attention of the Securities and Exchange Commission (SEC), as well as what it describes as a "similar scheme" in Europe regarding S&P's licensing fee policies for the use of U.S. International Securities Identification Numbers ("US ISINs") in the European Economic Area—an attempt that the European Union found to be an "abuse of monopoly power."

Will there be other suits challenging this structure/fees/practices? Stay tuned.

[i] More specifically, the suit alleges violations of Section 1 of the Sherman Act, Section 2 of the Sherman Act, New York General Business Law § 349(a), Connecticut Unfair Trade Practices Act §

42-110b(a), as well as breach of contract, and injunctive relief. Outside of the class action, Hildene, on its own behalf, also brings this action for a declaratory judgment that Hildene's use of CUSIPs is a "fair use" that does not infringe on any purported intellectual property rights of Defendants over CUSIPs.

NATIONAL ASSOCIATION OF PLAN ADVISORS

BY NEVIN E. ADAMS, JD

MARCH 14, 2022

The S.E.C. Moves Closer to Enacting a Sweeping Climate Disclosure Rule.

The commission gave initial approval to a much-anticipated rule that would require public companies to report the climate-related impact of their businesses.

The Securities and Exchange Commission has said for the first time that public companies must tell their shareholders and the federal government how they affect the climate, a sweeping proposal long demanded by environmental advocates.

The nation's top financial regulator gave initial approval to the much-anticipated climate disclosure rule at a meeting on Monday, moving forward with a measure that would bolster the Biden administration's stalled environmental agenda.

The proposed rule — approved by a 3-to-1 vote — aims to give investors a clearer picture of the risks that climate change might pose to companies, because of disasters like droughts and wildfires, changes in government environmental policies or consumers' declining interest in products that contribute to global warming.

Continue reading.

The New York Times

By Matthew Goldstein and Peter Eavis

March 21, 2022

Cooley: SEC's Climate Proposal - SCOOP!

According to exclusive reporting from Bloomberg, the SEC's new proposal for climate disclosure regulation—scheduled for a vote and release on Monday—will include a requirement to disclose some Scope 3 *emissions*, that is "greenhouse gases that are generated by other firms in [a company's] supply chain or by customers using [its] products." It's widely believed that Scope 3 emissions "make up the bulk" of most companies' emissions. It's unclear whether the proposed requirement would apply to all public companies or just larger ones, or whether the requirement might be phased in. As discussed below, whether or not to require disclosure of Scope 3 emissions has been a subject of heated internal debate at the SEC, and, the article suggests, the proposal appears to reflect some compromise.

The article indicates that the rules will require companies to discuss "indirect emissions that are 'material' to their operations. Because of the legal uncertainty surrounding the term, the proposal is likely to provide examples for companies to follow, [sources said]. The commissioners also compromised on whether the new corporate filings will need to be audited, another flashpoint. The regulation is likely to require expert review, but it will be phased in over time, the people said." Note that the frequently mentioned framework of the Task Force on Climate-Related Financial Disclosures provides for disclosure of Scope 3 emissions "if appropriate," which could suggest a materiality test.

As noted above, the wrangling over whether to require disclosure regarding Scope 3 emissions has been fierce—including among the commissioners. Back in January, Reuters reported that environmentalist and some activist investors were strongly advocating that the SEC require companies to make broad disclosure about GHG emissions, while business groups were "pushing for a narrower rule that will make it easier and less expensive to gather and report emissions data, and which will protect them from being sued over potential mistakes." The article reported that a "major issue staff are struggling with is whether and how some or all companies should disclose the broadest measure of greenhouse-gas emissions, also known as 'Scope 3' emissions, according to the sources and company and investor advocates." Another "big challenge" that the article highlighted was "identifying which Scope 3 metrics help investors gauge a company's financial prospects, and ensuring the rule is flexible enough to generate specific, rather than generic information." While activists may view Scope 3 emissions disclosure as "critical," some companies contended that "there is no agreed methodology for calculating Scope 3 emissions and providing that level of detail would be burdensome." In addition, they maintained, this information was not necessarily within each company's control and exposed companies to potential litigation.

The Reuters article discussed some compromises the staff was considering at the time, including whether to create a new safe harbor or to rely on the current safe harbor for forward-looking statements. One alternative under consideration was reportedly to require some information about Scope 3 emissions to be filed as part of companies' financial reports and other Scope 3 data to be submitted separately. The article reported that the staff had reached out to advocacy groups such as Ceres and Public Citizen for feedback on Scope 3 issues, including phase-ins and safe harbors. A Ceres representative indicated that the SEC had solicited his views on "whether it should include Scope 3 for large, high-revenue companies, then phase in medium and small-sized companies a year or two later." Time will tell whether any of these compromises will be included in the ultimate proposal. (See this PubCo post.)

And in February, Bloomberg reported that one of the reasons for the delay in the release of the SEC's climate disclosure proposal was internal conflict about the proposal—conflicts not between the Dems and the one Republican remaining on the SEC; rather, they were reportedly between SEC Chair Gary Gensler and the two other Democratic commissioners, Allison Herren Lee and Caroline Crenshaw, about how far to push the proposed new disclosure requirements, especially in light of the near certainty of litigation, and whether to require that the disclosures be audited. The article painted the SEC's dilemma about the rulemaking this way: "If its rule lacks teeth, progressives will be outraged. On the flip side, an aggressive stance makes it more likely the regulation will be shot down by the courts, leaving the Biden administration with nothing. Either way, someone is going to be disappointed."

According to the Bloomberg article, the issues centered around "how much information the agency can force companies to divulge without losing an almost certain legal challenge brought by Washington's business lobby or a Republican-led state. Fundamental to the debate, Bloomberg indicated, was the question of "materiality." (See this PubCo post for a discussion of the some of the commissioners' views of "materiality.") The authors reported that Gensler had "caution[ed] agency staff to make sure the climate proposal adheres to a legally defensible definition of materiality. He contend[ed] that only this approach can survive a legal challenge." According to the reporters' sources, "[t]ensions over the divergent approaches have reached a tipping point….At one meeting,… Gensler told SEC lawyers that their work must conform with the interpretation of materiality that has been laid out by the U.S. Supreme Court—a standard that underpins the SEC's guidance. Gensler made clear that, as far as he was concerned, there would be no more debate on the issue," the sources told Bloomberg. (See this PubCo post.)

Some contend that litigation is inevitable, regardless of what the proposal requires, and Bloomberg has reported that "[m]ost Republicans insist that regulating global warming is outside the agency's jurisdiction, and business groups have already been discussing a litigation strategy." The WSJ has also reported that some Republicans argue that "it isn't the SEC's job to mandate nonfinancial disclosures." In addition, the article continues, some industry organizations "told the SEC it didn't have legal authority to compel disclosures and impose its value judgments." One Republican state attorney general "wrote that 'West Virginia will not permit the unconstitutional politicization of the Securities and Exchange Commission. If you choose to pursue this course we will defeat it in court.'"

> **SideBar**
> According to a 2021 report from Deloitte of a 2021 survey of audit committee members globally, not that many companies had planned to disclose Scope 3 emissions. In the Americas, only 26% of respondents said they were reporting or planning to report Scope 3 emissions as part of their TCFD disclosures. Companies that were planning to report Scope 3 identified as the biggest challenges the ambiguity of measurement standards (92%), lack of robust information from the value chain (85%), lack of clear parameters to define Scope 3 emissions (77%), lack of understanding of the perceived value of this information (62%) and lack of co-operation from the parties in the value chain (46%). Deloitte observed that, while the entire task of addressing climate is enormous, "Scope 3 GHG emissions are significantly more difficult to quantify than those in Scope 1 or 2." However, Deloitte asserted, given that "Scope 3 emissions are likely to be the most material part of a company's carbon footprint, companies need to get more comfortable with preparing and exchanging information to facilitate greenhouse gas reporting in the value chain." (See this PubCo post.)

Of course, the SEC still has a few days before the meeting—time enough to make further changes in the proposal. How the proposal will ultimately shake out remains to be seen.

Cydney Posner on March 18, 2022

Cooley LLP

SEC Charges Texas School District and Former CFO with Fraud Related to Bond: Faegre

On March 16, 2022, the Securities and Exchange Commission charged Crosby (Texas) Independent School District (Crosby) and its former Chief Financial Officer, Carla Merka, with misleading investors in a $20 million municipal bond sale, which was issued to pay down outstanding construction liabilities and fund new construction projects.

The SEC's civil complaint alleges that Crosby failed to disclose $11.7 million in payroll and construction liabilities in connection with the January 2018 sale. The complaint also alleges the school district falsely reported that its general fund had $5.4 million in reserves in its 2017 fiscal year financial statements. According to the Complaint, Merka, who had ultimate authority over Crosby's fiscal year 2017 financial statements and was its highest-ranking executive with financial or accounting experience, was aware that Crosby's financial statements significantly underreported its existing liabilities and that she knowingly included the statements in the bond offering documents. In August 2018, seven months after the bond sale, Crosby's leadership disclosed its financial difficulties. The disclosure led to employee layoffs for the school district and the downgrading of Crosby's bonds.

Crosby's auditor, Shelby Lackey, was also charged with improper professional conduct in connection with an audit of the school district's 2017 financial statements. Specifically, the SEC alleged Lackey violated the Generally Accepted Auditing Standards (GAAS) by failing to obtain adequate evidence to verify Crosby's payroll and construction liabilities, failing to supervise the audit, and failing to exercise professional judgment and maintain professional skepticism.

Crosby consented to the entry of an order to settle the SEC charges on a no-admit, no-deny basis. The order finds that Crosby violated the anti-fraud provisions of the federal securities law. The order cites Crosby's remedial acts and cooperation with the SEC in ordering it to cease and desist from future anti-fraud violations. Lackey also agreed to settle the SEC's charges and consented to the entry of an order that, without admitting or denying any of the findings, suspends her from appearing or practicing before the SEC as an accountant with the right to apply for reinstatement after three (3) years. Merka agreed to pay a $30,000 penalty and to not participate in future municipal securities offerings. In an apparent attempt to highlight her primary role in the false reporting, the SEC effectuated the settlement with Merka through pleadings filed in the civil lawsuit, as opposed to the other parties who were allowed to settle via administrative orders.

This action highlights the SEC's efforts and approach in enforcing securities laws in the context of municipal bond offerings. In 2021, the Division of Examinations stated it would prioritize investments heavily used by retail investors or those that may present elevated risks, including municipal securities. See https://www.sec.gov/news/press-release/2021-39. Those involved in such offerings should consult experienced legal counsel in connection with preparing their offering materials, and particularly in any interaction with the SEC Division of Enforcement, in the event it commences an investigation or enforcement action.

by Michael R. MacPhail, Isaac Smith

March 21, 2022

Read the Responses to the MSRB's RFI on ESG Practices in the Muni Market.

The MSRB invited stakeholders to provide their perspectives on ESG disclosures and ESG-labeled bonds.

Read the responses.

MSRB RFI on ESG Practices in the Municipal Securities Market: SIFMA Comment Letter

SUMMARY

SIFMA provides comments to the Municipal Securities Rulemaking Board (MSRB) on their Notice (MSRB Notice 2021-17) requesting public input on environmental, social and governance (ESG) practices in the municipal securities market. The MSRB is seeking this input as part of its broader stakeholder engagement on ESG trends in the municipal securities market and to help inform its mandate of protecting investors, municipal issuers, and the public interest by promoting a fair, efficient and transparent municipal market.

Read the SIFMA Comment Letter.

BDA Joins Eight Municipal Market Advocacy Groups in Filing Joint Comment Letter on MSRB's Notice on ESG-Labeled Municipal Securities.

Read the Comment Letter.

Bond Dealers of America

MARCH 10, 2022

Market Response to MSRB ESG Survey Shows Frustration.

The Municipal Securities Rulemaking Board's request for information on environmental, social and governance considerations has elicited irritation at the board's attempt to regulate ESG matters and illustrated the challenges the board faces in trying to decide what if any steps it might take related to ESG.

The comment period for the RFI ended on Tuesday and the challenges ahead will be even more pressing now that the board kicked off its fact-finding mission to much industry fervor. Initial comments indicated that standardized ESG disclosures would add quite the workload for issuers, as was previously indicated in the Government Finance Officers Association's best practices on ESG, a document the group touched on significantly in its own submission.

But the board collected a total of 36 submissions from issuers, individuals, and industry groups that outline clearly the limits the board faces.

"We all agree that a bright line exists in practice between (i) the ESG risk-based disclosures that relate to and have a nexus to all credits and obligations, (ii) the process designated/labeled bonds and (iii) the disclosures that relate to and are requested by investors for such designated/labeled bonds," said the Disclosure Industry Working Group's joint letter, signed by the Securities Industry and Financial Markets Association, Bond Dealers of America, National Association of Municipal Advisors, National Association of Bond Lawyers, among many others, and led by the Government Finance Officers Association.

“It is important not to confuse or actively conflate these topics because each is different,” the joint letter said.

Many of the letters the MSRB received note the fact that the board is responsible for regulating broker-dealers and municipal advisors and that any regulations attempting to add a disclosure burden or to establish materiality should be reserved for the Securities and Exchange Commission.

“The MSRB does not have the authority to determine materiality and the content of issuer disclosures and market participant preferred activity, outside of the MSRB’s own rules over broker-dealers and municipal advisors,” the DIG letter said.

“While the board is charged with protecting issuers and investors, that authority is limited to the regulation of municipal securities dealers and municipal advisors, neither of whom have control over issuer disclosure documents or issuer ESG designation practices,” the Bond Dealers of America letter said. “This lack of authority means there is no meaningful action the MSRB could take to address any hypothetical issues associated with issuer ESG designations, so the purpose of the notice is unclear.”

But there are some things that respondents feel the board can do to help ESG investments in the muni market to become more transparent.

“There are many areas where the MSRB can contribute to the ESG conversation and where their authority rests,” the DIG joint letter said. “The primary contribution would be to improve EMMA and allow for disclosures to be readily entered and accessed,” the DIG letter said. “We cannot emphasize enough our consensus on this point and the need for general EMMA improvements to occur.”

Respondents were also quick to point out that if regulators want to get serious about ESG, referring to concepts generally is probably not going to win over the muni market.

“The RFI continues to reference these types of issuances as “ESG-Labeled Bonds” which is a misnomer as there is presently no such label,” the GFOA letter said. But that term is used throughout the market generally to discuss the topic of green or social bonds. Respondents urge the board these matters are disclosed and discussed separately.

“It is imperative to ensure that the topics of designated bonds, disclosures related to designated bonds, and general disclosure of ESG factors are kept separate,” the GFOA letter said. “Going forward, these discussions should be held separately from one another since they are about two very different concepts.”

Many of the issuer respondents disclose some information to credit ratings agencies, as the information provided often doesn’t differ much from what is provided in offering documents and does have a material effect on ratings. But when it comes to bond designations, some feel that a third-party opinion doesn’t matter, given how quickly the market for ESG investments is changing.

The New York City Housing Development Corporation, an issuer of both green and social bonds, doesn’t feel the need to get a third-party opinion on its bond designations because “it is not necessary to market HDC’s bonds and the market is constantly evolving,” Ellen Duffy, executive vice president of debt issuance and finance at the New York Housing Development Corporation said in a letter.

“Also, issuers do not see any pricing benefit of marketing ESG bonds to warrant this extra expense,” she added.

While the fact that bond designations don't add any pricing benefit has been observed, others in the market are seeing it differently.

"Our members are beginning to see that in some cases, an ESG designation on a bond may affect pricing, suggesting that the designation is material information," the BDA letter said.

But the NYCHDC does plan to provide annual updates connected with the disbursement of the proceeds for its Sustainable Development Bonds and the financing of mortgage loans, of which the reporting is completely separate from its obligations under its Continuing Disclosure Agreement.

The New Jersey Infrastructure Bank issued green bonds and like the NYCHDC, follows guidance from the International Capital Market Association. The Official Statement for any green bond issuance includes a use of proceeds section, but the NJIB has further suggestions for how issuers could handle disclosing this type of information.

"Municipal issuers could include a separate section in their Official Statement and other offering documents expressly devoted to ESG-Related Disclosures," the NJIB letter said.

The letter even goes even further to suggest the MSRB take a larger role in disclosure, departing from many of the submissions where respondents felt that such a move would be overstepping its mandate. "Guidance from MSRB for content would be helpful to establish guidelines about what should be reported."

The State of Florida Division of Bond Finance has not issued any designated bonds but agrees that some ESG-related information should be included in offering documents, as they include an "environmental risk factors" disclosure in addition to an "information technology security" disclosure. But these weren't considered as part of the ESG movement when Florida began to include them in offering documents.

"Municipal issuers have customarily provided this kind of information long before it was categorized as 'Governance' or 'Social' within the ESG moniker," said Ben Watkins, director of bond finance for the State of Florida in his letter.

"We do not feel that rearranging or renaming sections of offering documents as 'ESG' is necessary to meet the information needs of investors," he added. "If the relevant information disclosure information is included in a rational order and easy to follow, it should not require a label for investors to locate it within the offering document."

The RFI has offered the muni market an outlet to share ESG experiences, but what the board plans to do with this information is another question.

"MSRB has not established a roadmap for what it intends to do with the information gathered in this exercise or even possible options – perhaps because it has no legitimate role," the National Association and Educational Facilities Finance Authorities letter said. "The MSRB's considerable resources should be focused on regulatory issues relating to the regulated entities it oversees – not issuers/borrowers – and making enhancements and improvements to EMMA which all sectors of the public finance community have been imploring be undertaken for many years."

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 03/09/22 12:30 PM EST

SIFMA Statement on Inclusion of LIBOR Legislation in the Omnibus.

Washington, D.C., March 9, 2022 – SIFMA released the following statement from president and CEO Kenneth E. Bentsen, Jr., on the inclusion of the Adjustable Interest Rate (LIBOR) Act in the omnibus in the U.S. House of Representatives today:

“We commend the inclusion the Adjustable Interest Rate (LIBOR) Act, sponsored by Representative Brad Sherman (D-CA) and Senators Jon Tester (D-MT) and Thom Tillis (R-NC), in the Consolidated Appropriations Act of 2022.

“There are currently trillions of dollars of existing contracts and instruments that, as a practical matter, cannot be amended to utilize an alternative rate and Federal legislation is necessary to facilitate a smooth transition away from LIBOR to an alternative reference rate for these ‘tough legacy’ contracts. This legislation will benefit all market participants including LIBOR’s end users, who range from investors to companies to consumers.

“The legislation would provide four key benefits: (1) certainty of outcomes; (2) fairness and equality of outcomes; (3) avoidance of years of paralyzing litigation; and (4) preservation of liquidity and market resilience, and accordingly is supported not only by SIFMA, but also a range of other market participants, consumer groups, and regulators.

“We encourage the House and Senate to quickly pass this much-needed legislation so it will reach the President’s desk soon.”

SIFMA Statement on Senate Passage of LIBOR Legislation.

Washington, D.C., March 10, 2022 – SIFMA released the following statement from president and CEO Kenneth E. Bentsen, Jr., on the passage of the Adjustable Interest Rate (LIBOR) Act by the U.S. Senate:

“We commend the Senate’s bipartisan passage of the Adjustable Interest Rate (LIBOR) Act, sponsored by Senators Jon Tester (D-MT) and Thom Tillis (R-NC), with Chairman Brown (D-OH), Ranking Member Toomey (R-PA) and Representative Brad Sherman (D-CA).

“LIBOR will cease publication next year and there are currently trillions of dollars of existing contracts and instruments that, as a practical matter, cannot be amended to utilize an alternative rate. Federal legislation is necessary to facilitate a smooth transition to an alternative reference rate for these ‘tough legacy’ contracts. This legislation will benefit all market participants including LIBOR’s end users, who range from investors to companies to consumers.

“The legislation provides four key benefits: (1) certainty of outcomes; (2) fairness and equality of outcomes; (3) avoidance of years of paralyzing litigation; and (4) preservation of liquidity and market resilience, and accordingly is supported not only by SIFMA, but also a range of other market participants, consumer groups, and regulators.

“We appreciate both the House and the Senate’s swift passage of this important bill and encourage the signing of this much-needed legislation into law.”

LIBOR Act Protects US Legacy Contracts; New SOFR Use Growing - Fitch

Fitch Ratings-London/Milan/New York-11 March 2022: The Adjustable Interest Rate (LIBOR) Act provides strong protection for legacy contracts without workable fallback provisions, significantly reducing transition and disruption risk upon eventual USD LIBOR phase-out, Fitch Ratings says. The shift away from LIBOR for new issuance continues apace, with SOFR dominating new floating-rate issuance in 2022. Congress passed the LIBOR Act yesterday as a part of the Consolidated Appropriations Act, 2022.

The act requires SOFR plus a set spread, depending on the LIBOR term, to be used instead of USD LIBOR starting from mid-2023. The act applies to contracts with no or impracticable LIBOR fallback provisions, contracts that lack a specific alternative rate and those for which the determining person has not replaced the benchmark by the date required under the contract or mid-2023. By providing a defined alternative to LIBOR for contracts issued under US law, the act would result in consistent rates for a substantial portion of floating-rate bond and loan markets.

The act also provides contract continuity and safe-harbor provisions to shield parties from liability under potential lawsuits due to the transition away from LIBOR. Even if ultimately unsuccessful, litigation could be disruptive for transactions with affected contracts, particularly from consumer loan class-action lawsuits.

The Federal Reserve Board must issue regulations to administer the law within 180 days of passage, and operational challenges could arise in implementation. Conforming changes necessary to apply a replacement rate, such as updating where the new rate is published, are protected under the act; therefore, we consider these changes low risk for transaction parties. However, there remains a risk that parties may delay or have difficulty making the conforming changes. For consumer loan contracts, only conforming changes approved by the Fed are allowed and would be covered under the act. Regulations should clarify how this will be implemented.

For Federal Family Education Loan Program (FFELP) student loan asset-backed securities (SL ABS) LIBOR exposure, the act amends the Higher Education Act of 1965 to allow the LIBOR rate for special allowance payments to be substituted by SOFR plus a spread. The new rate will apply following certain notifications by the holder to the Secretary of Education, but if the notification does not occur by certain dates, the SOFR rate will automatically apply. Legacy LIBOR FFELP ABS notes are also expected to convert to a SOFR reference rate, so the risk of significant interest rate mismatches between assets and liabilities is mitigated.

US banks may use any reference rate other than LIBOR for loans, provided that management determines it is appropriate based on its funding model and customer needs. We expect some banks, particularly community and regional banks, to opt to use credit-sensitive benchmarks such as the American Financial Exchange’s Ameribor or Bloomberg’s Short-Term Bank Yield Index in lieu of SOFR, which may result in a multi-rate environment in the US. However, as the SOFR debt pipeline builds, so does the depth and liquidity of SOFR swap trading, which may mean the market coalesces around SOFR over time.

Since the start of 2022, new issuance in several markets has overcome the challenge of determining an agreed spread adjustment when moving from a LIBOR to SOFR reference rate. We have seen increasing issuance of leveraged loans and CLO notes referencing SOFR and more are expected.

Legacy contracts with fallback provisions that reference non-LIBOR rates such as prime or federal funds are not covered by the act, but are also likely to see minimal disruption risk if they have hardwired fallback language in line with recommendations from the Alternative Reference Rate Committee (ARRC). Standard leveraged loan documents have provided for the automatic conversion to a non-Libor rate, but conversion to a higher rate could pressure corporate interest coverage.

The Bond Pricing Institute, a Division of the BDA, Announces Steering Committee and 2022 Agenda.

View the BPI Announcement.

Bond Dealers of America

MARCH 8, 2022

GASB Requests Proposals for 2022 Crain Research Grants.

Read the GASB Request for Research.

03/10/22

MSRB Publishes 2021 Fact Book of Municipal Securities Data.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) today published its annual Fact Book, the definitive compilation of the most recent five years of statistics on municipal market trading, interest rate resets and disclosures. The data in the 2021 Fact Book can be further analyzed to identify market trends.

The MSRB collects real-time municipal securities trade data, as well as primary market and secondary market disclosures. In addition to making the data and disclosures available for free on its Electronic Municipal Market Access (EMMA®) website and compiling quarterly and annual statistics, the MSRB conducts independent research and analysis to support understanding of market trends. Recent MSRB research examines the use of external and internal liquidity in the municipal market; assesses the impact of electronic trading technology in the market; and studies the evolution of the taxable municipal bond market.

“With the 14th edition of the Fact Book, the MSRB is continuing its commitment to equip municipal market participants, policymakers, regulators, academics and others with information to understand long-term and emerging trends in our market,” said MSRB Director of Research Marcelo Vieira. “We are exploring and prototyping new, more dynamic ways to make market data available to the public in our new EMMA Labs innovation sandbox. We welcome feedback from stakeholders about how to enhance future editions of the Fact Book, perhaps ultimately replacing this static publication with a truly dynamic data dashboard that gives users greater flexibility to access and analyze the data throughout the year.”

EMMA Labs is a key part of the MSRB’s long-term strategic goal to leverage data to deepen market insights. One of the first prototypes available for users to explore in EMMA Labs is a dynamic dashboard for market data analysis that empowers users to discover and visualize market trends.

Highlights from the 2021 Fact Book include:

- A significant decline in par amount traded and number of trades in 2021 to the lowest levels since 2006. Par amount traded was down 28% in 2021 compared to 2020, while the number of trades decreased 10%.
- Persistent strength in trading of taxable securities, continuing the trend started in 2020, with taxable securities accounting for about 17% of the par traded in 2021, compared to 14% in 2020.
- A slight decrease in primary and continuing disclosures submitted to the MSRB in 2021. Primary disclosures were 13,697 in 2021, down from 13,914 in 2020, while continuing disclosures fell slightly to 156,294 in 2021 from 156,847 in 2020, largely as a result of a 3% decline in event-based submissions.

The 2021 Fact Book includes monthly, quarterly and yearly aggregate market information from 2017 to 2021, and covers different types of municipal issues, trades and interest rate resets.

Date: March 3, 2022

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

Hawkins Advisory: New Private Activity Bond Provisions for Qualified Carbon Dioxide Capture Facilities

A new category of tax-exempt private activity bonds was created as part of the Infrastructure Investment and Jobs Act, enacted in November 2021, to encourage private investment in carbon dioxide capture facilities. The attached Hawkins Advisory attempts to describe and explain the applicable provisions.

Read the Hawkins Advisory.

Joint Trades Letter in Support of LIBOR Legislation to Address "Tough Legacy" Contracts - SIFMA

SUMMARY

SIFMA in a joint letter with other associations provided comments to the Senate to quickly pass the much-needed LIBOR legislation. We, the undersigned organizations, support the Economic Continuity and Stability Act, sponsored by Senators Tester and Tillis with Chairman Brown and Ranking Member Toomey to address “tough legacy” contracts that currently reference LIBOR.

SIFMA signed with the following:

Structured Finance Association

Bank Policy Institute
Commercial Real Estate Finance Council (CREFC)
Institute for Portfolio Alternatives
Government Finance Officers Association
Student Loan Servicing Alliance
The Real Estate Roundtable
Education Finance Council
The Financial Services Forum
The Loan Syndications and Trading Association (LSTA)
Institute of International Bankers
Mortgage Bankers Association
The International Swaps and Derivatives Association (ISDA)
Independent Community Bankers of America
National Association of Corporate Treasurers
U.S. Chamber of Commerce, Center for Capital Markets Competitiveness
Consumer Bankers Association
Housing Policy Council
Investment Company Institute
American Bankers Association
The American Council of Life Insurers (ACLI)
Mid-Size Bank Coalition of America

Headlines for Alternative Lenders on LIBOR Replacement: McGuireWoods

The LIBOR Transition Continues

While Dec. 31, 2021 was a key LIBOR transition deadline for many lenders, the transition has continued in 2022 with alternative lenders in particular continuing to use the LIBOR tenors that will remain available until June 30, 2023. Lenders continue to explore different benchmark alternatives, from two- or three-part calculations for day one SOFR calculation to several emerging versions of "credit sensitive rates" that share operational similarities with LIBOR, which can have a material effect on the return on loans and negatively impact the efficiency of the capital markets. In multicurrency deals, the number of applicable benchmarks has multiplied, further complicating yield calculations. For more information, see "Banks Press Ahead with Term SOFR Preparation; Credit Sensitive Rates Under Scrutiny."

Hidden Costs of Reference Rates

Use of the LIBOR reference rates required a license with ICE Benchmark Administration (IBA), the administrator of the LIBOR reference rate. Replacement reference rates are likely to require a license with **each administrator of the applicable reference rate**. For more information, see "Banks Press Ahead with Term SOFR Preparation; Credit Sensitive Rates Under Scrutiny."

Beware Loan Documents Without Replacement Rates for LIBOR

The states of New York and Alabama have enacted laws with default benchmark rates for contracts governed by their state laws that do not include clearly defined or practicable LIBOR replacement benchmark rate provisions. A lender party to the rare New York or Alabama governed credit or loan agreement with LIBOR provisions but no default replacement rates for the LIBOR provisions could suddenly experience a drastic, unexpected change in the economics under that credit or loan agreement. For more information, see "LIBOR Legislation Bill Passed by New York State Legislature."

Key LIBOR Expiration Dates

All LIBOR settings have ceased, or will cease, to be provided by any administrator or no longer will be representative after:

- Dec. 31, 2021, in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month U.S. dollar settings; and
- June 30, 2023, in the case of the remaining U.S. dollar settings.

McGuireWoods LLC

March 4, 2022

New and Familiar Compliance Challenges for FINRA Members in 2021 and What That Means for 2022: Katten Muchin Rosenman

Payment for order flow (PFOF) and best execution; market access; finfluencers and gamification; and anti-money laundering were some of the most critical emerging and familiar compliance challenges faced by member firms addressed by the Financial Industry Regulatory Authority (FINRA) in 2021 through relevant guidance and its enforcement program.

Looking into 2022, FINRA is expected to continue to pay careful attention to compliance issues surrounding these challenges, as well as those newly identified in the authority's 2022 Report on Examination and Risk Monitoring Program.1 These include firm short positions and fails-to-receive in municipal securities; trusted contact persons; funding portals and crowdfunding offerings; disclosure of routing information; and portfolio margin and intraday trading.

This review elaborates in detail on top emerging and compliance challenges of members addressed by FINRA in 2021 and reviews additional 2022 issues that also may be targeted by FINRA.

Payment for Order Flow (PFOF) and Best Execution
In June 2021, FINRA issued Regulatory Notice 21-23 (Best Execution and PFOF), which reminded firms of their obligations with respect to PFOF2 and best execution.

Generally, FINRA Rule 5310 requires FINRA members to "use reasonable diligence to ascertain the best market for a security, and to buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." Regulatory Notice 21-23 made clear that PFOF arrangements do not alter a firm's best execution obligations, and to meet such obligations a firm must compare execution quality obtained from existing arrangements against quality that could be obtained from competing markets.

Securities and Exchange Commission (SEC) Chairman Gary Gensler recently sent a directive to SEC staff to consider whether additional best execution requirements or guidance are needed to promote investor protection, hinting at future developments in this area.3

In the past year, FINRA fined three firms for purported best execution violations, resulting in approximately $1.5 million in fines. In particular, FINRA assessed a fine of $850,000 against a member firm for allegedly failing to exercise reasonable diligence to ensure that it routed customer orders through venues that provided the best execution quality.4 FINRA found the firm prioritized the routing of marketable equity orders to market makers and exchanges that paid for that order flow or paid the highest rebates.

FINRA also found the firm failed to reasonably supervise for best execution; specifically, its written supervisory procedures (WSPs) provided no guidance as to how the supervisor should conduct an execution quality analysis of competing markets.

In addition, FINRA fined another member firm $575,000 for supposedly violating best execution obligations in connection to its role as a market maker in over-the-counter (OTC) securities.5 FINRA said the firm "[failed] to use reasonable diligence to ascertain the best market for the subject securities and [failed] to buy or sell in such a market so that the resultant prices to the customers were as favorable as possible under prevailing market conditions."6 The manual process used by the firm for comparing customer orders resulted in the firm, at times, missing better-priced messages and not executing orders at the best available price.

FINRA also determined that there were shortcomings in the firm's supervisory system — the firm did not account for price opportunities available through its electronic messaging service and thus had no way to determine if its customer orders received inferior executions to those available via the messages.

Further, FINRA fined a third member firm $80,000 for purportedly failing to comply with best execution obligations under FINRA Rule 5310. Specifically, FINRA found that the firm failed to "use reasonable diligence to ascertain the best market for a subject security and buy or sell in such market so that the resultant price to the customer was as favorable as possible under prevailing market conditions in connection with 26 corporate bond transactions."

In addition, FINRA also found that the firm failed to establish and maintain a supervisory system designed to comply with FINRA Rule 5310, fining the firm an additional $20,000.7

With respect to PFOF, FINRA fined a member firm $170,000, claiming the firm failed to disclose material aspects of its PFOF arrangements, among other things. Additionally, FINRA concluded that the firm did not establish and maintain a supervisory system, including WSPs, reasonably designed to achieve compliance with disclosure obligations pertaining to PFOF under Regulation NMS (Reg NMS) Rule 606.8 Although the firm's Rule 606 report9 in Q1 of 2018 stated that it may receive and/or make payments in varying amounts from the exchanges or other broker-dealers, FINRA said the report failed to disclose the material aspects of its relationship with its significant execution venues, including descriptions of any PFOF arrangements.

Market Access
Rule 15c3-5 of the Securities Exchange Act of 1934 (the Market Access Rule) requires broker-dealers providing market access (i.e., access to trading in securities on an exchange or alternative trading system) to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to manage financial, regulatory and other risks of the business.

FINRA reported five market access cases in 2021, totaling approximately $1.67 million in fines.

FINRA's market access cases can generally be distinguished by settlement amounts: (1) settlements above $1 million, which typically involve violations of multiple rules, including anti-money laundering (AML) violations, over a long period of time; (2) settlements around $300,000–$500,000, which involve a limited number of violations or affected transactions; and (3) settlements around $50,000, which generally involve minor procedural violations. An example of a market access case from each of the three categories above is highlighted below.

First, FINRA and various self-regulatory organizations (SROs) fined a member firm $1.25 million for, among other violations, allegedly failing to establish and maintain a supervisory system and regulatory risk management controls reasonably designed to monitor for potentially manipulative trading, such as potential layering, spoofing, wash trades, prearranged trades, marking the close and odd-lot manipulation.10

Importantly, FINRA and the SROs did not determine the firm failed to detect actual instances of manipulative trading — rather, they found that the firm's failures concerning the Market Access Rule resulted in potentially manipulative trading.

FINRA also found the firm failed to implement a reasonably designed AML program for the detection and reporting of potentially suspicious transactions. Specifically, FINRA claimed the firm's written AML procedures did not address potentially manipulative trading at all. These violations allegedly continued for a period of 10 years.

Second, FINRA fined a brokerage firm $310,000 for purportedly failing to comply with various provisions of the Market Access Rule for a period of under two years relating to establishing, monitoring, and amending customer credit limits and conducting annual reviews and certifications of the effectiveness of its market access risk management controls and supervisory procedures.11 FINRA said the firm's WSPs "did not include reasonably designed procedures for customer credit limits because they did not require firm personnel to conduct due diligence as to the customer's business, financial condition or trading patterns."12

Third, FINRA fined a broker-dealer $40,000, claiming that it failed "to establish financial risk management controls and supervisory procedures to systematically limit its financial exposure that could arise as a result of market access."13 For example, FINRA said the firm did not have any pre-trade controls to prevent the entry of orders that exceed preset credit or capital thresholds for customers. Because the purported violations were mostly procedural, FINRA assessed a lower fine.

Common market access issues across firms include failing to establish WSPs or having insufficient WSPs, failing to supervise for manipulative orders, failing to conduct an annual review of its business activity in connection with market access, and AML violations.

Finfluencers and Gamification

Exam Sweep of Broker-Dealer Practices Related to "Finfluencers" (Sept. 2021)

In September 2021, FINRA published guidance entitled "Social Media Influencers, Customer Acquisition, and Related Information Protection,"14 notifying member firms that FINRA is conducting a review of broker-dealer practices related to the acquisition of customers through social media channels.15 According to the guidance, the exam sweep focuses on firms' supervision and communications related to paid social media influencers. The sweep inquiry letter poses multiple questions and subparts, including requests for details regarding firms' relationships with social media influencers, including how they are found and compensated, information on any referral programs in which the firms may be engaged, and WSPs around the use of social media influencers.

Annual Report on Examination and Risk Monitoring Programs (Feb. 2021)

In February 2021, FINRA released its annual report on “Examination and Risk Monitoring Program,”16 which highlighted “gamification” as an emerging risk.17 Gamification features include “a range of technologies and techniques designed to influence investor behavior, including ‘games’ at sign-up; social networking tools; streaks with prizes, such as free stock; points, badges and leaderboards; and push notifications.”18 The annual reports warned broker-dealers of their existing regulatory obligations, including compliance with Regulation Best Interest (Reg BI), supervisory and diligence obligations, and various FINRA communications rules. Specifically, the guidance noted that broker-dealers must evaluate gamification features to determine whether they meet regulatory obligations to:

- comply with any Reg BI and Form CRS requirements if any communications constitute a “recommendation” that requires a broker-dealer to act in a retail customer’s “best interest;”
- make disclosures relating to risks to customers, fees, costs, conflicts of interest, and required standards of conduct associated with the firm’s relationships and services;
- prohibit the use of false, exaggerated or misleading statements or claims in any communications and ensure all firm communications are fair and balanced and do not omit material information concerning products or services;
- comply with account opening requirements that require firms to gather information about customers and approve certain types of accounts, including options accounts;
- develop a comprehensive supervisory system for such communication methods, including surveilling for red flags of potential violative behavior, and maintaining books and records of all communications related to the firm’s business as such; and
- address compliance with FINRA communications rules.

While no enforcement action has been brought by FINRA to date concerning the use of finfluencers or gamification sales practices, member firms in 2022 can expect to see enforcement activity related to potential violations of Reg BI, suitability obligations, communication standards (which require all member communication to be fair and balanced), and supervision.

Anti-Money Laundering (AML)
FINRA Rule 3310 requires member firms to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act of 1970 (BSA) and its implementing regulations. The BSA and related regulations impose a number of requirements, including “implementing and maintaining both AML programs and Customer Identification Programs (CIPs); filing reports of suspicious activity; verifying the identity of legal entity customers; maintaining procedures for conducting ongoing customer due diligence; establishing due diligence programs to assess the money laundering risk presented by correspondent accounts maintained for foreign financial institutions; and responding to information requests from the Financial Crimes Enforcement Network within specified timeframes.”19 In 2021, FINRA brought 12 cases against member firms and individuals for violations of Rule 3310, three of which are highlighted below.

Most notably, FINRA fined a prominent broker-dealer $57 million for several purported violations, one of which involved failing to establish or maintain a CIP in violation of Rule 3310 that was appropriate for the firm’s size and business.20 FINRA found that the member firm automatically approved accounts and ignored alerts despite the fact that its clearing firm had flagged those accounts as requiring further review for potentially fraudulent activity. The firm approved and opened more than 5.5 million new customer accounts during a two-and-a-half-year period without any employee whose primary responsibilities related to the firm’s CIP, charged FINRA.

FINRA fined another member firm $650,000 for, among other things, allegedly failing to establish an AML compliance program reasonably designed to detect, monitor, and cause the reporting of potentially suspicious activity relating to low-priced securities transactions.21 FINRA found that the firm failed to monitor for potentially suspicious activity involving equity trading.

Even when the firm later implemented monitoring systems, the systems were not reasonably designed to detect red flags associated with low-priced securities transactions. In addition, the firm supposedly failed to provide appropriate guidance and direction to its employees on how to properly use the systems, and ultimately did not detect and investigate several suspicious low-priced securities transactions.

FINRA fined another member firm $500,000 for, among other things, allegedly failing to describe in its AML policies "how the firm or its registered representatives should review or monitor customer stock deposits or subsequent trading activity to detect and investigate such red flags."22 Further, FINRA found that the firm's AML policies failed to describe and identify how the firm would investigate such red flags. In connection with the matter, FINRA also fined the firm's AML compliance officer $5,000, claiming the officer failed to properly implement the firm's AML policies and procedures.

Looking Ahead

In the past year, FINRA issued guidance and brought numerous enforcement actions in areas such as PFOF, market access, finfluencers and gamification, and AML. Many enforcement actions in the above high-priority and related topics resulted in heavy penalties and large fines for member firms, which serve as cautionary tales to industry participants of the perils and high costs of noncompliance.

As innovative technologies and business methodologies continue to emerge and challenge existing regulatory paradigms in 2022, member firms can expect further communications and enforcement actions. To that end, FINRA has stressed that it will "adapt its areas of focus throughout 2022 to address emerging regulatory concerns and risks for investors that may arise throughout the year,"23 including topics reviewed in this advisory as well as many others highlighted in FINRA's 2022 Report on Examination and Risk Monitoring Program, such as firm short positions and fails-t--receive in municipal securities; trusted contact persons; funding portals and crowdfunding offerings; disclosure of routing information; and portfolio margin and intraday trading.

Katten Muchin Rosenman LLP – Susan Light, Michael J. Lohnes and Alexander C. Kim

March 3 2022

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1 FINRA, "2022 Report on FINRA's Examination and Risk Monitoring Program" (Feb. 9, 2022), https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-moni-oring-program.
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9 Rule 606 of Reg NMS requires broker-dealers to disclose to customers certain information regarding their order routing practices for NMS securities and listed options. Specifically, Rule 606 requires broker-dealers to "make publicly available for each calendar quarter a report on its routing of non-directed orders in NMS securities during that quarter," which must include a "discussion of the material aspects of the [firm's] relationship with each venue . . . including a description of any arrangement for payment for order flow and any profit-sharing relationship and a description of any terms of such arrangements, written or oral, that may influence a broker's or dealer's routing decision." FINRA has identified "disclosure of routing information" as an examination priority in 2022, which means member firms can expect to see increased exam and enforcement activity related to Rule 606 violations.
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Aileen Tan, Financial Markets and Funds associate and candidate for admission to the New York State Bar, contributed to this advisory.

FINRA Issues 2022 Report on Its Examination and Risk Monitoring Program.

On February 9, 2022, the Financial Industry Regulatory Authority (FINRA) published its 2022 Report on its Examination and Risk Monitoring Program (the Report).1 The 60-page Report includes five new topic areas for 2022, flagged as such in the Report's table of contents: (1) firm short positions and fails-to-receive in municipal securities, (2) trusted contact persons, (3) funding portals and crowdfunding offerings, (4) disclosure of order routing information, and (5) portfolio margining and intraday trading.

FINRA highlights seven topic areas that received industry and public attention and were addressed through FINRA's exam and risk monitoring program: (1) Reg BI and Form CRS, (2) the Consolidated Audit Trail, (3) order handling, best execution, and conflicts of interest, (4) mobile apps, (5) special purpose acquisition companies (SPACs), (6) cybersecurity, and (7) complex products.

The Report also includes the perennial topic areas of past reports including anti-money-laundering, outside business activities, net capital, and books and records. The appendix includes specific examples of how firms have used prior FINRA reports and guidance to enhance their own compliance programs.

Sidley's Takeaways

While the Report covers more than 20 regulatory areas, some common themes emerge throughout.

First, the Report places a greater emphasis than past reports on topic areas in involving market integrity. This comes as no surprise given the volatility experienced in the markets during 2021.

Firms should expect continued attention to best execution and compliance with the order routing disclosure requirements of Rule 606 of Regulation NMS. FINRA emphasizes wholesale market maker best execution obligations and notes that best execution is one of the “cornerstones” of FINRA’s oversight activities. The Report informs us that FINRA, like the Securities and Exchange Commission, is focused on questions of potential conflicts of interest in payment for order flow arrangements with a clear shift in focus to firms with a zero-commission model. The findings from the 2020 targeted exam of zero-commission firms are still pending. Firms also should be prepared for CAT reporting compliance to be front and center in examinations this year, particularly as the final phases of rollout are completed. FINRA already has identified particular areas of noncompliance.

Second, as the industry changes the ways in which it offers services, the Report suggests that FINRA is increasingly focusing attention on online platforms and digital communications through which newer investors are often opening brokerage accounts. The manner in which firms are communicating through mobile apps, social media, and other digital platforms all have drawn FINRA’s attention and look to be in sharp focus in 2022. FINRA likely will look to hold communications on these platforms to the same standards of any other platform.

Last, but not least, 2022 will be the second full year of examinations for Reg BI compliance. As discussed below, firms should be prepared for examinations to include more substantive questions of Reg BI compliance in connection with specific recommendations such as private placements or complex products as well as examination of communications and whether they rise to the level of “recommendation,” particularly in connection with online broker-dealer models.

The Report is intended to provide broker-dealers with information to use to prepare for examinations and to review and assess compliance and supervisory procedures related to business practices, compliance, and operations. It also is an important preview of areas that may garner the interest of FINRA Enforcement.

Key Report Highlights

We summarize some key highlights of the Report below.

Reg BI and Form CRS

The Report provides extensive feedback for firms on Reg BI and Form CRS compliance exam findings. In particular, FINRA flags concerns about firms failing to update written supervisory procedures to address these ne requirements, in particular in the areas of

- identifying the individual(s) responsible for Reg BI and Form CRS compliance
- providing adequate detail regarding how the firm is complying with new requirements
- addressing costs and potential alternatives in making recommendations
- addressing recommendations of account types
- addressing conflicts of interest and incentives
- including recordkeeping and testing requirements
- memorializing processes or controls developed to address Reg BI and Form CRS

FINRA also found that some firms had inadequate training, failed to comply with duty of care obligations, and failed to provide “full and fair” disclosure of material facts related to the scope and terms of the customer relationship. Form CRS filings that exceeded the prescribed page length, omitted material facts or otherwise contained inaccuracies or omissions, and were not properly posted on firm websites were among other specific Form CRS observations in the Report. Firms will want to review carefully this section and pay close attention as FINRA is looking beyond basic procedures compliance and will review the supervision of the marketing and recommendations of accounts and particular product types through the lens of Reg BI compliance.

Order Handling, Best Execution, and Conflicts of Interest

Compliance with FINRA's best execution rule, Rule 5310, is a perennial focus area for FINRA. This year the Report reinforced FINRA's focus on payment for order flow (PFOF) arrangements and noted that it has been conducting a target review of wholesale market makers to evaluate their own execution quality reviews, whether PFOF arrangements influence their order handling practices, and any changes made in order handling practices during periods or market volatility. As the Report notes, FINRA examinations also found that some firms failed to assess execution in competing markets and failed to evaluate certain factors identified in Rule 5310 during "regular and rigorous reviews" such as speed of execution, price improvement, and the likelihood of execution of limit orders.

Consolidated Audit Trail (CAT)

According to the Report, CAT compliance is top of mind for FINRA. The Report identifies several findings of deficiencies including the submission of incorrect or incomplete reports. Exam findings also noted late resolution of repairable CAT errors and inadequate vendor supervision. As the final stages of the CAT rollout complete this summer, it will be important for broker-dealers to have effective supervisory procedures reasonably designed to achieve compliance with CAT reporting requirements that include using CAT report cards and considering a comparative review of CAT submissions against firm order records.

Mobile Apps

FINRA has increased its focus on educating newer investors entering the market through self-directed accounts and issued a special notice on June 30, 2021, requesting comments on effective ways to educate those new investors. The Report advises that firms using mobile apps must establish and implement a comprehensive supervisory system for communications on mobile apps so that statements are fair and balanced and do not contain false, misleading, or promissory statements. The Report also indicates that a false or misleading statement on one screen of a mobile app is not cured by a "one-click away" corrective disclosure. Given the Report's focus on mobile apps, expect FINRA to scrutinize all mobile app disclosures and communications in the same manner as any other written communication.

FINRA notes that firms using mobile apps to conduct business with their customers need to pay attention to whether information provided to customers via the app constitutes a "recommendation" that Reg BI would cover. Firms offering self-directed accounts will want to give particular attention to this issue.

Digital Communication Channels

FINRA advises firms to review policies on digital communications to address all permitted and prohibited communication channels and features. This comes on the heels of increased regulatory scrutiny in 2021 of record-retention practices for digital communications. FINRA also notes that firms should have processes to review for red flags of registered representatives' communication through unapproved digital channels and should review whether content on approved digital platforms, including social media, meets the standards of FINRA Rule 2210. For firms with mobile apps and other forms of digital communication, firms should be testing the accuracy of account and other information displayed in the mobile apps to confirm accuracy.

For those firms also engaged in digital asset activities, the Report notes that they should be confirming that there is a fair and balanced presentation addressing risks of digital assets and not misrepresenting the extent to which digital assets are regulated by FINRA or securities laws or eligible for SIPC or other protections thereunder.

Cybersecurity and Technology Governance

In 2021, mitigating the risk of online account takeovers and potential cyberintrusions through third-party vendors garnered FINRA's attention. FINRA observed that some firms did not have an adequate risk assessment process in place including failing to conduct regular penetration testing. Some firms also failed to encrypt all confidential data and sensitive firm information. Technology governance has been a key examination and enforcement focus for FINRA for some time. The Report shares key questions firms should consider in its technology governance, including what controls the firm implements to mitigate system capacity performance and integrity issues, how firms test system changes prior to being moved to a production environment, and postimplementation quality assurance. FINRA observed system capacity issues at firms during market volatility periods in 2021, and firms can expect that the regulator will remain watchful in this area throughout the next year.

Complex Products

Not surprisingly, the Report makes clear that FINRA will continue to look to risk disclosure and communications with customers about complex products. The Report turns particular focus to supervision and suitability of complex options strategies and approval for options trading. FINRA issued a regulatory notice on the topic, RN 21-15, in April 2021, followed by the launch of an ongoing targeted examination on options supervision and suitability in August 2021. The Report highlights conservation donation transactions as an area of concern as well as FINRA's longstanding interest in variable annuity transactions.

SPACs

SPACs make a reappearance in this year's Report where FINRA notes that over 70% of initial public offerings in the first quarter of 2021 were accomplished through SPACs. In October 2021, FINRA launched a targeted exam to explore a range of issues with SPACs including whether firms perform adequate due diligence on merger targets, whether adequate disclosures are provided to customers, and how firms are managing potential conflicts of interest in SPACs. FINRA will release its findings from this sweep at a later date.

The Report provides a thorough roadmap to FINRA's examination findings in key program areas. Firms should consider and implement, as necessary, practices and procedures in each of the areas and be prepared to address them in future examinations.

1 A copy of the complete Report is available at https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program.

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March 2, 2022

[Firm Short Positions and Fails-to-Receive in Municipal Securities: 2022 Report on FINRA's Examination and Risk Monitoring Program]

Regulatory Obligations and Related Considerations

Regulatory Obligations:

As detailed in *Regulatory Notice* 15-27, customers may receive taxable, substitute interest instead of the tax-exempt interest they were expecting when a firm effects sales to customers of municipal securities that are not under the firm's possession or control.7 This can occur when firm trading activity inadvertently results in a short position or a firm fails to receive municipal securities it purchases to fulfill a customer's order.

Firms must develop and implement adequate controls and procedures for detecting, resolving and preventing these adverse tax consequences to customers. Such procedures must include closing out fails-to-receive within the time frame prescribed within Municipal Securities Rulemaking Board (MSRB) Rule G-12(h) and confirming that their communications with customers regarding the tax status of paid or accrued interest for municipal securities are neither false nor misleading, in accordance with MSRB Rule G-17.

Related Considerations:

- Does your firm use exception reports to manage its municipal securities' short positions or fails-t--receive? If so, how does your firm use such reports, and which departments are responsible for managing them?
- When municipal securities short positions are identified, does your firm begin to cover the shorts, or do they wait until the trades have settled?
- What is your firm's process to close out fails-to-receive in accordance with the methods and time frame prescribed under MSRB G-12(h)?
- How does your firm detect instances that would require them to pay customers substitute interest? In those circumstances, what is the firm's process for notifying impacted customers and paying them substitute interest in a timely manner? If a customer does not want to receive substitute interest, what alternatives does the firm offer (e.g., offering to cancel the transaction and purchasing a comparable security that would provide tax-exempt interest)?
- How does your firm handle inbound or outbound account transfers sent through the Automated Customer Account Transfer Service (ACAT) that are delivered with no corresponding municipal bonds in possession or control?

Exam Findings and Effective Practices

Exam Findings:

- **Inadequate Controls and Procedures** – Not maintaining adequate procedures and controls for preventing, identifying and resolving adverse consequences to customers when a firm does not maintain possession or control of municipal securities that a customer owns.
- **Inadequate Lottery Systems** – Opting to use a random lottery system to allocate municipal short positions to certain customer accounts, but the system did not fairly or adequately account for or allocate substitute accrued interest payments.

Effective Practices:

- **Preventative Controls** – Maintaining processes to prevent or timely remediate municipal positions from settling short (e.g., covering these positions, finding a suitable alternative, cancelling the customer's purchase).
- **Operational and Supervisory Reports** – Developing operational and supervisory reports to identify customer long positions for which the firm has not taken possession and control of the security.
- **Review of Fail Reports** – Municipal securities principals performing regular, periodic reviews of Fail Reports to comply with the close-out requirements of MSRB Rule G12-(h).

Additional Resource

Regulatory Notice 15-27 (Guidance Relating to Firm Short Positions and Fails-to-Receive in Municipal Securities)

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7 These regulatory obligations stem from Exchange Act Rule 15c3-3(d)(4) and MSRB Rules G-17 and G-27 (for firm shorts), and MSRB Rule G12-(h) (for fails-to-receive).

California Warns Investors of Labor Market and Supply Chain Issues.

California, whose recovery of jobs lost during the height of the pandemic lags that of the U.S. overall, said low labor market force growth and supply chain disruptions pose risks to its municipal-bond investors.

In documents circulated to potential buyers of its $2.2 billion general-obligation deal on March 9, the state added the threats to its list of dangers they should consider.

The administration of Governor Gavin Newsom expects the labor force to recover to pre-pandemic levels in the third quarter this year. "If current labor market frictions (impediments to employers and job seekers agreeing on employment, e.g., disagreements on appropriate wages, workplace safety or ability to work remotely) persist longer than projected, then low labor force growth would constrain job growth, which in turn would lead to less consumption and spending," the state said in the documents.

California has regained 72% of the jobs lost during the onset of the pandemic, while the nation has recovered 87%, according to federal data. Its unemployment rate of 6.5% in December was the highest among U.S. states.

Meanwhile, the pandemic-wreaked havoc at factories and ports also present a threat to the state. If regular production and transportation don't resume by early 2023 as expected by the administration, "a slower resolution of supply chain issues would potentially keep inflation high for longer than assumed and could also lead to lower production and economic activity," the state said.

In the bond documents, California listed 13 risks. They are:

- Covid-19 pandemic
- Threat of recession
- Inflation
- Labor market friction

- Supply chain disruptions
- Capital gains volatility
- Global relations and trade
- Health care costs
- Housing constraints
- Debts and liabilities
- Climate change
- Energy risks
- Cybersecurity risks

California's general obligation bonds are rated Aa2 by Moody's Investors Service, AA- by S&P Global Ratings and AA by Fitch.

Bloomberg Markets

By Romy Varghese

March 2, 2022

Post-Issuance Tax Compliance and Continuing Disclosure Responsibilities for Issuers and Borrowers of Tax-Exempt Bonds (Second Edition) - Orrick

The tax-exempt bond market is perennially under heightened scrutiny by various regulators, including the Internal Revenue Service (the "IRS"), the United States Securities and Exchange Commission (the "SEC") and the Municipal Securities Rulemaking Board (the "MSRB"). A primary focus of these regulators is on post-issuance compliance.

The purpose of this publication is to summarize the topic of post-issuance compliance for interested parties. It is intended to assist:

- treasurers, finance directors, comptrollers, controllers and other responsible officials of state and local government issuers of tax exempt bonds ("Issuers"); and
- representatives of private, nongovernmental conduit borrowers (such as nonprofit institutions providing health care and higher education) that are allowed to borrow at tax-exempt rates from Issuers ("Borrowers").

Download pdf.

Orrick, Herrington & Sutcliffe LLP

February 23, 2022

FINRA Report Highlights New Topics and Emerging Risks for 2022.

On February 9, FINRA published its 2022 Report on FINRA's Examination and Risk Management Program (2022 Report), an authoritative resource for member firms to evaluate and, where necessary, enhance their compliance programs and operations procedures. The 2022 Report is just the second iteration of FINRA's pathbreaking annual Report on FINRA's Examination and Risk Management Program, which FINRA describes as an "up-to-date, evolving resource or library of information for firms." The annual report outlines relevant rule(s), key considerations, noteworthy findings, and effective practices on a broad range of regulatory obligations organized into four categories: (1) firm operations, (2) communications and sales, (3) market integrity, and (4) financial management.

The first report (2021 Report) synthesized and supplanted two of FINRA's prior annual publications, bringing together (1) FINRA's analysis of prior examination results, historically provided in the Report on Examination Findings and Observations; and (2) FINRA's forward-looking Risk Monitoring and Examination Program Priorities Letter, which highlighted the issues on which FINRA planned to focus its reviews for the coming year. Building upon the content of the 2021 Report (which we previously covered here), the 60-page 2022 Report includes several new topics, and identifies key areas of emerging risk that may receive increased scrutiny going forward. The 2022 Report also highlights several topics that received significant industry and public attention in 2021, including: (1) new SEC rules, such as Regulation Best Interest and Form CRS; (2) the increasing prevalence and sophistication of cybersecurity attacks; (3) securities trading via mobile applications; and (4) the increased use of special purpose acquisition companies (SPACs) to bring companies public. The 2022 Report states that FINRA will continue to assess member firms' programs and share information on these topics of interest as they develop, including in future annual reports.

Below, we summarize five entirely new topics found in the 2022 Report and catalog the emerging risks that FINRA has identified as likely to receive increased scrutiny in 2022 and beyond. However, FINRA member firms are encouraged to thoroughly review the 2022 Report. In particular, member firms should: (1) pay close attention to the topics that FINRA has flagged as "new" to the 2022 Report; and (2) identify the findings, observations, and effective practices relevant to their business models. The findings and best practices outlined in the 2022 Report can serve as a guide for member firms to evaluate their compliance programs and operations procedures to identify possible deficiencies or gaps that could result in the types of exam findings highlighted therein. The 2022 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.

I. New Topics Covered in the Report

Firm Short Positions and Fails-to-Receive in Municipal Securities. Customers may receive taxable, substitute interest instead of the expected tax-exempt interest when a firm effects sales to customers of municipal securities not under the firm's control — for example, when firm trading activity inadvertently results in a short position or when a firm fails to receive municipal securities it purchased to fulfill a customer's order. Firms must develop and implement adequate controls and procedures for detecting, resolving, and preventing these adverse tax consequences to customers.

Trusted Contact Persons. FINRA Rule 4512(a)(1)(F) requires firms, for each of their noninstitutional customer accounts, to make a reasonable effort to obtain the name and contact information for a trusted contact person age 18 or older, and describes the circumstances in which firms are authorized to contact the trusted contact person and disclose information about the customer account.

Funding Portals and Crowdfunding Offerings. Funding portals must register with the SEC and become a member of FINRA. Broker-dealers contemplating engaging in the sale of securities in reliance on the crowdfunding exemptions must notify FINRA in accordance with FINRA Rule 4518.

Disclosure of Routing Information. Rule 6060 of Regulation NMS requires broker-dealers to disclose information regarding the handling of their customers' orders in NMS stocks and listed options, so that customers can (1) better understand how the firm routes and handles their orders, (2) assess the quality of order handling services, and (3) ascertain whether the firm is effectively managing potential conflicts of interest.

Portfolio Margin and Intraday Trading. FINRA Rule 4210 permits member firms to apply portfolio margin requirements in margin accounts held by certain investors as an alternative to strategy-based margin requirements. Firms are required to monitor the risk of the positions held in these accounts during a specified range of possible market movements according to a comprehensive written risk methodology.

II. Emerging Risks

Emerging Low-Priced Securities Risk. FINRA has observed an increase in several types of activity in low-priced securities that could be indicative of fraud schemes, including an increase in such activity through foreign financial institutions that open omnibus accounts at U.S. broker-dealers.

Emerging Vendor Risk. Due to the recent increase in the number and sophistication of cyberattacks during the COVID-19 pandemic, FINRA reminds firms of their obligations to oversee, monitor, and supervise cybersecurity programs and controls provided by third-party vendors.

Emerging Customer Account Information Risks. Effective February 15, 2021, FINRA Rule 3241 requires a registered person to decline being named a beneficiary of a customer's estate, executor, or trustee or to have power of attorney for a customer unless certain conditions are met, due to the risk of a conflict of interest. Among other things, firms should (1) consider whether their policies and procedures establish criteria for a registered person acting in such capacity and (2) be able to perform a reasonable assessment of the risks of a registered person in such a position.

FINRA member firms should thoroughly review the 2022 Report, including the areas highlighted above, to identify the findings, observations, and effective practices relevant to their business models, and they should incorporate relevant practices into existing compliance programs.

Troutman Pepper – Jay A. Dubow, Ghillaine A. Reid, Bonnie Gill and Casselle Smith

February 17 2022

FINRA Publishes 2022 Report on Its Examination and Risk Monitoring Program: Mayer Brown

On February 9, 2022, the Financial Industry Regulatory Authority, Inc. ("FINRA") published its 2022 Report on FINRA's Examination and Risk Monitoring Program (the "Report"). FINRA intends for the Report to be an up-to-date, evolving resource for firms that may help inform their compliance programs. In this regard, the Report builds on the structure and content of last year's report and adds new topics for 2022, including funding portals and crowdfunding offerings, trusted contact persons, disclosure of routing information, portfolio margin and intraday trading, and firm short positions and fails-to-receive in municipal securities, as well as new material, such as new exam findings and effective practices, to topics that FINRA covered in 2021. Further, for each topical area covered in the Report, FINRA provides the relevant rule(s), key considerations for member firms' compliance programs, noteworthy findings from recent examinations, including findings that are particularly relevant for new member firms in their first year of operation, effective practices that FINRA observed during its oversight, and additional resources that may be helpful to member firms in reviewing their supervisory procedures and controls and fulfilling their compliance obligations. Firms should carefully review the Report as applicable to their business operations with a view to identifying potential gaps and/or areas for enhancement in their compliance programs and supervisory controls. In addition to the new topics for 2022, firms should pay attention to the new material that FINRA added to previously covered topics, in particular new exam findings and effective practices. When preparing for upcoming exams, firms should ensure that they can explain their current practices and that their current practices are appropriately documented, including relevant supervisory reviews, compliance reports and testing of supervisory systems.

Selected Highlights

The Report highlights certain areas that received considerable attention within the industry and beyond in 2021.

Regulation Best Interest ("Reg BI") and Form CRS. Firms should continue to expect FINRA to undertake a comprehensive review of firms' processes, practices and conduct in relation to requirements under Reg BI and Form CRS, including whether firms have established and enforce adequate written supervisory procedures ("WSPs"), file, deliver and track accurate Forms CRS, make recommendations that adhere with Reg BI's Care Obligation, identify and mitigate conflicts of interest and provide effective staff training.

Consolidated Audit Trail ("CAT"). FINRA continues to evaluate member firms for compliance with obligations under Rule 613 under the Securities Exchange Act of 1934 (the "Exchange Act") and the CAT NMS Plan FINRA Rule 6800 Series (collectively, the "CAT Rules"). FINRA emphasizes several aspects of the CAT Rules, including reporting required information to the Central Repository and maintaining effective supervision processes.

Order Handling, Best Execution and Conflicts of Interest. FINRA emphasizes that assessing firms' compliance with their best execution obligations under FINRA Rule 5310 (Best Execution and Interpositioning) is one of the cornerstones of FINRA's oversight activities and that it has evolved its oversight program to address changes in firms' business models, such as the advent of the "zero commission" model. FINRA launched a targeted exam initiative to evaluate the impact of the zero commission model on firms' order-routing and other business practices.1 FINRA also is reviewing firms' order handling disclosures for compliance with the requirements of SEC Rule 606 of Regulation NMS.

Mobile Apps. FINRA points out that the use of mobile applications ("apps") and related technologies to attract and interact with customers raise novel questions and potential concerns, including whether they encourage retail investors to engage in trading activities and strategies that may not be consistent with their investment goals or risk tolerance and how the apps' interface designs could influence investor behavior. FINRA notes that it has identified significant problems with some mobile apps' communications with customers and firms' supervision of activity on those apps, particularly controls around account openings. FINRA also launched a targeted exam initiative to assess firms' use of social media to acquire customers and compliance with obligations relating to the collection of information from those customers and other individuals who may provide data to firms.2

Special Purpose Acquisition Companies ("SPACs"). FINRA has increased its focus on firms' compliance with regulatory obligations in executing SPAC transactions. FINRA identifies several focus areas in its review of firms participating in SPAC offerings, including: due diligence conducted at the IPO and business combination stages, including as to the relevant officers, directors and control persons of the SPAC and SPAC-sponsor(s) and pre-identified acquisition targets; compliance with FINRA rules governing outside business activities ("OBAs"), private securities transactions ("PSTs") and Form U-4 amendments for associated persons who hold positions with, advise or personally invest in, SPACs or SPAC sponsors; whether firms are correctly taking net capital charges relative to the size of their commitment or using a written agreement with another syndicate member (i.e., "backstop provider"); and whether firms are maintaining and regularly updating their WSPs and supervisory controls to address risks related to SPACs (e.g., Reg BI, due diligence, information barrier policies, conflicts of interest). FINRA launched a targeted exam to explore issues relating to firms' SPAC activities, including how firms manage potential conflicts of interest in SPACs, whether firms are performing adequate due diligence on business combination targets and if firms are providing adequate disclosures to customers.3

On a separate note, FINRA advises firms that underwrite IPOs of issuers based in the People's Republic of China ("China-based issuers") to evaluate carefully whether the firms' controls are able to identify and report market manipulation, other abusive trading practices and potential anti-money laundering ("AML") concerns, which may result from the involvement of nominees for an undisclosed control person. In this respect, FINRA describes numerous red flags of potentially manipulative trading associated with how these investors open new accounts and trade these securities after completion of the IPO. FINRA also provides a list of resources regarding the risks associated with China-based issuers in recent statements from the U.S Securities and Exchange Commission ("SEC"). For additional information regarding the risks associated with China-based issuers, see our previous article here.

Cybersecurity. FINRA describes cybersecurity threats as "one of the primary risks firms and their customers face." In 2021, FINRA observed a continued increase in the number and sophistication of these threats and has issued alerts about phishing campaigns involving fraudulent emails purporting to be from FINRA, new customers opening online brokerage accounts to engage in Automated Clearing House ("ACH") "instant funds" abuse, the increase in bad actors using compromised registered representative or employee email accounts to execute transactions or move money, the use of customer information to gain unauthorized entry to customers' email accounts, online brokerage accounts or both (i.e., customer account takeover incidents), and using synthetic identities to fraudulently open new accounts.4 FINRA will continue to assess firms' information security programs and share information about cybersecurity threats and effective practices.

Complex Products. FINRA will continue to review firms' communications and disclosures made to customers in relation to complex products. FINRA will review customer account activity to assess whether firms' recommendations regarding these products are in the best interest of retail customers given their investment profile and the potential risks, rewards and costs associated with the recommendation. FINRA launched a targeted exam initiative in August 2021 to review firms' practices and controls relating to the opening of options accounts, which in some cases may be used to engage in complex investment strategies.5 With respect to mitigating the risk that recommendations of high-risk or complex investments might not be in a retail customer's best interest, FINRA notes as an effective practice establishing product review processes to identify and categorize risk and complexity levels for existing and new products, limiting high-risk or complex product, transaction or strategy recommendations to specific customer types, and applying heightened supervision to recommendations of high-risk or complex products.

Core Topics

The Report addresses 21 regulatory areas organized into four categories: Firm Operations;

Communications and Sales; Market Integrity; and Financial Management. We highlight below the new topics for 2022 and the new material that FINRA added to previously covered topics.

FIRM OPERATIONS

The Firm Operations section of the Report discusses AML obligations, cybersecurity and technology governance, OBAs and PSTs, books and records, regulatory events reporting under FINRA Rule 4530, firm short positions and fails-to-receive in municipal securities, trusted contact persons and funding portals and crowdfunding offerings.

FINRA highlights several considerations relating to both AML and cybersecurity and technology governance. FINRA notes that firms experiencing substantial growth or changes to their business should provide for reasonable growth and evolution in their AML programs alongside the business. In our experience, FINRA takes a similar view with respect to firms' cybersecurity and technology governance programs. FINRA also indicates that firms should consider whether they have appropriate procedures to communicate cyber events to their AML department, Compliance department or both, to fulfill regulatory obligations such as the filing of suspicious activity reports ("SARs"). In this regard, FINRA highlights as an exam finding that firms did not notify their AML departments of events that involve suspicious transactions including cybersecurity events, account compromises or takeovers, new account fraud, fraudulent wires and ACH transfers.6 FINRA expects that events involving, or enabled by, cybercrime be reported via SARs. In addition, FINRA urges firms to consider how FinCEN's 2021 publication of government-wide priorities for AML and countering the financing of terrorism will be incorporated into their risk-based AML programs.

FINRA addresses risks relating to OBAs and PSTs and reminds firms of their obligation under FINRA Rule 3270.01 to determine whether proposed OBAs will interfere with or otherwise compromise the registered representative's responsibilities to the firm and its customers, or should be treated as a PST subject to the requirements of FINRA Rule 3280. FINRA highlights as an effective practice conducting due diligence of OBAs that involve raising capital or directing securities transactions with investment advisers or fund companies in order to identify potential PSTs.

FINRA emphasizes, in particular for new member firms, that for purposes of compliance with the books and records requirements under SEC Rules 17a-3 and 17a-47 and FINRA rules, firms must file a Financial Notification when selecting or changing an archival service provider. Firms also should perform due diligence to verify vendors' ability to comply with applicable books and records requirements, including standards for electronic storage media ("ESM") and ESM notification requirements, and confirm that service contracts and agreements comply with ESM notification requirements. FINRA found that firms failed to comply with the ESM notification requirements, such as not obtaining the third-party attestation letters required by SEC Rule 17a-4(f)(3)(vii). FINRA also highlights as an effective practice firms' review of vendor contracts and agreements to assess whether firms will be able to comply with applicable books and records requirements.

FINRA did not add any new content with respect to regulatory events reporting under FINRA Rule 4530, but the Report's discussion of exam findings and effective practices in this area serves as helpful guidance.

With respect to firm short positions and fails-to-receive in municipal securities, a new topic in 2022, FINRA highlights findings relating to inadequate controls and procedures for preventing, identifying and resolving adverse consequences to customers when a firm does not maintain possession or control of municipal securities, which may result in customers receiving taxable, substitute interest instead of tax-exempt interest as expected. FINRA suggests certain effective practices to identify and prevent this issue, including developing operational and supervisory reports to identify customer long positions for which the firm has not taken possession or control of the security.

Another new topic in 2022 is trusted contact persons ("TCP"), as defined in FINRA Rule 4512(a)(1)(F). FINRA notes exam findings relating to firms' failure to make a reasonable attempt to obtain the name and contact information of a TCP for all non-institutional customers and not providing certain TCP-related written disclosures. FINRA also notes emerging customer account information risks relating to when registered representatives are named a beneficiary of a customer's estate, executor or trustee, or have a power of attorney for a customer.

FINRA adds discussion of regulatory obligations related to funding portals and crowdfunding offerings as a new topic in 2022. This is consistent with the increased SEC enforcement focus on crowdfunding. In September 2021, for example, in its first action in this area, the SEC charged a registered funding portal and certain of its executives in connection with allegedly conducting fraudulent and unregistered crowdfunding offerings. The Report identifies a number of exam findings, including among these, missing disclosures. Offerings on platforms have failed to include disclosures required by Regulation Crowdfunding, such as use of proceeds descriptions, offering process details, descriptions of capital stock, and financial statements. Funding portals also are failing to report written customer complaints (required by FINRA Funding Portal Rule 300(c)) and failing to make required filings, such as statements of gross revenues, within the specified time periods. The Report suggests developing annual compliance questionnaires to, among other things, verify the accuracy of associated persons' disclosures, as well as developing compliance checklists and schedules in order to assist in the process of confirming that obligations are being met in a timely manner. In addition, the Report notes that funding portals should be implementing supervisory review procedures tailored to the communications requirements applicable to portals.

COMMUNICATIONS AND SALES

The Communications and Sales section of the Report discusses Reg BI and Form CRS, communications with the public, private placements and variable annuities.

The Report contains a substantial amount of new material relating to Reg BI and Form CRS, including an overview of key regulatory considerations, a list of exam findings and a summary of effective practices observed in connection with FINRA's oversight activities. FINRA notes that the findings present an initial look at firms' practices and, as it continues to conduct exams and gather additional information on firms' practices, FINRA intends to publish additional findings in the future.

In addition, the Report includes a substantial amount of new content relating to communications with the public, with a particular focus on communications relating to mobile apps, digital assets, cash management accounts and municipal securities. For example, FINRA highlights findings relating to false, misleading and inaccurate information in mobile apps, including providing incorrect account balance or historical performance information, sending margin call warnings to customers whose account balances were not approaching or were below minimum maintenance requirements, and distributing false and misleading promotions through social media and "push" notifications that made promissory claims or omitted material information. FINRA also highlights several considerations for communications relating to municipal securities. FINRA reminds new member firms that they are required to file, prior to use, retail communications that are published or used in any electronic or other public media with FINRA's Advertising Regulation Department during their first year of membership.8 FINRA notes that it has observed deficient communications promoting digital assets that may create confusion about the role of the broker-dealer in relation to other entities involved in the offer of digital assets.

Given the increased reliance by issuers on private placements, the Report once again includes a discussion of private placements. The Report reminds firms of their due diligence obligations in connection with private placements, which are set forth in FINRA RN 10-22. The Report notes that FINRA's suitability rule continues to apply to non-retail customers, and Reg BI applies to recommendations to retail customers of any securities transaction, including recommendations relating to a private placement. The Report reminds firms of their obligation to make timely filings under FINRA Rules 5122 or 5123, and reminds firms of the recent amendments to these rules.9 Among its findings, FINRA notes that some firms failed to perform reasonable diligence concerning private placements, especially in connection with offerings that relate to issuers in businesses as to which the member firm lacks specialized experience. In addition, FINRA notes it has observed in exams that firms failed to inquire into and analyze red flags identified during the diligence practice. The Report highlights a number of effective practices in the area, including: creating checklists relating to private placements; conducting and documenting independent research on offerings and addressing any identified red flags; independently verifying aspects of the business plan that are key to the future prospects; identifying and addressing any conflicts of interest; and post-offering, conducting a review to ascertain whether offering proceeds were used in a manner consistent with the plan disclosed in the offering materials.

FINRA addresses risks relating to variable annuities in new content regarding firms' processes to supervise registered representatives who advise their clients' decisions on whether to accept a buyout offer. FINRA highlights findings relating to poor and insufficient data quality on variable annuity transactions, particularly in connection with exchange transactions, as well as failing to address inconsistencies in available data for variable annuities, data formats and reporting processes. FINRA notes as an effective practice creating automated solutions to synthesize variable annuity data when warranted in light of transaction volumes.

MARKET INTEGRITY

The Market Integrity section of the Report discusses CAT reporting obligations, best execution, disclosure of routing information, and the market access rule.

FINRA highlights several new exam findings relating to CAT reporting obligations, including inaccurate reporting of required information to the Central Repository, failure to resolve repairable CAT errors in a timely manner, and inadequate supervisory procedures and controls regarding CAT reporting and clock synchronization that are performed by third-party vendors.

FINRA emphasizes that best execution obligations apply to any firm that receives customer orders for purposes of handling and execution and reminds that any firm subject to FINRA Rule 5310 cannot transfer its duty of best execution to another person. FINRA urges firms to consider how they address potential conflicts of interest in order routing decisions, such as those involving affiliated broker-dealers or other entities, market centers that provide payment for order flow ("PFOF") or other orderrouting inducements, and orders received from customers of another broker-dealer for which the receiving firm provides PFOF. FINRA is conducting targeted best execution reviews of wholesale market makers concerning their relationships with broker-dealers that route to them as well as their own order routing practices and decisions.

Disclosure of routing information is a new topic for 2022. FINRA highlights numerous findings relating to order routing disclosures under Rule 606 of Regulation NMS, such as inaccurate quarterly reports (e.g., incorrectly stating that the firm does not have a profit-sharing arrangement or receive PFOF from execution venues), failure to adequately describe material aspects of the firm's relationships with disclosed venues in the quarterly report, and insufficient WSPs relating to, for example, failing to make updates to include new requirements of amended Rule 606(a)(1) or new Rule 606(b)(3).

FINRA adds new content regarding the Market Access Rule (SEC Rule 15c3-5). In particular, FINRA notes that the rule applies generally to securities traded on an exchange or alternative trading system ("ATS"), including equities, equity options, exchange-traded funds, debt securities, security-based swaps, security futures products and digital assets that meet the SEC's definition of a security. With respect to firms that operate an ATS that has subscribers that are not broker-dealers, FINRA instructs that such firms should consider how they establish, document and maintain a system of controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of this business activity.

FINANCIAL MANAGEMENT

The Financial Management section of the Report discusses net capital, liquidity risk management, credit risk management, segregation of assets and customer protection, and portfolio margin and intraday trading.

With respect to net capital compliance, FINRA highlights, in particular for new member firms, that if firms have an affiliate paying any of their expenses, Notice to Members 03-63 of the former National Association of Securities Dealers, Inc. ("NASD") sets forth specific requirements for establishing an Expense Sharing Agreement. In addition, firms with office leases should apply the guidance in RN 1908 for reporting lease assets and lease liabilities on their FOCUS reports. Moreover, firms must align their revenue recognition practices with the requirements of the Financial Accounting Standards Board's Topic 606 (Revenue from Contracts with Customers).10

FINRA recently adopted a new filing requirement relating to firms' liquidity risk management practices for firms with large customer and counterparty exposures.11 The new requirement, the Supplemental Liquidity Schedule ("SLS"), becomes effective on March 1, 2022, and the first SLS, which will be filed as a supplement to the FOCUS report, is due by May 4, 2022. FINRA directs firms to consider whether their liquidity risk management practices include processes for accessing liquidity during common stress conditions and "black swan" events, determining how the funding would be used, and using empirical data from recent stress events to increase the robustness of firms' stress testing. FINRA states that it observed firms incorrectly basing clearing deposit requirements on information that does not accurately represent their business operations, such as using the amounts listed on FOCUS reports rather than spokes in deposit requirements that may have occurred on an intra-month basis. In addition, an effective practice, FINRA states that firms' liquidity management plans should consider material changes in market value of firm inventory over a short period of time.

FINRA includes credit risk management and segregation of assets and customer protection as topics in the Report, as it did in last year's Report, although neither section contains new content for 2022. Nevertheless, FINRA's discussion of considerations and exam findings relating to these topics should be reviewed carefully, including FINRA's discussion of digital assets in the context of SEC Rule 15c3-3.

With respect to portfolio margin and intraday trading, a new topic for 2022, FINRA highlights findings relating to systems that are not adequately designed to identify credit risk exposure on an intra-day and end-of-day basis, failure to promptly identify and escalate elevated risk exposures to senior management (in part due to insufficient expertise), and WSPs that do not adequately outline intraday monitoring processes and controls. FINRA identifies several effective practices relating to internal risk frameworks, concentration risk and communicating with clients with large or significantly increasing exposures.

CONCLUSION

The Report addresses a variety of topics, ranging from findings that FINRA highlighted in prior reports and that FINRA continues to note in recent examinations to emerging risks representing potentially concerning practices that FINRA has observed and which may receive increased scrutiny going forward. Firms should address potential gaps in their compliance programs and incorporate relevant practices in a manner tailored to their business operations.

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1 See FINRA Targeted Examination Letter on Zero Commissions (February 2020). FINRA intends to share findings in the future.

2 See FINRA Targeted Examination Letter on Social Media Influencers, Customer Acquisition, and Related Information Protection (September 2021). FINRA intends to share findings in the future.

3 See FINRA Targeted Exam Letter on Special Purpose Acquisition Companies (“SPACs”) (October 2021). FINRA intends to share findings in the future.

4 See e.g., FINRA Regulatory Notice (“RN”) 21-20 (FINRA Alerts Firms to Phishing Email Using “gateway-finra.org” Domain Name) (June 2021); FINRA RN 21-18 (FINRA Shares Practices Firms Use to Protect Customers From Online Account Takeover Attempts) (May 2021); and FINRA RN 21-14 (FINRA Alerts Firms to Recent Increase in ACH “Instant Funds” Abuse) (March 2021).

5 See FINRA Targeted Examination Letter on Option Account Opening, Supervision and Related Areas (August 2021). FINRA intends to share findings in the future.

6 FINRA also highlights certain considerations relating to emerging low-priced securities risk as well as emerging vendor risk for cybersecurity.

7 We note that the SEC has proposed amendments to SEC Rule 17a-4 to, among other things, allow for electronic records to be preserved in a manner that permits the recreation of an original record if it is altered, over-written, or erased. See Electronic Recordkeeping Requirements for Broker-Dealers, Security-Based Swap Dealers, and Major Security-Based Swap Participants, 86 Fed. Reg. 68300 (Dec. 1, 2021).

8 See FINRA Rule 2210(c)(1)(A). Note, however, that firms may seek a waiver from this requirement under FINRA Rule 2210(c)(9)(A).

9 See FINRA RN 21-26 (FINRA Amends Rules 5122 and 5123 Filing Requirements to Include Retail Communications That Promote or Recommend Private Placements) (July 2021) and FINRA RN 21-10 FINRA (Updates Private Placement Filer Form Pursuant to FINRA Rules 5122 and 5123) (March 2021). 10 See NASD Notice to Members 03-63 (SEC Issues Guidance on the Recording of Expenses and Liabilities by Broker/Dealers) (October 2003); see also FINRA RN 19-08 (Guidance on FOCUS Reporting for Operating Leases) (March 2019). 11 See FINRA RN 21-31 (FINRA Establishes New Supplemental Liquidity Schedule (SLS)) (September 2021).

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

February 15 2022

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FINRA's 2022 Report on Exam and Risk Monitoring Program Adds Five Topic Areas: Cadwalader

In its annual Examination and Risk Monitoring Program Report, FINRA covered twenty-one different topics related to a firm's core compliance responsibilities. FINRA added five new topics since last year's report. The new topic areas include:

- Firm Short Positions and Fails-to-Receive in Municipal Securities;
- Trusted Contact Persons;
- Funding Portals and Crowdfunding Offerings;
- Disclosure of Routing Information; and
- Portfolio Margin and Intraday Trading.

For covered topics, the Report (i) identifies the relevant rules, key considerations for member firms' compliance programs, and noteworthy findings from recent examinations, and (ii) outlines effective practices that FINRA observed during its oversight while providing resources that the member firms may find helpful when reviewing their procedures and fulfilling their compliance obligations. Some of the areas of focus highlighted in the Report were:

- “FINRA’s initial findings from Reg BI and Form CRS reviews;
- firms’ compliance with certain regulatory obligations related to:
- the Consolidated Audit Trail,
- best execution and
- Rule 606 of Regulation NMS;
- problems with some mobile apps’ communications with customers and firms’ supervision of activity on those apps, particularly controls around account openings;
- firms’ compliance with their regulatory obligations with securities activities involving Special Purpose Acquisition Companies;
- the increasing number and sophistication of cybersecurity threats faced by firms and their customers; and
- firms’ communications and disclosures made to customers regarding complex products.”

FINRA stated that the Report is intended to be an up-to-date, evolving resource or library of information for firms.

Cadwalader Wickersham & Taft LLP

February 10 2022

FINRA Report Finds Short Position Controls Lacking.

Financial Industry Regulatory Authority examinations have uncovered a theme of inadequate controls and procedures related to municipal short positions and fails-to-receive, something the regulator stressed firms must be diligent about detecting and resolving to prevent adverse tax consequences to customers.

Firm short positions and fails-to-receive in municipal securities were among several new topics highlighted in the Financial Industry Regulatory Authority’s 2022 report on its Examination and Risk Monitoring Program released Wednesday.

The 70-page report covers more than two dozen topics. In addition to other compliance areas, the report also provides exam findings and compliance recommendations regarding municipal securities advertisements and communications.

In a release, Greg Ruppert, FINRA’s executive vice president for member supervision, noted the evolving nature of the securities industry landscape, describing it as “highly dynamic in terms of business models, technologies, products and compliance practices.”

“FINRA’s report looks at those significant changes through the lens of FINRA’s commitment to investor protection and market integrity, so that firms’ compliance programs can benefit from our findings about emerging and ongoing issues,” Ruppert added.

In terms of content, for each of the compliance areas addressed, FINRA’s report identified relevant rules and highlighted key compliance considerations.

“The report also summarizes noteworthy findings from recent examinations, outlines effective practices that FINRA observed during its oversight, and provides additional resources that may be helpful to member firms in reviewing their supervisory procedures and controls and fulfilling their compliance obligations," according to FINRA.

The section of the report dealing with regulatory obligations and considerations tied to firm short positions and fails-to-receive focused heavily on controls.

A muni short position, which FINRA has said in previous guidance is usually inadvertent, occurs when a firm sells bonds it does not actually have. This is sometimes due to a failure to receive bonds it ordered, and it then has to make substitute payments on those securities to the customer. That substitute interest paid to the customer might actually be taxable, because the Internal Revenue Service will not allow both that customer and whoever actually holds the bonds to both receive tax-exempt interest.

FINRA has brought enforcement actions against firms related to this problem. Notably, Merrill Lynch agreed last year to pay more than $1 million to settle FINRA charges related to short positions.

In this report, FINRA noted that firms must "develop and implement adequate controls and procedures for detecting, resolving and preventing adverse tax consequences to customers" that can stem from sales of municipal securities that are not under a firm's possession or control.

FINRA pointed out that those procedures must include closing out fails-to-receive within time frames specified in the Municipal Securities Rulemaking Board's Rule G-12(h). Related communications must not be false or misleading as prescribed in MSRB Rule G-17.

Exam findings in this area showed inadequate controls and procedures in instances where a firm does not maintain possession or control of a customer's municipal securities.

FINRA also found lottery systems that it says, "do not fairly or adequately account for or allocate substitute accrued interest payments for allocating municipal short positions to certain customer accounts."

According to the report, some effective compliance practices for firm short positions and fails-t--receive include maintaining processes to prevent or remediate municipal positions from settling short, and developing operational and supervisory reports to identify customer long positions outside of the firm?s possession and control.

Conducting regular and periodic review of fail reports to ensure compliance with MSRB Rule G-12(h), is another best practice, according to FINRA.

FINRA also posed a number of questions as related considerations in the municipal securities area. For example, does a firm use exception reports to manage municipal securities short positions or fails to receive? Another question involves timing – when municipal securities short positions are identified, does a firm cover the short or wait until the trades have settled?

Other considerations include the nature of a firm's process to close out fails-to-receive under MSRB Rule G-12(h), how firms detect instances that require them to pay customers substitute interest, and how firms handle inbound or outbound account transfers that are delivered without corresponding municipal bonds in possession or control.

The report also contains a section addressing regulatory obligations stemming from communications with the public, including communications involving mobile apps, digital communications channels, and digital asset and cash management accounts communications.

That communications section also covers MSRB Rule G-21 concerning advertising by brokers, dealers or municipal securities dealers.

FINRA outlined general standards regarding false, misleading or promissory statements or claims. For example, do a firm's communications include material information necessary to make them fair and balanced and not misleading?

Exam findings for municipal securities communications show firms "using false and misleading statements or claims about safety, unqualified or unwarranted claims regarding the expertise of the firm, and promissory statements about claims regarding portfolio growth," according to the report.

To address these concerns, FINRA pointed to some effective compliance practices for municipal securities advertisements including prior approval, training, risk disclosure, and review.

Essentially, FINRA suggests that firms require "prior approval of all advertisements concerning municipal securities by an appropriately qualified principal to confirm the content complies with applicable content standards."

In terms of risk disclosure, an effective practice identified by FINRA is "balancing statements concerning the benefits of municipal securities by prominently describing the risks associated with municipal securities, including credit risk market risk and interest rate risk."

Additionally, FINRA's report suggested that firms should provide education and training on applicable FINRA and MSRB rules and their firm's policies regarding municipal securities advertising.

According to FINRA, this means that firms should also review their communications to "confirm that the potential benefits of tax features [of municipal securities] are accurate and not exaggerated."

By Kelley R. Taylor

BY SOURCEMEDIA | MUNICIPAL | 02/09/22 01:53 PM EST

MSRB's ESG Request for Information Begins to Collect Submissions.

Responses to the Municipal Securities Rulemaking Board's request for information on environmental social and governance factors are beginning to show some indication of the challenges regulators face in responding to the growing interest in ESG investing.

Responses to the MSRB's December RFC so far have generally agreed that standardized ESG disclosures would add quite the workload for issuers, as was identified in the Government Finance Officers Associations best practices.

"When you mention ESG there's probably four different directions you can go with that and that's a challenge I think the market has," said Dave Erdman, capital finance director for the State of Wisconsin.

Many of these concerns were mentioned during GFOA's winter meeting, as many have remarked how broad ESG disclosures can be and how burdensome they may become should the MSRB or others decide they are necessary.

“It is not that issuers do not want to report ESG factors, but for many there are so many approaches which creates disorientation and questions about what is material or important,” said Dan Aschenbach, principal consulting partner at AGVP Advisory in his submission.

Some issuers are already beginning to submit responses on what kind of disclosures make sense for them.

“Voluntary disclosures make the most sense for the municipal market,” the City of Detroit said in its response, the only issuer to submit so far. “We agree with the GFOA guidance that standardized ESG disclosures would be overly burdensome, costly, and potentially inhibiting for municipal issuers who could decide not to use ESG designations they deserve to avoid the added cost and effort.”

But the matter of disclosure becomes slightly more complicated as it relates to the issuance of social bonds.

The City of Detroit issued $175 million in 2021 in social bond designation “based on the intended use of the bonds for the financing of blight removal purposes,” the submission said.

The City’s Social Bonds Designation follows the “Social Bond Principles,” as promulgated by the International Capital Market Association, updated most recently in June 2020.

“The proceeds of the bonds are funding projects consistent with a number of these categories, including affordable housing, employment generation and socioeconomic advancement and improvement, which is expected to benefit certain of the target population included by the ICMA in the Social Bond Principles,” the city said.

The City of Detroit decided to use ICMA standards saying they were “clear, easy to follow and fit our purpose.” The issuer also did not consider using a third-party vendor to certify the bonds as they “did not feel doing so would add any value or be a good use of money.”

Detroit also intends to disclose annually with EMMA on the spending of those bonds with the Social Bond designation, despite it not being required by the City. They also indicated the potential disparities that may arise from a dependence on ESG data vendors.

“Vendors that certify ESG Municipal Securities could cause a disparity in markets because small issuers may not be able to afford their services,” the submission said. “Such certification essentially price out issuers who would otherwise sell ESG bonds.”

The MSRB is also being asked to consider the matter of “greenwashing,” which the Securities and Exchange Commission is expected to address this year. Greenwashing refers to a misleading labeling of something as environmentally sound.

“Self-certification or examination in the private sector resulted in ‘greenwashing’ and now there are calls for disclosure regulation on what gets published,” AGVP?s Aschenbach said in his submission.

“The question remains in the private sector on what is material and relevant,” he added. “The municipal bond sector should recognize the potential for ‘municipal greenwashing’ and with limited municipal staff, understand the strain on ESG self-reporting.”

In the City of Detroit?s view, ESG considerations are very different in the corporate and public sectors and further guidance should reflect that.

“ESG considerations in the corporate sector are very different than in the public sector, and the type and frequency of disclosures should not be the same," the City of Detroit submission said. "The vast majority of municipal bonds clearly serve an ESG purpose; whereas the vast majority of corporate bonds do not."

"Corporate issuers who seek to use an ESG designation should be required to meet certain disclosure requirements, which are unnecessary for municipal issuers given the fundamental public purpose that municipal bonds serve by definition," the City of Detroit said.

Other submissions seek to address how one might seek to address historic ills in the financial system with the use of ESG designated bonds.

"An investor seeking to identify bonds that explicitly created racial and social equity, how would she do so?" said Joyce Coffee, president and founder of Climate Resilience Consulting in her submission. "The S in ESG frequently identifies projects that improve health, education or workforce outcomes," she added. "However, these outcomes could be ascribed to any demographic."

The MSRB is collecting responses until March 8.

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 02/04/22 01:49 PM EST

MSRB Announces Members of 2022 Board Advisory Groups.

Read the press release.

SEC's Gensler: Major Cybersecurity Regulatory Changes On the Horizon

Summary

A significant expansion of rules relating to cybersecurity risks—particularly for the financial sector—is under consideration by the Securities and Exchange Commission (SEC).

In public remarks last week, SEC Chair Gary Gensler previewed a number of areas in which the SEC is looking to "broaden and deepen" its oversight of cybersecurity practices and risks. They range from a broad expansion of system integrity rules to changes involving the timing and delivery of privacy notices. Although new rules governing cybersecurity disclosures have been anticipated for months, Gensler's remarks indicate that the SEC's plans go well beyond disclosure rules and are far more ambitious.

Significant Changes Likely for the Financial Sector and Its Service Providers

Extension of Reg SCI to "Large, Significant" Entities. One of the most far-reaching changes being considered involves broad expansion of the Regulation Systems Compliance and Integrity Rule (Reg SCI).

Reg SCI, adopted in November 2014, applies to entities that form the backbone of U.S. financial markets: self-regulatory organizations, including the securities and options exchanges, clearing agencies, FINRA, and the Municipal Securities Rulemaking Board (MSRB), as well as certain alternative trading systems (ATSs) and plan processors involved in distributing transaction and quotation information.

Reg SCI requires these covered entities to have policies and procedures in place to protect systems integral to key market functions: trading, clearance and settlement, order routing, market data, market regulation and surveillance. Reg SCI also requires covered entities to take corrective action and immediately notify the SEC if certain events occur. It also requires them to provide quarterly reports, conduct annual reviews and tests, and maintain books and records.

According to Gensler, the SEC is considering expanding Reg SCI to include “large, significant entities” such as market-makers, broker-dealers and Treasury trading platforms. The SEC took the first step just days after Gensler’s speech and proposed new rules that would require ATSs that trade government securities to comply with Reg SCI.

The other “large, significant entities” that might become subject to Reg SCI remain to be seen. Large market-makers and broker-dealers will certainly be on the list, but other large entities supporting these market functions should be watching developments closely. Even if these entities already have sophisticated controls in place, the additional event notification, reporting, review and testing required by Reg SCI—all under the SEC’s scrutiny—will present additional challenges.

Gensler also announced that the SEC is looking at ways “to deepen” Reg SCI to “shore up the cyber hygiene of important financial entities.” He provided no further details, so it is not clear what the SEC is planning to do here. Perhaps specific technical safeguards will be required, such as encryption and multi-factor authentication, along with other such measures.

New Rules for Investment Companies, Investment Advisers and Broker-Dealers. Beyond Reg SCI, Gensler also announced that the SEC is considering new rules for investment funds, advisers and broker-dealers. Here, the SEC is focusing on ways to strengthen “cybersecurity hygiene and incident reporting.” These changes would ensure entities continue to operate during significant incidents, provide clients and investors with better information, give the SEC “more insight into intermediaries’ cyber risks,” and create incentives to “improve cyber hygiene.” Gensler offered no particulars but indicated that guidance was being drawn from the Cybersecurity and Infrastructure Security Agency (CISA) and “others.” The “incentives” proposed to improve “cyber hygiene” will be of particular interest. They could range anywhere from safe harbors that encourage reporting to new attestation requirements with strict penalties.

Expanded Authority Over Financial Sector Service Providers. Another potentially far-reaching change being considered would give the SEC authority over third-party service providers that provide various administrative and technical services to financial sector registrants. Here, the SEC is reportedly considering “a variety of measures” such as requiring registrants to identify service providers that might pose cyber risks, and holding registrants accountable for service providers’ cybersecurity measures.

Gensler, however, also expressed interest in a far more sweeping change: giving “market regulators” the same type of power over third-party service providers that bank regulators have under the Bank Service Company Act. That Act subjects third parties performing certain services for banks, (e.g., data processing, Internet banking and mobile banking services), to regulation and examination by the bank regulators to the same extent as the banks themselves. If enacted, such a law potentially would give the SEC authority over the systems and operations of cloud service providers and payment processors, to name a few.

Reg S-P Notifications. According to Gensler, the SEC is also looking at ways to “modernize and expand” Reg S-P. Currently, Reg S-P requires brokers, dealers, investment companies and advisers to provide privacy notices to customers and have written policies and procedures in place to safeguard customer information. The potential changes, Gensler explained, would relate to how notification is given to clients when their personal information has been accessed, as well as the “timing and substance of notifications currently required.” Although not entirely clear, the SEC may be considering a new breach notification rule as well as updates to existing privacy notice forms.

Gensler also confirmed that the SEC is looking at new rules involving cybersecurity risk disclosures and practices that would be applicable to all public companies.

Cybersecurity Risk Disclosures. According to Gensler, the SEC is considering ways in which cybersecurity risk information can be presented by issuers in a “consistent, comparable, and decision-useful manner.” The SEC also is examining “whether and how to update disclosures” when cybersecurity events have occurred. Although no specifics were provided, proposed mandatory disclosures for cybersecurity risks, along with guidance for assessing the materiality of cyber events, may be expected.

Cybersecurity Practices. The SEC is also apparently preparing recommendations around company practices with respect to “cybersecurity governance, strategy, and risk management.” These issues have been the subject of SEC guidance, risk alerts and enforcement actions for the past several years. Look for proposed rules addressing internal controls for reporting cybersecurity risks and incidents and additional safeguards to protect customer information.

The SEC has staked out a very ambitious cybersecurity agenda for the months ahead. We’ll be following developments and provide updates as they occur.

Bryan Cave Leighton Paisner LLP – Lori Van Auken

January 31 2022

Municipal Securities Regulation and Enforcement: The Year in Review and a Look Ahead - Ballard Spahr

The municipal securities market carried its momentum from the first half of 2021 into a strong finish for the year against the backdrop of continued regulatory and enforcement actions. Despite new variants of COVID-19 emerging, which continue to impact travel, commerce, and the economy, the municipal market continued its strong upward trajectory, spurred by continued low interest rates and the anticipated injection of federal funds to state and local issuers as part of the Infrastructure Investment and Jobs Act.

View pdf.

GFOA Member Alert: Tier 1-3 SLFRF Project and Expenditure Report Due January 31

If your organization is a Tier 1-3, GFOA strongly recommends filing by the deadline. Completing the report as early as possible will ensure your jurisdiction will not be considered late, which may lead to a finding of non-compliance.

LEARN MORE

MSRB Votes to Extend Pandemic Relief and Implement a New Approach to Fees at Quarterly Board Meeting.

The Municipal Securities Rulemaking Board (MSRB) met virtually January 26-27, 2022 for its quarterly Board of Directors meeting, where the Board voted to extend certain temporary pandemic regulatory relief and refine its approach to the fees that enable the self-regulatory organization (SRO) to fulfill its mission to safeguard the $4 trillion municipal securities market. The Board discussed several other ongoing initiatives to advance the four goals outlined in its long-term strategic plan.

Regulatory Initiatives

“Our nation’s schools, hospitals and workplaces continue adapt to challenges presented by the pandemic,” said MSRB Chair Patrick Brett. “The MSRB has been operating fully remotely for nearly two years, and we appreciate the challenges posed to regulated dealer firms of conducting traditional in-person office inspections when their employees are working from remote offices.”

The Board voted to propose amending MSRB Rule G-27 to allow dealer firms to conduct office inspections remotely until December 31, 2022. This additional six-month extension would align with a similar extension that the Financial Industry Regulatory Authority (FINRA) filed with the Securities and Exchange Commission (SEC) earlier this month. Previous MSRB actions to provide temporary regulatory relief, data and information to support market participants during the pandemic are available on the MSRB’s dedicated COVID-19 information page on its website.

Also at its meeting, the Board determined to seek SEC approval of a proposal to implement structural changes to the organization’s approach to managing fee revenue and reserve levels to ensure a fair, equitable and sustainable balance of funding that will support its mandate to protect investors, issuers and the public interest.

As detailed in the MSRB’s FY 2022 Budget and FY 2021 Annual Report, the majority of the MSRB’s revenue comes from market volume-based fees on regulated entities, which has contributed to a cycle in which the MSRB accumulates excess reserves and then implements temporary solutions such as fee rebates and temporary fee reductions.

“We share regulated entities’ frustration with this cycle, which we addressed most recently with the largest temporary fee reduction in MSRB history that is on target to return $19 million in accumulated excess reserves to the industry by the end of this fiscal year,” Brett said. “Under the leadership of the Finance Committee and with the benefit of input from regulated stakeholders, the Board has undertaken a comprehensive examination of our finances.”

Finance Committee Chair Frank Fairman said, “We have developed an approach that maintains a sustainable financial model, adequately funds future expenses and, most importantly, mitigates the impact of market variability, providing a better mechanism for effectively managing reserve levels.” The MSRB plans to seek SEC approval of the new approach with an eye toward implementing it at the beginning of FY 2023.

The Board also met with FINRA President and CEO Robert Cook to discuss continued regulatory coordination on matters related to the municipal securities market.

Transparency Initiatives

The Board previewed preliminary concepts for a new user interface for the free Electronic Municipal Market Access (EMMA®) website based on extensive input from stakeholders.

“We are in the early stages of a complete transformation of the EMMA website that aims to make the market’s official online source for data and disclosures easier to navigate and more intuitive to use,” Brett said. “In the meantime, EMMA users can expect to see continued incremental improvements based on their feedback about pain points, such as recent improvements to help issuers more easily manage the process of associating individual securities to a disclosure filing in EMMA.” To help keep stakeholders informed of upcoming and longer-term EMMA enhancements, the MSRB now publishes a forward roadmap of its transparency and technology initiatives on its website.

Market Structure and Data

The Board also discussed a number of market structure topics, including price transparency considerations raised in the SEC’s recent proposal to amend Regulation ATS and the MSRB’s ongoing work to evaluate market feedback and data to understand the prevalence of pennying in the municipal market. This practice involves a dealer’s purchase of bonds for its own account from a customer seeking to sell a municipal security—after the dealer has reviewed other dealers’ bids—by matching a high bid or purchasing the bond at a price that is nominally higher than the highest bid.

The Board also discussed early feedback on EMMA Labs, the MSRB’s new innovation sandbox, where market stakeholders can collaborate with MSRB staff to test active prototypes, help improve their utility and accelerate the pathway to bring enhanced market transparency tools to life on the EMMA website.

Public Trust

The Board discussed engaging with stakeholders on emerging market topics and also discussed the work of its standing committees, including the Nominating Committee’s efforts to solicit applications through February 7, 2022, for two public members and two regulated members of the Board.

“One of the most important jobs for an SRO is selecting a new class of market experts to join us in overseeing the long-term strategic direction of the organization,” said Meredith Hathorn, MSRB Vice Chair, and Chair of the Board’s Nominating Committee. “The four new members who will join our Board for FY 2023 will have the opportunity to help advance our thinking on a number of critical topics for our market. We’re making great strides in leveraging technology and structured data to support informed decision-making, and we’re in the early stages of gathering information on Environmental, Social and Governance (ESG) practices and developing strategies to advance Diversity, Equity and Inclusion (DEI) in the municipal securities market.”

Date: January 28, 2022

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MSRB Launches Emma Labs as the Regtech Innovation Sandbox for the Future Of Municipal Bond Market Transparency.

Washington, DC – The Municipal Securities Rulemaking Board (MSRB) today launched EMMA Labs, its innovation sandbox for transparency enhancements for the $4 trillion municipal securities market. EMMA Labs enables investors and other market data users to test and develop prototypes collaboratively and provide feedback. The goal is to enhance the utility and accelerate the deployment of potential data analytics tools on the MSRB's Electronic Municipal Market Access (EMMA®) website , which provides free public access to real-time trade data and disclosures from tens of thousands of state and local governments and other entities.

"We are excited about EMMA Labs' potential to drive collaboration with market participants and allow us to co-create the future of municipal market transparency," said MSRB Chair Patrick Brett. "EMMA Labs is a key part of the MSRB's strategic plan to leverage data to deepen market insights and facilitate regulatory modernization – and it opens up a technological pathway for engaging with stakeholders on opportunities for strengthening our market to serve the public interest."

EMMA Labs serves as a proving ground for functional prototypes, called Active Labs, that could ultimately be deployed on the EMMA website. EMMA Labs is debuting with two Active Labs:

- A keyword search engine that unlocks the information contained within hundreds of thousands of disclosures submitted to the EMMA website as unstructured PDFs, and
- A dynamic dashboard for market data analysis that empowers users to discover and visualize market trends.

"With EMMA data now in the cloud, we will increasingly be able to leverage technology to create powerful analytical tools that empower data users to better identify, visualize and understand market trends," said Brian Anthony, MSRB Chief Data Officer. "The first Active Labs are an invitation to collaborate: Any individual can create a free EMMA Labs account to provide feedback on prototypes, and we welcome ideas for future Active labs, tools and partnerships."

The MSRB will host recurring virtual Innovation Office Hours to discuss ideas submitted through EMMA Labs.

Date: January 19, 2022

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Draft Companion Compliance Resources for Dealers and Municipal Advisors.

SUMMARY

SIFMA provided comments to the Municipal Securities Rulemaking Board (MSRB) Notice 2021-12 requesting comment on draft companion compliance resources for brokers, dealers and municipal securities dealers and municipal advisors.

View the SIFMA comment letter.

SEC Taking a Closer Look at Issuer Disclosure.

The Securities and Exchange Commission's acting director for its Office of Municipal Securities singled out disclosures related to its Rule 15c2-12 as an area the office is watching closely, following an academic study that found serious deficiencies in continuing disclosure.

Ernesto Lanza raised that subject in his remarks before the Government Finance Officers Association's Committee on Governmental Debt Management during GFOA's 2022 Winter Meeting.

"We think it needs to be more refined," Lanza said. "We think there's more to be looked into in that area. If there are ambiguities in the rules, we should have conversations around that. If there are people who need redouble efforts then we think they need redouble efforts," he added. "So that's an important thing."

The concern is over two 2019 amendments to SEC Rule 15c2-12, which require bond issuers to disclose the incurrence of a financial obligation of the issuer or obligated person, if material, in addition to any agreements to covenants, events of defaults, remedies, priority rights or other similar terms of a financial obligation of the issuer or obligated person, if material.

This matter caused some stir at the Brookings Municipal Finance Conference last year, when Federal Reserve economists Ivan Ivanov and Nathan Heinrich, in addition to the University of Cologne's Tom Zimmermann asserted that there was pretty significant underreporting under the two new provisions and that it remains a significant risk for investors.

Lanza acknowledged the Commission's efforts to quell the concerns that came out of the conference and further guidance on the issue may very well be on the way.

"We continue to think that disclosure is an important area to help provide some guidance," Lanza said.

A GFOA Committee Member remarked that during their time in the muni market, general disclosures have improved over time, but things are still not perfect. "We're always looking for ways we want to make it better," Lanza said. "And I think improvements are not across the board."

"I'd like to have some input and discussions around where the rough edges are," Lanza said. "Again, it looks relatively simple on paper but it is fairly complex to analyze what's in what's out and what needs to be disclosed." Lanza said.

The topic of disclosure eventually led participants to press Lanza on the Commission's as well as the Municipal Securities Rulemaking Board's efforts concerning ESG, a matter recently highlighted in the Board's request for information on ESG, which some believe is overstepping its boundaries and convoluting the matter even further.

"I think it's important for them to get whatever they think is important information and research and market input in order to make decisions on whether or not they undertake rulemaking or not," Lanza said.

"I don't adhere to the view that they can only ask questions on things that are directly related to a specific proposal that they're undertaking," he added. "I think they need to understand the marketplace to be able to undertake rulemaking."

But there is a line. "That doesn't speak to what they do with the information afterwards," Lanza said.

Ultimately the Commission leaves the MSRB to conduct its own fact finding mission if it hopes to provide further rulemaking on a particular issue. As for the SEC, there are no immediate plans to enact further rules, though they are keeping their eyes peeled.

"There's nothing on the agenda for us right at this moment, although we're obviously paying attention to that," Lanza said. "It can change from day to day in terms of what we're asked to do."

"It bothers me sometimes when sometimes, participants get the impression that there are certain comments that regulators don't want to hear," Lanza added. "We need to hear everything."

Lanza also said he champions efforts to provide more transparency in fixed income markets.

"There are existing transparency systems for post trade transactions," Lanza said. "We want to explore with the two SROs, FINRA and the MSRB, potential incremental improvements on the data flow, data quality, timeliness and the extent of the information."

"Clearly, those are areas that are not of direct concern to the municipal securities issuer community, but certainly have significant knock on effect in terms of efficiency of pricing, and that ultimately will have, if nothing else, potential impact on pricing and new issues down the line," he added. "We think that's an important thing to keep in mind."

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 01/24/22 01:12 PM EST

Treasury's Letter to Arizona May Impact Muni Issuance Disclosures.

The Department of the Treasury's Friday letter detailing its intentions to clawback some of Arizona's COVID-19 relief aid if the state doesn't redesign two of its pandemic-related programs may impact the disclosure of any state facing the prospect of a fight over those funds.

The American Rescue Plan Act's final rule on how its State and Local Fiscal Recovery Fund Program may be used included a provision which would deem programs, including using the stimulus funds to offset tax cuts, as "ineligible uses". The letter to Arizona Gov. Doug Ducey indicated that two programs, one being the $163 million grant program for schools that follow state laws banning public school mask mandates, would fall in that category.

"This is a unique situation since the letter was addressed to the state," said Eryn Hurley, deputy director of government affairs at the National Association of Counties. "Under ARPA, the state was allocated a portion of the funds and the counties were given their own allocations."

The American Rescue Plan Act allocated $65.1 billion to counties, which is separate from the state allocation and dispersed directly from the Treasury to the counties. Since the letter is addressing actions at the state level, its impact will largely stay at the state level and won't bleed into counties, Hurley said.

According to Dave Erdman, capital finance director for the State of Wisconsin, the Treasury's move to reign in Arizona shows they're willing to enforce the exact language on ARPA and SLFRF.

"From a municipal bond issuance perspective, it's clear that the Treasury will threaten and use these programs that came out of the ARPA," Erdman said. "But the biggest question is in regards to disclosure."

"How does a clawback of such need to be disclosed?" he added. "If the State of Arizona was going to do a public offering, or any state threatened with clawback, how do you get this information to investors, because it could be material."

A clawback at the state level could then affect future bond offerings, Erdman said, if a state was preparing an offering then gets hit with a clawback from Treasury.

"Treasury has to be careful when making those kinds of statements because it could scare investors and have an impact on the pricing of a transaction," Erdman said.

The Treasury letter gives the State of Arizona 60 days to remedy its two related programs, which from Ducey's Twitter response, doesn't seem likely.

"When it comes to education, President Biden wants to continue focusing on masks," he wrote. "In Arizona, we're going to focus on math and getting kids caught up after a year of learning loss."

"We will respond to this letter and we will continue to focus on things that matter to Arizonans," he added.

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 01/18/22 02:47 PM EST

Hawkins Advisory: Final Treasury Reissuance Regulations Addressing Modifications of Debt Instruments to Replace IBORs

Attached is a Hawkins Advisory describing recently released final Treasury Regulations providing guidance in connection with the reissuance consequences arising from modifications of existing debt instruments and other contracts to replace discontinued Interbank Offered Rates with alternative reference rates.

View the Hawkins Advisory.

An ESG Reckoning Could Be on the Horizon for Municipal Bonds.

The Municipal Securities Rulemaking Board, the self-regulatory organization over municipal bond issuers, has started a key first step on the way to regulation within the space. The MSRB has issued a Request for Information as of December, seeking to find out what ESG borrowers are disclosing regarding how their bonds relate to ESG, reports Bloomberg.

Municipal bonds related to ESG experienced a record year last year, bringing in $24.6 billion of green debt, the biggest portion of the ESG muni pie. However, an analysis done last year by a UN group found that borrowers weren't disclosing ESG data effectively or with any type of consistency, including risks that pertained to the environment and climate change.

Current ESG standards within municipal bonds are such that data and what is reported, as well as the frequency it is reported at, are all optional. The call for commentary, which is an appeal to public officials, bankers, investors, as well as the general public, focuses heavily on phrasing centered around the word "standard" or an iteration of it.

It's a bit of a writing on the wall situation and mirrors a larger call that the SEC put out in March 2021 requesting ESG commentary on climate disclosures by issuers. While no regulations have been forthcoming yet, analysts anticipate some sort of guidance at minimum to be released by the Commission this year.

The main culprit in drawing the regulatory attention within munis could be the very thing that brought in so much money to the space: green bonds. At their inception in 2013 when Massachusetts sold the very first self-styled green bonds to pay for a host of upgrades centered around energy efficiency, water quality, and pollution control, any state or local government could create a bond and decide that it was green without any oversight or standards. That's still mostly the case, though there have been some attempts at creating standards within the industry since.

"Many investors and other market participants are seeking ESG-related information beyond what historically has been provided to the market. In response, private vendors are offering ESG certification service," writes the MSRB in their statement.

The cropping up of private vendors centered around green bonds creates the potential for an uneven playing field for investors, with some investors having access to potentially better information, or even more information, than what is currently legally required. It's something the MSRB could be seeking to remedy in their Request for Information, and it remains to be seen what will come of the information gathered once the window closes for submissions.

ETF TRENDS

by KARRIE GORDON

JANUARY 5, 2022

GASB Adds Major Project, Pre-Agenda Research Area to Technical Plan.

Norwalk, CT, January 6, 2022 — During its December 2021 meeting, the Governmental Accounting Standards Board (GASB) approved the addition of a major project on going concern uncertainties and severe financial stress and pre-agenda research activity on subsequent events as part of its technical plan for the first third of 2022.

Going Concern Uncertainties and Severe Financial Stress

The GASB added this project based on the results of more than five years of research on the GASB's existing standards for going concern uncertainties and current practice with respect to identifying governments experiencing or in danger of severe financial stress.

The concept of going concern uncertainties was not specifically developed or significantly modified for the government environment when incorporated into the current GASB literature. Pre-agenda research indicates that, even when governments are in or have been experiencing severe financial stress, few dissolve or cease operations. Although current guidance provides that financial statement preparers have a responsibility to evaluate a government's ability to continue as a going concern, such an evaluation often poses challenges and has resulted in diversity in practice. These challenges also include determining whether or when governments have a responsibility to evaluate and disclose their exposure to severe financial stress.

The objectives of the project are to consider (1) improvements to existing guidance for going concern considerations (including the definition of a going concern) to address diversity in practice and clarify the circumstances under which disclosure is appropriate, (2) developing a definition of severe financial stress and criteria for identifying when governments should disclose their exposure, and (3) what information about a government's exposure to severe financial stress is necessary to disclose.

Subsequent Events

The objective of the pre-agenda research item on Subsequent Events is to (1) evaluate the effectiveness of the existing guidance for identifying and reporting subsequent events and (2) consider the need for revisions to those standards. If additional guidance is determined to be needed, another objective would be to consider the development of revised accounting and financial reporting for subsequent events.

As part of its consideration of the first-third 2022 technical plan, the GASB also considered but chose not to add (1) a project on interim financial reporting and (2) a pre-agenda research activity on related-party transactions.

More information on the new project and pre-agenda research activity is available on the GASB website under the Technical Plan section.

Muni Market's Regulator Is Seeking Standards for Disclosure on ESG Debt.

- **MSRB asks for feedback on how issuers disclose credit risk**
- **Government finance officers released best practices in 2021**

There's a big mess in MuniLand, and the Municipal Securities Rulemaking Board wants to clean it up.

The mess is "Environmental, Social and Governance" practices by municipal issuers, and the MSRB, the self-regulatory organization in charge of the $4 trillion market, wants feedback — from bankers to public officials to investors and the general public — about what borrowers disclose on how ESG relates to their bonds.

The MSRB put out its Request for Information in December, and said it wants comments by March 8. It's an issue that Mark Kim, the MSRB's chief executive officer, flagged back in September as ESG munis were headed for a banner year: Issuance of green debt alone, the largest part of the muni ESG segment, totaled a record $24.6 billion in 2021, data compiled by Bloomberg show. But one analysis last year found that borrowers don't disclose relevant data consistently or effectively, such as risks related to the environment.

The regulator's request for comment contains the word "standard" or a variation at least nine times. It also uses terms such as uniform and metrics. So you can see where this may be going — ultimately, the establishment of disclosure standards.

Right now, as is typical in the municipal market, everything is optional. The MSRB reminds readers that it is charged with enhancing both issuer and investor protection and "the overall fairness and efficiency of the municipal securities market." So the current state of affairs will never do, at least according to the MSRB.

Self-Styled Issuance

I blame green bonds for the regulatory interest in this topic. The securities are increasingly common in the U.S. corporate market, where investors are pushing for more sustainable debt. Municipal borrowers began offering them in 2013, when Massachusetts sold $100 million in self-styled green bonds to pay for improvements to water quality, energy efficiency and pollution control, according to the MSRB website.

Now, I always saw most munis as green bonds, used to improve the environment in some fashion. The key term in that description in the paragraph above was "self-styled." States and local governments seemed eager enough to slap the green label on certain bond issues, and when you'd ask them about it, about who decided what was a green bond, it turned out that they did. It was a marketing tool, and if certain investors were willing to go out of their way to buy a municipal bond labeled "green," well, terrific! There was no standard to it, no independent verification. At least, not at the beginning, and even now, not uniformly.

As the MSRB's request makes clear, that may be about to change.

"Many investors and other market participants are seeking ESG-related information beyond what historically has been provided to the market. In response, private vendors are offering ESG certification services." And you can stop right there. Once there's a multiplicity of sources for information, there's the possibility that some investors will get more or better information than the legally required disclosures in offering documents. The MSRB request lists five private vendors who currently certify green bonds, including Build America Mutual, Kestrel Verifiers and Sustainalytics.

And then toward the end of the request, the MSRB asks bluntly whether the ESG indicator from IHS Markit that it has incorporated on its EMMA website's new-issue calendar enhances market transparency. And then it asks, "What improvements could the MSRB make to the EMMA website regarding ESG-Related Disclosures, ESG-Labeled Bonds and other ESG-related information?"

Best Practices

The Government Finance Officers Association in 2021 released best practices concerning ESG disclosure, and best practices aren't just concocted overnight, so I asked them about it. Keep in mind that the MSRB in a footnote in its request quotes the GFOA as citing the impracticality of developing uniform metrics to gauge risks.

"One thing that stood out to us is the RFI at times tends to blur the bright line that exists between two things: 1. ESG disclosures on everyday bonds issued and 2. Designated Bonds (i.e. green or social bonds) which are designed to be issued for specific purposes," wrote Emily Swenson Brock, director of the GFOA's Federal Liaison Center, in an email. "We will do our best to clarify that bright line (by pointing to our best practices here) and provide the MSRB ideas on how the municipal bond industry can work together to advance issuer awareness and practice in ESG."

And Dave Erdman, Wisconsin's capital finance director and a member of the GFOA Debt Committee, said in an email, "Yes some metrics or standardization of criteria and requirements that must be met to have designated bond (such as green, social, etc) would be beneficial to all, in other words, everyone is playing the same game and aiming for the same fences when designating a bond, but do we really want to open the regulatory and reality door on standardization of disclosure language?"

It's clear that the age-old fight between the analysts who want more and issuers who already feel beleaguered by their demands is about to enter a new phase.

Bloomberg Markets

By Joseph Mysak Jr

January 5, 2022, 9:45 AM PST

— *With assistance by Danielle Moran*

(Joe Mysak is a municipal market columnist who writes for Bloomberg. His opinions do not necessarily reflect those of Bloomberg LP and its owner, and his observations are not intended as investment advice.)

NFMA's Diversity, Equity & Inclusion Initiatives.

The DEI Committee began work in 2021 on initiatives to promote Diversity, Equity & Inclusion in the NFMA. The first priority was to propose a new mission statement to be incorporated into the NFMA constitution. Effective December 27, 2021, the NFMA's constitution was amended with the new mission statement. To read the current NFMA constitution, click here.

For a better understanding of the goals of the DEI Committee, watch this short report by Anne Ross, 2021 NFMA Chair, Neene Jenkins and Nicole Byrd, Co-Chairs of the DEI Committee. For more information about the NFMA's DEI initiatives click here.

IRS and Treasury Guidance On the Transition From Interbank Offered Rates to Other Reference Rates.

Read the guidance from the IRS and Treasury.

IRS and Treasury Release Final Guidance on Libor Transition.

The Internal Revenue Service and Department of the Treasury have released final guidance on the transition away from Libor, setting Secured Overnight Financing Rate as an alternative and creating noncovered modification in the place of fair-value.

The cessation of Libor matters to the muni market because existing debt and contracts may reference it, potentially impacting variable-rate debt, swaps and contracts, among other things.

The final regulations hope to swap out the Libor rate that is no longer being published as of Dec. 31, 2021, but will be around until June 2023, with a new formula that won't change the economics of the deal or cause reissuance of the particular debt.

"It seems to follow pretty closely the recommendations of the Alternative Reference Rates Committee, the New York Fed group that's overseeing the Libor transition and it seems to provide needed flexibility for municipal issuers who may need to change the terms of outstanding deals in order to accommodate the loss of Libor without having to undergo a reissue," said Michael Decker, senior vice president of federal policy and research at the Bond Dealers of America.

"I think that's the main thing that the community was looking for and I think it's something that generally the community will be supportive of."

The proposed regulations, released on Oct. 9, 2019, leaned on fair market value to ensure the value of the debt stayed the same.

"How do you differentiate changes that are just swapping out the old formula for the new formula?," said Johnny Hutchinson, partner at Squire Patton Boggs and member of the National Association of Bond Lawyers' board of directors. "The way that the Proposed Regulations tried to do that was to say, the fair market value of your debt has to be the same, both before and after the change."

"But people get very skittish when you hand them a certificate signed that says these bonds are being sold at fair market value," he said.

Muni market participants often say that calculating marked-to-market fair-value poses challenges for municipal bonds because they don't often trade every day as stocks do. SOFR was another safe harbor outlined in the Proposed Regulations but has been somewhat controversial due to the short history of the formula being published, Hutchinson said.

With the final regulations, set to be published in the Federal Register on Jan. 4, the SOFR rate is mentioned as a qualified rate.

"A qualified rate is a SOFR-based rate or other qualified replacement rate, so long as it is in the same currency as the discounted IBOR or is otherwise reasonably expected to measure contemporaneous variations in the cost of newly borrowed funds in that currency," law firm Cadwalader Wickersham & Taft said.

But satisfying the requirements with a constant fair market value has been changed.

"That requirement has been completely scrapped, it looks like from an initial read," Hutchinson said. "Instead, the way that the Final Regulations are going to test whether the parties are really making changes beyond just swapping in a new formula for the old formula, is there are a list of what are called noncovered modifications and they all relate to changes in the timing or amounts of the cash flows on the debt."

The shift in approach basically says as long as you don't make these specific noncovered modifications, the IRS or Treasury won't inquire as to whether the fair market value is the same.

But some modifications to existing agreements may include both covered and noncovered components, which should be tested on a standalone basis, the regulation says. In a way, this makes things a bit more definitive for bond counsel as when a modification event occurs, they're able to pull up the list of noncovered modifications and see whether the specific event falls under it.

But still some uncertainty exists as bond counsel familiarize themselves with the long list of noncovered modifications. "If that's how the regulations work, I think that's a good thing," Hutchinson said. "It's helpful and it allows us to apply the rules with, a little bit more certainty than we had before."

For issuers, this may result in additional time and money spent with bond counsel. "That's what the attorneys do, they have to test whether or not they can be qualified," Emily Swenson Brock, director of the federal liaison program at Government Finance Officers Association. "It's hard because that adds a lot of cost and it adds a lot of time."

There is currently legislation passing through Congress that could affect that would allow for non-penalized modifications to outstanding contracts when LIBOR ceases to exist in June 2023. It passed the House in December in a 415-9.

It follows New York State legislation that hopes to minimize disruptions by allowing "tough legacy" contracts or those that expire after June 2023 and do not have fallback language specifying an alternative to use SOFR.

In a letter to Speaker of the House Nancy Pelosi and Republican Leader Kevin McCarthy GFOA and many other industry groups hoped to tip the scale in the industry's favor. "Without federal legislation to address these contracts, investors, consumers, and issuers of securities may face years of uncertainty, litigation, and a change in value," the letter said. "This would thereby create ambiguity that would lead to a reduction in liquidity and an increase in volatility."

By Connor Hussey

BY SOURCEMEDIA | MUNICIPAL | 02:58 PM EST

NFMA's New Mission Statement Approved.

Effective December 27, 2021, the NFMA's constitution was amended to incorporate a new mission statement. To read the current NFMA constitution, click here.

NFMA Municipal Analysts Bulletin - December 2021

Volume 31, No. 3 of the NFMA newsletter is available by clicking here. Also, please click here to read the special edition of the NFMA Municipal Analysts Bulletin, dated October 26, 2021. This special edition was published to provide NFMA members notification that the NFMA Board of Governors have approved a change to the NFMA mission statement, which represents an amendment to the NFMA Constitution. The proposed amendment is subject to a 60-day comment period by NFMA Regular Members.

RBC Paying $1M FINRA Settlement for Years of Junk Bond Oversight.

A brokerage firm accused of failing to track "junk bond" overconcentration in customer accounts for years has agreed to pay $1 million to settle with FINRA.

The regulator has sanctioned RBC Capital Markets, a New York-based broker-dealer with 2,400 registered representatives in its 275 branch offices, in a case involving potentially unsuitable concentration levels of high-yield bonds in customer accounts between July 2013 and June 2016.

During that period, RBC did not implement a supervisory system to comply with FINRA and Municipal Securities Rulemaking Board rules related to recommendations of high-yield corporate and municipal bonds, according to a letter of acceptance, waiver and consent from FINRA.

As a result, the firm failed to flag more than 100 customer accounts with conservative profiles for this kind of activity.

Additionally, FINRA officials said they have repeatedly reminded member firms of their sales practice obligations in connection with high-yield or "junk" bonds because of the increased risks. These bonds receive lower credit ratings, indicating a higher risk of default.

In settling the case without admitting or denying the charges, RBC agreed to a censure, $456,155 plus interest in restitution and a $550,000 fine. The case originated from a FINRA cycle examination of RBC.

According to the FINRA letter, RBC changed the tax coding of municipal bonds in its system in July 2013. This coding change inadvertently disabled alerts to identify potential concentration issues for further assessment.

RBC did not detect that the alerts were not working, in part, because the firm did not test its alerts during the relevant period, the FINRA letter alleges.

The defective alerts were discovered in September 2015, but the firm allegedly did not address the issue until July 2016. RBC is accused of failing to adopt alternate measures to identify potentially unsuitable concentrations in high-yield bonds and failing to tell supervisors that the alerts were not working as intended.

John Gebauer, president of the compliance firm National Regulatory Services, said this case highlights the importance of thoroughly testing written supervisory policies and procedures as part of the annual 3120 review.

"It appears that RBC thoughtfully designed a supervisory control system and implemented automated controls to ensure that the policies were followed," Gebauer said. "However, when firms implement a technology-based solution, that does not eliminate the need to regularly test the systems to be certain that they are operating as intended. Whether by bug or changing requirements.

"This unquestioning deference to the results of technology is, unfortunately, an increasingly common occurrence."

In a number of the impacted accounts, the holdings in high-yield bonds were more than six times the thresholds set by the firm, according to the FINRA letter.

"For example, Customer M, who was over 100 years old, was a trustee for two trust accounts, both of which had the most conservative investment objectives. By June 2015, 86% of one trust account and 100% of the second trust account consisted of high-yield municipal bonds," said the FINRA letter.

The regulator then described another customer who was more than 70 years old and had a joint account with a conservative investment objective that, at times, consisted of as much as 92% in high-yield bonds.

Financial Planning has reached out to RBC Capital Markets for comment.

Financial Planning

By Justin L. Mack

December 21, 2021

FINRA Fines RBC Over $280,000 for Violating Muni Rule.

RBC Capital Markets, LLC agreed to pay more than $280,500 to settle Financial Industry Regulatory Authority charges that it violated the Municipal Securities Rulemaking Board's suitability rules when it failed to establish, maintain, and enforce a supervisory system with respect to high-yield municipal bonds.

In a December 14 Letter of Acceptance, Waiver and Consent (AWC), RBC agreed to pay a total fine of $550,000, plus restitution and interest of over $450,000 and to be subject to a censure.

In so doing, RBC neither admitted nor denied FINRA's findings that it violated NASD Rule 3010(a) and 3010(b) and FINRA Rules 3110(a) and (b) and 2010 with respect to the firm's supervision of high-yield corporate bonds, and MSRB Rules G-27(b) and (c) with respect to high-yield municipal bonds.

Specifically, FINRA found that for a period of three years, from July 2013 to June 2016, RBC, which has been a FINRA regulated broker-dealer since 1993, failed to identify for review, more than 100 customer accounts that had conservative profiles for potentially unsuitable concentration levels of high-yield bonds, i.e., those with a higher risk of default.

Under MSRB Rule G-27(b), municipal dealers are required to establish and maintain a supervisory system, which includes written supervisory procedures that reasonably ensure compliance with applicable securities laws.

FINRA Rules 2111 and 3110(a) have similar requirements for supervision, diligence and suitability. For example, under FINRA Rule 2111, member firms must have a "reasonable basis to believe that a recommended securities transaction or investment strategies is suitable for a customer based on information obtained through reasonable diligence of the firm."

In this case, FINRA found that RBC's supervisory system did not flag recommendations that resulted in potentially unsuitable concentrations of high-yield bonds in certain customer accounts. FINRA also concluded the firm's procedures did not sufficiently address suitability factors that its representatives should consider before recommending high-yield bonds.

For example, FINRA said that for a number of years, RBC's procedures did not provide guidance as to what proportion of a customer's portfolio should be invested in those high-risk products.

Additionally, FINRA found that RBC had daily and monthly recommended automated alerts designed to identify potentially unsuitable concentrations of high-yield bonds. However, FINRA concluded the alerts did not function as intended because RBC changed the tax coding of municipal bonds in its system in 2013.

The change "inadvertently disabled the ability of the high-yield bond alerts to identify concentration issues for further assessment," FINRA said.

Additionally, FINRA concluded that RBC did not test its alerts and so was not aware the system wasn't functioning properly. According to the AWC, the firm realized the problem in 2015, but did not fix the system until 2016 and failed to adopt alternate measures to identify potentially unsuitable concentrations in customer accounts in the meantime.

As a result, FINRA found that RBC "did not review more than 100 conservative customer accounts for potentially unsuitable concentrations of high-yield corporate and municipal bonds." Some of those accounts contained high-yield bond concentrations more than six times higher than the thresholds set by the firm.

Consequently, FINRA charged RBC with failing to establish, maintain and enforce a supervisory system reasonably designed to achieve compliance with the relevant MSRB rules and imposed a censure, fine, and restitution and interest as sanctions.

Regarding the AWC, Nicole Garrison, director of corporate content, communications and social media for RBC Wealth Management-U.S., said, "we are deeply committed to careful management of the wealth clients entrust to us. As a firm, we pride ourselves on having strong policies and procedures in place to protect our clients. In the rare instance those policies and procedures fall short, we take steps to address them."

Garrison added, "We fully cooperated with FINRA and are pleased to have amicably resolved this case. This matter involves restitution to just 20 accounts and an issue that occurred and was fixed more than five years ago."

By Kelley R. Taylor

BY SOURCEMEDIA | MUNICIPAL | 12/16/21 01:59 PM EST

MSRB EMMA Update to CUSIP Groups Feature.

Issuers – we heard you. In response to stakeholder feedback the MSRB has introduced a completely redesigned "CUSIP Groups" feature that allows issuers to save a group of CUSIPs to use for future disclosure filings submitted to the EMMA.

Watch our tutorial.

MSRB RFC: New Draft Rule G-46

The MSRB is requesting a second round of comments on a new draft Rule G-46 to codify obligations of solicitor municipal advisors. Comments are due March 22, 2022.

[Read the request for comment.]

MSRB Opens Second Comment Period on Regulation of Solicitor Municipal Advisors: Cadwalader

The MSRB requested a second round of comments on revisions to proposed Rule G-46 ("Duties of Solicitor Municipal Advisors"). If adopted, the amendments would codify previously issued interpretive guidance concerning the requirements applicable to solicitor municipal advisors under Rule G-17 ("Conduct of Municipal Securities and Municipal Advisory Activities") (*see* related coverage).

In response to comments received during the first comment period, the MSRB is revising proposed MSRB Rule G-46 to (i) clarify that solicitor municipal advisors do not owe a fiduciary duty under the Exchange Act to clients in connection with solicitation activities and (ii) conform the rule to certain requirements that apply to non-solicitor municipal advisors and certain solicitations under IAA Rule 206(4)-1 ("Investment Adviser Marketing").

This new comment period will close on March 15, 2022.

December 16 2021

Cadwalader Wickersham & Taft LLP

Joint Trades Letter in Support of H.R. 4616, the Adjustable Interest Rate (LIBOR) Act.

SUMMARY

SIFMA in a joint letter with other associations, provided comments to the House of Representatives on the passage of H.R. 4616, the "Adjustable Interest Rate (LIBOR) Act," to address "tough legacy" contracts that currently reference LIBOR.

SIFMA signed with the following:

Structured Finance Association (SFA)
Bank Policy Institute
National Association of Corporate Treasurers
Education Finance Council
The Loan Syndications and Trading Association (LSTA)
The International Swaps and Derivatives Association (ISDA)
The Real Estate Roundtable
The Financial Services Forum
Institute of International Bankers
Government Finance Officers Association
Mortgage Bankers Association
Commercial Real Estate Finance Council (CREFC)
Consumer Bankers Association

Investment Company Institute
Institute for Portfolio Alternatives
Independent Community Bankers of America
U.S. Chamber of Commerce, Center for Capital Markets Competitiveness
Housing Policy Council
Student Loan Servicing Alliance
American Bankers Association
The American Council of Life Insurers (ACLI)

SEC Outlines Key Considerations for LIBOR-Linked Muni Securities.

A Securities and Exchange Commission staff statement issued Tuesday reiterates disclosure and fiduciary obligations of issuers and underwriters in light of the forthcoming transition away from Libor. And while those obligations are important, some municipal industry practitioners point to an already existing trend away from Libor-linked transactions.

Earlier this year, Libor's regulator, the Financial Conduct Authority, announced that it will cease the publication of 1-week and 2-month U.S. dollar Libor after Dec. 31, 2021. Remaining U.S. dollar Libors will cease in 2023.

The SEC staff statement "seems to be a restatement of existing obligations and requirements that apply to broker dealers and underwriters, both with respect to their issuer clients and their investor customers," said Michael Decker, senior vice president for research and public policy at Bond Dealers of America.

Decker points out that the statement "really focuses on ensuring that both sides of the transaction understand the risks associated with being involved in a Libor transaction, given that it appears Libor is going away pretty soon."

According to the staff statement, "understanding the potential risks, rewards, and costs is especially important when recommending Libor-linked securities."

The statement also highlights specific considerations for underwriters of primary offerings of municipal securities and those for broker-dealers making recommendations of municipal securities.

For example, SEC staff believe that it would be difficult for a broker-dealer to satisfy its duty of care to customers in a situation where the broker-dealer recommends a Libor-linked security without fallback language.

Fallback language specifies a process for identifying a replacement rate in the event that a benchmark rate is not available.

Essentially, the SEC sees the replacement rate for a Libor-linked security as a factor that generally should be considered as part of a recommendation.

Decker said that while fallback provisions were originally conceived for temporary instances where the Libor wouldn't be published for a short period of time, the provisions have now become more robust.

"They account for the notion that Libor may go away entirely and specify a more practical and workable kind of long-term solution," Decker said.

For example, Decker pointed out that instead of merely specifying the prime rate for some period of time, a Libor-transition fallback provision would specify the SIFMA index or some alternative index that the issuer and other parties to the transaction could use.

Regarding municipal securities underwriting, the SEC staff statement pointed to prior SEC staff guidance and guidance from the Municipal Securities Rulemaking Board concerning fair dealing requirements under MSRB Rule G-17.

The Office of Municipal Securities staff noted that "broker-dealers should consider the impact that the Libor transition may have in connection with other duties" including suitability standards in MSRB Rule G19 and disclosure rules under MSRB Rule G-47.

The SEC staff statement also reminds funds and advisors to monitor and manage conflicts of interest associated with the Libor transition.

Les Jacobowitz, a partner at Arent Fox, LLP who has extensive experience representing issuers, borrowers, underwriters, and financial institutions, has been writing about the Libor transition for a couple of years.

"As the UK FCA and U.S. regulators admonish, everyone should act now to slowUSD LIBOR use for the next four weeks through the year-end Libor/SOFR [Secured Overnight Financing Rate] transition deadline," Jacobowitz wrote Dec. 1.

Jacobowitz also noted that slowing of Libor use was "a recommendation and not a requirement."

However, with a nod to the classic movie, Casablanca, Jacobowitz says he is, "shocked, shocked" that Libor-linked instruments are still being recommended by underwriters and financial advisors.

"I can't believe issuers and conduit borrowers are still entering into Libor-based instruments, especially those that terminate after USD LIBOR goes away [in June 2023]," Jacobowitz explained.

Meanwhile, with respect to both interest rate swaps and floating rate notes, Decker is seeing notable movement away from Libor.

"There may be some new transactions that are still priced off of Libor, but it's my understanding that those are becoming rarer and rarer," Decker said.

Overall, Decker believes that underwriters, municipal advisors, and sales reps should be clear in their disclosure with customers and clients about Libor going away and about specifics of a transaction.

"In that sense, we agree with the SEC that disclosure and transparency are important," Decker said.

The Bond Buyer

By Kelley R. Taylor

December 08, 2021, 1:06 p.m. EST

SEC Staff Statement on LIBOR Transition - Key Considerations for Market Participants.

Read the SEC Staff Statement.

Staff of the U.S. Securities and Exchange Commission

Dec. 7, 2021

SEC Staff Issues Key Considerations on LIBOR Transition: Latham & Watkins

As a major LIBOR transition milestone approaches, a Staff Statement provides key considerations for market participants regarding their obligations.

On December 7, 2021, the Staff of the Securities and Exchange Commission (SEC) issued a statement (the Statement) on the transition away from the London Interbank Offered Rate (LIBOR). The transition away from LIBOR is reaching an inflection point as the publication of the USD LIBOR benchmark for the 1-week and 2-month USD LIBOR maturities and many non-USD LIBOR maturities cease immediately after December 31, 2021.[1] The SEC, like other regulators around the world, continues to emphasize its expectation that market participants understand the risks associated with LIBOR transition and take appropriate action to move to alternative rates in a manner that protects customers, counterparties, the firm itself, and the capital markets more broadly.

The Statement provides guidance for broker-dealers and registered investment advisers as they approach the imminent transition away from LIBOR, highlighting as part of conduct risk their duties under Regulation Best Interest (Reg. BI) as well as fiduciary obligations under the US securities laws. Specifically, the Statement includes timely reminders for:

- Broker-dealers recommending LIBOR-linked securities
- Broker-dealers underwriting or recommending municipal securities
- Investment advisers recommending LIBOR-linked securities
- Funds and investment advisers investing in LIBOR-linked securities
- Companies and issuers of asset-backed securities making disclosures related to the LIBOR transition

Obligations for Broker-Dealers Under Reg. BI

According to the Statement, broker-dealers should be mindful of their obligations under Reg. BI when recommending LIBOR-linked securities to retail customers. Under Reg. BI's Duty of Care, "a broker-dealer must exercise reasonable diligence, care, and skill to, among other things, understand the potential risks, rewards, and costs associated with the recommendation."

In the Statement, SEC Staff emphasized that based on a fact-specific analysis broker-dealers must have a reasonable basis to believe that any recommendation they make involving LIBOR-linked securities is in their retail customers' best interests. According to SEC Staff, "reasonable diligence" may take into account client investment objectives, as well as the characteristics of the underlying securities such as complexity, risks, rewards, costs, liquidity, volatility, likely performance, expected return, associated incentives, etc.

The Statement clarifies that, to meet the Reg. BI Standard, broker-dealers must confirm whether a security has robust fallback language in its offering documents that clearly defines an alternative reference rate (ARR) to LIBOR. If a security does not have robust fallback language, then the recommendation must be "premised on a specific, identified, short-term trading objective." In contrast, if a security does have robust fallback language, the broker-dealer must assess the impact the replacement rate will have on the expected performance of the security to determine whether the security is still in the customer's best interest.

Furthermore, under Reg. BI, broker-dealers that have agreed to perform monitoring services for a retail customer must reassess the potential risks, rewards, and costs of any LIBOR-linked security in their retail customer's account to ensure the investment is still in the customer's best interests. This obligation applies to buy, sell, or hold recommendations, and even when a broker-dealer remains silent (i.e., an implicit hold recommendation).

Obligations for Broker-Dealers Related to Municipal Securities

In addition to the Reg. BI standard for recommendations to retail customers, broker-dealers are subject to a few additional rules when recommending LIBOR-linked municipal securities.

1. Exchange Act Rule 15c2-12 requires broker-dealers to obtain and review a "deemed final" official statement by a municipal obligor. Per this rule, underwriters must have a reasonable basis to believe the key representations in the "deemed final" official statement are true. To meet this "reasonable basis" standard, broker-dealers underwriting municipal securities should review the municipal obligor's exposure to LIBOR-transition risks to ensure those risks are adequately addressed in the obligor's key representations.
2. Broker-dealers making recommendations to non-retail customers are subject to the suitability standard in MSRB Rule G-19. Accordingly, broker-dealers should consider a municipal obligor's exposure to LIBOR transition risks when making a suitability determination.
3. When broker-dealers sell or purchase municipal securities, MSRB Rule G-47 requires they disclose material information known or available to established industry sources regarding the municipal obligor's exposure to LIBOR transition risks.

Obligations for Registered Investment Advisers and Registered Funds

SEC-registered investment advisers must consider their fiduciary obligations under the Investment Advisers Act of 1940 when recommending LIBOR-linked securities and investment strategies. These fiduciary principles require advisers to consider whether LIBOR-linked investments are consistent with their client's goals. To do this, advisers must consider whether the investments or related contracts have robust fallback language providing a clear ARR. When an investment does include an ARR, advisers should consider whether those rates will cause the investment to depart from their client's goals or risk tolerance.

Funds and advisers should monitor and manage conflicts arising from the LIBOR transition. Specifically, advisers should make disclosures when the LIBOR transition impacts performance fees, which is likely for performance fees subject to a "hurdle rate" (the minimum return necessary for the adviser to start collecting the performance fee) that is tied to LIBOR.

LIBOR transition also implicates disclosure obligations for registered investment companies and business development companies to prevent misleading investors. Disclosures in offering documents for registered products must address the principal risks associated with the fund, including those related to the anticipated impact of LIBOR transition, if a fund invests a significant portion of its assets in LIBOR-linked investments.

Funds and advisers should also consider the impact the transition will have on valuation measurements that use LIBOR as an input, as well as the operational complexities that the LIBOR transition will introduce on their IT systems.

Obligations for Public Companies and Asset-Backed Securities Issuers

According to the Statement, public companies and asset-backed securities issuers should provide meaningful insight to investors about the status of their efforts to address LIBOR transition risks. Specifically, companies should provide material and specific qualitative and quantitative information to investors, "rather than general statements about the progress of the company's transition efforts to date." To aid these disclosure requirements, the Statement outlines several specific disclosure recommendations:

- Companies should generally disclose the steps they have taken to identify their LIBOR exposure, what the company has done thus far to mitigate LIBOR transition risks, and what steps remain to mitigate those risks.
- Companies with outstanding debt that lacks robust fallback provisions should disclose how much LIBOR-linked debt they will have outstanding after the cession date and the steps the company is taking to mitigate the risks involved.
- Companies that include disclosures about the LIBOR transition in response to more than one disclosure requirement within a single filing should provide cross-references or otherwise connect the information to clarify for the investor the company's LIBOR risk profile.
- Firms specifically subject to regulatory guidance (such as the joint statements issued by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation; and the Federal Reserve Board backed Alternative Reference Rates Committee) recommending that they avoid entering into new contracts that reference LIBOR after December 31, 2021, should disclose the details of their transition efforts and the impact of these efforts on their company, in alignment with such guidance.

Key Takeaways

The Statement's recommendations will be of particular interest to firms and individuals under the SEC's remit, as they may be indicative of the Staff's key regulatory and examination priorities. Since at least June 18, 2020, the SEC's Division of Examinations has highlighted that LIBOR transition is a priority, including when it issued a Risk Alert on LIBOR transition preparedness (see this Latham post for more information). As the long-anticipated deadline for key LIBOR tenors approaches, regulated firms should be alert to their various disclosure obligations and obligations under the fiduciary rules and Reg. BI. Firms should prepare for compliance with these rules, specifically as they relate to LIBOR transition.

Latham & Watkins LLP – Laura N. Ferrell, Marlon Q. Paz, Zach Lippman and Deric M. Behar

December 10 2021

MSRB RFC: ESG-Related Disclosure and ESG Labeling

Share Your Perspective on ESG Practices in the Muni Market

Read the MSRB's request for information on ESG-related disclosure and ESG labeling, and submit your comments by March 8, 2022.

December 8, 2021

MSRB Requests Information on ESG Practices: Cadwalader

The MSRB issued a Request for Information on environmental, social and governance ("ESG") practices in the municipal securities market. MSRB is seeking information on (i) the disclosure of related risk factors and practices, and (ii) the labeling and marketing of municipal securities with ESG designations. Responses must be submitted by March 8, 2022.

Specifically, MSRB is asking the following questions:

Municipal Issuers:

- Are you currently providing ESG disclosures or information beyond what is legally required in your offering documents?
- Do you believe that the information in the ESG disclosures should be standardized?

Investors in Municipal Securities:

- Do you consider ESG information material to your investment decision?
- Do you have access to ESG-related information to make an informed investment decision?

Dealers:

- Does underwriting ESG-labeled bonds create any novel compliance issues? How might that differ between a primary offering and purchase or sale in the secondary market?

Municipal Advisors:

- Does the formulation and delivery of advice for ESG-related bonds and ESG-related disclosures raise any novel compliance challenges?

All Municipal Market Participants:

- Are there any ESG factors that could pose a systematic risk to the municipal market?
- There are organizations that have established voluntary standards; do those standards provide adequate guidance and transparency for investors?

Cadwalader Wickersham & Taft LLP

December 8 2021
