Round Two of the SEC's MCDC Initiative: 22 Municipal Underwriters Settle Charges of Disclosure Failures

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The U.S. Securities and Exchange Commission (the "**Commission**") is continuing to scrutinize municipal bond offerings and bring enforcement actions aimed at improving underwriter due diligence and increasing information to investors. On September 30, 2015, the Commission announced a second round of enforcement actions under the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, securing settlements against 22 underwriting firms. While this second round of settlements again involves firms that self-reported violations, this series of actions targeted generally smaller firms and less egregious violations than the initial sweep of settlements in July 2015.

Under the MCDC Initiative (the "**Initiative**"), the Commission's enforcement division announced in March 2014 that it would recommend standardized, favorable settlement terms to issuers and underwriters who voluntarily self-reported violations involving misrepresentations in offering documents concerning an issuer's compliance with continuing disclosure obligations. The Commission's standard terms involve the imposition of penalties based on the number and size of the offerings identified, subject to a penalties cap based on the reported revenue of the firm.

The first round of settlements under the Initiative was instituted against 36 municipal underwriters on July 18, 2015. (See our coverage here). As is typical in many pre-litigation settlements with the Commission, the first round of settled orders provided little transparency on the Commission's method and rationale for calculating penalties. Without more information or explanation on the underlying conduct and the settlement calculation details, the announcement caused many to question whether there was an objective benefit to self-reporting.

The Commission's orders in the second series of settlements are similarly vague on the rationale for the penalty amounts imposed. In the first round of settlements, the penalties ranged from $40,000 to $500,000, with a median penalty of $250,000 and average penalty of $258,000. In the second round, the penalties ranged from $20,000 to $500,000, with a median penalty of $100,000 and an average penalty of $187,000. Notably, only one firm in the second round reached the $500,000 ceiling, which is a departure from the first round of settlements in which ten of 36 underwriters paid the maximum $500,000 penalty. Moreover, while the first round of settled proceedings included a laundry list of big names (e.g., BNY Mellon, Citigroup, Goldman Sachs, Merrill Lynch, and Morgan Stanley), the second round involved many small regional firms, which may explain the drop in the individual and average penalty amounts.

Although the orders in the second series of settlements still do not disclose the number or size of the offerings by each of the underwriters charged, they do reveal the specific issuer misrepresentations the firms failed to disclose. By comparing this data, it appears that the Commission focused less on the shortcomings in the firms' due diligence process or controls and more on the failures by underlying issuers that the underwriters failed to uncover. For example, Fifth Third Securities and Estrada Hinojosa & Company received penalties of $20,000 and $40,000, respectively, for failing to disclose that the issuers in certain offerings had made late financial filings.

On the other hand, Joe Jolly & Co. and The Frazier Lanier Company—two firms with less $2 million in revenue—each received the maximum $100,000 penalty (for small cap firms) because, in several offerings, they did not disclose issuers' failures to file annual financial reports or issuers' late filings. While the Commission faulted each of those underwriters similarly for conducting insufficient due diligence, the underwriters received larger penalties where the issuer's conduct involved both failures to file and late filings.

Like the first round, the underwriters all agreed—without admitting or denying the findings—to cease and desist from further violations. Each underwriter also agreed to hire an independent consultant to review its policies and procedures on due diligence for municipal securities underwriting.

In both rounds of settlements with municipal securities underwriters, the Commission touted the allegedly favorable settlement terms resulting from each firm's self-reporting of violations. However, it will be difficult to determine if self-reporting resulted in a true benefit or to quantify the amount of any such benefit until the Commission brings enforcement actions against non-participating firms and issuers.

A copy of the Commission's press release with links to each of the 22 enforcement actions can be found here. For additional information, please contact one of the Haynes Boone attorneys listed below:

SEC Enforcement Defense

Kit Addleman
214.651.5783

Ronald W. Breaux
214.651.5688

David Siegal
212.659.4995

Public Finance Chair

Cheryl K. Rosenberg
713.547.2074
