

## SEC MCDC Enforcement Initiative Update: SEC Announces Actions Against 71 Municipal Issuers

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September 1, 2016 Kit Addleman

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**PRACTICES** Capital Markets and Securities, Securities and Shareholder Litigation, Corporate

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On August 24, 2016, the SEC announced enforcement actions against 71 municipal and other issuers for violations in municipal bond offerings.<sup>1</sup> This announcement represents the first wave of settlements involving municipal issuers, as opposed to underwriting firms, brought under the SEC's Municipalities Continuing Disclosure Cooperation ("MCDC") Initiative. The actions, each of which included a settlement with the issuer, demonstrate the SEC's ongoing focus on the municipal bond market and, in particular, an emphasis on continuing disclosure obligations pursuant to Rule 15c2-12 of the Securities Exchange Act of 1934.

### The MCDC Initiative

In March 2014, the SEC's Enforcement Division launched its MCDC Initiative to encourage issuers and underwriters of municipal bonds to self-report potential violations of their continuing disclosure obligations. Under the initiative, issuers and underwriters that self-reported possible materially inaccurate statements in offering documents regarding continuing disclosure obligations would receive more favorable settlement terms than entities that did not self-report to the SEC.<sup>2</sup> In July 2014, the SEC announced its first enforcement action as part of the MCDC Initiative against Kings Canyon Joint Unified School District, a California municipal issuer.<sup>3</sup>

Subsequently, in three announcements over a span of eight months—June 2015, September 2015, and February 2016—the SEC initiated settled enforcement actions against underwriting firms pursuant to the MCDC Initiative. A total of 72 municipal underwriting firms entered into settlements with the SEC and agreed to pay civil penalties combined of over \$17 million. Those 72 firms comprised 96 percent of the market share for municipal underwritings.<sup>4</sup>

When announcing the final wave of underwriter settlements in February 2016, the SEC noted that it was beginning to review the self-reporting materials from issuers.

### Settlements Against Municipal Issuers

By press release on August 24, the SEC announced a wave of settled actions against issuers and other obligated persons,<sup>5</sup> under the MCDC Initiative. The SEC does not indicate whether additional actions against issuers will result from the Initiative but, in light of the number of underwriters who previously self-reported and entered into settlements, the 71 issuers charged are likely just the first group in a series of announcements. Previously, the only enforcement action against a municipal issuer under the MCDC Initiative was the action against the California school district shortly after the initiative was announced. This new collection of settlements covers a wide variety of municipal and other issuers including: states, cities, towns, counties, state agencies, universities, school districts, hospitals, and utilities.<sup>6</sup>

The SEC found that the 71 municipal issuers and obligated persons sold municipal bonds using offering documents that contained materially misleading statements or omissions about their compliance with continuing disclosure obligations. Many of the SEC's actions alleged that the issuers had falsely stated in offering materials that they were in compliance with disclosure obligations related to prior bond offerings or had omitted to disclose whether they had complied. The SEC's orders noted that the issuers had failed to timely file audited financial reports, operating data, and/or notices of late filings. Many of the orders alleged that a statement concerning prior compliance was false based on multiple late filings of required disclosures combined with other failures to file operating data.<sup>7</sup> But, the SEC also found that a single late filing, albeit a filing that was 1,014 days late, caused a statement of prior compliance with continuing disclosures to be false or misleading.<sup>8</sup>

Despite the broad assortment of issuers in the announcement and the differences in the nature and magnitude of the alleged disclosure violations, the terms of settlement are similar for each issuer. The settling parties did not admit or deny the SEC's findings, and they agreed to cease and desist from future violations. As required by the MCDC Initiative, they also agreed to establish appropriate policies, procedures, and training regarding continuing disclosure obligations; to comply with existing continuing disclosure obligations; to disclose the settlement in future offerings for the next five years; and to cooperate with any subsequent SEC investigations.

In accordance with the MCDC Initiative's recommendation, the SEC did not assess any civil penalties against any of the 71 issuers charged in the sweep. The lack of a monetary penalty is consistent with prior enforcement actions against municipal issuers, largely reflecting the fact that, if imposed, penalties likely would be satisfied by local or state tax revenues, harming taxpayers and the health of states, cities and local government entities.<sup>9</sup>

With these settlements, the SEC has now filed a total of 142 actions against 143 respondents as part of the MCDC Initiative.

### Conclusion

As noted in the 2012 Municipal Market Report, the SEC believes that the failure of issuers to comply with continuing disclosure obligations serves as a major challenge for investors.<sup>10</sup> This recent wave of settled enforcement actions focusing on issuers should serve as a reminder to municipal issuers and obligated persons of their continuing disclosure obligations and the need for accuracy in offering documents. While there likely will be additional but similar charges and sanctions against issuers who self-reported in connection with the MCDC Initiative, it remains to be seen what actions the SEC may take against issuers who failed to self-report prior violations and whether monetary penalties may yet be imposed against a municipality. Issuers who have not conducted an assessment of compliance practices should consider whether such an inquiry should be undertaken and whether corrective action could protect against or reduce sanctions by the SEC for past compliance failures. In addition, the MCDC Initiative covered only eligible issuers and underwriters, and the SEC is giving no assurance that individuals, such as municipal officials and employees of underwriting firms, who violated securities laws will be offered similar settlement terms. Because the SEC may seek remedies against individuals beyond those imposed pursuant to the MCDC Initiative, remedial action undertaken now by municipal officials may provide a basis for reduced charges or sanctions in the event of an SEC action against them.

Any of the lawyers in Haynes Boone's SEC Enforcement or Public Finance Practice Groups would be happy to discuss these settlements or other municipal securities compliance concerns with you.

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- 1 Press Release, [SEC Charges 71 Municipal Issuers in Muni Bond Disclosure Initiative](#) (Aug. 24, 2016).
  - 2 See Press Release, [SEC Enforcement Division Modifies Municipalities Disclosure Initiative](#) (July 31, 2014). It is not clear, however, that the MCDC Initiative's terms have been more favorable to self-reporting underwriters than settlement terms reached in certain pre-MCDC enforcement actions. See generally Kit Addleman & Sarah Mallett, [Surge of Settlements Under the SEC's MCDC Initiative Casts Doubt as to Leniency of Settlement Terms for Self-Reporters](#), Haynes Boone (June 2015).
  - 3 See [In the Matter of Kings Canyon Joint Unified School District, Securities Act Release No. 9610](#) (July 8, 2014).
  - 4 See Kit Addleman & Sarah Mallett, [SEC MCDC Enforcement Initiative Update: SEC Announces Final Actions against Municipal Bond Underwriters and Beginning of an Issuer Sweep](#), Haynes Boone (Feb. 2016).
  - 5 SEC Rule 15c2-12 defines "obligated person" as any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the Offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities). Generally obligated persons are nonprofit entities that borrow the proceeds of bond issuances and are obligated to repay principal and interest on the bonds. Press Release, [SEC Charges 71 Municipal Issuers in Muni Bond Disclosure Initiative](#) (Aug. 24, 2016).
  - 6 Andrew Ceresney, Director of the SEC Enforcement Division, identified the diversity among the settling entities as indicative that "continuing disclosure failures were a widespread and pervasive problem in the municipal bond market." Press Release, [SEC Charges 71 Municipal Issuers in Muni Bond Disclosure Initiative](#) (Aug. 24, 2016).
  - 7 See, e.g., [In the Matter of El Castillo Retirement Residences, Securities Act Release No. 10161](#) (Aug. 24, 2016). [In the Matter of Oklahoma Housing Finance Agency, Securities Act Release No. 10175](#) (Aug. 24, 2016); and [In the matter of Ohio State University, Securities Act Release No. 10188](#) (Aug. 24, 2016).
  - 8 See [In the Matter of The City of Oconomowoc, Wisconsin, Securities Act Release No. 10149](#) (Aug. 24, 2016).
  - 9 See, e.g., [In the Matter of the State of Kansas, Securities Act Release No. 9629](#) (Aug. 11, 2014); and [In the Matter of the State of New Jersey, Securities Act Release No. 9135](#) (Aug. 18, 2010).
  - 10 [U.S. Securities and Exchange Commission, Report on the Municipal Securities Market](#) (July 31, 2012).