# NATIONAL ASSOCIATION OF BOND LAWYERS

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## General Session: General Securities Law

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# GENERAL SECURITIES LAW

## I. INTRODUCTION

The U.S. Securities and Exchange Commission ("*SEC*" or the "*Commission*") is the law enforcement agency charged by Congress with civil enforcement of the federal securities laws. The purpose of the SEC is to "protect investors—including investors in municipal securities—maintain fair, orderly and efficient markets, and facilitate capital formation." *U.S. Securities and Exchange Commission, Report on the Municipal Securities Market*, July 31, 2012 (the "*2012 Report*"), at 2 (available at www.sec.gov/news/studies/2012/munireport073112.pdf).

Historically, municipal securities have been exempt from registration requirements under federal securities laws, but municipal securities are not exempt from the "antifraud provisions" described herein under Section VI. Failure to comply with all securities laws applicable to a transaction can result in liability for all of the parties to the transaction, including the lawyers.

## II. FEDERAL SECURITIES LAWS -- 1933 ACT REGISTRATION REQUIREMENT

A. Section 5 of the Securities Act of 1933 (the *"1933 Act"*) is its primary requirement: It generally provides that it is unlawful for any person to use the mail or other forms of interstate commerce to sell or deliver any security unless a proper "registration statement" has been filed with the SEC and is in effect.

B. **What is a "security"?**

The term "security" under the 1933 Act is very broad and includes bonds, notes, certificates of participation ("*COPs*"), other evidences of indebtedness and investment contracts, together with guarantees of any of the foregoing. *(1933 Act, § 2(a)(1), 15 USC § 77b(a)(1)).* This definition encompasses not only the primary instruments in most municipal financings (*i.e.,* bonds, notes and COPs), but also collateral documents such as guaranteed investment contracts ("*GICs*"), letters of credit, bond insurance policies and debt service reserve surety bonds. The term also may include certain leases, loan agreements, guarantees and other payment arrangements with third parties which may be deemed separate securities, as described below.

C. **Exempt Securities, *15 USC § 77c*.**

There are two ways to gain an exemption from the registration requirements of the 1933 Act: (1) exempt the security, or (2) exempt the transaction.

Section 3(a)(2) exempts most municipal securities from the registration requirement.

1. Most municipal securities do not need to be registered because Section 3(a) of the 1933 Act provides that, for most purposes, certain classes of securities are not subject to the 1933 Act. These include:

   a) Any security issued or guaranteed by the United States or any Territory thereof. *(1933 Act, § 3(a)(2)).*

b) Any security issued or guaranteed by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories. *(1933 Act, § 3(a)(2))*. Includes most municipal securities, but excludes securities issued by Indian tribes. No-action letters have extended this exemption to 63-20 corporations.

c) Any security issued or guaranteed by a national bank or a banking *institution* organized under the laws of any State, Territory or the District of Columbia, the business of which is substantially confined to banking and is supervised by the state or territorial banking commission or similar official. *(1933 Act, §3(a)(2)).*

(i) Includes most, *but not all*, letter of credit banks; may cover COPs issued by banks.

(ii) Letters of credit issued by domestic branches of foreign banks may qualify for a Section 3(a)(2) exemption on the basis of Interpretive Release No. 33-6661.

d) Any security which is an "industrial development bond" (within the meaning of Section 103I(2) of the 1954 Tax Code, as in effect in 1970) (each an "IDB") the interest on which is excludable from gross income under Section 103(a)(1) of the 1954 Tax Code (other than multi-family housing bonds and bonds issued to finance industrial parks). *(1933 Act, §3(a)(2)).*

(i) This exemption was added in 1970 to mitigate the impact of SEC Rule 131 (*17 CFR § 230.131)*, which was adopted by the SEC in 1968 (and amended in 1970) to combat potential abuses by industrial development bond issues. Rule 131 provides that the obligations of the ultimate obligor in a conduit bond issue are deemed to be separate securities (and thus would be subject to the 1933 Act registration requirements). The SEC has acknowledged that the exemption was intended to apply to both the industrial development bond itself and the underlying conduit loan.

(ii) This exemption does not include taxable IDBs, so Rule 131 analysis of the underlying conduit loan and related guarantees is still necessary.

(iii)This exemption includes most "exempt facility bonds" issued under Section 142 of the 1986 Tax Code and "qualified small issue bonds" issued under Section 144(a) of the 1986 Tax Code.

(iv)Multi-family housing bonds were specifically excluded from this exemption. While the bonds themselves will usually qualify under the Section 3(a)(2) exemption, the underlying conduit loan and related guarantees must be analyzed as potential separate securities. See Section II.C.2.d below.

e) Any security issued by an entity organized and operated exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes and not for pecuniary profit, no part of the net earnings of which inures to the benefit of any person, private stockholder or individual (which should include most 501(c)(3) corporations and some 63-20 corporations). *(1933 Act, §3(a)(4)).*

f) Any insurance policy issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner or other similar officer of a State or Territory or the District of Columbia. *(1933 Act, §3(a)(8))*. This exemption covers bond insurance policies of major bond insurers.

g) Securities offered and sold only to persons resident within a single State or Territory by an issuer that is resident (or incorporated by) and doing business with such State or Territory. *(1933 Act, §3(a)(11))*. This exemption can be lost if resale of the securities is out of state.

2. Separate Securities Analysis for Conduit Issues.

a) Under Rule 131(a), any part of a bond or other obligation (including those bonds or obligations otherwise exempt under Section 3(a)(2)) payable from payments to be made in respect of property or money which is or will be used under a lease, sale or loan arrangement, by or for an industrial or commercial enterprise, is considered a "separate security" issued by the lessee or obligor under such lease, sale or loan arrangement. Thus, the obligations of the ultimate obligor in a conduit bond issue are deemed to be separate securities and are subject to the 1933 Act registration requirements unless an exemption is available.

b) As noted above, the exemption under Section 3(a)(2) for tax-exempt IDBs mitigates the impact of Rule 131(a), but does not apply to separate securities related to taxable IDBs or multi-family housing conduit bonds.

c) Under Rule 131(b), the obligation(s) underlying a conduit issue will not be deemed to be a separate security if: (i) the obligation is payable from the general revenues of a governmental unit specified in Section 3(a)(2); or (ii) the obligation relates to a public project owned and operated by or on behalf of and under the control of a governmental unit; or (iii) the obligation relates to a facility that is leased to and under the control of an industrial or commercial enterprise but is part of a public project that is owned by a governmental unit.

d) In the case of multi-family housing issues, SEC no-action letters indicate that housing projects owned and operated by private developers may satisfy the requirements of Rule 131(b) if adequate governmental "control" is demonstrated. Factors showing governmental control include: (i) the right to access the project; (ii) the right to inspect books and records; (iii) the right to receive periodic reports relating to project operations; (iv) the right to obtain possession of the project in the event of a material default under the mortgage; (v) approval of the timing of construction; and (vi) approval of plans and specifications.

D. **Exempt Transactions, *15 USC § 77d.***

1. Section 4 "Issuer" Exemptions. If the securities being issued do not qualify as exempt securities under Section 3(a) of the 1933 Act, the issuer must register the securities or qualify the offering and sale of the securities as an exempt transaction under Section 4 of

the 1933 Act. **Note that separate exemptions under Section 4 apply for issuers and purchasers.**

a) Section 4(a)(6) exemption: Transactions involving offers or sales by an issuer solely to *"accredited investors"* if (i) the aggregate offering price is $5 million or less, (ii) there is no advertising or public solicitation in connection with the transaction, and (iii) the issuer files a Form D with the SEC.

b) Section 4(a)(2) (15 USC § 77d(2)) exemption: Transactions by an issuer not involving any *"public offering."* To be considered with"n "safe harbo"s," the issuer must comply with SEC Rules 501 through 508 *("Regulation D")(17 CFR §§ 230.501-230.508)*.

(i) Exemption for offerings of $10 million or less, measured over 12 months (a *"Rule 504 offering"*). Securities may not be sold pursuant to general solicitation, and the issuer must exercise *"reasonable care"* to assure purchasers are not *"underwriters."*

(ii) Exemption for offerings sold to not more than 35 purchasers, regardless of dollar amount (a *"Rule 506 offering"*). Among the requirements for meeting this exemption is that each purchaser (other than accredited investors) must have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment." Accredited investors do not count toward the 35 purchaser limit. A Rule 506 Offering exclusively to persons the issuer has taken reasonable steps to verify are accredited investors may be sold pursuant to general solicitation.

2. Section 4 "Purchaser" Exemptions. If the securities being issued do not qualify as exempt securities under Section 3(a) of the 1933 Act and have not been registered, the purchaser can qualify the initial purchase and subsequent resale of the securities as exempt transactions under Section 4 of the 1933 Act.

a) Section 4(a)(1) (15 USC § 77d(1) exemption: "Transactions by any person other than an issuer, underwriter, or dealer."

(i) The term *"underwriter"* is broadly defined to include any person who (X) has purchased securities from an issuer with a view to distribute such securities, or (Y) offers and sells securities for an issuer in connection with the distribution thereof. *(Rules 144 (17 CFR § 230.144) and 144A (17 CFR § 230.144A) provide safe harbors in this regard). (1933 Act, §2(a)(11)).*

(ii) *"Dealer"* means a person who works as an agent, broker or principal in the business of offering, buying, selling or otherwise dealing and trading in securities issued by another person. *(1933 Act, §2(a)(12)).*

(iii)The Section 4(a)(1) exemption should allow *"accredited investors"* other than dealers (*e.g.*, high net worth individuals) to acquire securities directly from an issuer that has qualified such sale under the 4(a)(2) or 4(a)(6) exemption.

b) Section 4(a)(3) exemption: "Transactions by a dealer (but not in the capacity of an underwriter), so long as the transactions"

(i) do not take place within 40 days after the initial public offering of the security by the issuer or an underwriter, or

(ii) do not take place within 40 days after the effective date of a registration statement, or

(iii) do not involve an unsold subscription or allotment to such dealer in connection with the distribution of the securities by the issuer or an underwriter. To qualify for this exemption, investment bankers must avoid activities that will cause them to be *"underwriters"* within the meaning of Section 2(a)(11) of the 1933 Act. *(SEC Rules 144 and 144A provide safe harbors in this regard.)*

c) Rule 144: If the requirements of Rule 144 are satisfied, the seller of the securities (not including the issuer) will not be deemed to be engaged in the "distribution" of the securities, and thus is not deemed to be an "underwriter." *Rule 144(b).* Rule 144 requires that the issuer make certain information publicly available *(Rule 144 (c)(2))* and that investors generally hold the securities for at least one year *(Rule 144(b)(1))*, among other requirements.

d) Rule 144A: The result is the same under Rule 144A—*i.e.*, the resale of securities by an investment banker (or other person) will not cause the investment banker to be an *"underwriter."* However, the requirements of Rule 144A are more lenient than those of Rule 144.

(i) Rule 144A involves the sale of securities only to qualified institutional buyers ("*QIBs*") by persons other than the issuer. *(Rule 144A(d)(1)).*

(ii) Most QIBs will qualify as "accredited investors" under Section 2(a)(15) of the 1933 Act and Rule 215 (17 CFR § 230.215), but not all accredited investors will qualify as QIBs.

(iii) The seller of the securities is allowed to rely on a certificate from the purchaser, among other things, to determine whether the purchaser is a QIB. *(Rule 144A(d)(1)(iv)).*

(iv) The seller must notify the purchaser that the seller is relying on Rule 144A for an exemption from Section 5 of the 1933 Act. *(Rule 144A(d)(2)).*

(v) Continuing disclosure requirement: the holder and the prospective purchaser of the securities must have the right to obtain from the issuer by the time of any sale or resale: (W) a brief statement of the nature of the issuer's business and the products and services it offers, which statement shall be as of a date within 12 months prior to the date of resale; (X) the issuer's most recent balance sheet, which must be dated not more than 6 months before the date of resale (if such balance sheet is not as of a date less than 6 months before the date of resale, it must be accompanied by additional statements of profit and loss and retained earnings from the date of such balance sheet to a date not less than 6 months before the date of resale); (Y) the issuer's most recent profit and loss and retained earnings statement, which must be for the 12 months preceding the date of such balance sheet; and (Z) similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation. *(Rule 144A(d)(4))*.

3. <u>Certain Real Estate Secured Debt</u>. Section 4(a)(5) exempts first mortgage notes for residential or commercial development originated by financial institutions. A $250,000 minimum applies and purchaser must buy for its own account.

## III. FEDERAL SECURITIES LAWS -- TRUST INDENTURE ACT OF 1939, *15 USC § 77aaa et seq.*

A. The Trust Indenture Act applies specifically to notes, bonds, other evidences of indebtedness, certificates of participation in such instruments, and guarantees of debt instruments *(Trust Indenture Act, §***304***(a)(1))*, and generally requires that any "indenture" under which securities are issued be qualified by the SEC. *(Trust Indenture Act, §§305 & 306)*. The term *"indenture"* is broadly defined to include indentures, mortgages, deeds of trust and similar instruments under which debt instruments are issued. Accordingly, bond ordinances and bond resolutions are potentially subject to the indenture qualification requirements.

B. As is the case with the registration requirements of the 1933 Act, certain securities and **transactions** are exempt from the indenture qualification requirements of the Trust Indenture Act. These include:

   1. Any security exempted from the provisions of the 1933 Act by means of Sections 3(a)(2) through (8), 3(a)(11) or 3(a)(13) of the 1933 Act. These securities are exempted from the Trust Indenture Act in its entirety.

   2. Securities issued under an indenture that limits the aggregate principal amount of such securities to $10 million. These securities are exempted from the Trust Indenture Act in its entirety.

   3. Securities issued in a transaction that is exempted from the requirements of Section 5 of the 1933 Act by Section 4 of the 1933 Act. These securities are exempted only from the indenture qualification requirements of the Trust Indenture Act.

## IV. FEDERAL SECURITIES LAWS -- THE ANTI-FRAUD PROVISIONS AND CIVIL REMEDIES.

A. **Overview of Statutory and Regulatory Bases for Liability.**

   1. Pursuant to amendments adopted in 1975 (the "*1975 Amendments*") to the 1933 Act and the Securities Exchange Act of 1934 (the *"1934 Act"*), Congress enacted a limited regulatory scheme for municipal securities by requiring certain firms transacting business in municipal securities and banks to register with the SEC as broker-dealers and municipal securities dealers, respectively. The 1975 Amendments also created the Municipal

Securities Rulemaking Board (the "*MSRB*"), a self-regulatory organization subject to SEC oversight that is authorized, as expanded by the Dodd-Frank Act, to adopt rules regulating the sale of municipal securities, as discussed below.

2. The 1975 Amendments did not give the SEC the authority to directly regulate municipal securities issuers and certain provisions of the 1975 Amendments (the "*Tower* Amendment") prohibit the SEC from directly or indirectly requiring municipal issuers to file documents or preregister prior to the sale of their securities. As a result, the SEC has largely relied on its express authority to regulate broker-dealers and municipal securities dealers, its oversight of the MSRB, and its enforcement authority under the antifraud provisions of the 1933 Act and the 1934 Act as its regulatory tools. These antifraud provisions essentially:

   a) Require disclosure of material information about securities to allow investors to make informed decisions.

   b) Prohibit misrepresentation or other fraudulent conduct in connection with the purchase and sale of securities.

B. **Anti-Fraud Rules – Source and Resources.**

1. The anti-fraud rules for purposes of federal securities laws include Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act. Both are discussed in detail below. Note that state anti-fraud laws may also apply.

2. A key distinction between a violation of Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act is intent.

3. See SEC Interpretation: Use of Electronic Media, Securities Act Release No. 7856, Securities Exchange Act Release No. 42,728 (Apr. 28, 2000). See also Office of Municipal Securities' "Application of Antifraud Provisions to Public Statements of Issuers and Obligated Persons of Municipal Securities in the Secondary Market: Staff Legal Bulletin No. 21 (OMS)" released February 7, 2020, available at https://www.sec.gov/municipal/application-antifraud-provisions-staff-legal-bulletin-21#_edn12.

4. Other resources:

   a) The Function and Professional Responsibility of Bond Counsel (2011, Third Edition), available at: https://www.nabl.org/wp-content/uploads/2023/02/20111031-NABL-Report-Roles-of-Bond-Counsel.pdf.

   b) An Update: Crafting Disclosure Policies (2021), available at https://www.nabl.org/wp-content/uploads/2023/02/20210125-NABL-Update-Report_Crafting-Disclosure-Policies.pdf.

C. **Section 17(a) of the 1933 Act, *15 USC § 77q*.**

1. It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly to:

   a) employ any device, scheme or artifice to defraud, or

   b) obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

   c) engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

2. Negligence is sufficient to establish a violation of Section 17(a)(2) of the 1933 Act. No finding of scienter (intent) is required. Negligence may be established by showing that the individual should have known or failed to conform to industry standards. Only the SEC can bring an action under Section 17(a).

D. **Section 10(b) of the 1934 Act, *15 USC § 78j* and Rule 10b-5, *17 CFR § 240.10b-5***

1. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, mails, or facilities of national securities exchange, in connection with the purchase or sale of any security, to:

   a) Employ any device, scheme or artifice to defraud;

   b) Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

   c) Engage in an act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

2. Rule 10b-5 requires scienter (a mental state embracing intent to deceive, manipulate or defraud), which may be established by a showing of recklessness. Recklessness is highly unreasonable conduct that is an extreme departure from the standards of ordinary care. Specific danger need not be known to the individual in question, but the danger must at least be so obvious that any reasonable person would have known of it.

3. Courts recognize private causes of action under Rule 10b-5. Both buyers and sellers are protected by Section 10(b) and Rule 10b-5. Liability can apply to various parties in transaction, including bond counsel or underwriters' counsel, but not based on causes of action for aiding and abetting.

4. Elements for a 10(b) claim - similar to traditional elements of common law fraud (elements listed in (a) - (f) below are discussed in detail in subparagraphs (7) - (12) below):

   a) Misstatement or omission.

b) Material fact (cf. opinion, projections).

c) Scienter (intent to deceive, manipulate or defraud plaintiff).

d) Reliance.

e) Proximate cause of damages.

f) Damages.

5. "Buyer or seller" rule establishes certain jurisdictional requirements for a cause of action (standing; plaintiff must be actual buyer or seller at time fraud occurred).

6. "In connection with" rule (misrepresentation or omission must occur in connection with the purchase or sale of security).

7. Element 1 - Misstatement or omission.

   a) With respect to omissions, see Backman v. Polaroid, 910 F. 2d 10 (1st Cir. 1990) - Rule 10b-5 does not mean that "by revealing one fact about a product, one must reveal all others that, too, would be interesting market wise, but means only such others, if any, that are needed so that what was revealed would not be 'so incomplete as to mislead'." Concept of duty to disclose (this duty concept is relevant to secondary market disclosure discussion).

8. Element 2 - Materiality ("facts and circumstances").

   a) TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976), "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would [not might] consider it important in deciding how to vote." TSC Industries, Inc., 426 U.S. at 449.

      (i) "There must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." TSC Industries, Inc., 426 U.S. at 449.

      (ii) Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (adopted TSC) materiality depends upon balancing of both indicated probability that event will occur and anticipated magnitude of event in light of totality of company facts; materiality depends on significance a reasonable investor would place on withheld or misrepresented information.

   b) Applies to certain opinions or projections, as well as facts.

9. Element 3 - Scienter - Supreme Court requires actual mental state embracing intent to deceive, manipulate or defraud rather than simple negligence (Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1975)).

a) Recklessness may substitute for actual intent - issue left open in Hochfelder but applied by circuit courts considering the issue.

(i) Reckless conduct involves more than simple or inexcusable negligence - requires extreme departure from standards of ordinary care.

(ii) Standard of proof is clear and convincing evidence rather than preponderance of the evidence.

10. Element 4 - Reliance (used as means of establishing causal connection between defendant's misrepresentation or omission and plaintiff's injury).

a) In cases of misstatements, plaintiff must have (i) actual knowledge of misstatement and (ii) belief in truth of the misstatement; misstatement must have been a cause of plaintiff's entering the transaction. But see "Fraud on the Market" and "Fraud Created the Market" theories below which avoid showing of reliance.

b) In cases of omission, reliance is presumed from showing of materiality (Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) presumption).

c) "Fraud on Market" Theory - no need for proof of actual reliance; with proper disclosure, security could not have been sold at any price; theory extends presumption of reliance to cases of affirmative misrepresentation by allowing presumption of reliance on market price and the market itself to substitute for proof of reliance; case law has developed from cases involving open, developed markets to new issuances in undeveloped markets (see Fraud Created the Market, below); now some retrenchment in theory. (Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), cert denied, 429 U.S. 816 (1976); Basic v. Levinson 485 U.S. 224; Stinson v. Van Valley Dev. Corp., 714 F. Supp. 132 (E.D. Pa. 1989, and 719 F. Supp. 362 (E.D. Pa. 1989); Freeman v. Laventhol & Horwath., 915 F.2d 193 (2d. Cir. 1990)).

d) "Fraud Created the Market" Theory – no need for proof of actual reliance; extension of "fraud on the market" theory to situations of newly issued securities on underdeveloped markets (where plaintiff has not read disclosure document) (Shores v. Sklar, 647 F. 2d 462 (5th Cir. 1981); Ross v. BankSouth, N.A., 885 F. 2d 723 (11th Cir. 1989) (economic unmarketability) and Abell v. Potomac Insurance Company, 858 F. 2d 1104 (5th Cir. 1988) (factual unmarketability)). Theory limited to two lines of cases: (1) situations where security is economically unmarketable because it's valueless, or (2) situations where security, whether or not it has economic value, was subject to a scheme so fraudulent and pervasive as to render it unmarketable.

11. Element 5 – Causation.

a) Plaintiff must show that the misstatement or omission was in some reasonably direct or proximate way responsible for loss.

b) Without causation, Rule l0b-5 serves as an insurance policy.

c) Courts do not always apply element.

12. Element 6 – Damages.

a) At common law, seller's remedy is a recission - may be problem if property has depreciated in value.

b) At common law, buyer's remedy is damages.

c) Theories of damages.

(i) Benefit of the bargain (value of what would have been received if misrepresentation were true vs. actual value of what plaintiff received).

(ii) Out-of-pocket loss (traditional for Rule l0b-5: fair market value given less fair market value of what was received).

(iii)Problem of dates on which to measure damages.

d) Section 12(2) (generally inapplicable to municipal securities) permits recission.

13. Statute of Limitations.

a) Federal court applies either state, common law fraud or Blue Sky law limitations.

b) Lampf Case (Lampf v. Gilbertson, 501 U.S. 350) - established uniform statute of limitations for federal securities fraud actions (one year from discovery of violation or three years after sale); decision applied retroactively.

## V. FEDERAL SECURITIES LAWS -- COMMON LAW CAUSES OF ACTION

A. Fraud and deceit - action for money damages.

B. Rescission (for use by buyer (restitution) or seller (breach of contract))

1. Elements

2. Equitable Defenses

## VI. FEDERAL SECURITIES LAWS -- RULE 15c2-12, *17 CFR § 240.15c2-12.*

Rule 15c2-12 (the *"Rule"*) was promulgated in 1989 and originally covered only matters related to primary offerings of municipal securities. The Rule is not an antifraud rule; rather, it is a procedural rule intended to provide better information to investors in the primary and secondary markets. The Rule was amended in 1994 to add the continuing disclosure provisions discussed below, and further amended in 2008, 2010 and 2018 to modify certain of the continuing disclosure provisions of the Rule.

A. **Applicability**. Brokers, dealers and municipal securities dealers *("Participating Underwriters")* involved in a primary offering of municipal securities in a principal amount greater than $1 million *("*Offering*")* must comply with the requirements of the Rule or must be exempt from the requirements of the Rule before acting as an underwriter in such an Offering. Initial step is to determine whether the Rule applies to a particular offering. *(Rule 15c2-12(a))*.

1. *Primary offering* is defined by the Rule (at *15c2-12(f)(7))* to be an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities. Primary offering specifically includes a remarketing of municipal securities if such remarketing involves (a) a change in authorized denomination from $100,000 or more to less than $100,000 or (b) a change in the period of tender for redemption or purchase from a period of nine months or less to a period of more than nine months. Other remarketings would also be included unless specifically exempt under the Rule.

2. Exemptions from the Rule.

    a) <u>Limited placement exemption</u>. The Rule does not apply to municipal securities in authorized denominations of $100,000 or more which are sold to no more than 35 knowledgeable and experienced investors who are not purchasing with a view to distributing the securities. *(Rule 15c2-12(d)(1)(i))*.

    b) <u>Short-term debt exemption</u>. Prior to the 2010 amendments to the Rule, the Rule did not apply to the primary offering of municipal securities in authorized denominations of $100,000 or more and (i) that which had a maturity of nine months or less <u>or</u> (ii) that could be tendered at option of the holder for redemption or purchase at least every nine months. Effective December 1, 2010, although securities that can be tendered at option of the holder for redemption or purchase at least every nine months remain exempt from the primary offering provisions of the Rule, these securities are subject to the continuing disclosure provisions of the Rule. *(Rule 15c2-12(d)(1) and (5))*.

    c) <u>Limited exemption from continuing disclosure requirements</u>. Prior to the 2008 amendments to the Rule, the Rule did not apply to any Obligated Person (defined at *15c2-12(f)(10))* who, at the time of the issue, would be an Obligated Person with respect to less than $10 million of outstanding municipal securities. Amendment to the Rule. Effective July 1, 2009, an Obligated Person that has $10 million or less in outstanding securities is subject to the events notice requirements and is required to provide financial information and operating data that is "customarily prepared by such obligated person and is publicly available." Financial information and operating data are required to be submitted on at least an annual basis.

        (i) Includes current offering.

        (ii) Excludes offerings exempt under existing provisions of the Rule relating to limited offerings and short-term securities.

        (iii) Includes offerings under $1 million unless otherwise exempt from the Rule.

d) Limited exemption from annual reporting requirements. None of the Rule *requirements* except event disclosure undertakings apply to offerings of municipal securities having a stated maturity of 18 months or less. *(Rule 15c2-12(d)(3)).*

e) Obtain and review "deemed final" official statement ("DFOS"). The Participating Underwriter must obtain and review an official statement "deemed final" by an issuer of municipal securities (with certain permitted omissions) prior to bidding for, purchasing, offering or selling such municipal securities. *(Rule 15c2-12(b)(1)).*

3. *Issuer of municipal securities* is defined by the Rule (at *15c2-12(f)(4))* to be the governmental issuer and the issuer of any separate security, such as a conduit borrower.

4. Official statement must be "deemed final" by the issuer prior to offering the securities, i.e., before a purchase contract would ordinarily be executed. However, the Rule does not require that the official statement be "deemed final" by such an Issuer in writing. Often the bond purchase agreement or authorizing document contains a representation deeming the preliminary official statement (the *"POS"*) final.

5. The following are permitted omissions: the offering price(s), interest rate(s), selling compensation, aggregate principal amount, principal amount per maturity, delivery dates, any other terms or provisions required to be specified in a competitive bid, ratings, other terms of the securities depending on such matters, and the identity of the underwriter(s). This is information determined at pricing and therefore is not known at the time the POS or other document(s) are deemed final.

   a) Redemption *terms* are not specified but may be considered terms dependent on offering price and therefore a permitted omission.

   b) Similarly, the use of proceeds information may be dependent on the aggregate principal amount of the offering and omitted.

   c) Credit enhancement information.

6. A combination of documents may qualify as a "deemed final" official statement. If material changes are made in a financing after the POS is printed but prior to pricing, the POS will not be an adequate document to serve as the deemed final official statement and will need to be supplemented.

7. The Participating Underwriter must not only obtain a "deemed final" official statement but must also review it in a professional manner in both a negotiated offering and competitive bid situation. By participating in an underwriting, an underwriter makes an implied recommendation about the securities sold in the offering and implies that it has a reasonable basis for believing in the accuracy and completeness of key representations made in the disclosure documents. *(See SEC Rel. No. 34-26100 (September 22, 1988), SEC Rel. No. 34-26985 (June 28, 1989) and SEC Rel. No. 34-33741 (March 9, 1994) (the "Interpretive Release").*

B. **Dissemination to potential customers**. Except in competitively bid offerings, from the time the issuer selects the Participating Underwriter until a final official statement is available, the Participating Underwriter is required to send, no later than the next business day, a copy of the most recent preliminary official statement, if any, to any potential customer on request. From the time the final official statement becomes available until the earlier of (1) 90 days from the end of the underwriting period, or (2) the time when the final official statement is available from the MSRB, but in no case less than 25 days following the end of the underwriting period, the Participating Underwriter is required to provide the final official statement to any potential customer on request. *(Rule 15c2-12(b)(2) and (b)(4)).* "End of the underwriting period" means the later of such time as (i) the issuer delivers the securities to the Participating Underwriters or (ii) the Participating Underwriter does not retain, directly or as a member or an underwriting syndicate, an unsold balance of the securities for sale to the public. *(Rule 15c2-12(f)(2).*

C. **Contract to receive final official statement.** The Participating Underwriter is required to contract with an issuer (or an agent thereof such as a financial printer) to receive within 7 business days after a final agreement to purchase, offer or sell municipal securities (ordinarily, a bond purchase agreement in a negotiated offering and an "award" pursuant to a notice of sale for a competitive offering) and within sufficient time to accompany confirmations to customers, copies of a final official statement in sufficient quantities to meet requests and MSRB rule requirements (such as MSRB Rules G-15 and G-32, requiring delivery of information). This is an important rule for underwriter's counsel in coordinating printing and delivery of the final official statement. Delivery may need to be sooner than seven business days if the closing is earlier than seven business days from pricing. *(Rule 15c2-12(b)(3)).*

D. **What is a final official statement?**

1. *Final official statement* is defined by the Rule (at *15c2-12(f)(3))* as "a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete... and that sets forth... information, including financial information or operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts and other persons material to an evaluation of the Offering..."

   a) The parties determine whose financial information is material to the Offering and the form and content of such information to be included. *(SEC Rel. No. 34-34961, November 10, 1994, the "Adopting Release," at fn. 32).*

   b) The definition of final official statement allows information to be included by specific reference to documents previously made "publicly available." Documents are considered publicly available only if submitted to the MSRB (see VI., F., 5, below) or, if concerning a reporting company, filed with the SEC, and if a final official statement, must be available from the MSRB. *(Adopting Release at fn. 47).*

   c) Final official statement includes all information and documents that have been cross referenced. *(Adopting Release at fn. 45).*

   d) Commission encourages use of voluntary guidelines and Interpretive Release in preparing disclosure documents. *(Adopting Release at fn. 35).*

E. **Determine that satisfactory continuing disclosure commitment has been made**. Participating Underwriters must have reasonably determined that an issuer of municipal securities and/or an Obligated Person for whom financial or operating data is presented in the final official statement has undertaken in writing for the benefit of the bondholders to provide certain required information. The undertaking is often in the form of a Continuing Disclosure Agreement from all Obligated Persons and may be an agreement with a dissemination agent. *(Rule 15c2-l2(b)(5))*.

1. The undertaking must encompass ongoing information about issuers and/or other *"Obligated* Persons*"* for whom financial information is provided in the final official statement.

2. *Obligated Person* is defined by the Rule to be 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 in the Offering (other than bond insurers, letters of credit or liquidity providers).

   a) Nexus to the financing is through a contractual commitment or other arrangement that is structured to support payment of all or part of the obligations on the municipal securities, whether or not enforceable by bondholders. *(Adopting Release at fn. 69).*

   b) Persons that are the source of cashflow, but have no relationship to the financing, are not included. *(Adopting Release at fn. 70).*

   c) The phrase "obligations on the municipal securities" in the definition is intended to encompass debt obligations, lease payments and any other repayment obligation on or resulting from the municipal securities. *(Adopting Release at fn. 72).*

   d) The definition includes, but is broader than, the concept of issuers of separate securities under Rule 131 pursuant to the 1933 Act. *(Adopting Release at fn. 73).*

   e) The definition does not include a specified percentage of payment. The issuer and other participants are to determine, at the time of preparing the final *official* statement, which Obligated Persons (by name or objective criteria) are material to an Offering. *(Adopting Release No. at fn. 78). (See American Bar Association, March 15, 1996 [referred to as the "ABA Letter"] for a discussion of pooled financings).*

   f) Bond insurers, letter of credit providers and other liquidity facility providers are excluded from the definition of Obligated Person to avoid the burden on issuers to obtain information about such providers and on the basis of *representations* that such providers will deposit publicly available reports which may be easily obtained. *(Adopting Release at fn 82). (See National Association of Bond Lawyers,* June 23, 1995 [referred to as "NABL I"], *Question 22 and National Association of Bond Lawyers, September 19, 1995 [referred to as "NABL II"], Question 9).*

3. Scope of Required Information. The information required to be disclosed to the market through the undertaking includes certain annual financial information, audited financial statements and material events notices. *(Rule 15c2-12)(b)(5)(i)).*

   a) Annual financial information.

      (i) Annual financial information must be provided (X) for each Obligated Person for whom financial information is presented in the final official statement or (Y) for each Obligated Person meeting the objective criteria specified in the undertaking. Undertaking must identify these people. *(Rule 15c2-12(b)(5)(i)(A)).*

      (ii) *Annual financial information* is defined by the Rule (at *15c2-12(f)(9))* to mean financial information or operating data, provided annually, of the type included in the final official statement with respect to the affected Obligated Person. The undertaking must specify in reasonable detail this information and specify the date by which and to whom the information will be delivered. *Rule 15c2-12(b)(5)(ii)).*

      (iii) The Rule does not specify the reporting format or content of such annual report. Content is determined at time of preparing the final official statement and annual information must be of the same type. The final official statement serves as a baseline for continuing information. Nevertheless, the Adopting Release cautions that "[t]he fact that the amendments rely on the final official statement to set the standard for ongoing disclosure should not serve as an incentive for issuers to reduce existing disclosure practices in the preparation of the final official statement." *(Adopting Release at fn. 34).*

      (iv) Reference may be made to other information already submitted to the MSRB or the SEC, including other final official statements. *(Adopting Release at fn. 44). (See NABL 1, Question 7; NABL II, Question 8).*

      (v) The Adopting Release emphasizes the intended quantitative nature of the information. *(Adopting Release at fn. 111).*

      (vi) Reference should be made to applicable industry guidelines for determining operating data to be provided initially and on an ongoing basis. *(Adopting Release at fn. 111).*

      (vii) Changing conditions. Issuers and Obligated Persons cannot *unilaterally* determine that certain types of information are no longer necessary or meaningful to investors. *(Adopting Release at fn. 111).* However, persons about which information is provided may be adjusted to the extent they are identified by objective criteria and information need not be provided about persons that are no longer Obligated Persons with respect to the securities. *(See NABL 1, Questions 15 and 16).*

   b) Audited financial statements.

(i) If not otherwise submitted as part of the annual financial information, audited financial statements for each Obligated Person are required to be disseminated only when and if otherwise available. *(Rule 15c2-12(b)(5)(i)(B) (But see NABL II, Question 11).* Recommended "best practice" is that audited financial statements should be made available to interested parties within six months of the issuer's fiscal year end.

(ii) The Release states that "it is anticipated that full financial statements will be provided for entities with ongoing revenues and operating expenses." *(Adopting Release at fn. 104) (See NABL I, Question 6).*

(iii) The Rule does not mandate any specific use of either GAAP or GAAS. Undertaking must identify in reasonable detail to accounting principles to be used. *(Adopting Release at fn. 105).*

c) <u>Event notices.</u>

(i) Prior to December 1, 2010, the Rule at (b)(5)(i)(C) required an undertaking to require an issuer or Obligated Person to provide "timely" notice of eleven events, if "material."

(ii) Effective December 1, 2010 (*see SEC Rel. No. 34–62184A, May 26, 2010, "Adopting Release II")*, the Rule at (b)(5)(i)(C) was amended to require an undertaking to require an issuer or Obligated Person to provide notice of the following fourteen events within 10 business days of the occurrence of the event:

(1) Principal and interest payment delinquencies;

(2) Non-payment related defaults, if material;

(3) Unscheduled draws on debt service reserves reflecting financial difficulties;

(4) Unscheduled draws on credit enhancements reflecting financial difficulties;

(5) Substitution of credit or liquidity providers, or their failure to perform *(see NABL II, Question 3)*;

(6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security;

(7) Modifications to rights of security holders, if material;

(8) Bond calls, if material, and tender offers *(see NABL I,* Question *8 and NABL II, Question 10)*;

(9) Defeasances;

(10) Release, substitution, or sale of property securing repayment of the securities, if material;

(11) Rating changes *(see NABL I, Question 9)*;

(12) Bankruptcy, insolvency, receivership or similar event of the obligated person;

(13) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and

(14) Appointment of a successor or additional trustee or the change of name of a trustee, if material.

d) <u>2018/2019 Rule Amendments.</u>

(i) On August 20, 2018 (*see SEC Rel. No. 34–83885; File No. S7-01-17, August 20, 2018, "Adopting Release")*, the SEC announced that the Rule at (b)(5)(i)(C) now requires an undertaking to require an Issuer or Obligated Person to provide notice with the MSRB's EMMA system of two new events in addition to the above-referenced fourteen events, within 10 business days of the occurrence of the event:

(1) New Event 15 - Incurrence of a "financial obligation" of the Issuer or Obligated Person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a "financial obligation" of the Issuer or Obligated Person, any of which affect security holders, if material; and

(2) New Event 16 - a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of the "financial obligation" of the issuer or Obligated Person, any of which reflect financial difficulties.

(ii) The Compliance Date was February 27, 2019 (180 days from the date of publication in the Federal Register). Any Continuing Disclosure Agreement executed on or after the Compliance Date must have the two new events. The new Rule amendments do not apply retroactively to issuers' existing obligations under prior agreements. Therefore, the two new events, do <u>not</u> have to be included in Continuing Disclosure Agreements that predate the Compliance Date.

(iii) The Rule, as amended, includes a definition of "financial obligation," which is needed in order to implement new events (15) and (16). A "Financial Obligation" means a (i) debt obligation; (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) guarantee of (i) or (ii). The term "Financial Obligation" will not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with the Rule.

(iv) New Rule 15 – Regarding Materiality in New Event 15, the SEC maintains the position that "materiality determinations should be based on whether the information would be important to the total mix of information made available to the reasonable investor." In the Rule amendments, the SEC affirms the materiality standard of the Northway decision.

(v) New Event 16 – Does not use the materiality standard. The controlling factor is that the event "reflects financial difficulties."

(1) SEC Guidance: In the Adopting Release, the SEC rejected suggestions to provide additional guidance or narrow the term "financial difficulties", stating it "believes that the term is not vague, as the concept of 'reflecting financial difficulties' has been used in paragraphs (b)(5)(i)(C)(3) [unscheduled draws on debt service reserves reflecting financial difficulties] and (4) [unscheduled draws on credit enhancements reflecting financial difficulties] since the 1994 amendments to Rule 15c2-12, and, as such, market participants should be familiar with the concept as it relates to the operation of Rule 15c2-12."

(2) Default - The Adopting Release also rejects defining "default" as a formal "event of default" as the SEC "believes that there are defaults that may reflect financial difficulties even if they do not qualify as 'events of default' under transaction documents." (*see* 83 FR 44715)

e) Additional information. Information in addition to that specified in the undertaking may need to be disclosed to the secondary market to make the disclosure complete and satisfy antifraud provisions of the federal securities laws. *(Adopting Release at fn. 112)*.

f) A final official statement must also disclose the specifics of the undertakings required by the Rule. At a minimum, the description of the undertaking must inform market participants of the identity of entities about which information will be provided and the type of information to be provided. *(Rule 15c2-12(f)(3))*.

g) The final official statement must disclose any instances in the previous five years in which an Obligated Person covered by the continuing disclosure undertaking has failed to comply, in all material respects, with any previous undertaking or agreement in a written contract or agreement to provide continuing disclosure. *(Rule 15c2-12(f)(3))*. As underwriter's or disclosure counsel it may be part of your scope of engagement to check the Electronic Municipal Market Access system (*"EMMA"*) (see VI., F., 5, below) to see if any required filings have been made on a timely basis.

(i) A Participating Underwriter is not prohibited from underwriting an offering in which an issuer or Obligated Person has failed to comply with previous undertakings. *(Adopting Release at fn. 53)*.

(ii) If failure to comply has not been remedied, however, or if there is a history of *"persistent and material breaches,"* the Participating Underwriter probably cannot form a reasonable basis for relying on the accuracy of the ongoing disclosure representations of such issuer or Obligated Person. *(Adopting Release at fn. 53 and Adopting Release II at fn. 350)*.

4. Reasonable Determination.

a) A *"reasonable determination"* that a qualified continuing disclosure undertaking has been made must be made by the Participating Underwriter prior to purchasing or selling municipal securities in connection with an Offering. *(Rule 15c2-12 (b)(5)(i))*.

(i) A Participating Underwriter needs to receive assurances from the issuer or Obligated Persons in a purchase agreement, notice of sale or otherwise that the undertakings to be made in the indenture, bond resolution or elsewhere would be made before agreeing to act as an underwriter. *(Adopting Release at fn. 22)*.

(ii) Participating Underwriters will review the "deemed final" official statement with a view to ascertaining that it contains, among other things, certain specifics of the continuing disclosure undertakings as required by the definition of final official statement. *(Adopting Release at fn. 27)*.

5. Deposit and Dissemination of Information.

a) Past Practices. Prior to 2008, ongoing disclosure filings were submitted to each Nationally Recognized Municipal Securities Information Repository *("NRMSIR")*, and the appropriate state information depository *("SID")* if an "appropriate" SID has been established in the applicable state. The SEC briefly approved the use of the "Central Post Office" (created by the Municipal Advisory Council of Texas), an electronic filing system whereby issuers and Obligated Persons could make filings electronically at www.DisclosureUSA.org, free of charge. Once a transmission was made to the Central Post Office, the Central Post Office transmitted the information to the NRMSIRs and applicable SIDs.

b) Current Practice: Electronic Municipal Market Access (*"EMMA"*)

(i) In 2008, the SEC amended the Rule to require issuers and Obligated Persons to submit annual financial information and any material event notices in an electronic format to the MRSB through its web-based system known as Electronic Municipal Market Access, or "EMMA." The amendment affects all filings made after July 1, 2009, including filings made pursuant to undertakings entered into before July 1, 2009. *(See www.emma.msrb.org)*

(ii) Effective July 1, 2009, in a separate action in conjunction with its amendment of the Rule, the SEC:

(1) designated the MSRB as the sole NRMSIR for bonds issued prior to July 1, 2009, and

(2) revoked its "no action" letters that designated the four then current NRMSIRs and approved DisclosureUSA as a means for filing with those NRMSIRs.

(iii) Submissions to EMMA had to be filed in portable document format or "PDF." Beginning January 1, 2010, documents were required to be filed in word-searchable PDF.

c) Dissemination Agents. Dissemination responsibilities may be delegated by the issuer/obligated party to designated agents. Some issuers also use their own trustee or financial advisor as dissemination agent. *(Adopting* Release *at fn. 87). See also SEC No-Action Letter, dated September 21, 2011 re: Digital Assurance Certification, LLC ("DAC").* For a fee, a dissemination agent typically collects and compiles an issuer's annual financial information and files it, along with audited financial statements, with EMMA. In addition, a dissemination agent reviews an issuer's compliance with the filing of Event Notices. Using a dissemination agent is not mandatory.

d) Disclosure of Information Not Specifically Enumerated in the Rule. Issuers/obligated persons may undertake to file information in addition to what the Rule specifically requires to be in an undertaking. This may consist of reporting annual financial information on a more frequent than annual basis, or non-financial information for ESG (Environmental, Social or Governmental) bonds. If an issuer/obligated person fails to comply with such obligations, this could be considered a "failure to comply with a previous undertaking or agreement in a written contract or agreement." See Part VI.E.3.g above.

e) Selective Disclosure; Liability concerns with selective disclosure. Selective disclosure regulations of the SEC, known as "Regulation FD" or "Regulation Fair Disclosure," do not apply to municipal issuers directly. Regulation FD requires "that when an issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it must make public disclosure of that information." (*see SEC, Rule FD, Selective Disclosure and Insider Trading, Release Nos. 33-7881, 34-43154, IC-24599, File No. S7-31-99, 17 CFR Parts 240, 243, and 249*)).

## VII. FEDERAL SECURITIES LAWS - - SEC ENFORCEMENT.

### A. The Process

1. Investigations

a) Enforcement actions are generally preceded by an investigation; may be formal or informal.

b) Formal investigation requires entry of an order by the SEC directing its staff to conduct inquiry (authorizes the staff to issue subpoenas and administer oaths).

c) Informal investigation can be initiated by the SEC staff without specific authorization.

2. Enforcement Actions - At the end of the investigation, staff at the SEC may recommend an enforcement action (staff is not required to inform a person that an investigation is over and no enforcement action will be brought).

a) Administrative Proceedings – The SEC has power to initiate an administrative proceeding before an administrative law judge. A party can consent to the entering of a proceeding without admitting or denying the charges contained therein.

(i) If the target is a person subject to registration or regulation by the SEC (e.g., broker-dealer), the SEC may impose monetary penalties, remedial sanctions, a temporary cease-and-desist order or a permanent cease-and-desist order.

(ii) For any other person, the SEC may impose a permanent cease-and-desist order.

(iii)The SEC can also order an accounting and disgorgement of profits obtained illegally in either case.

b) Civil proceeding in federal district court.

c) Criminal referral to the Department of Justice.

d) Referral to other federal, state or self-regulatory authorities.

e) Deliver a "21(a) Report" - Issuance of a report on an investigation based on the statutory authority under Section 21(a) of the 1934 Act to issue such a report. Allows the SEC to make statements without bringing an action. As a practical matter, always done with the consent of the parties involved.

B. **SEC Enforcement Activity**.

1. Increasing Emphasis on Municipal Securities Offerings.

a) Enforcement activity generally is based on broad antifraud provisions of securities laws; therefore, cases are driven by facts and circumstances. Chapter 3 of *Disclosure Roles of Counsel* (3rd ed. 2009) summarizes many of these enforcement actions. See American Bar Ass'n, Disclosure Roles of Counsel in State and Local Government Securities Offerings (3rd ed. 2009) (from a project sponsored by NABL and the American Bar Ass'n).

b) The SEC authority over broker-dealers (investment bankers) is broad, but is limited as to other parties. As to lawyers, issuers and independent financial advisors, the SEC's enforcement powers are limited to the antifraud provisions of the securities laws (primarily Section 10(b) of the 1934 Act and 17(a) of the 1933 Act). Some believe that the SEC tries to fit a wide range of actions under these provisions, as it is the only authority for action.

c) New York City: SEC Staff Reports. (1977; 1979). The SEC broadly addressed the municipal securities market in connection with the financial crisis in New York City in the mid-1970s. This was the first significant promulgation from the SEC in recent history with respect to a specific municipal situation. The SEC staff issued a report in 1977 concerning transactions in securities issued by New York City and then issued its final report in 1979.

(i) The two stated objectives of the report, which lay the groundwork work for much of the enforcement activity that the SEC has undertaken in the past 15 years, were:

(1) To determine the nature and extent of the knowledge of City officials, underwriters, and bond counsel with respect to the steadily worsening financial condition of the City.

(2) To compare the knowledge of these parties to the disclosures made to the public.

(ii) The report states that "Although municipalities have certain unique attributes by virtue of their political nature, insofar as they are issuers of securities, they are subject to the proscription against false and misleading statements."

(iii) The report concluded that the City had employed budgetary, accounting and financing practices which distorted its true financial condition and that investors in its securities did not receive the protections of the federal securities laws. The report also concluded that, in varying degrees, the participants in the underwriting process, including the principal underwriters, bond counsel and the rating agencies, failed to meet their responsibilities to the investing public.

(iv) The report found that there appears to be no clear understanding that the underwriter should make a reasonable investigation to assure the accuracy of the information disclosed. There also is no clear separation or statement of the functions of issuers' and underwriters' counsel.

(v) The SEC determined not to take any enforcement action against New York City or the professionals.

d) Washington Public Power Supply System (*"WPPSS"*): SEC Staff Report (1988). Eleven years after the New York City Report, the SEC staff issued a report regarding its investigation of WPPSS.

(i) The report focused on three issues:

(1) Developments during the sale of bonds relating to costs, financing, power demand and participant support.

(2) Marketing of the bonds during the same period, including the roles of the underwriters, the rating agencies and unit investment trusts.

(3) The extent to which WPPSS counsel recognized and disclosed legal problems relating to the validity of those agreements.

(ii) The SEC closed its investigation without initiating enforcement action in part, because the matter "reflects systematic characteristics of the regulatory framework for municipal securities that might be addressed more appropriately by regulatory or legislative initiatives."

(iii) On the same day, the SEC published a release on the regulation of the municipal securities market and proposed Rule 15c2-12.

2. Key Factors Examined by SEC in Recent Enforcement Cases.

a) Responsibilities under federal securities laws by issuer officials that authorize disclosure documents.

b) Degree and manner in which issuer officials rely on staff, third-party experts and attorneys in the drafting and review of disclosure documents.

c) Applicability and interpretation of materiality standard.

d) Responsibilities of underwriters.

e) Responsibilities of non-regulated third-parties.

3. Responsibility of Local Government Officials.

a) Orange County

(i) The SEC investigated Orange County, California, in connection with various municipal securities offerings and certain investment strategies undertaken in connection therewith. These matters ultimately led to the County filing bankruptcy and the default by the County on over $900 million of municipal securities.

(ii) The financings aggregated over $2 billion of offerings by the County and other entities within the County. The repayment of the financings was dependent upon pooled investment funds managed by the County. The basic strategy employed by two County employees was to borrow funds by issuing short term securities and investing the borrowed funds in securities with longer maturities. The investment strategy was dependent upon interest rates of the short-term securities being lower than the longer maturity securities. Also, a significant amount of leverage was integral to the investment strategy which used derivative instruments. The strategy collapsed when short term interest rates rose.

(iii) The SEC alleged that the disclosure documents used by the County failed to disclose information material to investors. The SEC alleged that the issuers did not describe either the investment strategy of the County investment pools or the dependence on the success of the strategy to pay the bonds.

(iv) The SEC obtained permanent injunctions against the two County employees and cease and desist orders against the County and the Board of Supervisors.

(v) In its report, the SEC set forth its views regarding the responsibilities under the federal securities laws of local government officials who authorized the issuance of municipal securities and related disclosure documents. The report states: "In authorizing the issuance of securities and related disclosure documents, a public official may not authorize the disclosure that the official <u>knows to be false</u>; nor may a public official authorize disclosure <u>while recklessly disregarding facts</u> that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has <u>knowledge of facts</u> bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors <u>without taking steps appropriate under the circumstances</u> to prevent the dissemination of materially false or misleading information regarding those facts." The test of "steps appropriate under the circumstances" becomes important guidance. The report says that steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

(vi) The report demonstrates that the SEC puts an affirmative responsibility on issuers' officials with respect to the disclosure. Issuers should be told this and understand the important role that they play in their disclosure documents.

(vii) The SEC concluded in the report that the reliance upon hired professionals did not relieve the Board of the responsibility to question the professionals involved to determine if they have knowledge of material facts.

b) <u>City of Victorville, CA</u>.

(i) In April 2013, the SEC filed a complaint against an underwriter, two investment bankers, a developer, a city, the director of economic development for the city, and an Airport Authority (the "Authority"), alleging fraud in connection with tax increment bonds issued by the Authority in 2006, 2007, and 2008. Proceeds from the bonds were used to fund redevelopment projects on a former Air Force base located in San Bernardino County, California.

(ii) According to the SEC's complaint, the redevelopment projects undertaken by the Authority included four new airplane hangars. The complaint alleges that in constructing the hangars, the underwriter, one of the investment bankers, and the developer misappropriated $2.75 million in bond proceeds to pay excessive construction and property management fees, which were concealed from the Authority. Due to the non-disclosure of the unauthorized and excessive fees, the

SEC contends that the 2007 and 2008 Official Statements contained material misstatements and omissions.

(iii) The complaint further alleges that the Authority's 2008 Official Statement was false and misleading because it misstated the tax increment available to repay bondholders and the debt service ratio for the bonds. The SEC alleges that the calculations of the tax increment and debt service ratio were based on an improperly inflated $65 million valuation by the developer of the new airplane hangars.

(iv) Finally, the complaint alleges that the underwriter and investment bankers falsely represented to investors that they had reviewed the Authority's Official Statements as part of their due diligence efforts and that the information contained therein was complete and accurate.

(v) The SEC's complaint is based on nine claims of securities law violations. The claims include securities fraud and aiding and abetting securities fraud against all of the defendants, as well as alleged violations and aiding and abetting violations of MSRB Rules G-17, G-27, and G-32 against the underwriter and investment bankers. The SEC is seeking civil penalties, disgorgement, and permanent injunctions against the defendants.

c) City of Miami, FL

(i) In July 2013, the SEC filed an enforcement action in federal court against a City of Miami and its former budget director alleging securities fraud in connection with the City's 2007 and 2008 annual financials and subsequent 2009 bond offerings. This lawsuit, the first the SEC has brought against a municipality for a violation of a cease-and-desist order, highlights the SEC's continued increased scrutiny of the substance of primary and secondary municipal market disclosures as well as the related conduct of municipal officials.

(ii) The SEC's complaint against the City focused on interfund transfers by the City. The SEC alleged that, from 2007 to 2009, the City made transfers from capital project funds (which comprised monies restricted to specific purposes) to a general use fund to mask deficits in the general fund. The interfund transfers totaled $37.5 million, according to the SEC. The SEC asserted that these improper transfers falsely inflated the general fund balance to meet a reserve level requirement for that fund. Bolstering the City's general fund in this manner led ultimately to more favorable ratings by credit rating agencies on the City's 2009 bonds, according to the SEC.

(iii) The SEC claimed that the City made numerous material misrepresentations and omissions about the interfund transfers in its bond offering documents and its 2007 and 2008 annual financials. This included the failure to disclose the full amount or effect of the transfers to the general fund's budget and balance; the misstatement that transferred project funds were "unexpended" or "unused" when in fact the funds were allocated to and needed for specific projects; the failure to disclose that a portion of the transferred funds were restricted from interfund transfer; and the failure to disclose that the City had not adjusted its capital projects funds budget to reflect the transfers to the general fund.

(iv) The SEC charged that the City's former budget director arranged the improper transfers, misrepresented the true nature of transfers to City officials and others (including the rating agencies), and falsified justification for transfers in the City's internal records. The SEC asserted that the improper transfers came to light when the City's Office of Independent Auditor General issued a report in 2009 after conducting an annual compliance review.

(v) In its complaint, the SEC pleaded claims against both the City and former budget director for violations of Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act (and Rule 10b-5 thereunder); a claim against the former budget director for aiding and abetting the City's violation of Section 10(b)/Rule 10b-5; and a claim against the City for violations of a 2003 cease-and-desist order due to prior violations of the anti-fraud provisions. December 27, 2013, the court denied the City's motion to dismiss the SEC's claims against it.

(vi) In 2016, a federal jury found the City and the former budget director guilty of defrauding investors by not disclosing the City's true financial picture. The City settled for a $1mm penalty and the SEC sought a record $450,000 civil penalty against the budget director, which was reduced to $15,000 by a Judge on the U.S. District Court for the Southern District of Florida.

4. Stale Financial Information (Maricopa County, Arizona (1996)).

a) The SEC instituted and settled cease and desist proceedings against Maricopa County, Arizona, the population center of Arizona and the sixth largest county in the country. The SEC charged that the Official Statements used in connection with the July 1993 offer and sale of two series of general obligation bonds failed to disclose that the County's financial condition had seriously worsened between the close of the fiscal year covered by the audited financial statements in the official statements and the time of issuance of the 1993 bonds.

(i) The SEC's order alleged that the Official Statements failed to disclose that the County had developed a deficit in its general fund and had nearly doubled the deficit in its medical center enterprise fund.

(ii) The Official Statement for one of the offerings represented that bond proceeds would be used to finance specific County projects, although the Order alleged that the County in fact planned to use the bond proceeds to finance its deficit on a temporary basis.

(iii) The Order found that the omitted facts were material and would have been important for an investor to consider in deciding whether or not to purchase the County's bonds.

b) The Maricopa County proceedings illustrate the SEC's view that facts may be material even if they do not adversely affect the ability to pay principal and interest in a timely fashion. The County's short-term deficit had no impact on its ability to levy unlimited ad valorem property taxes to pay its general obligation debt, and the County was current in the payment of all general obligation debt service, including the 1993 Bonds. The enforcement proceedings therefore suggest that omissions concerning an issuer's financial condition, at least in the SEC's view, may be material, regardless of the possibility of default.

5. <u>Reliance on Experts (City of Miami (2001 SEC LEXIS 1250 (2001))- S.E.C. v. City of Miami, Fla., 988 F. Supp. 2d 1343, 1347 (S.D. Fla. 2013)</u>.

   a) The SEC brought action against the City of Miami, City's manager and City's finance director in connection with omissions and misstatements in three Official Statements and a Comprehensive Annual Financial Statement (CAFR) claiming that the City had falsely misrepresented the lack of an adverse change in financial condition.

      (i) Recent downgrade by Standard & Poor's had not been disclosed

      (ii) Bond funds were actually used for operating expenses

      (iii) Reasons given for programs disguised the poor financial health of the City

   b) Significant differences from historical cases

      (i) Bonds were insured by municipal bond insurance

      (ii) Never any default

      (iii) Liability found for use of CAFR unconnected to actual sale of bonds

   c) City contended it relied on its accountants in the financial disclosure, but administrative judge denied defense.

   d) In order to successfully claim reliance on experts, must show

      (i) Complete disclosure

      (ii) Sought advice as to challenged conduct

      (iii) Received advice that action was appropriate

      (iv) Relied in good faith on advice

   e) City failed to satisfy any elements

6. <u>Postemployment Benefits/Disclosure Procedures Part #1 (City of San Diego (2006))</u>.

a) The City of San Diego, California is subject to a cease and desist order entered on November 14, 2006 to resolve an administrative proceeding brought by the SEC. The order found that the City violated the antifraud provisions of the federal securities laws, including in connection with the offer and sale of five separate municipal bond offerings. In particular, it found that the "City failed to disclose material information regarding substantial and growing liabilities for its pension plan and retiree health care and its ability to pay those obligations in the future in the disclosure documents for its 2002 and 2003 offerings, in its continuing disclosures filed in 2003, and in its presentations to the rating agencies."

b) The San Diego proceeding highlights why issuers should carefully consider whether to implement appropriate disclosure controls and procedures, both to ensure the accuracy and completeness of those disclosures that are subject to federal securities law liability and to establish compliance by municipal officials with their legal responsibilities. San Diego's procedures, adopted after the commencement of an SEC investigation into the City's disclosure practices, go considerably beyond those utilized by most municipal issuers, even large issuers that are regularly in the market. The City's procedures, however, provide a menu of alternatives that regular issuers may wish to consider in determining what controls and procedures may be appropriate for their particular circumstances. Basic elements of any such controls and procedures would likely include:

(i) Disclosure training for officials responsible for producing, reviewing and approving disclosures;

(ii) Establishing a procedure with accountability for review of relevant disclosure; and

(iii) Ensuring that any procedures established are in fact followed.

7. Postemployment Benefits/Disclosure Procedures Part #2 (State of New Jersey (2010)).

a) The SEC charged the State of New Jersey with violating securities fraud laws for its failure to disclose that it was underfunding the State's two largest pension plans in connection with over $26 billion in bonds issued by the State from August 2001 through August 2007.

b) The SEC found that New Jersey made material misrepresentations and omissions in various bond disclosure documents, including continuing disclosures, by specifically failing to disclose the fact that New Jersey was unable to continue making contributions to the pension funds without raising taxes, cutting services or otherwise altering its budget.

c) The SEC also found that New Jersey failed to provide certain financial information regarding its pension funding in bond disclosure documents.

d) In agreeing to settle the matter, the SEC considered New Jersey's cooperation with the investigation and certain remedial measures taken by the State, which included:

(i) Hiring disclosure counsel to advise the State on an on-going basis regarding its disclosure obligations under the federal securities laws.

(ii) In 2007 and 2008, with the assistance of disclosure counsel, reviewing the State's bond offering documents and enhancing its disclosures.

(iii) With the assistance of disclosure counsel, reviewing and evaluating the State's disclosure practices, and instituting formal, written policies and procedures relating to its bond offerings.

(iv) Establishing a committee of senior officials to oversee the entire disclosure process and to review and make recommendations regarding the State's disclosures and disclosure practices.

(v) Implementing an annual mandatory training program for State employees involved in the disclosure process to ensure compliance with the State's disclosure obligations under the federal securities laws.

8. Postemployment Benefits/Disclosure Procedures Part #3 (State of Illinois (2013)).

a) In March 2013, the SEC charged the State of Illinois with securities fraud for allegedly misleading investors by failing to disclose the systematic underfunding of its pension plans. The SEC alleged that the information was omitted from bond offering documents between 2005 and 2009.

b) The State consented to the cease-and-desist order without admitting or denying the SEC's allegations. Importantly, the order provided that the State's conduct was actionable as negligence; the SEC did not claim that the State's conduct constituted intentional securities fraud. The SEC noted that the State had taken remedial actions, such as retaining disclosure counsel and effecting written disclosure controls, policies, and procedures.

c) Most states' employee pension plan funding obligations are legislatively imposed, and Illinois is no exception. Beginning in 1995, the State Pension Funding Act sought to address pension funding issues and achieve 90 percent funding through a 50-year contribution schedule. According to the SEC's order, those contribution calculations resulted in underfunded pension obligations, increased unfunded pension liability, and deferral of public pension contributions, which posed significant future risks to the State's financial health. The SEC's order noted that between 1996 and 2010, unfunded pension liability increased by $57 billion.

d) In the offering documents, the State disclosed that its pension obligations are funded under a statutory plan and provided details of the plan. According to the SEC, however, the State failed to disclose that the plan could threaten its budget and financial condition, which in turn could have jeopardized the security of bondholders' investments.

e) The SEC's order also alleged that the State failed to provide investors with material information about amendments to the statutory plan. In particular, the SEC found that the State did not inform investors of the impact of legislatively enacted pension holidays that lowered contribution requirements in 2006 and 2007. Consequently, these holidays increased the State's unfunded pension liability and further pushed payment of the deferred portion of the contribution into the future.

f) Here, as in the previous case against a state, the SEC did not seek monetary fines or penalties on the State or any individuals.

9. Continuing Disclosure Obligations.

a) City of Harrisburg, PA

(i) In May 2013, the SEC charged the City of Harrisburg with misleading investors about its financial health in the annual State of the City address, as well as in its financial and budget reports. This is the first SEC action against a state or local government based on statements made publicly, as opposed to in the required municipal bond disclosure documents. The action is also the first to cite the failure of a municipal securities issuer to post continuing disclosure information on EMMA as contributing to the SEC's finding of fraud.

(ii) The SEC's allegations relate both to general obligation bonds issued by the city and to debt for which the City acted as primary guarantor. The SEC order charged that the City's 2007 annual financial report failed to include that the City had made $4 million in guarantee payments on debt for a resource recovery facility (the "RRF").

(iii) Although the City had been repaid in 2007 from proceeds of a subsequent borrowing, the SEC alleged that the prior guaranty payments were an indicator of possible future debt guarantee payments required for the RRF. The SEC's order also charged that the City's 2008 financial report did not accurately reflect the likelihood of continued guarantee payments by the City or their effect on the City's financial condition.

(iv) According to the SEC, the 2009 budget posted on the City's website did not include the RRF debt guarantee payments the City knew would likely be required and misstated the City's credit rating. The SEC further alleged that the city's 2009 midyear fiscal report, intended to reflect the City's budget-to-actual numbers, improperly omitted $2.3 million in RRF guarantee payments made by the City. The final public misstatement alleged by the SEC occurred in the State of the City address given by the Mayor in 2009 (an election year). According to the SEC, the Mayor improperly described the RRF financial difficulties as an "additional challenge" and an "issue that can be resolved" after it had become clear the City may be forced to make significant RRF guarantee payments.

(v) The SEC claimed that the City failed to timely post its 2008, 2009, 2010, and 2011 annual financial reports and certain event notices on EMMA as required by its continuing disclosure obligations as an issuer and a guarantor. As a result, according to the SEC, investors looked elsewhere for information about the City's financial health, and what they found included material misrepresentations and omissions by the City.

(vi) Quoting 1994 Interpretive Guidance issued by the SEC, the order states that "[s]ince access by market participants to current and reliable information is uneven and inefficient, municipal issuers presently face a risk of misleading investors through public statements that may not be intended to be the basis of investment decisions, but nevertheless may be reasonably expected to reach the securities markets." The SEC found the public statements by the City material, given the "total mix" of limited public information.

(vii) The SEC's order considered remedial actions taken by the City, including developing written disclosure policies and procedures, designating a City administrator to file annual financial information and event notices with EMMA, and implementing an annual training program for City employees involved in the disclosure process. The City also agreed to post its disclosure policy on EMMA as well as on its website. The City consented to the SEC's order without admitting or denying the allegations, and no monetary fines were imposed.

(viii) The SEC issued a Section 21(a) report. These are rarely issued. The SEC uses Section 21(a) reports as a vehicle to signal how it views a particular problematic area or set of practices – so they are essentially policy statements. Perhaps more importantly, they put people on notice that going forward, the SEC and its Enforcement Division would consider similar conduct to be fair game for more conventional enforcement actions.

(ix) Why: Based upon information obtained during the investigation, the Commission deemed it appropriate that it issue a Section 21(a) report to address the obligations of public officials relating to their secondary market disclosures for municipal securities. Public officials should be mindful that their public statements, whether written or oral, may affect the total mix of information available to investors, and should understand that these public statements, if they are materially misleading or omit material information, can lead to potential liability under the antifraud provisions of the federal securities laws.

(x) Lesson: Issuers and other municipal market participants should follow and further develop voluntary industry initiatives to enhance disclosure policies and procedures for both primary offering and ongoing disclosures. Such initiatives may include the adoption of issuer disclosure committees and training programs.

b) West Clark Community Schools

(i) In July 2013, for the first time, the SEC issued a cease-and-desist order charging a school district with falsely stating in 2007 municipal bond offering documents that it was compliant with its continuing disclosure obligations. In a related action, the SEC charged the school district's underwriter and its vice president with inadequate due diligence and supervision in failing to discover the school district's lack of compliance.

(ii) In 2005, using the services of the underwriter, the school district issued $52 million in municipal bonds. In connection with the 2005 transaction, as required by SEC Rule 15c2-12, the school district contractually agreed to provide annual financials as well as material event notices. In 2007 offering documents, the school district represented that it was compliant with its continuing disclosure undertakings. The school district, however, had not submitted any of the required annual financials or event notices. The SEC charged that the school district violated Section 17(a)(2) of the Securities Act, Section 10(b) of the Exchange Act, and SEC Rule 10b-5. As part of its settlement with the SEC, the school district agreed to remedial actions, including adopting written disclosure policies and implementing annual training for personnel involved in the bond offering and disclosure process.

(iii) In a related cease-and-desist order, the SEC charged that the underwriter and its vice president violated Section 17(a) of the Securities Act, Sections 10(b) and 15B(c)(1) of the Exchange Act, SEC Rules 10b-5 and 15c2-12, and MSRB Rule G-17 by failing to discover that the school district was delinquent in its continuing disclosure obligations. The SEC also charged the underwriter with violating MSRB Rule G-20 by providing improper gifts and gratuities to issuer personnel, including lunches, golf trips, and tickets to Chicago Cubs games as well as Notre Dame football games. The SEC further alleged that the underwriter charged such expenses back to the school district as official statement printing and distribution costs. Without admitting or denying the SEC's allegations, the underwriter agreed to pay approximately $580,000 to settle the charges and to enhance its disclosure and expense reimbursement policies. The underwriter's vice president, also without admitting or denying the SEC's allegations, agreed to pay approximately $48,000 to settle the charges as well as to a one-year collateral bar and permanent supervisory bar.

c) The Municipalities Continuing Disclosure Cooperation Initiative (the *"MCDC"*)

(i) Overview

Rule 15c2-12 of the Securities Exchange Act of 1934 (the "Exchange Act") requires that all underwriters buying or selling municipal securities ensure that the issuer has committed to providing continuing disclosures regarding the security and the issuer. Specifically, Rule 15c2-12 mandates disclosures regarding instances in the previous 5 years in which the issuer failed to comply in all material respects with any previous continuing disclosure requirement.

While the SEC may file enforcement actions under Section 17(a) of the Securities Act of 1933 (the "Securities Act"), and/or Section 10(b) of the Exchange Act against issuers who falsely state that they have complied with all continuing disclosure requirements, underwriters for the offending offerings may also be the target of enforcement if they failed to exercise adequate due diligence to form a reasonable basis for believing the truthfulness of a key representation in the issuer's official statement.

MCDC was initiated to incentivize issuers and underwriters to self-report potential violations of the continuing disclosure requirements by providing them with favorable settlement terms.

(1) For offerings of $30 million or less, the underwriter was required to pay a civil penalty of $20,000 per offering containing a materially false statement;

(2) For offerings of more than $30 million, the underwriter was required to pay a civil penalty of $60,000 per offering containing a materially false statement;

(3) However, there was a cap on the total amount that an underwriter could be liable for. Such cap was dependent on the underwriter's total revenue as reported on its Annual Audited Report.

The MCDC did not provide any guarantees for individuals associated with the non-complying offers (i.e., municipal officials or employees of the underwriting firm).

(ii) Related Cases - Underwriters

In June 2015, the SEC announced that it had made enforcement determinations on 36 municipal underwriting firms, in September 2015, it announced enforcement determinations against another 22, and, in February 2016, it announced enforcement determinations against another 14.

The SEC alleged each of these firms allegedly sold municipal bonds with offering documents that contained "materially false statements or omissions about the bond issuers' compliance with the continuing disclosure obligations." Additionally, the SEC charged that the firms had neglected to conduct sufficient due diligence and therefore failed to identify the omissions or misstatements before offering and selling the bonds.

All 72 cases were under the MCDC, and the firms all self-reported the violations. This represented settlements with 96% of the market and generated total penalties of $18 million.

A representative case was *In the Matter of Edward D. Jones & Co., L.P.* In that case, Edward Jones acted as senior or sole underwriter for a number of securities offerings in which the official statements failed to disclose non-compliance with previous continuing disclosure undertakings, making certain statements materially false and/or misleading. Specifically, in at least three offerings, the issuer had failed to disclose that it had filed annual or audited financial reports late and failed to file required notice of late filings.

(1) As underwriter, Edward Jones had "failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers… regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12."

(2) In addition to a $100,000 civil money penalty, pursuant to the MCDC, Edward Jones was required to hire an Independent Consultant to review its policies and procedures for municipal securities underwriting due diligence and make recommendations for improvements.

(iii) Related Cases - Issuers

A total of 72 actions.

The issuers and obligated persons settled without admitting or denying the findings and agreed to cease and desist from future violations. No financial penalties were assessed in connection therewith in accordance with the terms of the terms of the initiative.

The SEC imposed remedial sanctions on issuers and obligated persons across 45 states, numerous cities, and a number of state authorities, municipalities, school districts, and healthcare providers. The SEC found that each of these entities sold municipal bonds using offering documents that contained materially false or misleading statements or omissions about their compliance with continuing disclosure obligations associated with previous offerings.

In December 2016, the SEC announced it was finished with MCDC settlements and would turn its attentions to violators who did not report, whom the SEC considered to be at high risk for future violations.

(iv) Post MCDC Enforcement Actions - *Beaumont Financing Authority* (August 2017)

(1) The Beaumont Financing Authority case is the first SEC enforcement action against municipal issuers/underwriters that did not voluntarily self-report.

(2) The Beaumont Financing Authority ("BFA"), its former executive director, underwriter O'Connor & Company Securities Inc. ("O'Connor"), and its co-founder were charged by the SEC over false statements made about prior compliance with continuing disclosure obligations in five bond offerings.

(3) The charges stem from BFA bond issuances in 2012 and 2013. According to the SEC, BFA had issued approximately $260 million in bonds in 24 separate offerings from 2003 to 2013. In connection with those offerings, City of Beaumont Community Facilities District No. 93-1 (the "Facilities District"), a community facilities district established by the City of Beaumont, had agreed to provide investors with continuing disclosures.

(4) From at least 2004 to April 2013, the Facilities District regularly failed to provide investors with information in accordance with its continuing disclosure agreement. BFA failed to disclose this poor record of compliance when it conducted the 2012 and 2013 offerings totaling more than $32 million.

(5) The SEC charged BFA with negligence in committing securities fraud. BFA agreed to cease and desist from future securities law violations and to retain an independent consultant to review its policies and procedures. It also agreed to establish appropriate and comprehensive policies, procedures, and training for employees as well as designate an independent consultant to review its policies and procedures and make recommendations for modifications or improvements.

(6) Beaumont's former city manager, who also had been former executive director of BFA, agreed to pay a $37,500 penalty and be barred from participation in any future municipal bond offerings. The SEC said he "failed to exercise reasonable care" and "repeatedly either failed to read and understand the district's [continuing disclosure agreements] or disregarded their requirements." He was also charged with negligence in committing securities fraud.

(7) O'Connor agreed to pay a $150,000 penalty, for violating securities fraud laws and MSRB Rules G-17 on fair dealing and G-27 on supervision (significantly higher than the $20,000 per transaction penalty under the voluntary MCDC Initiative). The underwriter's co-founder also paid a $15,000 penalty and agreed to a 6-month suspension from the securities industry.

10. <u>Issuer Financial Penalties - Greater Wenatchee Regional Events Center Public Facilities District</u>.

a) In November 2013, the SEC announced that it has, for the first time, assessed a financial penalty against a municipal securities issuer. The penalty arose from a settled administrative proceeding charging the issuer with negligently misleading investors in a bond offering that financed the construction of a regional events center and ice hockey arena. The SEC routinely has declined to impose penalties on municipal issuers on the ground that it does not want to impose penalties that must be paid by taxpayers, but in this case the SEC appears confident that the issuer can pay the penalty without taxpayer assistance. The settlement also is notable for the wide scope of transaction participants sanctioned.

b) The SEC's charges arose from a $41.77 million offering of Bond Anticipation Notes (the "BANs") by the Greater Wenatchee Regional Events Center Public Facilities District (the "District") in 2008. The BANs were to mature in 2011, with the principal to be repaid solely through the issuance of long-term bonds. By 2011, however, the District was unable to issue long-term refunding bonds, and consequently defaulted on the BANs. This occurred for two reasons: the events center's revenue was insufficient to support a long-term take-out financing, and the District's ability to issue long-term debt was constrained by the City of Wenatchee's legal debt capacity of $19.3 million.

c) Before the 2008 offering, the District hired an outside developer to develop and operate the events center. Over the course of the development and construction of the events center, the developer prepared a series of financial projections to be used both for budgeting purposes and for inclusion in the District's Official Statement accompanying the BANs. An independent consultant reviewing the developer's first two sets of projections, however, identified errors with the projections and raised concerns about the events center's economic viability.

d) The developer subsequently produced a new set of projections, which were not reviewed by the independent consultant, according to the SEC's Order. After reviewing the new projections, the former Mayor of the City of Wenatchee and a senior staff member urged the developer to include more optimistic numbers in its projections, arguing that they were confident that the local citizens would support the events center. The developer then provided a set of revised projections, which were included in the Official Statement for the BANs.

e) According to the SEC, the Official Statement was materially false and misleading on several fronts:

(i) It failed to warn investors that the District's obligation to pay off the BANs could be constrained by the City's debt limit.

(ii) It wrongly stated there had been no independent reviews of the financial projections for the events center, when, in fact, an independent consultant had examined the projections twice and questioned the project's economic viability.

(iii) It failed to inform investors that the Mayor and the senior staffer had influenced the revised financial projections, rendering them unduly optimistic.

f) The District agreed to pay a $20,000 penalty and undertake remedial actions to settle the SEC's charges. The SEC stated that it believes the penalty will be paid from the events center's operating fund without directly affecting District taxpayers. In addition to the District, the SEC's settled proceedings also name the developer and its then-CEO, the underwriter and its lead investment banker, and the District's senior staff member who certified the accuracy of the Official Statement.

11. <u>Tax Law Violations as Securities Law Violations – City of South Miami, FL</u>.

a) In May 2013, the SEC charged a municipality with fraud for allegedly failing to disclose improper arrangements with the developer of a city parking and retail project that put at risk the tax-exempt status of bonds held by investors. The SEC announced a settlement with the city through a cease-and-desist order.

b) According to the SEC's order, the City entered into a lease agreement (the "Lease") in 2002 with a for-profit developer to develop a mixed-use retail and public parking project. Under the Lease, the City incurred the costs of the parking structure portion of the project and maintained control over its operation, maintenance, and revenue. The limited role of the developer was key to the project's eligibility for tax-exempt financing, according to the SEC. The City received a $6.5 million loan to finance the project from proceeds of tax-exempt bonds issued by the Florida Municipal Loan Council (the "FMLC") in 2002. In connection with the loan, the SEC alleged the City represented in a tax certificate that bond proceeds would not be used for the retail portion of the project and that the project would be operated in accordance with IRS regulations. According to the SEC's order, however, the City subsequently loaned $2.5 million of the bond proceeds to the developer (the "Developer Loan") without the knowledge of the FMLC or bond counsel.

c) Later in 2002, the City Commission voted not to move forward with the project and the developer sued the City, according to the SEC's order. The SEC alleges that the Lease was revised as part of negotiations to settle the lawsuit to provide, among other revisions, that the City would lease both the retail and the parking portion of the project to the developer as well as share parking profits with the developer (the "Lease Revisions").

d) According to the SEC's order, in 2006 the City failed to disclose information to the FMLC about the Developer Loan and the Lease Revisions in connection with the FMLC's issuance of an additional series of tax-exempt bonds, resulting in an inaccurate 2006 tax certification. The SEC alleged that bond proceeds were used to loan an additional $5.5 million to the City. Furthermore, the SEC alleged the City failed to disclose to the FMLC the Developer Loan and the Lease Revisions in annual certifications, which included a certification by the City that the tax-exempt status of the bonds had not been affected by any events.

e) The SEC's order found that the City's failure to disclose the Developer Loan and Lease Revisions was material because, if such actions by the City caused the interest on the 2002 and 2006 bonds to become taxable, investors could be subject to tax penalties. Furthermore, investors trading the bonds relied on their tax-exempt status for pricing purposes and investment decisions, according to the SEC.

f) As part of its settlement with the SEC, the City agreed to undertake remedial efforts, including hiring an independent consultant to review the City's disclosure policies and procedures and help implement disclosure compliance training programs. The SEC did not impose any monetary fines on the city. In a related settlement, the City settled possible tax-exempt issues with the Internal Revenue Service pursuant to its Voluntary Compliance Agreement Program.

12. <u>Other Theories of Liability in SEC Enforcement Cases. (Caveat: These theories are heavily dependent on facts and circumstances.)</u>.

a) Failure to disclose credit risks.

b) Illegal payments/material interests on transaction.

c) Garden variety fraud.

d) Failure to disclose possible loss of tax exemption.

e) Failure to disclose source of escrow securities and excessive markups.

f) Bond counsel negligence.

g) Inappropriate reliance on experts.

C. **Focus on Enforcement.**

1. SEC Reorganization. The SEC recently reorganized itself into five specialized enforcement units, including the Municipal and Public Pension Fund Unit. These units are focusing on five areas of misconduct: offering and disclosure fraud; tax or arbitrage-driven fraud; pay-to-play and public corruption violations; public pension accounting and disclosure violations; and valuation and pricing fraud.

2. Memorandum of Understanding. The SEC and the IRS agreed to coordinate on municipal enforcement matters and other areas relevant to municipal securities. Pursuant to a Memorandum of Understanding dated March 2, 2010, the SEC and the IRS agreed "to work cooperatively to identify issues and industry trends within the tax-exempt bonds/municipal securities industry and to develop strategies to enhance performance of their respective responsibilities. To support this effort, the parties will share information, primarily through the creation of a committee … in connection with the respective responsibilities of the parties regarding tax exempt bonds/municipal securities, in a manner consistent with, and as permitted by, the laws and other requirements that govern the parties."

3. "Report on the Municipal Securities Market" (July 31, 2012). In its report the SEC identified a "wish list" of legislative actions to expand its authority over municipal disclosure practices as well as potential regulatory actions the SEC could undertake pursuant to its existing authority.

   a) Legislative grant of authority to require issuers to prepare and disseminate disclosure documents for their securities.

   b) Legislative elimination of the 3(a)(2) exemption from the registration requirement for conduit borrowers.

   c) Legislative grant of authority to establish requirements for the financial statements of issuers.

   d) Legislative grant of authority to enforce compliance with continuing disclosure obligations.

   e) Issuing updated interpretive guidance regarding disclosure obligations.

f) Amending Rule 15c2-12 to expand the types of required continuing disclosures and provide methods to address noncompliance.

4. Municipalities Continuing Disclosure Cooperation Initiative (See discussion herein).

5. Recent Cases Brought by the SEC based on Fraud Claims.

   a) The SEC alleges that the failure to disclose transactions that presented a conflict of interest in the Official Statement was a material omission in the Official Statement—*SEC v. United Neighborhood Organization of Chicago and UNO Charter School Network, Inc.*, Civil Action No. 1:14-cv-4044 (N.D. Ill., filed June 2, 2014).

   b) The SEC alleges that the failure to disclose in a current Official Statement that the proceeds of bonds previously issued by the governmental entity were not used in a manner consistent with the description in the Official Statement for the prior bond issue was a material omission in the current Official Statement—*SEC v. City of Harvey, Illinois and Joseph T. Letke*, Civil Action No. 1:14-cv-4744 (N.D. Ill., filed June 24, 2014).

   c) The SEC brings action against a former mayor and former city administrator under Section 20(a) of the Exchange Act, each as a control person—*In the Matter of Allen Park, Michigan*, Administrative Proceeding File No. 3-16259 (November 6, 2014).

   d) The SEC alleges that failure to disclose in the Official Statement that a governmental entity's pension liability was significantly underfunded *was* a material omission in the Official Statement—*SEC v. State of Kansas*, Administrative Proceeding File No. 3-16009 (August 11, 2014).

   e) In April, 2016, the SEC charged the Town of Ramapo (NY), its local development corporation, and four Town officials, with fraud for allegedly not properly disclosing the Town's deteriorating financial situation (strain on the Town's finances caused by the financing of a minor league baseball stadium and the Town's declining sales and property tax *revenues*) in the municipal bond offering documents. A joint enforcement action by the SEC, U.S. Attorneys and the FBI, led to criminal charges against the Town Supervisor and the other Town officials. Judgments in June and November of 2018 permanently barred all defendants from participating in any offerings of municipal securities and ordered the payment of civil penalties. *SEC v. Town of Ramapo et al.*, Civil Action No. 16-cv-2779 (S.D.N.Y., filed April 14, 2016).

   f) The SEC charged the Port Authority of New York and New Jersey (the "Port Authority") with violations of Sections 17(a)(2) and 17(a)(3) of the 1933 Act stating the Port Authority was aware of risks to a series of New Jersey roadway projects but failed to inform investors purchasing the bonds to fund them. The Port Authority settled for $400,000 and is the first municipal issuer to admit wrongdoing in an SEC enforcement action. *SEC v. The Port Authority of New York and New Jersey*, Administrative Proceeding File No. 3-17763 (January 10, 2017).

g) In March 2017, the SEC charged Rhode Island Economic Development Corporation ("RIEDC") *and* Wells Fargo with fraud based on a failure to disclose in the Official Statement the borrower's acknowledgment that bond proceeds were insufficient to cover project costs (the borrower's company went bankrupt, which in turn triggered a default on the bonds). RIEDC <u>and</u> Wells Fargo were **both** charged with fraud and also "aiding and abetting" the SEC violations. The SEC stated that "Municipal issuers and underwriters must provide investors with a *clear-eyed view* of the risks involved in…[a] project being financed through bond offerings…" In addition, the SEC also charged Wells Fargo with violations of Section 15B(c)(1) of the 1934 Act and MSRB Rules G-17 and G-32 for conflicts of interest and failure to disclose to investors a side deal which doubled the underwriter's fees from the amount disclosed. Both RIEDC and Wells Fargo have settled the case with the SEC, however, the lead banker on the failed bond offering remains a defendant. SEC v. Rhode Island Commerce Corporation (F/K/A Rhode Island Economic Development Corporation), Wells Fargo, et.al., No. 1:16-cv-107 (D.R.I. filed March 7, 2016).

h) In November 2017, the SEC charged the Town of Oyster Bay (NY) and the Town Supervisor with fraud, alleging that the Town and Town Supervisor defrauded investors by hiding the existence and potential impact of side deals with a local businessman who owned and operated restaurants and concession stands at several locations in the Town. The SEC alleges that the Town failed to disclose loan guarantees totaling $20 million during 26 securities offerings it issued between August 2010 and December 2015. Case was settled in March of 2018. SEC v. Town of Oyster Bay, NY and Venditto, Case 1:17-cv-06809 (E.D.N.Y. filed November 21, 2017).

i) In January 2018, the SEC charged Malachi Financial Products, Inc., a municipal advisor, and its principal, with defrauding the City of Rolling Fork, Mississippi, failing to disclose certain related-party payments and violating their fiduciary duty to the city in connection with a municipal bond offering. Specifically the SEC alleged that Malachi (1) submitted a fraudulent post-closing invoice for unperformed and unauthorized services and (2) failed to disclose to the city its acceptance of payments from a municipal underwriter in return for recommending the underwriter to the city (and the city's subsequent hiring of the underwriter based on the recommendation). These actions violated Sections 15B(a)(5) and 15B(c)(1) of the 1934 Act and MSRB Rule G-17, which requires municipal advisors to deal fairly with their clients. In June 2018, a federal district court entered judgments against Malachi and its principal, whereby the SEC revoked Malachi's registration as a municipal advisor and permanently barred its principal from serving as a municipal advisor. SEC v. Malachi Financial Products, Inc., et al., Civil Action No. 3:18-cv-00001 (S.D.M.S., filed January 2, 2018)

j) In 2019, the SEC brought an enforcement action against Montebello Unified School District ("MUSD"), its former Chief Business Officer (Ruben Rojas) and its Superintendent of Schools (Anthony Martinez) for defrauding investors by failing to disclose fraud and internal controls concerns raised by MUSD's independent auditor. According to the SEC's complaint and order, MUSD's independent auditor repeatedly raised concerns about allegations of fraud and internal controls issues to MUSD's

Board of Education and management. In response, MUSD allegedly refused to authorize the fees needed for the audit firm to complete its audit and instead decided to terminate the audit firm. The offering documents for MUSD’s $100 million of general obligation bonds in December 2016 failed to disclose this information to investors and instead included a copy of the District's audit report from the prior fiscal year, which included an unmodified or "clean" audit opinion from the firm.

k) The SEC's complaint charged Rojas with violating the antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as well as Section 17(a) of the Securities Act and seeks permanent and conduct-based injunctions as well as a financial penalty. The Rojas portion of this matter is still being litigated; the other parties settled. MUSD was ordered to cease and desist from future violations of the antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as well as Section 17(a) of the Securities Act. It also agreed to engage an independent consultant to evaluate its policies and procedures related to its municipal securities disclosures. Martinez was ordered to cease and desist from future violations of Section 17(a)(3) of the Securities Act and also ordered to pay a $10,000 penalty. See SEC Charges Los Angeles County School District and Two Officials with Defrauding Investors in $100 Million Bond Offering, SEC Litigation Release No. 24602 (September 19, 2019)

l) In April 2020, the SEC charged William Alfred Batchelor and John Michael Zukoski with misleading investors in a $25.4 million bond offering for Tri-Valley Learning Corporation. Batchelor, then CEO, and Zukoski, then Director of Finance, were charged with signing offering documents and related certifications despite knowing that the Tri-Valley Learning Corporation was in “serious financial distress,” and that the offering contained misleading financial projections. Batchelor and Zukoski agreed to be enjoined from future violations of the charged provision and from participating in future municipal debt offerings. Batchelor agreed to pay a $20,000 penalty and Zukoski agreed to pay a $15,000 penalty.

m) Similarly, in September 2020 the SEC charged Park View School, Inc. and its former President, Debra Kay Slagle, with misleading investors in an April 2016 $7.6 million municipal bond offering. According to the SEC's complaint, in the years and months leading up to the bond offering, Park View experienced significant operating losses and repeatedly made unauthorized withdrawals from two reserve accounts to cover routine operating expenses, to pay other debts, and to transfer money to affiliated entities. Park View allegedly provided investors an offering document that included misleading statements about profit and expense projections and showed that Park View would be profitable in the upcoming fiscal year and able to repay the bondholders. Park View defaulted one year later by reducing the interest payments that it made on the bonds. Without admitting or denying the allegations in the complaint, Slagle and Park View agreed to settle with the SEC and to be enjoined from future violations of the charged securities laws. Slagle further agreed to pay a $30,000 penalty and to be enjoined from participating in future municipal securities offerings. See SEC Press Release 2020-208 (September 14, 2020).

n) In 2022, the SEC 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 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's complaint against the city, Brooks-Harris filed in the U.S. District Court for the Western District of New York, charges him with violating the antifraud provisions of the securities laws. The complaint also charges others 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.

o) In 2022, the SEC charged Crosby Independent School District (Crosby ISD) and its former Chief Financial Officer, Carla Merka, with misleading investors in the sale of $20 million of municipal bonds in order to pay its outstanding construction liabilities and fund new capital projects. The SEC also charged Crosby's auditor, Shelby Lackey, with improper professional conduct in connection with the audit of the school district's 2017 fiscal year financial statements. Crosby ISD agreed to settle the SEC's charges by consenting, without admitting or denying any findings, to the entry of an order finding that it violated the antifraud provisions. The SEC's complaint against Merka, filed in U.S. District Court for the Southern District of Texas, charges her with violating the antifraud provisions of the securities laws. Without admitting or denying the allegations in the complaint, Merka agreed to pay a $30,000 penalty and not participate in any future municipal securities offerings.

p) In 2022, the SEC charged former City of Johnson City, Texas chief administrative officer and city secretary, Anthony Michael Holland, with securities fraud for creating and causing to be distributed falsified financial statements and a falsified audit report for the city's 2016 fiscal year. According to the SEC's complaint, Holland created the falsified documents to prevent discovery on his ongoing embezzlement of funds. The complaint alleges that, between 2015 and 2020, Holland stole approximately $1 million from the city, including $107,137 during the 2016 fiscal year. The complaint further alleges that, to hide his theft, Holland initially delayed the annual independent audit of the City's 2016 financial statements, and then, in approximately August 2018, falsified the 2016 documents by changing dates on the 2015 financial statements and audit report. According to the complaint, Holland then provided the falsified documents to the mayor and municipal advisor, knowing that the material would be posted to the public website and the Municipal Securities Rulemaking Board's Electronic Municipal Market Access (EMMA) system and made available to investors. During the time the falsified documents were available to investors on EMMA, investors engaged in secondary trading in the city's outstanding municipal bonds. Holland was also criminally charged by the United States Attorney's Office for the Western District of Texas and pled guilty to one count of Theft from a State or Local Government and admitted to stealing over $1 million from the City for his personal benefit.

6. Recent Cases Brought by the SEC Against Underwriters

   a) In 2022, the SEC charged 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. 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.

   b) In 2022, the SEC 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. 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 monetary relief. 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.

## VIII. MUNICIPAL SECURITIES RULEMAKING BOARD AND ITS RULES.

A. The MSRB is a self-regulatory organization for the municipal securities industry created by Congress in 1975. The MSRB is authorized by federal law to make rules with respect to municipal securities activities for brokers and dealers and municipal advisory activities or municipal advisors but not issuers, investors, rating agencies or other market participants. *(www.msrb.org)*.

B. Rules have force of law; enforcement and inspection authority for rules delegated to Financial Industry Regulatory Authority (*"FINRA"*) for securities firms; FDIC, Federal Reserve Board and Comptroller for the Currency for Banks and the SEC for certain **municipal** advisors.

C. Rules must be approved by the SEC.

D. The mission of the MSRB is to protect investors, municipal entities, including issuers of municipal securities, obligated persons and the public interest and to promote a fair and efficient municipal market. The MSRB supports this mission by rulemaking, collection and dissemination of market information and educational activities.

E. Retrospective Rule Review: Since 2012, the MSRB has had a formal process of revisiting its rules and their interpretations to help ensure that they continue to achieve their intended purposes and take into account the current state of the municipal securities market.

F. The Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted July 21, 2010. Among other things, the Act modified the composition of the MSRB's board of directors and expanded the MSRB's authority to regulate municipal advisors.

G. In September 2013, the SEC issued its final definition of "municipal advisor" for purposes of registration, giving the MSRB the green light to proceed with its municipal advisor rulemaking activities.

H. Rules are available at: http://msrb.org/Rules-and-Interpretations/MSRB-Rules.aspx

## IX. STATE BLUE SKY LAWS.

A. In addition to the federal securities laws, the sale of bonds likely is subject to state securities laws. The laws are commonly known as the *"blue sky laws."* Historically, states required the registration or qualification of securities before such securities could be sold within such states.

1. No obvious pattern of regulation.

2. Uniform act serves as starting point for many states.

3. Many exceptions and distinctions.

B. Blue Sky Memoranda are surveys of state securities law registration requirements.

1. Preliminary Blue Sky Memorandum is delivered to the underwriters at the time the Preliminary Official Statement is distributed to the public.

2. *Exempt Securities Section* includes a list of states where the security is exempt from registration and a list of states where further action is necessary for the security to be offered without registration.

3. *Exempt Transactions Section* includes, for each state surveyed, the transactions that are exempt from registration. Generally, these transactions are between sophisticated parties.

4. Final Blue Sky Memorandum is delivered at pricing to confirm what actions have been taken to gain exemption in states where further action was necessary.

5. Bring down is delivered at closing to confirm whether there have been any changes.

6. CCH Blue Sky Reporter or NABL Blue Sky Materials are very helpful.

C. In 1996, Congress enacted the National Securities Markets Improvements Act *("NSMIA")*, which added Section 18 to the 1933 Act (15 U.S.C. § 77r), which curtailed the states' authority to require the registration or qualification of *"covered securities,"* to impose conditions on the use of offering documents, and prohibit the offer or sale of securities within its jurisdiction based on the merits of the securities or the issuer. "Covered securities" generally include:

1. Securities that are exempt from registration pursuant Section 3(a) of the 1933 Act, except that municipal securities that are exempt under Section 3(a)(2) are not "covered securities" with respect to offers and sales in the state in which the issuer is located.

2. Securities that are exempt from registration pursuant to the SEC's rules and regulations issued under Section 4(a)(2) of the 1933 Act. 1933 Act, §18(b)(4)(D).

D. Under Section 18 of the 1933 Act, a state securities commission can require that the issuer of "covered securities": (i) file with the state any document required to be filed with the SEC pursuant to the 1933 Act (*e.g.*, a Form D); (ii) file annual or periodic reports of the value of the securities sold or offered to persons located in the state; and (iii) consent to service of process. These filings are for notice purposes only. The state securities commission also can assess a fee for the filings. State requirements may vary depending upon the federal securities exemption relied upon. A state securities commission can suspend the offering or sale of securities within the state if the issuer fails to submit any filing or fee that is required by state law and is otherwise permitted by Section 18(c) of the 1933 Act.

E. As a practical matter, the issuer should file (or cause to be filed) the proper forms with each state in which the securities are expected to be offered before the offering. Once the securities are sold, revised forms (reflecting the final issue size, etc.) must be filed in the states in which the purchaser(s) resides. If the purchaser is represented by counsel and is involved with structuring the financing, it may be possible to delegate the "blue sky" filings to such counsel.