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E-ALERT | Securities

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SEC STEPS UP ENFORCEMENT EFFORTS IN THE MUNICIPAL BOND MARKET

On July 24, 2012, the SEC issued a warning of a possible enforcement action against the City of Miami for allegedly misleading investors about its financial health prior to its municipal bond offering. This action is part of the SEC's recent focus on the municipal bond market. Similar SEC actions against various participants in that market are likely to increase.

Two years ago, the SEC formed a specialized enforcement unit to focus on municipal securities and public pensions, headed by two veteran SEC enforcement attorneys with significant experience in enforcement actions related to municipal securities. Since then, the unit has been increasingly active in investigating and bringing enforcement actions against broker-dealers, issuers and public officials. Recent activity includes:

- The SEC staff's July 24 letter to the City of Miami stating that it had decided to recommend that the Commission bring a civil injunction action against it for deceiving investors ahead of the city's bond offerings in 2007 and 2008. According to the *Miami Herald*, the city allegedly moved approximately $26 million from its capital budget to its general fund in an effort to make it appear as if its budget was balanced. The SEC also sent a similar letter to former Miami city administrator Michael Boudreaux.
- From December 2010 to December 2011, the SEC announced several settlements with broker-dealers in connection with fraudulent bid-rigging practices involving investment of municipal bond proceeds.
- In August 2010, the SEC settled fraud claims against the State of New Jersey for allegedly misleading investors in $26 billion of municipal bonds by failing to disclose that it was underfunding the state's two largest pension plans.
- In October 2010, four former San Diego city officials agreed to pay financial penalties for their roles in misrepresentations and omissions about the city's financial problems with respect to its pension and retiree health care obligations.
- In March 2010, the SEC issued a Report of Investigation warning firms that play-to-play rules apply to affiliated finance professionals, not just to a firm's employees. Municipal Securities Rulemaking Board (MSRB) Rule G-37 generally prohibits firms from underwriting municipal bonds for an issuer for two years after the firm or individuals connected with that firm makes a contribution to an elected official of that municipality. In the report of investigation, the SEC made clear that an executive who supervises the activities of a broker, dealer, or municipal securities dealer is not exempt from the Municipal Securities Rulemaking Board (MSRB)'s pay-to-play rule just because he or she may be outside the firm's corporate governance structure.

The SEC's renewed vigor in pursuing alleged fraudulent conduct in municipal bond market will be aided by the Dodd-Frank Act. It authorizes the SEC to impose civil penalties up to $150,000 on "any person" as part of an administrative proceeding before a SEC administrative law judge if the Commission finds that the person violated the Securities and Exchange Act of 1934 (Exchange Act) or any rules issued thereunder. Under the securities laws, a "person" is defined to encompass natural persons and entities, including companies, governments, agencies, or government instrumentalities. *See*, *e.g.*, 15 U.S.C. 78c(a)(9). Previously, the SEC could only obtain civil penalties by bringing an action in federal court. The Act, therefore, makes it easier for the SEC to impose fines and penalties on municipal market participants.

Dodd-Frank also directs the SEC to undertake studies relating to the efficiency and adequacy of disclosure in the municipal securities market. In particular, the Act mandates the SEC to make a recommendation as to whether Congress should amend or repeal Section 15B(d) of the Exchange Act, commonly known as the Tower Amendment. The Tower Amendment limits the authority of the SEC or the MSRB to require an issuer of municipal securities to make any filing with those agencies prior to the issuance of such securities.

The SEC has made numerous remarks regarding the need for additional Congressional authority to allow the Commission to regulate municipal securities. Most recently, on July 31, 2012, the SEC issued its Report on the Municipal Securities Market that outlines the Commission's recommendations for legislative action providing the SEC increased authority to regulate that market, additional rulemaking by the SEC and the MSRB and enhanced industry best practices, Based on those statements, the Report and increased enforcement and legislative activity, a more active regulation of municipal securities is looming.

If you have any questions concerning the material discussed in this client alert and our capabilities to assist you in SEC enforcement matters, please contact the following members of our securities enforcement practice group:

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