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Municipal Securities Regulation & Enforcement

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The second half of 2020 was marked by the continuation of the COVID-19 pandemic. COVID-19 affected travel, commerce, the economy, and financial markets in the United States and globally. However, with a vaccine on the horizon and municipal issuances set to beat previous record highs, the municipal securities market maintained stability in the face of a tumultuous year.

The MSRB released a number of rulemakings which targeted, among other things, COVID-19 relief measures, the MSRB's board membership, a clarification to MSRB Rule G-32, and conforming amendments to MSRB rules in response to the U.S. Securities and Exchange Commission's (SEC's) Regulation Best Interest. The Financial Industry Regulatory Authority (FINRA) and the SEC brought a number of significant enforcement actions relating to flippers, deficient disclosures, supervisory failures, providing false information to FINRA in connection with an exam, failure to register as a municipal advisor, and failure of an underwriter to disclose conflicts in violation of MSRB Rule G-17. The SEC released a revised definition of Accredited Investor and Qualified Institutional Buyer. Finally, the SEC's Order Granting Temporary Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Registered Municipal Advisors (TCE) expired on December 31, 2020, and outgoing SEC Chairman Clayton announced his expectation that it will not be extended into 2021.

President Biden nominated Gary Gensler as SEC Chair to replace Jay Clayton. Gensler, a former Goldman Sachs Group banker who currently is a professor of economics and management at MIT, served as Chair of the Commodity Futures Trading Commission (CFTC) from 2009 to 2014, where he developed a reputation as a vocal and active regulator. At the CFTC, Gensler implemented dramatic new swaps trading rules mandated by Congress following the 2007-2009 financial crisis. He also oversaw the prosecution of investment banks for rigging the London Interbank Offered Rate (LIBOR), the benchmark for trillions of dollars in lending worldwide. Since November, he has led Biden's transition planning for financial industry oversight.

ENFORCEMENT ACTIONS – YEAR-END REVIEW

SEC Charges Registered Broker-Dealer and Its Salespeople for Retail Order Misconduct in Facilitating Trades to and From Flippers

On July 20, 2020, the SEC ordered a registered broker-dealer to pay more than $10 million to resolve charges that it allegedly circumvented the priority given to retail investors in certain municipal bond offerings. According to the SEC's order, over a four-year period, the broker-dealer improperly allocated bonds intended for retail customers to parties known in the industry as "flippers." The flippers immediately resold or "flipped" the bonds to other broker-dealers at a profit. The SEC's order found that the broker-dealer's registered representatives knew or should have known that flippers were ineligible for retail priority. Additionally, the SEC's order alleged that the broker-dealer's registered representatives improperly obtained new issue bonds for its inventory by using flippers to obtain bonds rather than submitting orders directly with the syndicate. Without admitting or denying the findings, the broker-dealer consented to a cease-and-desist order that found it had violated the disclosure, fair dealing,

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and supervisory requirements of MSRB Rules G-11(k), G-17, and G-27, and had also failed to reasonably supervise within the meaning of Section 15(b)(4)(E) of the Securities Exchange Act of 1934.

In related actions, the SEC settled proceedings against two of the broker-dealer's registered representatives for allegedly negligently submitted retail orders for municipal bonds on behalf of their flipper customers. In both orders, the SEC alleged that the two registered representatives helped the broker-dealer's bond traders improperly obtain bonds for the broker-dealer's own inventory through their flipper customer.

SEC Charges Registered Broker-Dealer and Its Salespeople for Flipping Muni Bonds in Violation of Federal Securities Laws and MSRB Rules and for Causing the Flippers to Violate Broker Registration Requirements

In a separate case dealing with flippers, on September 14, 2020, the SEC settled with another registered broker-dealer and two of its registered representatives for circumventing the priority given to retail and institutional investors in certain municipal bond offerings. According to the SEC's order, the registered broker-dealer improperly allocated new issue municipal bonds intended for retail customers to flippers, who then resold the bonds to other broker-dealers. The order again found that the registered representatives knew or should have known that the flippers were not eligible for retail priority, and that they allowed the registered broker-dealer to obtain bonds for its own inventory by using flippers as proxies to place customer orders, circumventing the priority of orders. Without admitting or denying the SEC's findings, the registered broker-dealer consented to a cease-and desist order for willfully violating the antifraud provisions of Section 17(a)(3) of the Securities Act of 1933, Section 15B(c)(1) of the Securities Exchange Act of 1934, the disclosure, fair dealing, and supervisory provisions of MSRB Rules G-11(k), G-17, and G-27, and failing to reasonably supervise within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Notably, the settling broker-dealer also agreed to settle charges that it caused the flippers to violate Section 15(b) of the Exchange Act, which requires individuals performing broker-dealer activities to be registered with the SEC. The Order alleges that the "regularity of participation in securities transactions for the accounts of others" required the flippers to register as broker-dealers, and the broker-dealers trading with them "knew or should have known" that the flippers were not registered with the SEC. The settlement raises difficult questions as to the responsibilities of broker-dealers to monitor their trading partners.

In related actions, the SEC instituted settled proceedings against two of the broker-dealer's registered representatives. In both orders, the SEC's found that the two registered representatives negligently submitted retail orders for new issue municipal bonds on behalf of their flipper customers and helped their registered broker-dealer obtain bonds for their its own inventory.

FINRA Fines Investment Bank and Financial Services Company for Supervisory Rule Violation

On September 3, 2020, FINRA settled charges against a financial services company for allegedly violating MSRB Rule G-27 on supervision after FINRA alleged the firm did not have a supervisory system reasonably designed to identify and prevent prohibited pre-arranged transactions. FINRA found that from October 31, 2017, through February 27, 2020, the firm did not have a supervisory system, including written supervisory procedures (WSPs), which were reasonably designed to detect and prevent its broker dealers from executing pre-arranged transactions. Furthermore, the firm did not have exception reports, trade alerts, or other ways to detect potential pre-arranged transactions; instead, the firm relied on its supervisors to detect and prevent those transactions as part of their daily review of thousands of transactions. During the requisite time period, FINRA alleged that a former registered representative effected 56 pairs of pre-arranged transactions in municipal securities between the customers' accounts by trading with another broker-dealer. The transactions were executed simultaneously, whereby the firm would sell the municipal bonds as agent on behalf of one of their customers to another broker-dealer and then buy back the bonds on the same day from the same broker-dealer as agent on behalf of another firm customer. The firm agreed to pay a $40,000 fine and be censured while neither admitting nor denying FINRA's findings that it violated MSRB Rule G-27 on supervision.

SEC Charges Charter School Operator and Its Former President With Fraudulent Municipal Bond Offering

On September 14, 2020, the SEC charged a state-funded nonprofit charter school operator and its former president with misleading investors in an April 2016 municipal bond offering. The SEC's complaint filed in the U.S. District Court for the District of Arizona charged the charter school operator and its former president with violating antifraud provisions of the federal securities laws after making false and misleading statements about the charter school's financial condition in the months and years leading up to the bond offering. The charter school operator experienced substantial 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, none of which was disclosed in the offering document provided to investors. The conduit borrower in the offering defaulted only one year after the April 2016 offering and subsequently reduced the interest payments that it made on the bonds. Without admitting or denying the allegations in the complaint, the charter school operator agreed to settle with the SEC and to be enjoined from future violations of the charged securities laws. The former president of the charter school agreed to pay a $30,000 penalty and to be enjoined from participating in future municipal securities offerings.

FINRA Settles With Placement Agent in Reg D Offering for Failure to Retain Evidence of the Process and Results of a Due Diligence Investigation

On September 23, 2020, FINRA settled with a placement agent for failing to perform due diligence and supervise an employee in connection with the placement of securities by the placement agent in a Regulation D offering. According to the settlement, the transaction involved the sale of Regulation D securities to a qualified institutional buyer of preferred stock of a publicly listed company in the amount of $10 million. The placement agent's due diligence file was deemed insufficient because it contained only an email with a hyperlink to public EDGAR (the Electronic Data Gathering, Analysis, and Retrieval system) filings and the stock purchase agreement, which contained the terms of the transaction. The placement agent allegedly did not document the "process or results of a reasonable investigation into the issuer of the preferred stock shares, meetings, tasks performed, and documents and information reviewed as described by FINRA Regulatory Notice 10-22 and required by the firm's own written procedures." While not the subject of a municipal securities enforcement action, the result has an analogous application to municipal securities private placements and duties of a municipal securities placement agent. You can read our full alert on this settlement and its impact on placement agents here.

SEC Fines Charter School Financing and Consulting Firm and Its President for Providing Municipal Bond Advice Without Registering as a Municipal Advisor

On September 25, 2020, the SEC settled charges with a charter school financing and consulting firm and its president for allegedly providing municipal bond advice without registering as municipal advisors as required under federal law. According to the SEC order, the charter school consulting firm and its president provided municipal advice to 12 charter schools in connection with the issuance of municipal bonds from July 2014 through September 2019. These bond offerings were sold through conduit issuers and raised roughly $222 million. The SEC found that the advice involved advice on financing structures and interest rates, debt service analysis and amortization schedules, selection of the conduit municipal issuer, and selecting an underwriter. In a public statement, the SEC stated that these services are "routinely provided by a registered municipal advisor to municipal entities and obligated persons." The firm and its president did not admit or deny the SEC's findings and agreed to cease-and-desist orders and to jointly and severally pay $30,000 for violating registration provisions under Section 15B(a)(1)(B) of the Securities Exchange Act of 1934.

FINRA Fines Registered Broker-Dealer for Failing to File Accurate VRDO and Other Information to the SHORT System

On October 7, 2020, a FINRA-registered broker-dealer agreed to pay $47,500 to settle charges it violated MSRB Rules G-34 on CUSIP requirements and Rule G-27 on supervision after FINRA found it failed to accurately submit variable rate demand obligation (VRDO) interest rate information. FINRA found that from April 1, 2009, to March 28, 2018, the broker-dealer failed to accurately submit minimum denomination and maximum interest rates to the MSRB's Short-term Obligation Rate Transparency System (SHORT), which collects information and documents on municipal securities bearing interest at short-term rates, including VRDOs. During this period, FINRA also found that the broker-dealer failed to establish and maintain a supervisory system. The broker-dealer agreed to pay the fine and be censured while neither admitting nor denying FINRA's findings that it violated MSRB Rules G-34 and Rule G-27.

SEC Pulls Illinois City Back Into Court for 2014 Settlement Violations

On October 28, 2020, the SEC filed a motion in the U.S. District Court for the Northern District of Illinois Eastern Division asking the court to order the city of Harvey, Illinois, to implement December 2014 recommendations laid out by an independent consultant aimed at strengthening the city's "weak and ineffective system of internal controls." According to the motion, a March 2019 report conducted by an accounting firm concluded the "internal control environment within the city of Harvey is still unreliable and informal and most likely will remain so unless forced by external regulatory bodies or a renewed commitment by the new administration to remediate undocumented controls and policies and procedures as a top priority in 2019." The SEC's filing comes during the city's efforts to restructure its debt under an agreement struck earlier in 2020 with bondholders who sued to intercept tax collections amid ongoing general obligation bond defaults. Under the agreement, which was approved by a Cook County Circuit Court judge, the City of Harvey was allowed to keep 90% of pledged tax revenues, while bondholders receive the other 10%. The agreement runs to June 2, 2022, as long as the city honors the will of the pact that call for it to continue negotiations and move toward a debt restructuring with its municipal advisory firm.

D.C. Circuit Sustains SEC Order Against Chief Compliance Officer for Failure to Report a Statutorily Disqualified Person to FINRA and Supervisory Failures at Two Registered Broker-Dealers

In July 2015, a Chief Compliance Officer (CCO) for a registered broker-dealer was fined for failing to review and monitor the firm's electronic communications. According to FINRA's allegation against the CCO, the CCO failed to conduct daily reviews of electronic communications, maintain a record of the reviews, review electronic communications generated by someone associated with the firm who transmitted the information through a Bloomberg account, and enforce the firm's WSPs, all in violation of NASD Rule 3010 and FINRA Rule 2010.

In December 2015, the same CCO was then employed at another registered broker-dealer and was censured, fined, and suspended pursuant to a FINRA Office of Hearing Officers (OHO) decision. While CCO at a FINRA member firm, the CCO failed to report to FINRA that an associated person at the firm was involved in a variety of business activities with a statutorily disqualified person. Additionally, the CCO failed to follow supervisory procedures pertaining to his review of the firm's electronic correspondence, failed to conduct an appropriate review of the firm's email and Bloomberg communications, and failed to institute a heightened review of the associated person's email and Bloomberg communications to monitor the associated person's and statutorily disqualified person's business relationship. The CCO appealed both decisions through FINRA's National Adjudicatory Council (NAC). The NAC's decisions upholding the OHO's findings can be found here and here. The CCO then appealed both of NAC's rulings to the SEC. The SEC sustained FINRA's disciplinary action, holding that the CCO failed to review electronic correspondence for "substantial periods of time," which was unreasonable and inconsistent with both firm's WSPs. The SEC's decisions upholding the NAC's findings can be found here and here. The CCO then consolidated both appeals to the U.S. Court of Appeals for the District of Columbia Circuit. On October 23, 2020, the D.C. Circuit sustained the SEC's opinions and orders, holding that the SEC's determination was supported by substantial evidence, namely, that the CCO failed to ensure review of electronic correspondence at both firms and failed to report the broker-dealer's relationship with a statutorily disqualified person. Notably, the D.C. Circuit rejected the CCO's argument that FINRA reporting rules apply to member firms and not individuals. Under FINRA Rule 0140(a), FINRA rules apply to all members and persons associated with a member shall have the same duties and obligations as a member.

Broker-Dealer Agrees to FINRA Fine for Failing to Correctly Report Trades

On November 23, 2020, FINRA settled charges with a New Jersey-based broker-dealer firm alleging that it violated MSRB Rules G-8 on books and records, G-14 on reports of sales or purchases, and G-27 on supervision after FINRA found the firm failed to correctly report 147,000 trades. The firm acts as an interdealer broker by facilitating trades between buyers and sellers on electronic and voice platforms. FINRA found that from April 2016 through March 2019, the firm failed to report roughly 147,000 trades to MSRB's Real-time Transaction Reporting System (RTRS) in increments of seconds. Those roughly 147,000 trades represented 100% of the municipal transactions that were reported by the firm. The firm's misconduct resulted from a system issue whereby transactions were being reported with "00" in the seconds field, which caused trades not to be reported in the RTRS. Additionally, according to the settlement, during the same time period, the firm failed to conduct a documented comparison required under its WSPs to confirm the accuracy of the time of the trades reported to the MSRB. Without admitting or denying the findings, the firm agreed to pay a $25,000 fine and be censured.

Individual Agrees to FINRA Fine for Altering Documents Sent to FINRA and Violating MSRB Rule G-17's Disclosure Requirements

On November 23, 2020, FINRA settled charges with an individual alleging the individual altered documents and failed to disclose conflicts of interest. FINRA alleged that on two separate occasions in 2016, he produced altered documents in response to FINRA requests for evidence of supervisory review. According to FINRA, he downloaded 12 report cards via the MSRB's RTRS, which showed the number and percentage of trades that the firm reported late. The reports also included the date the individual downloaded the document from RTRS. FINRA alleged the broker-dealer deleted the downloaded dates, circled percentages on some report cards, and initialed each one in an attempt to give the false appearance of a contemporaneous supervisory review of the firm's report cards when in fact he had not conducted the service.

Additionally, FINRA settled charges that the individual, acting as co-underwriter and the firm's Municipal Securities Principal, failed to ensure the proper disclosures under MSRB Rule G-17 were made to the issuer, customers, and participants in an offering of municipal securities. According to FINRA, disclosures should have been made of the underwriter's financial interests in a company that provided oversight activities and other services to the borrower representing the financed project. Without admitting or denying the findings, the individual agreed to pay a $7,500 fine and a four-month suspension.

Investor-Owned Utility Settles SEC Charges

On December 3, 2020, the SEC settled charges with an investor-owned utility that co-managed a failed twin nuclear reactor project with a South Carolina-owned municipal utility. The corporation and its subsidiary owned 55% of the twin-reactor project, while the South Carolina-owned municipal utility owned the remaining 45%. The municipal utility owners abandoned the project after determining that completing the units would cost municipal utility customers another 41% in rate increases by 2030 and another $7 billion above the $4.5 billion already spent on the project. Without a partner to finish the project, the investor-owned utility decided to abandon the project completely. The SEC's February 2020 complaint alleged that two of the investor-owned utility's former senior executives misled investors by claiming that the nuclear project would qualify for more than $1 billion in tax credits when they knew that the project was far behind schedule and unlikely to qualify for tax credits. The complaint also alleged that the company's false statements and omissions boosted its stock price, and allowed them to raise rates on customers and sell more than $1 billion in bonds. Without admitting or denying the allegation, the company and its subsidiary agreed to pay a $25 million penalty, $112.5 million in disgorgement plus prejudgment interest, and a permanent injunction.

SEC Settles Charges for Misleading Disclosures About Impact of COVID-19

On December 4, 2020, the SEC announced it settled charges against a corporate issuer for misleading disclosures about the impact of the COVID-19 pandemic on its business operations and financial condition in connection with its required Form 8-K filings. See our legal alert for more information. The SEC alleged that the company violated Section 13(a) of the Exchange Act and Rules 13a-11 and 12b-20 thereunder which collectively require an issuer of a registered security to file accurate reports to the SEC on Form 8-K that contain material information necessary to make the required statements made in the reports not misleading. The SEC alleged that in March 2020, the company failed to disclose that it had sent a letter to each of its restaurant landlords stating that it was not going to pay rent for April 2020, that the company was losing $6 million in cash per week, and that it only had 16 weeks of cash remaining.

In a press release accompanying the order, the SEC included a reminder about the Corporate Issuer Statement it issued on April 8, 2020, on the importance of disclosure. See our July 2020 Mid-Year Newsletter for a recap of SEC statements and disclosure guidance related to COVID-19 disclosure for municipal issuers and borrowers.

Global Investment Bank Settles Charges With FINRA Over Alleged Failure of Establishing and Maintaining 529 Savings Plan System

On December 15, 2020, FINRA announced it settled charges with a global investment bank for failing to establish and maintain a supervisory system reasonably designed to supervise representatives' recommendations to customers to purchase particular share classes of 529 savings plans in violation of

MSRB Rule G-27. FINRA alleged that the firm's supervisory system was not reasonably designed in that (1) the firm failed to provide adequate guidance to representatives regarding the importance of considering share-class differences when recommending 529 plans and (2) the firm failed to provide supervisors with adequate guidance or the information necessary to properly evaluate the suitability of 529 share-class recommendations. From January 1, 2008, to July 21, 2016 (the time in question), the firm was a designated broker-dealer for 30 state-sponsored 529 plans and held about $930 million in customers' assets in those 529 plan accounts. The firm was not fined, and FINRA credited the firm with its cooperation in proactively initiating a review and correction of its supervisory systems and procedures applicable to 529 plan recommendations. Instead, the firm agreed to a censure and paying restitution amounting to $685,520 plus interest.

SEC Settles Charges Against a Municipal Underwriter for New Issue Sales to Broker Dealers Citing Misleading Advertising in Connection With Its Distribution of Municipal Bonds

On December 22, 2020, the SEC announced it settled charges against an underwriter for violations of MSRB Rules G-17 and G-21. See the Order here. According to the SEC's findings, during the time period in question, the underwriter sold roughly 76% of the par value of its offerings to broker-dealers, rather than directly to investors, and 35% of the par value of those offerings were sold to a single broker dealer, who then resold the bonds to investors at prices higher than the initial offering prices. The SEC found that notwithstanding this "regular practice," the underwriter at the same time represented on its website and in RFP responses to issuers that the underwriter had "an extensive customer base which would allow it to locate suitable investors for the bonds and sell the bonds at competitive interest rates." According to the Order, since underwriters must make truthful and accurate representations about their capacity and resources to perform the underwriting and not to misrepresent or omit material facts, the SEC found that the underwriter's practice was a violation of MSRB's Rule G-17 on fair dealing. The SEC also alleged that the underwriter violated MSRB's Rule G-21 on advertising because the underwriter's website was considered a professional advertisement and the statements about its distribution capabilities were false and misleading. Our legal alert has more information.

FINRA Announces Interim Progress of Voluntary 529 Plan Initiative

On December 30, 2020, FINRA announced initial results of its voluntary self-reporting 529 Plan Shares Class Initiative (529 initiative), which included more than $2.7 in restitution and interest to customers owning approximately 3,900 accounts, arising from settlements with two firms and matters resolved through cautionary action letters. These results stemmed from FINRA's January 2019 initiative, through Regulatory Notice 19-04, aimed at promoting member firms' compliance with the rules governing share-class recommendations of 529 savings plans and promptly compensating harmed customers. The 529 initiative encouraged firms to review their supervisory systems and procedures regarding 529 plan share-class recommendations, self-report potential violations of applicable rules, describe and demonstrate past or future corrective actions, and provide FINRA with a plan to remediate harmed customers. FINRA's settlements with two firms may be found here and here.

FINRA and the SEC Find Recurring Deficiencies in the Municipal Market

The Bond Buyer reported on August 17, 2020, that FINRA and SEC examiners announced recurring deficiencies in the timeliness of conflict of interest disclosures, supervisory procedures and advertising issues in recent municipal advisor exams. The SEC, FINRA, and MSRB discussed these findings in a joint webinar held on August 13, 2020.

The Bond Buyer reported that the SEC found that about 60% of municipal advisor examinations had Rule G-44 deficiencies relating to written compliance policies and written supervisory procedures and that the SEC expressed concerns that compliance policies and procedures are not being followed. FINRA noted deficiencies with the timeliness of G-42 conflict of interest disclosures and that firms are not disclosing all potential conflicts, such as if the firm is providing other services to the municipal entity. FINRA found cases where underwriters were providing advice prior to perfecting an exception from the municipal advisor rules, such as the IRMA exception. Lastly, regulators faulted municipal advisors for making claims on their websites or in emails that can't be substantiated.

Litigation Update – Flint Water Crisis

On October 7, 2020, victims of the Flint, Michigan, water contamination crisis filed a lawsuit in the U.S. District Court for the Eastern District of Michigan against the underwriters of bonds sold in 2014 to finance a new water pipeline built to serve the city and the surrounding area. The plaintiffs are seeking up to $2 billion in damages from three underwriters involved in the deal, accusing them of aiding and abetting in the events that led to the lead poisoning crisis.

The crisis dates back to 2014, when the city's contract with Detroit to receive water from Lake Huron ended. In April 2014, the city turned to the Flint River for its water supply while awaiting the completion of the $285 million Karegnondi water supply pipeline carrying water from Lake Huron to Flint and other Genesee County communities. The city failed to properly treat the Flint River water, which triggered lead contamination due to pipe corrosion. It was not abated until the fall of 2015, when the city shifted back to Detroit-supplied water.

The lawsuit accuses the underwriters of knowing of the "hazards to human health presented by the Flint River's highly corrosive water and Flint's aging network of lead service lines, Flint's inability to pay for necessary upgrades to the Flint" water plant and "the fact that Flint's residents and water users would begin consuming raw, untreated, and deleterious water shortly after the switch in April 2014." The plaintiffs allege that because the underwriters all either employed an internal public water expert or retained a consultant with significant public water expertise, they were aware of Flint's troubled plans, and knew "100% that if they participated in the bond sale, children would get hurt …"

Litigation Update – SIFMA Brings Challenge to SEC's Temporary's Conditional Exemption

The Securities Industry and Financial Markets Association (SIFMA) filed a supplementary brief in its lawsuit against the SEC, arguing that the SEC did not solicit stakeholders' input when it released its TCE. Read the full text of the exemption here. SIFMA argued the Order was "arbitrary and capricious" and called for the U.S. Court of Appeals for the D.C. Circuit to strike it down. The TCE allows non-dealer municipal advisors to solicit investors in certain private placements of municipal bonds. Notwithstanding the TCE expired at the end of 2020, SIFMA alleged that the SEC violated the Administrative Procedure Act because the exemption was based on "incoherent rationale" and depended on "an unsupported factual premise." The SEC filed a motion to oppose adding more news articles to the administrative record, arguing that it based the TCE on increased unbudgeted costs by municipalities and uncertainty about revenue during the COVID-19 pandemic, in addition to the news articles. Moreover, the SEC disputed that SIFMA's arguments that the SEC deliberately excluded news articles to hide facts that would contradict the order or negligently excluded them because they were published in the same news sources. In a letter addressed to a member of Congress, the SEC Chairman Clayton announced his expectation that the TCE will not be extended.

Litigation Update – Whistleblower VRDO Cases

As described in our 2019 Year-End Newsletter and 2020 Mid-Year Newsletter, lawsuits were filed in California, Illinois, Massachusetts, and New York (joined with suits filed by the Cities of Philadelphia and Baltimore) alleging fraud by several investment banks acting as remarketing agents in the municipal variable rate demand obligation (VRDO) market. In late July 2019, attorneys for several of the banks filed a motion to dismiss the New York, Philadelphia, and Baltimore lawsuits in the U.S. District Court for the Southern District of New York. On November 2, 2020, the court denied the motion to dismiss, but dismissed the unjust enrichment claims, stating that they were duplicative. Six of the defendants must also face breach of contract claims.

On February 13, 2020, the State of New York exercised its right to object to dismissal of the lawsuit on the basis of the New York False Claims Act's public disclosure bar, a legal standard that exists to prevent whistleblowers from filing lawsuits supported by information that was already known to the public. Once the State exercised this option and objected to dismissal on a public disclosure ground, the court could not address the issue. On March 30, 2020, the Supreme Court of the State of New York denied the defendants' joint motion to dismiss the case. On December 29, 2020, the New York Supreme Court Appellate Division denied the application of several defendants seeking to appeal the decision. As of the date of this newsletter the lawsuit is still pending, though the court has encouraged the parties to resolve the matters through the Neutral Evaluation Program, an alternative dispute resolution system that seeks to provide informal assessment of cases through the issuance of non-binding opinions.

On April 10, 2020, the Office of Illinois Attorney General Kwame Raoul notified the Circuit Court of Cook County that it was blocking dismissal of the VRDO case on public disclosure grounds. As of the most recent filings on December 9, 2020, the case is still ongoing, with a case status call set for January 29, 2021.

On July 23, 2019, the Massachusetts Superior Court dismissed the Massachusetts lawsuit on the basis that the public disclosure bar prevented the suit. The plaintiff appealed this ruling to the Supreme Judicial Court for the Commonwealth of Massachusetts. Read the Appellant's brief and reply brief in opposition to the Motion to Dismiss, and the Appellee's brief in support of the Motion to Dismiss here. Oral argument on the appeal was held on January 6, 2021.

On July 7, 2020, the State of California filed its fifth Amended Complaint in the Superior Court of California, requesting a jury trial. The plaintiff again alleges that the defendants colluded in a "robo-resetting" scheme, and as a result caused the State of California to pay artificially high interest rates on VRDOs and hundreds of millions of dollars in VRDO-related overcharges. The defendants have filed a Notice of Demurrer to Plaintiff's fifth Amended Complaint on the grounds that Plaintiff did not state facts sufficient to constitute a cause of action under the California Rules of Civil Procedure. Arguments were heard on December 18, 2020.

MSRB RULEMAKING – YEAR-END REVIEW

MSRB Membership and Committees

On August 5, 2020, the SEC approved changes to MSRB Rules A-3 on membership and A-6 on committees. These amendments reduced the size of the MSRB's board to 15 from 21. Additionally, applicants that want to be considered as public members on the board will have to abide by a longer "cooling off" period (the length of time that an individual must have been separated from employment or other association with any regulated entity), as the SEC increased this period from two years to five years. Board members term limits were also affected by the rule changes, with the length of service on the board capped at six years. Additionally, the rule change replaced the requirement that at least one and not less than 30% of regulated members on the 21-member Board be municipal advisors with a requirement that the 15-member Board include at least two municipal advisors. The SEC and MSRB noted that these changes are designed to improve board governance. The effective date was October 1, 2020.

On September 15, 2020, the MSRB filed additional amendments to Rules A-3 and A-4 with the SEC. The rule proposals included: revising the Board's quorum requirement; modifying the voting requirement for the Board to remove a member for cause; permitting the Board to meet by way of electronic means; updating the requirement for taking Board action without a meeting; and moving the provision on Board resolutions into its own subsection. You can read the full text of the rule changes in the Federal Register here and here.

Clarification on MSRB Rule G-32 - Enhanced Disclosure

On October 13, 2020, the MSRB filed a Notice of a Proposed Rule Change to Amend MSRB Rule G-32 with the SEC, to clarify that the "yes/no" flags for the BQ Data Field, the PAC Bond Data Field, and the Put Date Field must be manually completed. The proposed rule change is intended to put underwriters on notice that these fields will not be auto-populated with information input into the New Issue Information Dissemination Service (NIIDS). The proposed rule change seeks to clarify a prior rule filing that the MSRB submitted to the SEC on April 10, 2019, and that was subsequently approved by the SEC, as amended, on June 27, 2019, which required the addition of 66 data fields to Form G-32. In the Notice of Filing, the MSRB stated that the proposed compliance change become effective on March 31, 2021. On December 9, 2020, the SEC proposed the rule change.

MSRB Again Grants Conditional Temporary Relief to Dealers Due to COVID-19

On December 2, 2020, the MSRB filed a proposed rule for immediate effectiveness with the SEC that called for additional temporary regulatory relief to brokers, dealers, and municipal securities dealers and municipal advisors in light of the ongoing COVID-19 pandemic. The proposed rule change will (i) allow internal inspections of Offices of Supervisory Jurisdiction, branch offices and non-branch locations remotely, subject to certain conditions, for the remainder of calendar year 2020 and calendar year 2021, without an onsite visit to the office or location; (ii) provide a temporary extension of time for the appropriate securities association or regulatory agency (FINRA, the SEC, OCC, FRB and FDIC) to initiate periodic examinations of dealers; (iii) further extend the period of time for individuals who meet the definition of a municipal advisor principal to pass the Municipal Advisor Principal Qualification Exam (Series 54 Examination) to November 12, 2021; and (iv) make a technical amendment to Supplementary Material .12

under Rule G-3 to update a cross reference. If a dealer plans to conduct remote examinations, it must amend or supplement its WSPs. The proposed rule provides important guidance to dealers on what it considers reasonably designed procedures for conducting remote inspections. Dealers are advised to amend their WSP's accordingly. On December 9, 2020, the Commission [published a notice] to solicit comments on the proposed rule change.

COVID-19 AND OTHER TRENDS IN THE MUNICIPAL MARKET – YEAR-END REVIEW

During the second-half of 2020, the U.S. and rest of the world continued dealing with the ongoing impacts of COVID-19. Below are some industry trends in the face of the continued pandemic.

Weekly COVID-19-Related Disclosure Summary

The MSRB is monitoring disclosures to the EMMA website and on April 2, 2020, began aggregating links to any disclosures that reference COVID-19. The MSRB has continued publishing this on a weekly basis. The MSRB's [weekly summary] continues to provide statistics on the growing number of primary market and continuing disclosures from states, municipalities, and other issuers around the country that have felt the impact of COVID-19 on their financial and operating status.

Frequently Asked Questions Related to COVID-19 Pandemic Regulatory Relief

The MSRB is maintaining answers to frequently asked questions (FAQs) to address COVID-19 pandemic-related regulatory measures and guidance for brokers, dealers, municipal securities dealers, and municipal advisors in light of disruptions to normal business activities. This resource is meant to be read in conjunction with applicable MSRB rules and interpretations, see [here]. Topics covered include professional qualifications, supervision, transaction reporting, mark-up disclosure, best execution and fair pricing, regulatory fees, and additional background and resources.

Disclosure Statistics and Other Industry Trends

At the October 5, 2020, meeting of the SEC Fixed Income Market Structure Advisory Committee (FIMSAC), members of the Committee again stressed the importance of more timely municipality disclosures. Read the full report [here].

The Bond Buyer reported that in 2020, state and local governments issued a record $474.1 billion of municipal debt across 12,940 deals, surpassing 2017's record of $448.6 billion and well ahead of 2019's $426.3 billion of issuance across 11,596 deals. Municipal bond funds ended the year with net inflows of $20.5 billion despite withdrawals of $30.9 billion from March 4 through April 8, at the start of the COVID-19 pandemic.

CONCLUSION

Throughout his tenure, Clayton pushed for more prompt annual financial reporting from issuers, as well as a more consistent release of unaudited interim information to improve municipal disclosure, as evident in his [Published Statement] in May 2020 with the SEC's Office of Municipal Securities in regard to disclosure during the COVID-19 pandemic and the [SEC bulletin] which addressed how anti-fraud laws apply to disclosures (see a further discussion of the SEC bulletin in our [mid-year newsletter]). Chairman Clayton also oversaw implementation of the SEC's Temporary Conditional Exemption and Regulation Best Interest ([Reg BI]) which strengthened broker-dealer standard of conduct beyond existing suitability obligations and made it clear that a broker-dealer may not put its financial interests ahead of the retail investor.

Although we do not know all of the initiatives Gensler may pursue, we expect that in the first half of 2021 the SEC will continue to focus on timely and meaningful disclosure, particularly as it relates to the continued impact of COVID-19 on the financial and operational conditions of issuers and obligated persons.

Although the effective dates for new interpretive guidance to Rule G-17 and the new Form G-32 have been delayed until March 2021 due to COVID-19, SIFMA has published updated form G-17 letters to enhance and streamline G-17 disclosures, and we anticipate greater focus by broker-dealers on implementing these changes as the effective date approaches. Implementation of the MSRB's board changes will impact board governance and potentially the direction of MSRB rule-making.

FINRA continues to execute its ongoing risk monitoring, market surveillance, and enforcement programs, while prioritizing matters that present the most risk during the COVID-19 pandemic. Namely, FINRA is focusing in particular on matters involving fraud, illicit schemes, and other manipulative activities seeking to take advantage of the volatile conditions in the market created by COVID-19. FINRA's COVID-19 Fraud Task Force, created in March 2020, continues to work with law enforcement authorities and track any potential fraud scenarios that may impact investors related to COVID-19.

The MSRB plans to begin a multi-year initiative in 2021 to clarify guidance behind its rules, including retiring some guidance. As part of its ongoing retrospective rule review, the MSRB plans to seek comment on Rule G-27 regarding supervision in the first quarter of 2021 and is also doing a request for comment on a new rule for solicitor municipal advisors as part of reviewing Rule G-17 on fair dealing.

Finally, with the expiration of the SEC Temporary Conditional Exemption at the end of last year and a political transition with the new presidential administration, we are continuously monitoring developments related to any reappearance into 2021.

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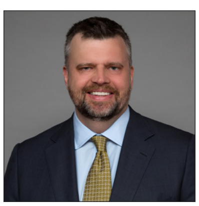

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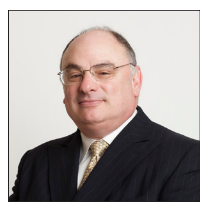

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