

# A LITTLE HELP FROM OUR FRIENDS: MOVING BEYOND ENFORCEMENT TO IMPROVE STATE AND LOCAL GOVERNMENT COMPLIANCE WITH FEDERAL SECURITIES LAWS

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*State and local government borrowing affects Americans' daily lives. Most of this borrowing is in the form of bonds sold to investors. These bonds are used to finance schools, roads, airports, power transmission systems, hospitals, and other infrastructure that we use regularly. The U.S. Securities and Exchange Commission (the "SEC") has an important role in protecting investors that buy and sell these bonds, including by ensuring that investors have accurate and complete information about the securities they are buying. The SEC is in a position to see what state and local governments are doing throughout the country, and its actions impact these governments nationwide. This article discusses several aspects of the internal policies and practices of state and local governments that have been identified by the SEC as leading to inadequate disclosure, how the SEC has responded to these factors, and whether there are better ways for the SEC, for states, or for other entities to address them in the future. The article concludes that although recent SEC enforcement of securities laws has caused state and local government issuers to make positive changes, there is little to be gained by additional aggressive enforcement. Instead, interpretive guidance from the SEC and support and guidance from state governments and others could more effectively guide issuers towards improved disclosure, and towards better debt management in general.*

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## INTRODUCTION

Although most people give them little (if any) thought, “municipal bonds touch every aspect of our lives.”<sup>1</sup> State and local governments issue hundreds of billions of dollars of debt securities (referred to as “municipal bonds”) annually.<sup>2</sup> These bonds are important not only because of the volume of issuance, but because they provide funds to build and improve vital public infrastructure ranging from schools, hospitals and roads to airports, power transmission systems and ports.<sup>3</sup> They matter not only to the investors that buy and trade them, but to taxpayers and residents of every community in the United States.

Like corporate securities, municipal bonds are sold to and traded by investors. A well-functioning municipal bond market is essential to these investors, to the state and local governments that issue and sell bonds, and, ultimately, to the nation’s economy.<sup>4</sup> It is important to state and local governments and to investors that municipal bonds are priced fairly and that investors have confidence in the market.<sup>5</sup>

The U.S. Securities and Exchange Commission (the “SEC”) plays an important role in maintaining the integrity of U.S. securities markets, including the municipal bond market. Its duties include enforcing the Securities Act of 1933, as amended (the “Securities Act”), and the Securities and Exchange Act of 1934, as amended (the “Exchange Act”), the two principal bodies of law governing the sale of securities in the United States. The purposes of the Securities Act include “provid[ing] full and fair disclosure of the character of securities

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1. Andrew J. Ceresney, Dir., Div. of Enf’t, Sec. & Exch. Comm’n, Keynote Address at the Securities Enforcement Forum: The Impact of SEC Enforcement on Public Finance (Oct. 13, 2016), <https://www.sec.gov/news/speech/speech-ceresney-10132016.html>.

2. See SEC. INDUS. & FIN. MKTS. ASS’N, 2018 FACT BOOK 25 (2018), <https://www.sifma.org/wp-content/uploads/2017/08/US-Fact-Book-2018-SIFMA.pdf> [<https://perma.cc/23WQ-98RZ>] (indicating that state and local governments issued \$448.1 billion in long-term bonds in 2017).

3. See Ceresney, *supra*, note 1 (“[I]f your children attend a public school or a university; if you have been treated at a local hospital; if you have visited a library, park or sports facility; if your parents reside in an assisted living facility; if you took the subway, or drove on roads or bridges or through a tunnel today; even if you turned on your tap water this morning, you are likely seeing the tangible results and benefits of the municipal securities marketplace.”).

4. See *infra* Section II.A.

5. See Paul S. Maco, *Building A Strong Subnational Debt Market: A Regulator’s Perspective*, 2 RICH. J. GLOB. L. & BUS. 1, 4 (2001) (noting that fair and efficient markets are important to subnational governments and to investors buying their securities). See also *infra* section II.A.

sold . . . and prevent[ing] frauds in the sale thereof . . . .”<sup>6</sup> The purposes of the Exchange Act include “provid[ing] for the regulation of securities exchanges and of over-the-counter markets . . . [and] prevent[ing] inequitable and unfair practices on such exchanges and markets.”<sup>7</sup>

The SEC is in a position to see what state and local governments issuing bonds (sometimes referred to in this article as “municipal issuers” or “issuers”) are doing throughout the country, and its actions influence the behavior of issuers nationwide. In recent years, the SEC has increased the level of enforcement activity in the municipal market and has acted against state and local governments that do not appear to have intentionally or recklessly deceived investors, but rather have internal practices that have unwittingly led to inaccurate or misleading disclosure. It also has required modifications to internal policies and practices as part of settlements with state and local governments. As one commentator put it, “. . . the new frontier in municipal securities enforcement is as much about imposing discipline on poorly managed local governments as it is about policing fraud.”<sup>8</sup>

The SEC has identified several factors that are common among local governments and that result in inadequate disclosure—in particular, political pressure to avoid giving bad news, compartmentalization, failure to clearly identify who is responsible for disclosure and compliance, lack of training and experience with municipal securities and disclosure, and failure to recognize the importance of compliance with disclosure obligations. While the SEC’s purpose in addressing these factors is to protect investors, doing so may also benefit citizens and taxpayers. However, the SEC’s use of enforcement actions as a principal means of communicating with the municipal market is costly to state and local governments (particularly those against which the SEC has taken enforcement proceedings), and ultimately to taxpayers.

This article discusses the SEC’s increased activity vis-à-vis state and local governments, the factors that it has identified as leading to

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6. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 pmb1.

7. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 pmb1. “Over-the-counter markets” refers to trading of securities through dealer networks (rather than on a national securities exchange). This is how municipal bonds are traded. U.S. GOV’T ACCOUNTABILITY OFF., GAO-12-265, MUNICIPAL SECURITIES: OVERVIEW OF MARKET STRUCTURE, PRICING, AND REGULATION (2012); *see also* *Glossary of Municipal Securities Terms: Over-the-Counter Market (OTC)*, MUN. SEC. RULEMAKING BD., [http://www.msrb.org/Glossary/Definition/OVER-THE-COUNTER-MARKET\\_OTC.aspx](http://www.msrb.org/Glossary/Definition/OVER-THE-COUNTER-MARKET_OTC.aspx) (last visited Oct. 21, 2019).

8. Maggie Guidotti, Comment, *Seeking “the SEC’s Full Protection”: A Critique of the New Frontier in Municipal Securities Enforcement*, 82 U. CHI. L. REV. 2045, 2072 (2015).

deficient disclosure by state and local governments, and how it has addressed them through recent enforcement actions. It considers the effectiveness and costs of the SEC's actions and suggests that while enforcement has served an important purpose and has led to positive changes in municipal issuer behavior, there are better means for the SEC and others to address these issues going forward.

Parts I and II of this article provide context for the discussion. Part I provides an overview of the municipal securities market. Part II presents the relevant aspects of federal regulation of municipal securities, then describes the SEC's role in enforcing federal securities laws and constraints on its ability to act with respect to municipal bonds. The SEC's recent activity in the municipal securities market, the problems the agency identified, and how the agency addressed these problems are then discussed in Part III.

Part IV of this article considers the impact of the SEC's enforcement actions and explores alternative methods of addressing the problems identified by the SEC. The article concludes that although the SEC's recent enforcement actions have been effective, there is little to be gained by ongoing aggressive enforcement actions by the SEC, and that additional interpretive guidance from the SEC and additional support and guidance from state governments and others would be a better means of improving disclosure, and potentially could improve debt management in general.

## I.

### OVERVIEW OF THE MUNICIPAL SECURITIES MARKET

#### A. *Municipal Bonds*

Approximately \$448 billion of municipal bonds were issued by more than 7,500 unique state and local government issuers and more than \$3.8 trillion of municipal bonds were outstanding in 2017.<sup>9</sup> The

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9. SEC. INDUS. & FIN. MKTS. ASS'N, *supra* note 2, at 25, 27, 29 (referring to municipal securities with a maturity of more than 13 months). This compares to approximately \$380 billion issued by over 10,500 unique issuers and a total of approximately \$1.9 trillion outstanding in 2003. *Id.* "Bonds" generally have a term of more than one year and sometimes more than 20 years. GRANT A. DRIESSEN, CONG. RESEARCH SERV., RL30638, TAX-EXEMPT BONDS: A DESCRIPTION OF STATE AND LOCAL GOVERNMENT DEBT, Summary, 4 (2018). See also *Glossary of Municipal Securities Terms: Bond*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/Glossary/Definition/BOND.aspx> (last visited Oct. 21, 2019); *Glossary of Municipal Securities Terms: Short Term or Short Term Range*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/glossary/definition/short-term-or-short-term-range.aspx> (last visited Oct. 21, 2019) (describing "Bonds" as usually having a term of three or more years). Unlike corporations, state and local governments do not issue equity securities. See ROBERT A. FIPPIER, *THE SECURITIES LAW OF PUBLIC FINANCE* § 1:2.1 (3d ed. 2017) ("The

state and local governments issuing municipal bonds range from small school districts and special districts to large states with populations of tens of millions.<sup>10</sup> They issue bonds primarily to finance and refinance capital projects.<sup>11</sup>

### 1. *Municipal Bonds Are Not All the Same*

There are a wide variety of municipal bonds. Municipal bonds may bear interest at a rate that does not change (a “fixed rate bond”) or at a rate that changes periodically based on market conditions or a predetermined index (a “variable rate bond”).<sup>12</sup> Principal and interest on municipal bonds may be paid from a single source or a combination of sources, including property taxes, sales taxes or other taxes, the local government issuer’s general fund, or revenues from a particular project, such as a utility system or an airport.<sup>13</sup> Municipal bonds may also include other terms, such as a requirement that they be repaid before their final maturity date on a predetermined schedule or upon the occurrence of specified events, or at the option of the issuer or the owner of the bond.

Payment of principal and interest on some municipal bonds is guaranteed by a bank or a bond insurer, though this has become less common since the 2008 global financial crisis.<sup>14</sup> Use of bond insurance declined from approximately 57% of issuances being insured in

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confinement of public finance to the debt markets is both historical and a by-product of the economics of capitalism.”). Local governments also issue shorter term debt securities referred to as “notes,” which are subject to some, but not all, of the same regulations.

10. *See, e.g.,* ABBOTT INDEP. SCH. DIST., OFFICIAL STATEMENT DATED JUNE 10, 2015 cover, 39 (2015), <https://emma.msrb.org/EA724285-ER695361-ER1096873.pdf> (Texas school district with enrollment of approximately 265 students issuing approximately \$4.0 million of bonds); *About California*, STATE OF CAL. INV. REL., <https://www.buycaliforniabonds.com/state-of-california-ca/about/i27> (last visited Oct. 23, 2019) (indicating that the State of California has a population of 39.9 million and providing a link to current bond offerings by the State).

11. *See* DRIESSEN, *supra* note 9, at 6 (“Long-term tax-exempt bond issues also can be characterized by their status as new issues or refunding issues (refundings). New issues represent bonds issued to finance new capital facilities. Refundings usually are made to replace outstanding bonds with bonds that carry lower interest rates or other favorable terms.”).

12. SEC. & EXCH. COMM’N, REPORT ON THE MUNICIPAL SECURITIES MARKET 8 (2012), <https://www.sec.gov/news/studies/2012/munireport073112.pdf> [<https://perma.cc/5XQG-G6RQ>].

13. *See id.* at 7 (describing some sources of payment for municipal bonds). Principal and interest on some municipal bonds are paid by a non-profit or for-profit third party. *Id.* The involvement of a third party raises distinct issues that are beyond the scope of this article.

14. *Id.* at 10–11.

2005 to approximately 19% in 2008 and approximately 4% in 2012<sup>15</sup> before rebounding slightly to approximately 6% in 2015 and 2016.<sup>16</sup> Prior to the global financial crisis, bond insurance was primarily provided by insurers that had AAA credit ratings (the highest rating),<sup>17</sup> and the large number of bonds insured by highly rated insurers provided a perception of greater similarity among bonds to investors, who believed they could rely on the insurer to pay debt service if the issuer could not.<sup>18</sup> As bond insurers were downgraded or went bankrupt in the wake of the global financial crisis,<sup>19</sup> and as fewer bonds were insured, this perceived homogeneity was lost, and investors focused more on disclosure and the risks of the bonds they were buying.<sup>20</sup>

## 2. *Municipal Bond Defaults Are Rare, But They Do Occur*

Defaults on municipal bonds are rare, but they do occur, and defaults have been somewhat more frequent since 2008 than they were in the preceding thirty-seven years. The five-year default rate for municipal bonds rated by Moody's Investors Service, one of the three main organizations providing credit ratings of municipal bonds, between 2008 and 2017 was 0.18%, as compared to 0.09% for the period from 1970-2017.<sup>21</sup> Fifty-five defaults of Moody's rated bonds oc-

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15. Oliver Renick & Maria Bonello, *Bond Insurance Then & Now: The Revival of an Industry*, BOND BUYER (Apr. 30, 2014), <https://www.bondbuyer.com/news/bond-insurance-then-now-the-revival-of-an-industry>. See also SEC. & EXCH. COMM'N, *supra* note 12, at 10–11 (more than half of municipal bonds issued in each year from 2000-2007 were supported by bond insurance or a bank guarantee, as compared to 17% in each year from 2009-2011).

16. Aaron Weitzman, *Bond Insurance Remains on Course Despite Unfavorable Market Conditions*, BOND BUYER (Feb. 13, 2017), <https://www.bondbuyer.com/news/bond-insurance-remains-on-course-despite-unfavorable-market-conditions>.

17. See Bernard Garruppo & Gary Binkiewicz, *The Municipal Bond Insurance Industry: A Chronology*, MUNICIPALBONDS.COM (Sept. 6, 2016), <http://www.municipalbonds.com/bond-insurance/the-municipal-bond-insurance-industry-chronology/> (noting that historically, the principal municipal bond insurers had AAA ratings, though there were other bond insurers that did not).

18. See U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 7, at 14, n.29 and accompanying text (referring to the prior "homogenization of the credit quality of most municipal securities" and reporting that some bond market participants had indicated that the decline in bond insurance increased the importance of independently evaluating credit quality).

19. See Renick & Bonello, *supra* note 15 (describing changes in the bond insurance industry).

20. See SEC. & EXCH. COMM'N, *supra* note 12, at 51–52 (discussing the perceived "commoditization" of the bond market as a result of insurance and the greater focus on disclosure following the 2008 global financial crisis).

21. MOODY'S INVESTORS SERV., US MUNICIPAL BOND DEFAULTS AND RECOVERIES, 1970-2017 1 (2018). By comparison, the five-year global corporate default rate on



curred in the period from 2007-2017.<sup>22</sup> Several highly-publicized defaults on municipal bonds have occurred since 2008, including defaults by Jefferson County, Alabama, the City of Stockton, California, the City of Detroit, Michigan, and the Commonwealth of Puerto Rico.<sup>23</sup> In addition, even where there hasn't been a default, some state and local governments have experienced major financial challenges in recent years.<sup>24</sup> Despite the low default rate for municipal bonds, investors have been "forced to recognize that . . . there are clear differences among municipal credits."<sup>25</sup> Even in the absence of a default, the financial condition of the issuer can affect the price at which municipal bonds are purchased and sold in both the primary and secondary markets.<sup>26</sup> Without accurate and complete disclosure, investors may not have the necessary information to determine a fair price for the securities they are buying or selling.

### 3. *Federal and State Tax Exemption*

The U.S. federal government and state governments subsidize most local government borrowing. The federal government reduces the cost to state and local governments of issuing debt by making interest earnings on most of such debt exempt from federal income tax.<sup>27</sup> Tax-exempt debt typically bears interest at a lower rate than taxable debt of identical credit quality because lenders receive the

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Moody's-rated corporate securities was 6.6% in the period from 2008-2017 and 6.7% in the period from 1970-2017. *Id.*

22. *Id.* at 3. There have been periods with much higher rates of default, most recently during the Great Depression. There were more than 4,700 issuers who defaulted on municipal bonds reported in the period from 1929-1937. GEORGE H. HEMPEL, *THE POSTWAR QUALITY OF STATE AND LOCAL DEBT* 19, 22 (1971).

23. See MOODY'S INVESTORS SERV., *supra* note 21, at 30-85 (describing all defaults of Moody's rated municipal bonds from 1970-2017). Between 2011 and 2017, the municipal securities market experienced five of the six largest municipal bankruptcy filings in U.S. history (Puerto Rico, Detroit, Jefferson County, Stockton, San Bernardino, California; the 1984 Orange County, California bankruptcy was the fourth largest). Amendments to Municipal Securities Disclosure, Exchange Act Release No. 34-83885, 2018 WL 3993096 at \*5, n.28 (Aug. 20, 2018).

24. See ROBERT DOTY, *EXPANDING MUNICIPAL SECURITIES ENFORCEMENT: PROFOUND CHANGES FOR ISSUERS & OFFICIALS* 39 (2016) (noting the financial deterioration of issuers including the City of Chicago, the Chicago Public School System and the State of Illinois); MOODY'S INVESTORS SERV., *supra* note 21, at 86-90 (describing "near misses").

25. DOTY, *supra* note 24, at 39.

26. See Section I.B for a discussion of the primary and secondary markets.

27. In 2011, 90.6% of state and local government securities were issued on a tax-exempt basis. SEC. & EXCH. COMM'N, *supra* note 12, at 11. In 2017, the loss of federal tax revenue (also referred to as a "tax expenditure") resulting from the exemption from income of interest on public purpose tax-exempt bonds was \$28.6 billion. DRIESSEN, *supra* note 9, at 3.

benefit of tax exemption.<sup>28</sup> Interest on most state and local government debt is also exempt from home state taxation.<sup>29</sup>

#### 4. State Regulation

Most states have constitutional and/or statutory restrictions on the amount of debt that local governments within their borders may issue (or the amount that they can issue without voter approval) and impose constraints on the structure and terms of that debt and the purposes for which it can be borrowed.<sup>30</sup> These restrictions are intended to serve a variety of purposes, including promoting fiscally sound decision-making, reducing the risk of default, preventing excessive burdens on taxpayers, and promoting interperiod equity—the concept that the burden of paying for a facility should be spread fairly over the period during which the facility is used.<sup>31</sup>

##### B. Issuing and Trading Municipal Bonds

The sale of municipal bonds by or on behalf of the issuer of those securities is referred to as a “primary offering” and the market for newly issued bonds is referred to as the “primary market.”<sup>32</sup> Trading

28. See DRIESSEN, *supra* note 9, at 1 (explaining that investors are willing to earn a lower interest rate on tax-exempt bonds because their earnings after taxes are the same as if they had earned interest at a higher rate but had to pay taxes on the interest).

29. *State Taxation of Municipal Bonds for Individuals*, SEC. INDUSTRY & FIN. MKTS. ASS’N, <http://www.investinginbonds.com/learnmore.asp?catid=8&subcatid=54&id=225> (last visited Aug. 10, 2019); Daniela Pylypczak-Wasylyszyn, *Are Municipal Bonds Exempt from State Taxes?*, MUNICIPALBONDS.COM (June 24, 2015), <http://www.municipalbonds.com/tax-education/tax-exemption-from-state-income-taxes>.

30. See U.S. ADVISORY COMM’N ON INTERGOVERNMENTAL RELATIONS, M-186, STATE LAWS GOVERNING LOCAL GOVERNMENT STRUCTURE AND ADMINISTRATION 10 (1993) (describing the prevalence of several types of restrictions, including debt limits, voter approval requirements and restrictions on the purposes for which debt can be used); Clayton P. Gillette, *Fiscal Home Rule*, 86 DENV. U. L. REV. 1241, 1255 (2009) (“Virtually every state constitution imposes limits on the amount of debt that its political subdivisions can issue in order to fund capital projects . . .”); James E. Spiotto, *The Role of the State in Supervising and Assisting Municipalities, Especially in Times of Financial Distress*, MUN. FIN. J., Spring 2013, at 1, 6–8 (noting that all but three states have debt limits and describing some of these).

31. See U.S. ADVISORY COMM’N ON INTERGOVERNMENTAL RELATIONS, STATE CONSTITUTIONAL AND STATUTORY RESTRICTIONS ON LOCAL DEBT 37–39 (1961) (identifying potential negative impacts of excessive debt on the borrowing government, other local governments and the state as reasons for restrictions and describing the purpose of debt limits as allowing local governments to borrow responsibly); Gillette, *supra* note 30, at 1256 (identifying protection of taxpayers and interperiod equity as justifications for restrictions on debt); Spiotto, *supra* note 30, at 10 (identifying prevention of financial crises and defaults as reasons for the imposition of debt limits).

32. *Glossary of Municipal Securities Terms: New Issue of Municipal Securities or New Issue*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/Glossary/Definition/>

of municipal bonds after issuance is referred to as the “secondary market” for the bonds.<sup>33</sup> Municipal bonds are traded through dealers in what is referred to as an “over-the-counter” market, not on a securities exchange as with corporate stock.<sup>34</sup> The following sections provide general descriptions of primary offerings and secondary market trading of municipal bonds.

### 1. *Primary Offerings of Municipal Bonds*

Newly issued municipal bonds are typically sold to the public through an investment bank acting as an underwriter in either a competitive or a negotiated sale.<sup>35</sup> In a competitive sale, an issuer sells the bonds to the lowest bidding underwriter.<sup>36</sup> In a negotiated sale, the issuer selects an underwriter to purchase the bonds on negotiated terms.<sup>37</sup> In both cases, the underwriter then sells the bonds to investors.<sup>38</sup> The underwriter in a negotiated sale usually plays a much more active role in the transaction than an underwriter does in a competitive sale.<sup>39</sup> Federal securities laws regulate underwriters; the aspects of

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NEW-ISSUE-MUNICIPAL-SECURITIES-OR-NEW-ISSUE.aspx (last visited Aug. 20, 2019); *Glossary of Municipal Securities Terms: Primary Market*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/Glossary/Definition/PRIMARY-MARKET.aspx>; *Glossary of Municipal Securities Terms: Primary Offering*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/Glossary/Definition/PRIMARY-OFFERING.aspx> (last visited Aug. 20, 2019).

33. *Glossary of Municipal Securities Terms: Secondary Market*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/Glossary/Definition/SECONDARY-MARKET.aspx> (last visited Aug. 20, 2019).

34. U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 7, at 1; SEC. & EXCH. COMM'N, *supra* note 12, at 19.

35. SEC. & EXCH. COMM'N, *supra* note 12, at 15. Sometimes issuers borrow directly from banks or sell securities directly to a single investor or small group of investors rather than offering them to the public. See Proposed Amendments to Municipal Securities Disclosure, 82 Fed. Reg. 13928, 13929 (proposed Mar. 15, 2017) (noting that direct purchases of securities by investors and bank loans have increased since 2009). Not all of the same rules apply to these transactions and these transactions are not addressed in this article.

36. SEC. & EXCH. COMM'N, *supra* note 12, at 17.

37. *Id.* at 16.

38. *Id.* at 15.

39. See CAL. DEBT AND INV. ADVISORY COMM'N, CDIAAC No. 06-04, CALIFORNIA DEBT ISSUANCE PRIMER, 10–12 (2006), <http://www.treasurer.ca.gov/cdiac/debtpubs/primer.pdf> (describing the roles played by an underwriter in a competitive and a negotiated sale); Jun Peng et al., *Method of Sale in the Municipal Bond Market*, in THE HANDBOOK OF MUNICIPAL BONDS 51, 57 (Sylvan G. Feldstein & Frank J. Fabozzi eds., 2008) (noting that underwriters in negotiated sales have much more time to become familiar with the issue and that as a consequence, underwriters in negotiated sales are expected to perform more “due diligence,” or investigation into the accuracy and completeness of an offering document).

that regulation that are relevant to the discussion in this article are discussed in Sections II.C.2 and II.C.3.

State and local governments often engage an external advisor (referred to as a “municipal advisor” or “financial advisor”) to assist in developing a financing plan, structuring the transaction, and negotiating with underwriters.<sup>40</sup> Federal securities laws regulate municipal advisors as discussed in Section II.C.4.

State and local governments issuing bonds engage lawyers to serve as bond counsel; the primary role of these lawyers is to provide an expert opinion as to the validity of the bonds and the tax treatment of interest on the bonds.<sup>41</sup> Increasingly, issuers also engage lawyers as disclosure counsel to assist them in complying with their disclosure obligations under federal securities law.<sup>42</sup>

## 2. *The Secondary Market for Municipal Bonds*

In addition to buying bonds in primary offerings, investors also buy and sell municipal bonds through dealers in the secondary market.<sup>43</sup> In 2011, there were more than 10 million transactions in the secondary market totaling more than \$3 billion dollars.<sup>44</sup> While state and local government issuers are not directly involved in secondary trading of their bonds, ongoing disclosure requirements discussed in Section II.C.2.b stem from the possibility of investors buying or selling municipal bonds years after they are issued.

## II.

### FEDERAL REGULATION OF MUNICIPAL BONDS

This Section discusses federal regulation of municipal bonds, the roles that the SEC and the Municipal Securities Rulemaking Board (the “MSRB”) play in enforcing federal securities laws, and constraints on their abilities to act. This discussion provides a framework for understanding the enforcement actions discussed in Part 4 of this

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40. See CAL. DEBT AND INV. ADVISORY COMM’N, *supra* note 39, at 8–9 (describing the types of services provided by municipal advisors). Municipal advisors were used in 60.2% of reported municipal debt issuances in California in 2017. Jeff Field, *Top Municipal Market Financing Team Participants: Calendar Year 2017*, DEBT LINE, Feb. 2018, 3–4.

41. SEC. & EXCH. COMM’N, *supra* note 12, at 47.

42. *Id.* at 48.

43. *Id.* at 19–20.

44. *Id.* at 21. This despite the fact that trading is relatively infrequent, with only about 1% of outstanding municipal bonds being traded on any given day in 2010. U.S. GOV’T ACCOUNTABILITY OFF., *supra* note 7, at 6.

article and the analysis of the effectiveness and cost of the SEC's actions and alternative approaches discussed in Part 5.

A. *The U.S. Government Regulates the Sale of Securities, Including Municipal Bonds*

The U.S. government regulates the sale of securities, including municipal bonds, "in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and the Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions."<sup>45</sup> The Securities Act and the Exchange Act were passed during the Great Depression, a time when "the broad base of public confidence upon which our economic structure depends" had been largely destroyed, with the purpose of restoring public confidence.<sup>46</sup> The Securities Act generally regulates initial offerings of securities and the Exchange Act regulates trading of securities in the secondary market and regulates underwriters and other participants in securities markets.<sup>47</sup> The Exchange Act also established the SEC.<sup>48</sup>

Investors are more likely to invest securities if they know they are paying a fair price.<sup>49</sup> Companies depend on investors to provide money to expand and governments depend on investors to lend them money to complete infrastructure projects. Furthermore, accurate and complete information improves the efficiency of markets, which in turn should result in an overall allocation of resources that is more beneficial to society as a whole.<sup>50</sup> Thus, the principal purposes of the Securities Act and the Exchange Act, and of the regulations promul-

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45. 15 U.S.C. § 78b (2012).

46. *New U.S. Securities Law: Speech of Hon. Garland S. Ferguson, Jr., Federal Trade Commissioner* (National Broadcasting Company broadcast Sept. 12, 1933). See also DOTY, *supra* note 24, at 40 (attributing the functioning of the municipal securities market after recent highly publicized defaults as largely due to "the existence . . . of well-defined disclosure and due diligence practices").

47. 1 LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, *FUNDAMENTALS OF SECURITIES REGULATION* 57–60 (6th ed. 2011).

48. 15 U.S.C. § 78d (2012).

49. See, e.g., *Basic Inc. v. Levinson*, 485 U.S. 224, 246–47 (1988), quoting *Schlanger v. Four-Phase Sys. Inc.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982) ("[I]t is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?"); Lisa M. Fairchild & Nan S. Ellis, *Municipal Bond Disclosure: Remaining Inadequacies of Mandatory Disclosure Under Rule 15c2-12*, 23 J. CORP. L. 439, 456 (1998) (noting that when investors have confidence that relevant information is reflected in securities prices, they are more likely to invest and their transaction costs are reduced).

50. See Fairchild & Ellis, *supra* note 49, at 456 (noting that information improves efficiency and that efficiency improves resource allocation).

gated under these acts, are promoting accurate and complete disclosure about securities sold to the public and preventing fraudulent or unfair practices in the sale of securities.<sup>51</sup>

The U.S. Securities and Exchange Commission plays an important role in maintaining the integrity of U.S. securities markets. Its mission is “to protect investors – including investors in municipal securities – maintain fair, orderly, and efficient markets, and facilitate capital formation.”<sup>52</sup>

### *B. Municipal Securities Are Less Regulated than Corporate Securities*

Although municipal securities are subject to some federal regulation as described in Section II.B, they are exempt from significant portions of both the Securities Act and the Exchange Act.<sup>53</sup>

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51. See *supra* notes 6 & 7 and accompanying text; *New U.S. Securities Law*, *supra* note 46 (“[T]he principal purpose . . . of the [S]ecurities [A]ct is that full disclosure shall be made of all material facts concerning an issue of securities that is offered for sale to the public.”); *What We Do*, SEC. & EXCH. COMM’N, <https://www.sec.gov/Article/whatwedo.html#intro> (last modified June 10, 2013) (“The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it.”).

52. SEC. & EXCH. COMM’N, *supra* note 12, at 2.

53. Commentators have suggested several reasons for the different treatment of state and local government securities, including the federal form of U.S. government and politics, a perceived lack of abuses in municipal markets, the historic relative sophistication of municipal investors, and the traditional local nature of municipal securities markets. See, e.g., Municipal Securities Disclosure, 53 Fed. Reg. 37778, 37786 (proposed Sept. 28, 1988) (identifying “the local nature of markets, the absence of demonstrated abuses, and the sophistication of investors” as influences and noting that Congress was “persuaded that direct regulation of the process by which municipal issuers and municipalities raise funds to finance governmental activities would place the [SEC] in the position of gate-keeper to the financial markets, a position inconsistent with intergovernmental comity”); Fairchild & Ellis, *supra* note 49, at 441 (referring to “Constitutional concerns regarding congressional authority to regulate the issuance of securities by state and local governments” and noting that “it was believed that the improprieties which prompted federal regulation of the corporate securities market were less likely to arise in the municipal market.”); James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 39 (1959) (noting that municipal bonds were included in the initial draft of the Securities Act but were ultimately exempted for “obvious political reasons”); Maco, *supra* note 5, at 4 (citing the federal form of government and resulting political considerations at the time the securities laws were adopted). It is beyond the scope of this article to discuss the appropriateness of these exemptions, though others have done so. For some critical commentary, see, e.g., Luis A. Aguilar, *Statement on Making the Municipal Securities Market More Transparent, Liquid, and Fair*, SEC. & EXCH. COMM’N (Feb. 13, 2015), <https://www.sec.gov/news/statement/making-municipal-securities-market-more-transparent-liquid-fair.html> (advocating for the repeal of the Tower

The Securities Act exempts securities issued by state and local governments from all of its provisions, except where it specifically provides otherwise.<sup>54</sup> Unlike corporations issuing securities for sale to the public, municipal issuers do not need to file a registration statement with the SEC and are not subject to detailed requirements specifying what needs to be included in the document by which the securities are offered (a prospectus for a publicly sold stock, an official statement for municipal bonds).<sup>55</sup>

The Exchange Act exempts securities issued by state and local governments from specifically identified provisions, including the requirements for periodic reporting.<sup>56</sup> This means that unlike public companies, state and local governments are not required to file detailed annual and quarterly reports.<sup>57</sup> Instead, state and local governments are indirectly required to provide updates to some of the information in their offering documents annually and to disclose the occurrence of certain events as described in Section II.C.2.b.

Furthermore, neither the SEC nor the MSRB is authorized under the Exchange Act to impose rules or regulations directly or indirectly requiring an issuer of municipal bonds to file any application, report, or document with the SEC or the MSRB before selling securities.<sup>58</sup> The Exchange Act also expressly states that it does not authorize the MSRB to directly or indirectly require an issuer of municipal securi-

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Amendment (described below) and the repeal of the exemption of municipal bonds from the registration and disclosure provisions of the Securities Act and Exchange Act); Spencer T. Bachus, *Federal Policy Responses to the Predicament of Municipal Finance*, 40 CUMB. L. REV. 759, 793–94 (2010) (advocating for regulatory changes including enhanced disclosure standards); Lisa M. Fairchild & Nan S. Ellis, *Rule 15c2-12: A Flawed Regulatory Framework Creates Pitfalls for Municipal Issuers*, 2 WASH. U. J.L. & POL'Y 587, 623–25 (2000) (recommending repeal of the Tower Amendment and direct regulation of municipal securities disclosure); Teresa A. Gabaldon, *Financial Federalism and the Short, Happy Life of Municipal Securities Regulation*, 34 J. CORP. L. 739 (2009) (advocating greater regulation of municipal securities disclosure).

54. 15 U.S.C. § 77c(a)(2) (2012).

55. See 15 U.S.C. § 77f (2012) (requiring registration of securities generally, but without stating that the provision applies to exempt securities). The Securities Act and regulations detail the type of information to be included in a prospectus. See 15 U.S.C. § 77g (2012); 17 C.F.R. pts. 210 and 229 (setting forth requirements for prospectus). In contrast, while state and local governments are indirectly required to provide offering documents for their bonds, there are very limited rules about the content of those documents. See Section II.C.2.a *infra* for more detail.

56. 15 U.S.C. §§ 78c(a)(12), (29), 78l(a), 78m (2012).

57. Public companies file annual reports on Form 10-Q and quarterly reports on Form 10-K. The content of these reports is addressed in Regulations S-K and S-X.

58. 15 U.S.C. § 78o-4(d)(1) (2012). The MSRB is described at notes 64–67 *infra* and accompanying text.



ties to provide the MSRB or a purchaser of the securities with any information or document about the issuer.<sup>59</sup> These provisions, which are sometimes referred to as the “Tower Amendment,”<sup>60</sup> were added to the Exchange Act in 1975 in conjunction with legislation that created the MSRB and empowered it to impose rules on municipal brokers and dealers, with SEC approval, and provided for enforcement of the MSRB’s rules by the SEC and other entities.<sup>61</sup>

As a result of the exemptions described above, and of the Tower Amendment, the SEC regulates municipal disclosure indirectly by regulating underwriters and uses enforcement actions to provide guidance to municipal issuers.<sup>62</sup>

### C. Regulation of Municipal Securities

Municipal bonds are nonetheless subject to the “antifraud provisions”<sup>63</sup> of the Securities Act and the Exchange Act and are regulated by the SEC and the MSRB. The SEC’s activities include adopting rules and interpreting and enforcing federal securities laws and regulations.

The MSRB is a self-regulatory organization created through amendments to the Exchange Act in 1975.<sup>64</sup> The MSRB is required to adopt rules that, among other things, are “designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, . . . to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, . . . and the public interest . . . .”<sup>65</sup> The MSRB is authorized to make rules regarding, among other matters, municipal

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59. 15 U.S.C. § 78o-4(d)(2) (2012). The MSRB can require an underwriter to provide information about an issuer to the MSRB or a purchaser of the issuer’s securities, but only if the information is available from another source. 15 U.S.C. § 78o-4(d)(2) (2012).

60. Named for Senator John Tower, who proposed the amendments.

61. SEC. & EXCH. COMM’N, STAFF REPORT ON THE MUNICIPAL SECURITIES MARKET 6–8 (1993). Prior to the 1975 amendments, which were adopted because of abusive practices by municipal securities professionals, the growth of the municipal securities market, the variety of municipal securities being offered and changes in the typical investor, the municipal securities market was “largely unregulated.” *Id.* at 6.

62. See *infra* Section II.C.2 and note 110 and accompanying text.

63. See *infra* Section II.C.1.

64. SEC. & EXCH. COMM’N, *supra* note 12, at 33. The composition of the MSRB and the scope of its powers and obligations are set forth in 15 U.S.C. § 78o-4(b).

65. 15 U.S.C. § 78o-4(b)(2)(C) (2012). “Municipal financial products” include derivatives, guaranteed investment contracts and investment strategies. 15 U.S.C. § 78o-4(e)(5) (2012). State and local governments sometimes enter into municipal financial products in conjunction with issuing bonds.



securities transactions by underwriters and advice provided to municipal entities by underwriters and municipal advisors concerning municipal bond issuances and municipal financial products.<sup>66</sup> The MSRB's rules generally are subject to SEC approval and are enforced by the SEC and other agencies.<sup>67</sup>

The antifraud provisions and the most relevant SEC and MSRB rules are discussed in the remainder of this Section II.C.

### 1. *Antifraud Provisions Apply to Municipal Securities*

Like corporate securities, municipal bonds are subject to Section 17(a) of the Securities Act ("Section 17(a)"), Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated pursuant to the Exchange Act ("Rule 10b-5"), which are collectively referred to as the "antifraud provisions."<sup>68</sup>

The provisions under the two acts are similar to each other, but not identical. Most relevant for purposes of this article, both Section 17(a) and Rule 10b-5 prohibit fraud and the use of "any untrue statement of a material fact" or the omission of "a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading" to obtain money or property, in the case of Section 17(a), and in connection with the purchase or sale of securities, in the case of Rule 10b-5.<sup>69</sup>

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66. 15 U.S.C. § 78o-4(b)(2) (2012).

67. 15 U.S.C. §§ 78o-4(c), 78s(b) (2012); SEC. & EXCH. COMM'N, *supra* note 12, at 34.

68. *Glossary of Municipal Securities Terms: Anti-fraud Provisions*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/Glossary/Definition/ANTI-FRAUD-PROVISIONS.aspx> (last visited Feb. 11, 2019). Notwithstanding that fraud is commonly thought of as an intentional act, *see, e.g.*, JOHN DOWNES & JORDAN ELLIOT GOODMAN, *DICTIONARY OF FINANCE AND INVESTMENT TERMS* 158 (6th ed. 2006) (defining fraud as purposeful); *Fraud*, *LAW DICTIONARY*, <https://thelawdictionary.org/fraud/> (last visited Feb. 3, 2019) (describing fraud as "intentional"), recklessness or even negligence can suffice in SEC enforcement actions. *See infra* notes 74–75 and accompanying text.

69. Section 17(a) provides that:

"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 use of the mails, directly or indirectly—(1) to employ any device, scheme, or artifice to defraud, or (2) to 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 (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Both Section 17(a) and Rule 10b-5 refer to “material” facts. Information is “material” if there is “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” and if “there is a substantial likelihood that a reasonable [investor] would consider it important.”<sup>70</sup>

The antifraud rules apply to offering documents delivered to investors, to the continuing disclosure filings described in Section II.C.2.b, and to any other information that an issuer provides to the public “that is reasonably expected to reach investors and the trading markets,” even if that information is made public for other reasons.<sup>71</sup> This is significant because state and local governments routinely provide a wide range of information to the public and state and local government officials regularly make public statements.<sup>72</sup>

The SEC pursues actions against state and local governments under both Section 17(a) and Rule 10b-5.<sup>73</sup> While the SEC must prove “scienter” in order to prove a violation of Section 17(a)(1) and Rule 10b-5, it need not do so for violations of Section 17(a)(2) and (3).<sup>74</sup> This means that a material misstatement or omission need only be *negligent* for the SEC to prevail in an action under Section 17(a)(2),

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15 U.S.C. § 77q(a) (2012). “Person” as used in the Securities Act includes a government or a political subdivision, and the exemptions provided in Section 3 of the Securities Act, including the exemption for municipal bonds, do not apply to Section 17. 15 U.S.C. §§ 77b(a)(2), 77q(c) (2012). Section 10(b) of the Exchange Act makes it illegal to use interstate commerce, the mails or a national securities exchange in order to “use or employ, in connection with the purchase or sale of . . . any security . . . any manipulative or deceptive device or contrivance” in violation of rules promulgated by the SEC. 15 U.S.C. § 78j(b) (2012). Rule 10b-5 provides that:

“It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.”

17 C.F.R. § 240.10b-5 (2019).

70. *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

71. Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, 59 Fed. Reg. 12748, 12756 (Mar. 17, 1994) [hereinafter Statement of the Commission Regarding Disclosure Obligations].

72. *Id.* at 12756.

73. Actions by private parties under the antifraud provisions are beyond the scope of this article.

74. *Aaron v. SEC*, 446 U.S. 680, 701–02 (1980).

though at least recklessness would be required under Rule 10b-5.<sup>75</sup> The SEC's enforcement methods are discussed in Section II.D.

## 2. *Underwriters of Municipal Bonds are Required to Provide Disclosure to Investors*

Underwriters of municipal securities are regulated by the SEC and the MSRB. These regulations impose a framework of disclosure requirements on underwriters. These requirements have the effect of indirectly requiring issuers to prepare offering documents and to agree to provide certain information subsequent to the sale of bonds.

### a. *Offering Documents (Preliminary Official Statements and Official Statements)*

Before bidding for, purchasing, offering or selling municipal bonds in a primary offering, underwriters must obtain an offering document that the state or local government issuer considers final, other than specified information such as the principal amount, interest rate and offering price of the bonds, underwriters' compensation, and credit ratings on the bonds.<sup>76</sup> This document is referred to as a "preliminary official statement."<sup>77</sup> A preliminary official statement is used by underwriters to market bonds in advance of their sale.<sup>78</sup> Underwriters in negotiated primary offerings are required to provide a copy of the preliminary official statement to any potential customer upon request until the final official statement is available.<sup>79</sup>

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75. See *id.* at 686, n.5 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976) ("scienter" as a "mental state embracing intent to deceive, manipulate or defraud"; the court did not address whether "scienter" might include recklessness in some circumstances)); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (observing that every court of appeals that has considered the issue has found that "scienter" includes recklessness, but the degree of recklessness has varied); Ann M. Olazábal & Patricia S. Abril, *Recklessness as a State of Mind in 10(B) Cases: The Civil-Criminal Dialectic*, N.Y.U. J. LEGIS. & PUB. POL'Y 305, 319–25 (2015) (discussing various interpretations by federal courts of the level of recklessness that can result in a violation of Rule 10b-5).

76. 17 C.F.R. § 240.15c2-12(b)(1) (2019).

77. *Glossary of Municipal Securities Terms: Preliminary Official Statement (POS)*, MUN. SEC. RULEMAKING BD., [http://www.msrb.org/Glossary/Definition/PRELIMINARY-OFFICIAL-STATEMENT-\\_POS\\_.aspx](http://www.msrb.org/Glossary/Definition/PRELIMINARY-OFFICIAL-STATEMENT-_POS_.aspx) (last visited Aug. 13, 2019).

78. BROOKE D. ABOLA & STEPHEN A. SPITZ, ORRICK, HERRINGTON & SUTCLIFFE LLP, *DISCLOSURE OBLIGATIONS OF ISSUERS OF MUNICIPAL SECURITIES* 7 (2011). Sometimes only a final official statement is prepared for an issuance of variable rate bonds and is used to market the bonds as well as to meet the final official statement delivery requirements.

79. 17 C.F.R. § 240.15c2-12(b)(2) (2019).

Underwriters also are required to contract with state and local government issuers to receive a final official statement (typically referred to simply as an “official statement”) from the state or local government issuer in time to deliver it to those buying the bonds from the underwriter at the time a confirmation of the order requesting payment is sent, and are required to deliver an official statement to any potential customer upon request for at least 25 days after the bonds are issued and to post the official statement on the MSRB’s Electronic Municipal Market Access website ([www.emma.msrb.org](http://www.emma.msrb.org)) (“EMMA”).<sup>80</sup> The official statement must include the terms of the bonds, information about the issuer and other entities, enterprises, funds and accounts material to the evaluation of the offering, including operating data and financial information, a description of the continuing disclosure undertakings of the issuer, and any instances of material noncompliance with prior continuing disclosure undertakings in the last five years.<sup>81</sup>

While the ultimate responsibility for the official statement rests with the issuer, underwriters recommending securities must have a reasonable basis for their recommendation, and the SEC has stated that the participation of an underwriter in an offering is an “implied recommendation” of the securities being offered.<sup>82</sup> This includes exercising reasonable care in reviewing and evaluating the accuracy of the official statement for the bonds being offered.<sup>83</sup> Underwriters also must review the official statement to comply with their obligation to “deal fairly with all persons” under MSRB Rule G-17 and their obligations to have a reasonable basis to believe that the bond is a suitable

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80. 17 C.F.R. § 240.15c2-12(b)(3)–(4) (2019); MUN. SEC. RULEMAKING BD., RULE G-32(B)(1)(B): DISCLOSURES IN CONNECTION WITH PRIMARY OFFERINGS, <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-32.aspx> (last visited Aug. 30, 2019); *see also* MUN. SEC. RULEMAKING BD., MSRB NOTICE 2010-37: MSRB REMINDS FIRMS OF THEIR SALES PRACTICE AND DUE DILIGENCE OBLIGATIONS WHEN SELLING MUNICIPAL SECURITIES IN THE SECONDARY MARKET (2010), <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-37.aspx> [hereinafter MSRB NOTICE] (noting that the MSRB has interpreted Rule G-17 to require underwriters to deliver all material facts about the transaction known to the dealer or “reasonably accessible to the market,” including significant features of the bonds and facts material to assessing the risk of the investment). EMMA is accessible to the general public without charge.

81. 17 C.F.R. § 240.15c2-12(f)(3) (2019). *See infra* Section II.C.2.b for discussion of continuing disclosure undertakings. In contrast, the requirements for offering documents for corporate securities offerings are very detailed. *See* 17 C.F.R. pts. 210, 229 (2019).

82. Municipal Securities Disclosure, 53 Fed. Reg. 37,778, 37,787 (proposed Sept. 28, 1988) (to be codified at 17 C.F.R. pt. 240).

83. *Id.* at 37,787–88. The level of care required in negotiated transactions is higher than in competitive transactions. *Id.* at 37,789–90.

investment for their customers under MRSB Rule G-19.<sup>84</sup> The SEC has noted that the lack of detailed disclosure requirements increases the importance of underwriter review of the official statement “as a means of guarding the integrity of new offerings.”<sup>85</sup>

*b. Underwriters Must Determine that Issuer Is Obligated to Provide Ongoing Disclosure*

Underwriters may not buy or sell municipal bonds in a public offering unless they have reasonably determined that the issuer has agreed in writing to provide annual updates of financial information and operating data that is included in the official statement, audited financial statements (if available) and notice of certain enumerated events such as payment delinquencies, material defaults, credit rating changes, insolvency, and the incurrence of or default under certain debt obligations.<sup>86</sup> These written agreements are referred to as “continuing disclosure undertakings.” Updates and notices are posted on EMMA.<sup>87</sup> Annual updates are not required to be comprehensive updates of the entire official statement, but rather of operating data and financial information included in the official statement; typically, the undertaking includes a list of specific information that is required to be updated.<sup>88</sup>

While the relevant SEC rule does not include a deadline for the filing of annual financial information, 35% have deadlines of 180 days after the end of the fiscal year, and fewer than 20% have deadlines in

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84. MUN. SEC. RULEMAKING BD., MSRB NOTICE, *supra* note 80.

85. Municipal Securities Disclosure, 53 Fed. Reg. at 37,781.

86. 17 C.F.R. § 240.15c2-12(b)(5) (2019). These requirements also apply to any other entity or person that is obligated to support payment on the bonds, including nonprofit or for-profit entities (referred to herein as “other obligated entities”). In transactions where a state or local government is issuing bonds on behalf of another entity and that other entity is solely responsible for paying debt service on the bonds, the issuer is not required to enter into such an agreement. For the sake of simplicity, this article does not address these types of financings. There are some limited exceptions to this rule. 17 C.F.R. § 240.15c2-12(d) (2019).

87. 17 C.F.R. § 240.15c2-12(b)(5) (2019); *Continuing Disclosures*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/Market-Transparency/Continuing-Disclosure.aspx> (last visited Aug. 14, 2019).

88. See Justin Pica & Timothy J. Reimers, Presentation at the California Debt and Investment Advisory Commission Seminar: Continuing Disclosure Responsibilities 3, 31 (Mar. 19, 2015), <https://www.treasurer.ca.gov/cdiac/seminars/2015/20150317/day3/3.pdf> (annual reports include information specified in a continuing disclosure undertaking, form of continuing disclosure undertaking with placeholder for list of information to be updated).

excess of 270 days.<sup>89</sup> Notices of enumerated events must be filed within 10 business days after the occurrence of the event.<sup>90</sup>

Continuing disclosure undertakings cannot be enforced by the SEC or by underwriters. Typically, the holders of a specified percentage of the bonds can take legal action to compel performance with the agreement, but a violation of the agreement is not a default on the bonds and the bondholders have no right to recover monetary damages.<sup>91</sup> If bondholders have ever taken such a legal action, it was an uncommon occurrence.<sup>92</sup>

Official statements for bonds being issued must disclose material noncompliance with any continuing disclosure undertakings during the preceding five years.<sup>93</sup> The SEC has noted that the likelihood that an issuer will comply with its continuing disclosure undertaking is important to investors.<sup>94</sup> The requirement that past noncompliance be disclosed also is intended to incentivize issuers to comply with undertakings.<sup>95</sup> This incentive is likely weaker for issuers that do not expect to issue bonds, and therefore prepare official statements, in the future. Issuers have not always complied with this disclosure requirement.<sup>96</sup>

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89. MUN. SEC. RULEMAKING BD., *TIMING OF ANNUAL FINANCIAL DISCLOSURES BY ISSUERS OF MUNICIPAL SECURITIES* 12–13 (2017), <http://www.msrb.org/msrb1/pdfs/MSRB-CD-Timing-of-Annual-Financial-Disclosures-2016.pdf>; see also Abola & Spitz, *supra* note 78, at 22 (“Most issuers agree to provide the annual report for a given fiscal year within six to nine months of the fiscal year close. . . .”); Peter J. Schmidt, DPC Data Inc., *Recent Trends in Municipal Continuing Disclosure Activities* 21 (2011) (indicating that the mean number of days after the end of the fiscal year agreed to was 222.2).

90. 17 C.F.R. § 240.15c2-12(b)(5)(C)(2019).

91. See Pica & Reimers, *supra* note 88, at 35 (default provision in form continuing disclosure undertaking); Schmidt, *supra* note 89, at 14 (noting that a failure to make continuing disclosure filings “never constitutes an event of default under a bond resolution or trust indenture”).

92. See U.S. GOV’T ACCOUNTABILITY OFF., GAO-12-698, *MUNICIPAL SECURITIES: OPTIONS FOR IMPROVING CONTINUING DISCLOSURE* 14 (2012) (“SEC staff told us that they were not aware of any public statements about any such lawsuits having occurred.”); Tesia Nicole Stanley, *Narrowing the Disclosure Gap: Is EMMA EDGAR for the Municipal Securities Market?*, 7 J.L. ECON. & POL’Y 91, 109 (2010) (describing bondholder legal action to enforce an undertaking as “unlikely”).

93. 17 C.F.R. § 240.15c2-12(f)(3) (2019).

94. Municipal Securities Disclosure, Exchange Act Release No. 34-34961, 57 SEC Docket 2641, 1994 WL 640013, at \*8 (Nov. 10, 1994); Sec. & Exch. Comm’n, *Municipalities Continuing Disclosure Cooperation Initiative*, <https://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml> (modified Nov. 13, 2014) [hereinafter MCDC Initiative].

95. Municipal Securities Disclosure, Release No. 34-34961, *supra* note 94, at \*8; MCDC Initiative, *supra* note 94.

96. See *infra* notes 180–85 and accompanying text for further discussion.

### 3. *Underwriters of Municipal Bonds are Required to Provide Information to Municipal Issuers*

Underwriters have a duty to “deal fairly with all persons” (including state and local government issuers) and are prohibited from engaging in “any deceptive, dishonest, or unfair practice.”<sup>97</sup> The MSRB has interpreted this rule to require underwriters in negotiated offerings to provide specified information to state and local government clients, including a statement that the underwriter does not have a fiduciary duty to the issuer, and information about whether the underwriter’s compensation is contingent on the closing of the transaction and any conflicts of interest.<sup>98</sup> In addition, underwriters must disclose the material aspects of the financing structures they recommend, taking into account the level of expertise of the issuer and the complexity of the transaction structure.<sup>99</sup>

### 4. *Municipal Advisors Are Regulated and Have a Fiduciary Duty to State and Local Government Clients*

While historically municipal advisors were largely unregulated, in 2010 the U.S. Congress passed legislation which required municipal advisors to register with the SEC, gave the MSRB the power to regulate them, and imposed a fiduciary duty on them when advising state and local governments.<sup>100</sup> This was a reaction to abuses against local governments that came to light during the 2008 global financial crisis.<sup>101</sup> This fiduciary duty includes a duty of loyalty and a duty of care.<sup>102</sup> The duty of loyalty includes dealing honestly and in good faith and acting in the client’s best interest regardless of the interests of the municipal advisor.<sup>103</sup> The duty of care includes having appro-

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97. MUN. SEC. RULEMAKING BD., RULE G-17, <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx> (last visited Aug. 29, 2019); MUN. SEC. RULEMAKING BD., INTERPRETIVE NOTICE CONCERNING THE APPLICATION OF MSRB RULE G-17 TO UNDERWRITERS OF MUNICIPAL SECURITIES (2012), [http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.%20.aspx?tab=2#\\_D54ECA77-2CE6-4ED9-BB05-3C9B32FB7BF4](http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.%20.aspx?tab=2#_D54ECA77-2CE6-4ED9-BB05-3C9B32FB7BF4) [hereinafter MSRB G-17 INTERPRETIVE NOTICE].

98. MSRB G-17 INTERPRETIVE NOTICE, *supra* note 97.

99. *Id.*

100. Registration of Municipal Advisors, Final Rule, Exchange Act Release No. 34-70462, 107 SEC Docket 919 (Sept. 20, 2013) (codified at 15 C.F.R. §§ 780-4(a), (b), (c), (e)(4)) (final rule).

101. *Id.* at 28–29.

102. MUN. SEC. RULEMAKING BD., RULE G-42(A), <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-42.aspx> (last updated Feb. 7, 2019).

103. MUN. SEC. RULEMAKING BD., RULE G-42, SUPPLEMENTARY MATERIAL .02, <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-42.aspx> (last updated Feb. 7, 2019).



priate knowledge and expertise and having a reasonable basis for advice provided to the client and for representations and information provided to the client or other parties involved in a transaction.<sup>104</sup> Municipal advisors are also required to “deal fairly with all persons.”<sup>105</sup>

#### *D. The SEC Enforces Federal Securities Laws and MSRB Rules*

The SEC has the power to enforce federal securities laws, including against state and local governments, government officials, underwriters, municipal advisors and others.<sup>106</sup> In addition, the SEC has the power to enforce MSRB rules against municipal advisors and underwriters in municipal financings.<sup>107</sup> The SEC exercises these powers through its Division of Enforcement, which “conducts investigations into possible violations of the federal securities laws, and litigates the [SEC’s] civil enforcement proceedings in the federal courts and in administrative proceedings.”<sup>108</sup> The Division’s Public Finance Abuse Unit, which was created in 2010 in response to perceived abuses in the municipal finance market, is responsible for proceedings against state and local governments and other municipal securities market participants.<sup>109</sup>

The SEC uses enforcement actions not only to punish those that have violated federal securities laws, but also to provide guidance to other state and local government issuers, municipal underwriters, municipal advisors, and other participants in the municipal securities markets.<sup>110</sup>

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104. MUN. SEC. RULEMAKING BD., RULE G-42, SUPPLEMENTARY MATERIAL .01, <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-42.aspx> (last updated Feb. 7, 2019).

105. MUN. SEC. RULEMAKING BD., RULE G-17, <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx> (last visited Aug. 29, 2019).

106. See FIPPINGER, *supra* note 9, §§ 15:2-3, 15.8.1 (describing the SEC’s enforcement powers with respect to state and local governments, government officials and legislators, underwriters and municipal advisors, among others).

107. See FIPPINGER, *supra* note 9, § 15:8.1 (describing, among other things, the SEC’s authority to enforce the MSRB’s rules). Other organizations also enforce the MSRB’s rules, including the Financial Industry Regulatory Authority and bank regulators.

108. *About the Division of Enforcement*, SEC. & EXCH. COMM’N, <https://www.sec.gov/enforce/Article/enforce-about.html> (last modified Aug. 2, 2007). The SEC does not prosecute criminal offenses, but it can refer matters to the U.S. Department of Justice. See FIPPINGER, *supra* note 9, §15:9 (describing authority to transmit evidence and parallel SEC and criminal actions).

109. Ceresney, *supra* note 1.

110. See DOTY, *supra* note 24, at 42 (describing SEC enforcement as “a highly successful regulatory tool”); FIPPINGER, *supra* note 9, § 15:1 (noting that part of the Division of Enforcement’s mission is to “influence and improve standards of conduct and practices by issuers and other market participants”).



### 1. *Administrative Proceedings*

The SEC adjudicates some alleged securities law violations itself through a proceeding before an administrative law judge, who is an independent employee of the SEC.<sup>111</sup> As a result of these proceedings or due to settlement of them, the SEC sometimes issues “cease-and-desist orders,” which direct a person to refrain from conduct that violates the law.<sup>112</sup> Because the SEC writes the cease-and-desist orders itself, these orders “provide the SEC with an opportunity to comment on the application of the securities laws . . .” and to “explain its theory of the case.”<sup>113</sup> This makes cease-and-desist orders a more effective way for the SEC to communicate its views to the municipal securities market than an injunction in a court proceeding. The SEC can also impose penalties and disgorgement of illegal profits in an administrative proceeding.<sup>114</sup> If the person or entity against which a cease-and-desist order was issued violates that order, the SEC can seek a monetary penalty in federal court.<sup>115</sup>

### 2. *Action in Federal Court*

The SEC also brings actions against alleged violators of federal securities laws in federal court.<sup>116</sup> If the SEC prevails, the court will issue an injunction, which is an order that prohibits future violations.<sup>117</sup> The court can also impose monetary penalties and disgorgement of illegal profits.<sup>118</sup> A person or entity that violates an injunction may have to pay fines or (in the case of a person) go to prison for contempt of court.<sup>119</sup> The SEC is more likely to pursue an injunction in federal court rather than a cease-and-desist order in an administrative proceeding when the conduct of the alleged violator is particularly egregious.<sup>120</sup>

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111. GEORGE E. GREER, ORRICK, HERRINGTON & SUTCLIFFE LLP, SEC INVESTIGATIONS AND ENFORCEMENT ACTIONS: A PRACTICAL HANDBOOK FOR MUNICIPAL SECURITIES ISSUERS 18 (2011); *About the Division of Enforcement*, *supra* note 108.

112. *See* FIPPINGER, *supra* note 9, § 15:8.2 (describing cease-and-desist orders as the result of an administrative hearing or settlement).

113. *Id.* §§ 15:1, 15:8.3[B].

114. *Id.* § 15:8.3[E]; *About the Division of Enforcement*, *supra* note 108.

115. GREER, *supra* note 111, at 19.

116. FIPPINGER, *supra* note 9, § 15:1; *About the Division of Enforcement*, *supra* note 108.

117. GREER, *supra* note 111, at 17.

118. *About the Division of Enforcement*, *supra* note 108.

119. FIPPINGER, *supra* note 9, § 15:1; *About the Division of Enforcement*, *supra* note 108.

120. FIPPINGER, *supra* note 9, § 15:8.3[B].

### 3. *Public Report of Investigation*

Sometimes, the SEC concludes an investigation into misconduct by issuing a public report instead of or in addition to pursuing an administrative proceeding or civil action.<sup>121</sup> These reports are relatively rare,<sup>122</sup> but are used when (a) the SEC wishes to discuss the application of federal securities laws to “controversial and timely legal issues in public finance” and to encourage commentary and discussion; (b) the SEC wishes to avoid imposing monetary penalties on taxpayers; (c) the settlement negotiations with the subject of the investigation dictate such a result; or (d) the subject has taken remedial steps to prevent future wrongdoing and has cooperated with the SEC during the investigation, or the officials who engaged in the misconduct are no longer associated with the investigated party.<sup>123</sup>

## III.

### RECENT SEC ENFORCEMENT ACTIVITY AGAINST STATE AND LOCAL GOVERNMENTS

In recent years, the SEC’s Enforcement Division has been more active in the municipal securities market, including against municipal issuers, than it has been in the past. Prior to 2010, the SEC had not devoted “sustained enforcement attention” to municipal bonds, nor had it developed “deep expertise regarding abuses in public financing.”<sup>124</sup> In January 2010, the Division created a new specialized unit (later renamed the Public Finance Abuse Unit) to focus on misconduct in the municipal securities market and with respect to public pension funds,<sup>125</sup> presumably at least in part as a response to changes in the market and problems that had come to light as a result of the 2008 global financial crisis.<sup>126</sup> The volume of enforcement actions against state and local government issuers increased dramatically beginning in 2013, likely in part as a result of the creation of the Public Finance

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121. These reports are authorized under Section 21(a) of the Exchange Act and are sometimes referred to as Section 21(a) reports.

122. The SEC issued ten Section 21(a) reports between 1996–2010, three of which directly related to public finance. FIPPINGER, *supra* note 9, § 15:6.1. The SEC released six Section 21(a) reports 2011–2018, including one relating to public finance. *See Reports of Investigations*, SEC. & EXCH. COMM’N, <https://www.sec.gov/litigation/investreports.shtml> (last modified Oct. 16, 2018).

123. FIPPINGER, *supra* note 9, § 15:6.1.

124. Ceresney *supra*, note 1.

125. Press Release, Sec. & Exch. Comm’n, SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence (Jan. 13, 2010), <https://www.sec.gov/news/press/2010/2010-5.htm>; Ceresney *supra*, note 1.

126. *See supra* notes 19–20 & 101 and accompanying text.

Abuse Unit in 2010, and consistent with the SEC's approach to enforcement at that time, which was described by the Chair of the SEC in 2013 as being driven by the theory that "minor violations that are overlooked or ignored can feed bigger ones, and, perhaps, more importantly, can foster a culture where laws are increasingly treated as toothless guidelines."<sup>127</sup> In the three and a half years from 2013 through mid-2016, the SEC brought enforcement actions against seventy-six state or local governments and sixteen public officials, as compared to six state and local governments and twelve public officials over the period from 2002 to 2012.<sup>128</sup> The SEC has been "sending a message to the market participants, especially the issuers of municipal bonds really, that they need to be out there taking seriously their obligations under the federal securities laws."<sup>129</sup>

The nature of the SEC's enforcement activity has changed in recent years. Since 2013, the SEC has imposed tougher penalties on state and local government issuers and municipal officials, including the first civil penalties imposed on local government issuers, the first prohibitions of municipal officials from participating in future bond offerings, and more frequent imposition of substantial civil penalties

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127. Mary Jo White, Chair, Sec. & Exch. Comm'n, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), <https://www.sec.gov/news/speech/spch100913mjw>. This is sometimes referred to as "Broken Windows" enforcement. *Id.*

128. Ceresney *supra*, note 1. Many of the state and local governments were under the MCDC Initiative discussed in Section III.E.1, *infra*; even without these, actions against state and local governments increased dramatically. While the SEC highlighted no new enforcement actions against state or local governments under the antifraud provisions on the relevant portion of its web site in 2018 or the first half of 2019, *see Recent Municipal Securities Enforcement Actions*, SEC. & EXCH. COMM'N, <https://www.sec.gov/municipal/oms-enforcement-actions.html> (last visited Nov. 7, 2019), and the SEC may be focusing less on "technical errors or smaller transgressions" in the municipal market going forward, Kyle Glazier, *Outlook 2018: SEC's Top Muni Cop Lists Enforcement Priorities*, BOND BUYER (Dec. 26, 2017, 6:00 AM), <https://www.bondbuyer.com/news/secs-top-muni-cop-lists-2018-enforcement-priorities>, the SEC's Enforcement Division continues to be active in the municipal market. For example, an investigation of Dallas County Schools in Texas was reported in 2018 and another of Sweetwater Union High School District in California was reported in 2019. Scott Friedman, *Feds Expand Investigation of Dallas County Schools*, NBC 5 DALL.-FORT WORTH, <https://www.nbcdfw.com/investigations/Feds-Expand-Investigation-of-Dallas-County-Schools-481977041.html> (last updated May 7, 2018, 6:33 PM); Will Huntsberry, *The SEC Is Looking into Sweetwater Union's Financial Dealings*, VOICE OF SAN DIEGO (Jan. 28, 2019), <https://www.voiceofsandiego.org/topics/education/the-sec-is-looking-into-sweetwater-unions-financial-dealings>. Of course, an investigation does not necessarily lead to an enforcement action.

129. Elaine Greenberg, Chair, Public Finance Abuse Unit, Div. of Enf't, Sec. Exch. Comm'n, *quoted in* GREER, *supra* note 111, at 6.

on municipal officials.<sup>130</sup> In the last few years, the SEC has also required issuers to take specific steps to improve disclosure.<sup>131</sup>

In addition to acting in cases of what appear to be intentional or reckless deception of investors,<sup>132</sup> over the last several years, the SEC has acted against state and local governments with internal practices that appear to have led to inaccurate or misleading disclosure. Cease-and-desist orders have discussed not only why the disclosure was false or misleading, but also the circumstances that led to false or misleading disclosure being prepared. The following sections will discuss a few of the factors that the SEC has identified as leading to violations of the antifraud provisions, and how it has responded to them.

### A. *Avoiding Giving Bad News*

One problem that the SEC has identified is the tendency of politicians and state and local government officers to avoid “acknowledging that anything bad has happened on their watch.”<sup>133</sup> In part, this probably is a general human inclination.<sup>134</sup> However, it is likely to be intensified in a political environment in which there are regular elections and administration changes. “An administration facing an election may be disinclined to make public disclosure of issues that are likely

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130. DOTY, *supra* note 24, at 5–6. *See also* Guidotti, *supra* note 8, at 2062–63 (describing the SEC’s “recent zeal” for monetary penalties); Kevin J. Harnish et al., *A Series of Firsts in Muni Bond Enforcement Since 2010*, LAW360 (Nov. 17, 2016, 11:29 AM), <https://www.law360.com/articles/863361/a-series-of-firsts-in-muni-bond-enforcement-since-2010> (noting that while the imposition of civil penalties on government officials used to be “extraordinary,” it should “now be considered the norm”).

131. DOTY, *supra* note 24, at 4.

132. *See, e.g.*, Complaint at 1–3, SEC v. City of Harvey, No. 1:14-cv-047744 (N.D. Ill. June 24, 2014), (alleging, among other things, that a town official had diverted bond proceeds to improper purposes, including to the town’s comptroller); Complaint & Jury Demand at 2–3, SEC v. Town of Oyster Bay, No. 1:17-cv-06809 (E.D.N.Y. Nov. 21, 2017) (alleging, among other things that the Town of Oyster Bay and its Chief Executive Officer had intentionally concealed indirect guarantees of more than \$20 million of loans to a concessionaire that had given substantial gifts to town officials); Luke Torrance, *Oyster Bay Covered Up Singh Loan Guarantee: Auditor*, ISLAND NOW (May 9, 2018), <https://theislandnow.com/news-98/oyster-bay-covered-up-singh-loan-guarantee-auditor/> (“Singh testified . . . that he provided Venditto with gifts . . . in exchange for \$20 million in town loan guarantees”); Complaint & Jury Demand at 2–5, SEC v. Town of Ramapo, No. 16-cv-2779 (S.D.N.Y. Apr. 14, 2016) (alleging, among other things, that several individuals knowingly falsified financial statements) [hereinafter Ramapo Complaint].

133. Linda Chatman Thomsen, Dir., Div. of Enf’t, Sec. & Exch. Comm’n, Speech at the AICPA National Conference on Current SEC and PCAOB Developments: Lessons Learned from San Diego (Dec. 11, 2007), <https://www.sec.gov/news/speech/2007/spch121107lct.htm>.

134. The Director of the SEC Division of Enforcement noted that corporate officers and directors have the same tendency. *Id.*

to be embarrassing during an election campaign, and financial problems may be pushed forward to be dealt with by a new administration.”<sup>135</sup> The SEC has undertaken enforcement actions in several instances where it appears that this tendency led to inadequate disclosure.

For example, the desire to continue telling a positive story when things were going wrong seems to have led the City of Allen Park, Michigan to make false and misleading disclosure. The city had planned a \$146 million movie studio in partnership with a private developer.<sup>136</sup> The studio was described in local news as “a shot in the arm to an area hurt badly by the recession and a steep downturn in the auto industry.”<sup>137</sup> The scope and expected revenue-generating capacity of the project had been dramatically reduced by the time the city issued bonds to finance the project in November 2009 and June 2010.<sup>138</sup> However, the city disclosed neither the reduction in scope in its Official Statements, nor that the city’s budget included a substantial donation connected to the project that the city knew it would not receive.<sup>139</sup> The SEC pointed out in its cease-and-desist order that the plans for the full project were maintained on the city’s web site until at least June 2010, even though the project had been scaled back by mid-2009.<sup>140</sup> The SEC also described the city’s Mayor, who settled separate charges with the SEC, as “an active champion of the project.”<sup>141</sup>

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135. FIPPIER, *supra* note 9, § 15:3.2. Others have noted that local governments may tend to overutilize debt for the same reason. *See, e.g.*, ROBERT S. AMDURSKY ET AL., *MUNICIPAL DEBT FINANCE LAW: THEORY AND PRACTICE* 208 (2d ed. 2013) (“[L]ocal officials, who will want to demonstrate constructive activity to constituents before the next election, have incentives to overutilize debt, paying scant attention to long-term adverse effects.”); Richard Briffault, *Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, 34 *RUTGERS L.J.* 907, 917–18 (2003) (“the ability to shift the costs forward may . . . induce elected officials to incur too much debt” because “they can get the credit for the new project immediately, while the blame for the additional taxes needed to pay off the debt will be borne by their successors”).

136. City of Allen Park, Securities Act Release No. 9677, Exchange Act Release No. 73539, 2014 WL 5764984, at \*1 (Nov. 6, 2014) (cease-and-desist order).

137. Mike Householder, *Hollywood 48101: Allen Park Movie Studio Moves Forward*, OAKLAND PRESS (Aug. 28, 2009), [https://www.theoaklandpress.com/news/hollywood-allen-park-movie-studio-moves-forward/article\\_2c0e0771-f718-56f2-8fe1-b6296a22c416.html](https://www.theoaklandpress.com/news/hollywood-allen-park-movie-studio-moves-forward/article_2c0e0771-f718-56f2-8fe1-b6296a22c416.html).

138. City of Allen Park, 2014 WL 5764984, at \*2–3.

139. *Id.* at \*3–4.

140. *Id.* at \*2.

141. Press Release, Sec. & Exch. Comm’n, SEC Charges Allen Park, Mich. and Two Former City Leaders in Fraudulent Muni Bond Offering for Movie Studio Project (Nov. 6, 2014), <https://www.sec.gov/news/press-release/2014-249> [hereinafter Allen Park Press Release].

The SEC similarly identified “avoid[ing] further political fallout” as one of the reasons that officials in the Town of Ramapo, New York allegedly falsified the town’s financial statements by “recognizing fraudulent receivables, omitting unpaid liabilities, and improperly recording transfers from other funds. . . .”<sup>142</sup>

Even large issuers can be vulnerable to political pressure. The Port Authority of New York and New Jersey (the “Port Authority”), which provides “transportation, terminal and other facilities of commerce” in parts of New York and New Jersey, is one of the largest municipal issuers in the U.S. and has a budget of \$7 to \$8 billion per year.<sup>143</sup> The SEC issued a cease-and-desist order against the Port Authority relating to its failure to disclose to investors or to the Port Authority’s Board of Commissioners that there was question about whether the Port Authority could legally provide funding for the projects for which the bonds were being issued.<sup>144</sup> In its order, the SEC highlighted some of the political pressure on the Port Authority, emphasizing announcements by the New Jersey Governor about a transportation plan that included Port Authority funding for the projects.<sup>145</sup>

The SEC identified written policies and procedures, use of outside counsel and training as measures to help address these problems.<sup>146</sup> These topics are discussed in greater detail in Sections III.C and III.D.

### B. *Compartmentalization*

The SEC also has identified compartmentalization within state and local governments as a contributor to violations of the antifraud provisions. Compartmentalization, as used in this article, occurs when expertise and information about various aspects of the government and

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142. Ramapo Complaint, *supra* note 132, at 2.

143. Port Auth. of N.Y. & N.J., Securities Act Release No. 10278, 2017 WL 83465, at \*1–2 (Jan. 10, 2017) (cease-and-desist order).

144. *Id.* at \*1–2.

145. *Id.* at \*5–6.

146. *See, e.g.*, City of Allen Park, Securities Act Release No. 9677, Exchange Act Release No. 73539, 2014 WL 5764984, at \*5–6 (Nov. 6, 2014) (noting remedial actions the city had taken and that these were taken into consideration in agreeing to enter into the cease-and-desist order); Port Auth. of N.Y. & N.J., 2017 WL 83465, at \*8–10 (describing remedial actions taken by the Port Authority and requiring the Port Authority to establish written policies and procedures and provide training regarding disclosure, among other things); Ramapo Complaint, *supra* note 132, at 39 (requesting that remedies include requiring the retention of outside experts and an independent review of the town’s financial reporting procedures and controls).

its operations are held within separate departments or divisions that do not effectively communicate with each other.

For example, the SEC stated in a 2013 cease-and-desist order that the failure by the State of Illinois to disclose material information about underfunding of the State's pension plans and related risks to the State stemmed in part from the State's failure to implement policies "designed to ensure that material information was assembled and communicated to individuals responsible for disclosure determinations"; that "[a]s a result, the State lacked proper mechanisms to identify and incorporate into its official statements relevant information held by the pension systems and other bodies within the State."<sup>147</sup> The SEC also criticized the State's lack of disclosure counsel and training as "institutional failures."<sup>148</sup> Among the remedial measures that the SEC took into account in accepting the State's settlement offer were the formation of a disclosure committee responsible for collecting information and evaluating the State's disclosure obligations, and the establishment of a practice that ensures that the appropriate individuals review the State's pension disclosure.<sup>149</sup>

Similarly, the SEC identified "insufficient procedures and poor communication" between two state agencies as the reason the State of Kansas failed to provide material information about its unfunded pension liabilities in its official statements.<sup>150</sup> The SEC took into account remedial actions taken by the State—including mandating closer cooperation and communication, designating responsible parties within state agencies, establishing a disclosure committee and requiring training of personnel—in agreeing to accept the State's settlement offer.<sup>151</sup>

### C. *Lack of Clear Policies and Procedures*

The SEC has repeatedly emphasized how important it is that state and local governments have and follow clear policies and procedures that identify specific individuals responsible for disclosure.<sup>152</sup> At a

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147. Illinois, Securities Act Release No. 9839, 2013 WL 873208, at \*7 (Mar. 11, 2013) (cease-and-desist order).

148. *Id.* These topics are discussed in Section III.D, *infra*.

149. *Id.* at \*8-9.

150. Kansas, Securities Act Release No. 9629, 2014 WL 3896055, at \*1 (Aug. 11, 2014) (cease-and-desist order).

151. *Id.* at \*6-7.

152. The focus on policies and procedures also extends to corporate issuers; the prevention of fraud through policies and procedures by corporate issuers and other entities regulated by the SEC is seen by some as a "fundamental new theme" of the Exchange Act. See FIPPINGER, *supra* note 9, § 1:7.7[B] (noting that changes in law have had this effect). NABL noted that "the importance of written disclosure policies . . . appear to represent one of [the SEC's] major emphases in the municipal securities



minimum, these policies and procedures should identify responsible individuals, state the process by which disclosure is drafted and reviewed, and provide appropriate checks and balances.<sup>153</sup>

Recent SEC actions have highlighted the importance of policies and procedures. For example, in 2017, the SEC found that the City of Beaumont, California's Financing Authority failed to disclose that its affiliated community facilities district had "regularly failed to comply" with its continuing disclosure undertakings due to a failure to exercise reasonable care.<sup>154</sup> In particular, the SEC noted that the Authority and the district did not have "formal written policies or procedures for the preparation of accurate, complete and timely official statements or post-issuance continuing disclosures," did not maintain appropriate records of bond transactions, and did not clearly delineate responsibilities among staff, officers and others, but instead relied on one individual "without any significant governance, oversight or supervision."<sup>155</sup> The SEC required the Authority to establish appropriate policies and procedures, to retain an independent consultant and adopt all recommendations made by the consultant unless agreed to by the SEC, and to provide periodic training, among other things.<sup>156</sup>

The SEC indicated that the State of New Jersey's lack of written policies and procedures relating to the review and updating of offering documents and failure to provide training to employees about the State's disclosure obligations caused its antifraud provision violations that led to a 2010 cease-and-desist order against the State.<sup>157</sup> The SEC also noted that the City of Harrisburg, Pennsylvania lacked policies and procedures to ensure that its publicly released financial information was materially accurate or to ensure compliance with its continuing disclosure undertakings during the time that the City made materially inaccurate public statements about its finances and had not complied with its continuing disclosure undertakings.<sup>158</sup>

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market." NAT'L ASS'N OF BOND LAWYERS, CRAFTING DISCLOSURE POLICIES A-4 (2015).

153. Thomsen, *supra* note 133. For detailed discussion of what should be included in policies and procedures, see NAT'L ASS'N OF BOND LAWYERS, *supra* note 152.

154. Beaumont Fin. Auth., Securities Act Release No. 10406, 2017 WL 3614281, at \*2-3 (Aug. 23, 2017) (cease-and-desist order).

155. *Id.* at \*4.

156. *Id.* at \*5-7.

157. New Jersey, Securities Act Release No. 9135, 2010 WL 3260860, at \*13 (Aug. 18, 2010) (cease-and-desist order); Press Release, Sec. & Exch. Comm'n, SEC Charges State of New Jersey for Fraudulent Municipal Bond Offerings (Aug. 18, 2010), <https://www.sec.gov/news/press/2010/2010-152.htm>.

158. City of Harrisburg, Exchange Act Release No. 69515, 2013 WL 1869030 at \*5-6, 8 (May 6, 2013) (cease-and-desist order). As noted previously, the SEC also



This emphasis was also apparent in the cease-and-desist orders against more than sixty state and local governments as part of the Municipalities Continuing Disclosure Cooperation Initiative (“MCDC”),<sup>159</sup> which all included a requirement to establish appropriate policies and procedures.<sup>160</sup> Additionally, in at least eleven cases since 2010, the SEC has required the adoption or review of written policies and procedures or has indicated that it accepted a settlement offer in part because such policies and procedures had been adopted.<sup>161</sup>

Of course, once policies and procedures are adopted, it is important that issuers comply with them.<sup>162</sup>

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identified “insufficient procedures” as part of the reason for the State of Kansas’s Securities Act violations. *See* note 150 and accompanying text.

159. MCDC is described in detail in Section III.E.1.

160. *See infra* note 190 and accompanying text.

161. *See* City of Allen Park, Securities Act Release No. 9677, Exchange Act Release No. 73539, 2014 WL 5764984, at \*5–6 (Nov. 6, 2014); Beaumont Fin. Auth., Securities Act Release No. 10406, 2017 WL 3614281, at \*5–6 (Aug. 23, 2017); Greater Wenatchee Reg’l Events Ctr. Pub. Facilities Dist., Securities Act Release No. 9471, 2013 WL 5914980, at \*10 (Nov. 5, 2013) (cease-and-desist order); City of Harrisburg, 2013 WL 1869030, at \*8, \*10; Illinois, Securities Act Release No. 9839, 2013 WL 873208, at \*8–9 (Mar. 11, 2013); Kansas, Securities Act Release No. 9629, 2014 WL 3896055, at \*6–7 (Aug. 11, 2014); New Jersey, 2010 WL 3260860, at \*12–13; Port Auth. of N.Y. & N.J., Securities Act Release No. 10278, 2017 WL 83465, at \*9–10 (Jan. 10, 2017) (cease-and-desist order); City of S. Miami, Securities Act Release No. 9404, 2013 WL 2244383, at \*7 (May 22, 2013) (cease-and-desist order); W. Clark Cmty. Sch., Securities Act Release No. 9435, 2013 WL 3874859, at \*4–5 (July 29, 2013) (cease-and-desist order); Westlands Water Dist., Securities Act Release No. 10053, 2016 WL 890833, at \*7 (Mar. 9, 2016) (cease-and-desist order). The West Clark order included some specifics about what the mandated written policies and procedures should contain, including identifying a specific individual responsible for ensuring compliance with undertakings and requiring that person to annually certify to another official at West Clark that the submissions were current and accurate. W. Clark Cmty. Sch., 2013 WL 3874859, at \*4. The requirement of certification to another official means that there is a second person at the district who should track whether filings have been made by the deadline.

162. *See* Jack Casey, *Lawyers Say Policies, Procedures Key for Issuers Amid SEC Focus on Enforcement*, BOND BUYER (May 24, 2017, 12:50 PM), <https://www.bondbuyer.com/news/lawyers-say-policies-procedures-key-to-helping-issuers-as-sec-continues-emphasis-on-enforcement> (quoting former SEC lawyer Peter Chan as saying that it is important for issuers to be able to demonstrate compliance if the SEC asks); NAT’L ASS’N OF BOND LAWYERS, *supra* note 152, at 6 (noting that documenting compliance is particularly important in the case of an SEC or other investigation).

#### D. Lack of Expertise and Insufficient Training

Many local governments do not have internal expertise regarding municipal bonds.<sup>163</sup> The SEC has pointed to lack of expertise and lack of training as contributing to disclosure problems. In a 2013 cease-and-desist order against the City of South Miami, Florida, which had risked the tax-exempt status of its bonds because of misrepresentations and noncompliance by the issuer but continued to make certifications to the contrary, the SEC highlighted “significant turnover” in the City’s Finance Department as an issue and noted that “[t]he City’s finance directors, while responsible for receiving, signing, and returning the annual compliance certifications, had no previous experience completing, reviewing, or assessing disclosure requirements or tax issues in bond offerings and did not receive any training or guidance on the subject.”<sup>164</sup> As noted above, the SEC also highlighted a lack of training as one of the causes of the State of New Jersey’s securities law violations in its 2010 cease-and-desist order against the State of New Jersey and related press release.<sup>165</sup>

Training has thus been a priority in crafting remedies. The SEC required each of the state and local governments against which it issued cease-and-desist orders as part of MCDC to implement a periodic training program.<sup>166</sup> In each of the eleven cases since 2010 requiring the adoption or review of written policies and procedures, the SEC either mandated the implementation of a training program or accepted a settlement offer because one had been implemented.<sup>167</sup>

The SEC also has required state and local governments to retain outside experts or has agreed to accept a settlement offer in part be-

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163. See, e.g., Jack Casey, *MCDC’s Appropriateness, Effect on Market Disclosure Debated*, BOND BUYER (May 5, 2016, 10:20 AM), <http://www.bondbuyer.com/news/washington-securities-law/mcdcs-appropriateness-effect-on-market-disclosure-debated-1102961-1.html> (stating that some panelists indicated that the main problem with disclosure is lack of resources, and that officials for small issuers sometimes have multiple responsibilities; one panelist cited the example of a finance director for a small school district who also drives the school bus); Monique Moyer, *Current Issues Facing Bond Issuers and Their Financial Advisors*, MUN. FIN. J., Summer 2003, at 17, 18 (noting that most cities and counties have few resources dedicated to debt management and that their advisors frequently know more about the cities’ or counties’ own bonds than the cities and counties do); JUSTIN MARLOWE, GOVERNING INST., GOVERNING GUIDE TO FINANCIAL LITERACY: CONNECTING MONEY, POLICY AND PRIORITIES 5 (2014), [https://media.erepublic.com/document/GOV14\\_FinancialLiteracy\\_v.pdf](https://media.erepublic.com/document/GOV14_FinancialLiteracy_v.pdf) (reporting that only thirty-eight percent of federal, state, county, and local government leaders consider themselves very knowledgeable in public finance).

164. City of S. Miami, 2013 WL 2244383, at \*5.

165. See *supra* note 157 and accompanying text.

166. See *infra* note 190 and accompanying text.

167. See *supra* note 161.

cause they have already done so in several instances. For example, when it agreed to accept a settlement offer from the State of New Jersey, the SEC specifically noted the involvement of disclosure counsel in enhancing the State's disclosure process, both as a participant in the committee overseeing the process and as a provider of disclosure training.<sup>168</sup> Similarly, in the Allen Park matter, the city's agreement to adopt written policies and procedures drafted by disclosure counsel, to involve disclosure counsel in any bond offerings by the city for two years, and to designate disclosure counsel to train personnel was incorporated in the cease-and-desist order.<sup>169</sup> The SEC identified retention of outside bond counsel for all of its bond offerings as one of the remedial actions taken by the Port Authority and retention of disclosure counsel as one of the remedial actions taken by the State of Illinois.<sup>170</sup> The SEC has also required independent consultants to be involved in reviewing and, where needed, improving disclosure policies in cases against several local governments.<sup>171</sup>

*E. Failure to Recognize Importance of Compliance  
with Disclosure Obligations*

The SEC also seems to be concerned that some state and local governments do not take their disclosure obligations seriously and that there is "an entrenched culture of noncompliance."<sup>172</sup> The lack of expertise and lack of training discussed in Section III.D may contribute to the failure to recognize the importance of compliance with federal securities laws.<sup>173</sup> In addition, officials' focus on and dedication of resources to the government's core mission may come at the expense of compliance with obligations that may be perceived as ancillary, in-

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168. New Jersey, Securities Act Release No. 9135, 2010 WL 3260860, at \*12 (Aug. 18, 2010).

169. City of Allen Park, Securities Act Release No. 9677, Exchange Act Release No. 73539, 2014 WL 5764984, at \*5 (Nov. 6, 2014).

170. Illinois, Securities Act Release No. 9839, 2013 WL 873208, at \*8 (Mar. 11, 2013); Port Auth. of N.Y. & N.J., Securities Act Release No. 10278, 2017 WL 83465, at \*9 (Jan. 10, 2017).

171. *See, e.g.*, Beaumont Fin. Auth., Securities Act Release No. 10406, 2017 WL 3614281, at \*5–6 (Aug. 23, 2017); City of S. Miami, Securities Act Release No. 9404, 2013 WL 2244383, at \*7–8 (May 22, 2013); Port Auth. of N.Y. & N.J., 2017 WL 83465, at \*9.

172. *See* Aguilar, *supra* note 53.

173. *See* U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 92, at 14–15 (noting that some issuers fail to comply with their continuing disclosure undertakings because they do not understand or are not aware of their obligations, and that staff turnover can contribute to the problem).

cluding disclosure obligations.<sup>174</sup> Ironically, the fact that state and local governments release a “wide range of information routinely . . . to the public, formally and informally . . . in their day-to-day operations”<sup>175</sup> may cause them to focus less on federal securities laws and disclosure directed to investors; they may be releasing a lot of information, but could still be making material misstatements or omissions in official statements, failing to make required continuing disclosure filings, or releasing improperly vetted information to the public that is misleading to investors.<sup>176</sup>

The SEC’s Enforcement Division has sent a clear message that state and local governments should take their disclosure obligations under federal securities laws seriously through a “bold and unrelenting”<sup>177</sup> approach to enforcement, including MCDC, other increased enforcement activity, tougher penalties for government issuers, and a more aggressive approach towards municipal officials.

### 1. *The Municipalities Continuing Disclosure Cooperation Initiative*

The SEC’s 2014 Municipalities Continuing Disclosure Cooperation Initiative was the first self-reporting initiative taken by the Enforcement Division since 1975<sup>178</sup> and one of the most significant actions taken by the Enforcement Division with respect to the municipal market in recent years.

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174. *See id.* at 14–15 (noting that “completing priorities in times of budgetary challenges” may result in noncompliance). State and local governments must invest time and money to prepare quality official statements and comply with continuing disclosure obligations. While monetary costs for preparing an official statement, such as the charges of disclosure counsel and the printer, are often paid out of bond proceeds (so the government pays them over time as it pays debt service on the bonds), costs associated with continuing disclosure undertakings, such as charges of disclosure counsel or a municipal advisor that assists in the preparation of filings, cannot be paid this way.

175. Statement of the Commission Regarding Disclosure Obligations, *supra* note 71, at 12755.

176. For example, the SEC acted against the City of Harrisburg, Pennsylvania, because there were material misstatements and omissions in information posted on the City’s website at a time when the City was experiencing financial difficulties and was not complying with its continuing disclosure undertakings. City of Harrisburg, Exchange Act Release No. 69515, 2013 WL 1869030, at \*1–2 (May 6, 2013).

177. Mary Jo White, then chair of the SEC, used this phrase to describe her approach. *See* Mary Jo White, Chair, Sec. & Exch. Comm’n, Speech at the New York University Program on Corporate Compliance and Enforcement: A New Model for SEC Enforcement: Producing Bold and Unrelenting Results (Nov. 18, 2016), <https://www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html>.

178. Ceresney, *supra* note 1.

a. *Reasons for MCDC*

MCDC was intended to address instances in which issuers had failed to disclose prior noncompliance with continuing disclosure undertakings in official statements. As described in Section II.C.2.b, underwriters are prohibited from buying or selling municipal bonds in a public offering unless they have reasonably determined that the issuer has entered into a continuing disclosure undertaking to post updated information annually and to provide notice of specified events. Official statements are required to disclose any instances of material noncompliance in the preceding five years.<sup>179</sup>

The SEC perceived noncompliance with continuing disclosure undertakings and failure to disclose material noncompliance as “widespread,”<sup>180</sup> and there is reason to believe that the SEC was correct in its assessment. In a 2002 study, the National Federation of Municipal Analysts (“NFMA”) found that approximately fifty-eight percent of issuers and other obligated entities did not deliver all of the information that was required by their continuing disclosure undertakings.<sup>181</sup> A NFMA official noted that compliance declined as years passed and that noncompliance was more common among small and medium issuers.<sup>182</sup> She also noted that many material event notices were “filed weeks or months after the event, or they are not filed at all.”<sup>183</sup> In addition, the California Debt and Investment Advisory Commission (“CDIAC”) determined in 2011 that over twenty percent of a random sample of California state and local government issuers either filed their financial statements with EMMA more than thirty days later than they had agreed to in their continuing disclosure undertakings or did not file them at all.<sup>184</sup> Another report indicated that for the period 2005-2009, over fifty-six percent of issuers or other obligated entities failed to make a filing for at least one year, and nineteen percent made

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179. 17 C.F.R. § 240.15c2-12(f)(3) (2019).

180. MCDC Initiative, *supra* note 94, at § I.

181. Press Release, Nat’l Fed’n of Mun. Analysts, NFMA Releases Results of Disclosure Survey (May 23, 2002), [http://www.nfma.org/assets/documents/disclosure\\_survey.pdf](http://www.nfma.org/assets/documents/disclosure_survey.pdf) [<https://perma.cc/T2MB-E3DC>]. The study also evaluated the adequacy of the undertakings and concluded that 40.9% of issuers and other obligated entities had inadequate undertakings, failed to comply with undertakings, or both. *Id.*

182. Transcript of Securities and Exchange Commission Field Hearing on The State of the Municipal Securities Market at 45–46 (Sept. 21, 2010), <https://www.sec.gov/spotlight/municipalsecurities/092110transcript.txt> (statement of Mary Colby, Exec. Comm. of the Bd. of Dirs., Nat’l Fed’n of Mun. Analysts).

183. *Id.* at 47.

184. CAL. DEBT & INV. ADVISORY COMM’N, MUNICIPAL MARKET DISCLOSURE: CAFR FILINGS—A TEST OF COMPLIANCE AMONG CALIFORNIA ISSUERS 2 (2011), <https://www.treasurer.ca.gov/cdiac/publications/cafr.pdf>.

no filings at all during the period and described noncompliance as "broad based and pervasive across the market," rather than limited to small issuers, a specific type of bond or specific region.<sup>185</sup>

*b. Provisions of MCDC*

MCDC provided issuers and underwriters with an opportunity to self-report failures to disclose noncompliance with prior continuing disclosure undertakings in official statements.<sup>186</sup> In exchange, the SEC offered to recommend standardized settlement terms that would be more lenient than the SEC would offer to entities that did not self-report.<sup>187</sup> For instance, the standardized terms did not include any monetary penalties for issuers.<sup>188</sup> The terms included standardized monetary penalties for underwriters for each violation, but there were caps on the total penalty that an underwriter would be charged based on the underwriter's total revenue.<sup>189</sup> Settlements for issuers would require the issuer to comply with existing undertakings and to establish policies and procedures and a training program regarding continuing disclosure obligations, among other things.<sup>190</sup> Settlement agreements with underwriters would require the implementation of processes and procedures recommended by an independent consultant.<sup>191</sup> Self-reporting would not protect municipal officials or employees of underwriting firms.<sup>192</sup>

*c. Response to MCDC*

Because underwriters' total civil penalty was capped, they had incentives to report as many transactions as possible once they were reporting enough transactions to reach the cap.

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185. SCHMITT, *supra* note 89, at 11, 18.

186. Even though the official statement is the issuer's document, an underwriter may violate the antifraud provisions if it does not perform adequate due diligence to form a reasonable basis for believing the accuracy of the official statement. *See supra* notes 82–84 and accompanying text. *See also* MCDC Initiative, *supra* note 94, § II (emphasizing the underwriter's obligation to have a reasonable basis to believe the accuracy of key representations in an official statement applies to representations about past compliance with continuing disclosure undertakings).

187. The SEC specifically indicated that it would likely seek stronger remedies for violations that were not self-reported, including financial sanctions for issuers and higher financial sanctions for underwriters. MCDC Initiative, *supra* note 94, § III.E.

188. *Id.* § III.C.3.

189. *Id.*

190. *Id.* § III.C.2.

191. *Id.*

192. *Id.* § III.D.

Furthermore, because both underwriters and issuers could self-report the same failure to disclose past noncompliance under MCDC, and because the SEC had indicated that settlements with parties that had not self-reported could include more stringent terms, including higher monetary penalties, there were incentives to report failures to disclose noncompliance because the issuer and the underwriter would each be in a worse position if the other reported an instance of non-compliance and they did not.

MCDC received a great deal of attention in the municipal market. Organizations such as the Government Finance Officers Association (“GFOA”), the National Association of Bond Lawyers (“NABL”), and the CDIAC provided materials to assist issuers in determining how to respond.<sup>193</sup> Law firms sent out alerts to clients and gave presentations about MCDC.<sup>194</sup> Eighty-three percent of respondents to a GFOA survey reported that an underwriter had contacted them about continuing disclosure compliance as a result of the survey, thirty-nine percent said an underwriter had reported them to the SEC under MCDC, and seventy-nine percent reported that they had hired outside professionals to assist in determining whether and how to respond to MCDC.<sup>195</sup>

It was reported that at least 1,000 self-reports were filed under MCDC.<sup>196</sup> Ultimately, the SEC entered into settlements with more than seventy underwriters as a result of the initiative, comprising approximately ninety-six percent of the market share for municipal un-

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193. See Cal. Debt & Inv. Advisory Comm’n, *Municipalities Continuing Disclosure Cooperation Initiative*, CAL. ST. TREASURER, <https://www.treasurer.ca.gov/cdiac/mmra/mcdc.asp> (last visited Feb. 17, 2019).

194. See, e.g., *The SEC’s MCDC Initiative: Where to Go From Here*, KATTEN MUCHIN ROSENMAN LLP (Oct. 14, 2014), [https://www.kattenlaw.com/files/72574\\_The\\_SECs\\_MCDC\\_Initiative\\_Where\\_To\\_Go\\_From\\_Here.pdf](https://www.kattenlaw.com/files/72574_The_SECs_MCDC_Initiative_Where_To_Go_From_Here.pdf) [<https://perma.cc/5HZG-HJSV>]; Daniel M. Deaton et al., *New Initiative from the SEC Encourages Municipal Issuers and Underwriters to Self-Report Material Misrepresentations Regarding Continuing Disclosure Failings or Risk Harsher Penalties*, NIXON PEABODY LLP (May 8, 2014), [https://www.nixonpeabody.com/-/media/Files/Alerts/169096\\_MCDC\\_Initiative\\_Public\\_Finance\\_Alert\\_8MAY2014.ashx](https://www.nixonpeabody.com/-/media/Files/Alerts/169096_MCDC_Initiative_Public_Finance_Alert_8MAY2014.ashx) [<https://perma.cc/3WEF-ANY4>]; *The S.E.C. Is Serious About Continuing Disclosure: What Issuers, Obligors and Underwriters Need to Know About the New Self-Reporting Initiative*, ORRICK (May 14, 2014), <https://www.orrick.com/Insights/2014/05/The-SEC-is-Serious-About-Continuing-Disclosure>.

195. *MCDC Initiative Survey*, GOV’T FIN. OFFICERS ASS’N, (June 2, 2015), [http://www.gfoa.org/sites/default/files/MCDC%20Survey%20Results\\_Web.pdf](http://www.gfoa.org/sites/default/files/MCDC%20Survey%20Results_Web.pdf) [<https://perma.cc/6VS6-9RBC>].

196. Hilary Russ, *U.S. Towns, Schools Admit to Failing to Filing Financial Disclosures*, REUTERS (Dec. 1, 2014, 7:20 PM), <https://www.reuters.com/article/us-municipals-filings/u-s-towns-schools-admit-to-failing-to-filing-financial-disclosures-idUSL2N0TL14X20141202>.



derwritings.<sup>197</sup> The SEC also entered into settlements with more than seventy issuers and other obligated entities, including more than sixty state and local governments.<sup>198</sup> Issuers with which the SEC entered into settlements under MCDC included states, municipalities, school districts, and special districts, among others.<sup>199</sup> These issuers were “of all types and sizes, not just small, infrequent issuers.”<sup>200</sup>

## 2. *Increased Enforcement Activity and Tougher Penalties for Government Issuers*

In addition to sending the message through MCDC that issuers need to take their disclosure responsibilities seriously, the SEC has conveyed this message by taking more enforcement actions against government issuers and by imposing tougher penalties on them. As was noted earlier in this article, the SEC has focused on the municipal market in recent years and has significantly increased the number of enforcement actions against state and local governments (even if MCDC is excluded from the calculation).<sup>201</sup> Since 2013, the SEC has taken action against a government on the basis of political speech (public statements by its mayor) and has taken action against an issuer for statements made in certificates never expected to be seen by investors, both for the first time.<sup>202</sup> It appears that the SEC also may have begun pursuing more cases involving municipal bonds in federal

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197. Press Release, Sec. & Exch. Comm'n, SEC Charges 71 Municipal Issuers in Muni Bond Disclosure Initiative (Aug. 24, 2016), <https://www.sec.gov/news/press-release/2016-166.html>.

198. *Id.*; Press Release, Sec. & Exch. Comm'n, SEC Charges California School District with Misleading Investors (July 8, 2014), <https://www.sec.gov/news/press-release/2014-133>.

199. For a list of all of the cease-and-desist orders and links to the cease-and-desist orders, other than Kings Canyon Joint Unified School District, see Press Release, Sec. & Exch. Comm'n, *supra* note 197. The Kings Canyon Joint Unified School District Order is available at SEC Charges California School District with Misleading Investors, *supra* note 198.

200. Jack Casey, *SEC Ends MCDC Settlements, Turns to Violators that Didn't Participate*, BOND BUYER (Dec. 13, 2016, 3:12 PM), <https://www.bondbuyer.com/news/sec-ends-mcdc-settlements-turns-to-violators-that-didnt-participate> (quoting LeeAnn Gaunt, Chief, Sec. & Exch. Comm'n, Div. of Enf't).

201. See *supra* notes 125–29 and accompanying text.

202. DOTY, *supra* note 24, at 5 (referring to the Harrisburg cease-and-desist order discussed at notes 158, 176 and accompanying text, *supra*, and the S. Miami cease-and-desist order discussed at note 164 and accompanying text, *supra*).



court<sup>203</sup> and that the SEC is coordinating more with criminal authorities on municipal matters.<sup>204</sup>

The SEC has also imposed tougher penalties on issuers. It assessed its first civil penalty against a government issuer (\$20,000) in its 2013 cease-and-desist order regarding a misleading official statement of a municipal corporation formed to finance an arena and hockey rink.<sup>205</sup> Referring to this cease-and-desist order, the co-director of the SEC's Enforcement Division stated that "[f]inancial penalties against municipal issuers are appropriate for sanctioning and deterring conduct when, as here, they can be paid from operating funds without directly impacting taxpayers."<sup>206</sup> An agricultural water district in California was required by the SEC to pay a \$125,000 civil penalty because of its violation of Securities Act antifraud provisions.<sup>207</sup> The City of Miami agreed to pay \$1,000,000 to the SEC as part of a settlement of a case that the SEC brought in federal court alleging that the city had violated a prior cease-and-desist order and the antifraud provisions of the Securities Act and the Exchange Act by falsely inflating the City's general fund balance in its financial statements and official statements.<sup>208</sup> The Port Authority of New York and New Jersey was required to pay a \$400,000 civil penalty as part of a settlement.<sup>209</sup> In addition, in recent years the SEC has required issuers to retain independent consultants and to take other actions.<sup>210</sup>

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203. *See id.* at 113–14 (referring to the appearance of a strategy to do this).

204. *Id.* at vii, n.4 (describing coordination with the U.S. Department of Justice and indicating that the SEC intends to increase its coordination with criminal authorities in the future).

205. Greater Wenatchee Reg'l Events Ctr. Pub. Facilities Dist., Securities Act Release No. 9471, 2013 WL 5914980, at \*10 (Nov. 5, 2013); Press Release, Sec. & Exch. Comm'n, SEC Charges Municipal Issuer in Washington's Wenatchee Valley Region for Misleading Investors (Nov. 5, 2013), <https://www.sec.gov/news/press-release/2013-235>. One commentator notes that the SEC's "recent zeal for monetary penalties" stems in part from 2010 changes in law that allowed the SEC to impose monetary penalties against municipal issuers in cease-and-desist proceedings; previously the SEC could only pursue monetary penalties against the issuers in federal court actions. Guidotti, *supra* note 8, at 2063.

206. Press Release, Sec. & Exch. Comm'n, *supra* note 205 (quoting Andrew Ceresney, Co-Dir., Sec. & Exch. Comm'n, Div. of Enf't).

207. Westlands Water Dist., Securities Act Release No. 10053, 2016 WL 890833, at \*7 (Mar. 9, 2016).

208. Complaint, SEC v. City of Miami, No. 13-cv-22600 1-2 (S.D. Fla. filed Jul. 19, 2013), <https://www.sec.gov/litigation/complaints/2013/comp-pr2013-130.pdf>; White, *supra* note 177.

209. Port Auth. of N.Y. & N.J., Securities Act Release No. 10278, 2017 WL 83465, at \*10; *see supra* notes 143–45 accompanying text for further discussion of this action.

210. Some of these are discussed *supra* Sections III.C–D.

### 3. *More Aggressive Action Against Government Officials*

Consistent with the view that “[h]olding individuals liable for wrongdoing is a core pillar of any strong enforcement program,”<sup>211</sup> the SEC has taken a more aggressive approach towards individual government officials in recent years. For example, in 2014, the SEC for the first time held a municipal official responsible for misrepresentations in official statements because he controlled the issuer, even though he was not directly accused of knowledge of misrepresentations in official statements.<sup>212</sup>

Since 2013, more aggressive enforcement has also involved more frequent and steeper civil penalties on municipal officials. While the SEC imposed a total of \$85,000 of civil penalties on five officials from 1998–2012 (and no civil penalties on officials before 1998), it imposed a total of \$180,000 on eight officials from 2013 to mid-2016.<sup>213</sup> The \$50,000 penalty imposed on a government official in 2016 was more than double the largest civil penalty previously imposed on a government official.<sup>214</sup> More recently, the former executive director of a California joint powers authority agreed to a \$37,500 civil penalty in a 2017 settlement with the SEC,<sup>215</sup> and in 2018, two officials of a New York town agreed to civil penalties of \$10,000 and \$25,000, respectively, and a federal court imposed \$327,000 in civil

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211. White, *supra* note 177.

212. Allen Park Press Release, *supra* note 141. The SEC did this again in 2016. Press Release, Sec. & Exch. Comm’n, Mayor in Illinois Settles Muni Bond Fraud Charges, May 19, 2016, <https://www.sec.gov/news/pressrelease/2016-93.html> [hereinafter Harvey Press Release]. Some commentators have suggested that in both of these circumstances, the SEC believed the official in question knew or should have known of the fraud. See Leonard Weiser-Varon, John R. Regier & Breton Leone-Quick, *Current and Former SEC Officials Speak About Enforcement Issues Concerning Municipal Securities*, MINTZ BLOG (Mar. 14, 2015), <https://www.mintz.com/insights-center/viewpoints/2891/2015-03-current-and-former-sec-officials-speak-about-enforcement> (“[I]t appears as if the SEC believed they had proof that Allen Park’s mayor was complicit in the alleged fraud.”); DOTY, *supra* note 24, at 117 (“One is left to infer in both the Harvey and Allen Park actions . . . that the Mayors ‘must have known’ or ‘should have known’ what was occurring.”).

213. DOTY, *supra* note 24, at 6.

214. *Id.* at 31 (referring to the penalty levied on the general manager of Westlands Water District in a 2016 cease-and-desist order).

215. SEC v. Kapanicas, SEC Litigation Release No. 23920, 2017 SEC LEXIS 2627 (Aug. 24, 2017), <https://www.sec.gov/litigation/litreleases/2017/lr23920.htm> [hereinafter Kapanicas Release]. This individual also pleaded guilty in California court to embezzlement and misappropriation of public funds and was sentenced to one year of home detention and three years of probation and ordered to pay \$1,000,000 in restitution. City News Serv., *Former Beaumont City Officials Plead Guilty to Felony Charges*, L.A. TIMES (Dec. 19, 2017, 2:10 PM), <https://www.latimes.com/local/lanow/la-me-ln-beaumont-corruption-20171219-story.html>.

penalties on another official of the same town.<sup>216</sup> In some instances, the SEC imposed penalties when officials did not personally benefit from the alleged violations of the antifraud provisions.<sup>217</sup>

In addition, in recent years, the SEC has begun prohibiting some municipal government officials from further participation in municipal bond offerings.<sup>218</sup> Both the former mayor and the former city administrator of Allen Park, Michigan agreed not to participate in future municipal bond offerings as part of their settlements with the SEC.<sup>219</sup> The mayor of an Illinois city and the executive director of a California joint powers authority similarly agreed to be barred from participating in future municipal bond offerings.<sup>220</sup> These prohibitions can have severe effects on an individual's career.<sup>221</sup>

#### IV.

#### THE IMPACT OF THE SEC'S ACTIVITY AND OTHER AVENUES FOR IMPROVEMENT

The SEC's recent enforcement activity appears to have been effective in changing issuer behavior in ways that lead to improved disclosure, but also has been costly. Section IV.A discusses the changes to issuer behavior that have resulted from the SEC's activity, while

216. SEC v. Town of Ramapo, SEC Litigation Release No. 24161, 2018 WL 2761646 (June 8, 2018), <https://www.sec.gov/litigation/litreleases/2018/lr24161.htm> [hereinafter June Ramapo Release]; SEC v. Town of Ramapo, SEC Litigation Release No. 24351, 2018 WL 5994094 (Nov. 15, 2018), <https://www.sec.gov/litigation/litreleases/2018/lr24351.htm>. The latter individual also received a 30-month prison sentence and a separate \$75,000 fine after being convicted on related federal criminal charges. Lynn Hume, *Three Ramapo, N.Y., Officials Get Lifetime Bars from Muni Offerings*, BOND BUYER (June 8, 2018, 3:13 PM), <https://www.bondbuyer.com/news/three-ramapo-ny-officials-get-life-time-bars-from-muni-offerings>. The Town of Ramapo matters are also discussed at note 132 and at note 142 and in accompanying text.

217. *Id.*

218. Joseph Dever, *Commentary: SEC Quietly Seeks Industry Bars Against Municipal Officials*, BOND BUYER (Dec. 17, 2014, 11:34 AM), <https://www.bondbuyer.com/opinion/commentary-sec-quietly-seeks-industry-bars-against-muni-officials>.

219. Allen Park Press Release, *supra* note 141. See *supra* notes 136–141 for a description of the circumstances that led to the SEC charges against these officials.

220. Harvey Press release, *supra* note 212; Kapanikas Release, *supra* note 215. Officials of the Town of Ramapo also agreed as part of a settlement to be barred from participating in future municipal bond offerings. June Ramapo Release, *supra* note 216.

221. See Dever, *supra* note 218 (noting that a ban on participating in municipal bond issuances “will undoubtedly affect that individual’s current and future employment in the public finance sector” and may be a “career-ending sanction”); Guidotti, *supra* note 8, at 2087–88 (noting that the SEC fraud settlement will make it harder for the former mayor of Allen Park to be elected to public office and would make it difficult for him to work for a city in any capacity).

Section IV.B touches on the associated costs. The remainder of Part IV discusses alternative means for the SEC and others to address the issues that the SEC has identified in the future.

A. *The SEC's Actions Appear to Have Changed Issuer Behavior*

The SEC's recent enforcement activity appears to have changed the behavior of government issuers. One commentator noted that "[t]hrough MCDC and other enforcement actions, the Securities and Exchange Commission has led virtually all underwriters of municipal securities, and many issuers, to change their internal practices" and has "revolutionize[d] . . . municipal securities due diligence practices by underwriters and disclosure practices by issuers."<sup>222</sup>

1. *Continuing Disclosure*

It appears that the Chair of the SEC was correct in her assessment that "All indications are that MCDC has vastly increased issuer compliance with their continuing disclosure obligations."<sup>223</sup> A 2016 survey of municipal analysts revealed that "there is agreement among analysts that disclosure had improved dramatically" as a result of MCDC.<sup>224</sup>

Submissions of financial information to EMMA increased from approximately 72,000 in 2012 to over 101,000 in 2014.<sup>225</sup> Filing levels remained relatively high in 2015–2018 (approximately 97,000 in 2015, 98,000 in 2016, 102,000 in 2017, and 96,000 in 2018).<sup>226</sup> The continued higher levels of filing are arguably more significant because some of the filings in 2014 may have been filings made to correct prior failures to file during the period when issuers were determining how to respond to MCDC.<sup>227</sup> While it may be that some of the increase in the number of submissions is because of growth in the number of outstanding bond issuances subject to continuing disclosure

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222. DOTY, *supra* note 24, at 42, 79.

223. White, *supra* note 177.

224. Jack Casey, *MCDC Has Improved Disclosure but Issues Remain*, BOND BUYER (Apr. 22, 2016, 11:35 AM), <https://www.bondbuyer.com/news/mcdc-has-improved-disclosure-but-issues-remain> (citing Lisa Washburn, Chair, Nat'l Federation of Mun. Analysts).

225. MUN. SEC. RULEMAKING BD., 2016 FACT BOOK 66 (2017).

226. MUN. SEC. RULEMAKING BD., 2018 FACT BOOK 66 (2019). The decline in 2018 is curious; it may be a result of fewer issuers with obligations outstanding or might be a result of waning attention a few years after MCDC. Further inquiry into this is merited.

227. See Casey, *supra* note 163 (quoting Lisa Washburn, Chair, Nat'l Federation of Mun. Analysts, as saying that analysts saw a lot of filings on EMMA after MCDC was announced).

undertakings or for other reasons, it is probable that a significant portion of the increase is attributable to increased focus on continuing disclosure compliance by both issuers and underwriters (and their respective counsel) post-MCDC.<sup>228</sup>

Many issuers have reassessed their policies and procedures related to continuing disclosure compliance since MCDC,<sup>229</sup> and the use of third-party consultants to review past compliance has become common.<sup>230</sup> In addition, since MCDC, underwriters, disclosure counsel and underwriters' counsel have focused more on the accuracy of official statement disclosure of past noncompliance with continuing disclosure undertakings.<sup>231</sup>

## 2. *Adoption of Policies and Procedures*

Anecdotally, at least, there also is more focus on policies and procedures related to disclosure. The State of Illinois began to implement remedial measures following the release of the SEC's order against the State of New Jersey in 2010, including retaining disclosure counsel, enhancing its pension disclosure, developing training materials, adding formal disclosure controls regarding pension information and establishing a disclosure committee that collects information, approves the state's disclosure and ensures that offering documents have been reviewed.<sup>232</sup> Commentators at The Bond Buyer's 2016 California Public Finance conference emphasized the importance of written disclosure policies for issuers.<sup>233</sup> State agencies and other organiza-

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228. This is both because of greater awareness of continuing disclosure obligations and the need to disclose material noncompliance, and because underwriters comprising approximately 96% of market share in municipal bond offerings are subject to cease-and-desist orders issued under MCDC. *See supra* note 197 and accompanying text.

229. Gregg Bienstock, *Commentary: Sound Continuing Disclosure Policies and Procedures Are Critical*, BOND BUYER (Feb. 12, 2018, 2:34 PM), <https://www.bondbuyer.com/opinion/sound-continuing-disclosure-policies-and-procedures-are-critical>.

230. Jack Casey, *How MCDC Has Changed Continuing Disclosure Practices*, BOND BUYER (Sept. 21, 2016, 10:38 AM), <https://www.bondbuyer.com/news/how-mcdc-has-changed-continuing-disclosure-practices> (quoting Cyrus Torabi, Shareholder, Strading Yocca Carlson & Rauth).

231. *Id.* (citing Eric Goldstein, Principal Admin. Analyst, The Metropolitan Water District of Southern California and Cyrus Torabi, S'holder, Strading Yocca Carlson & Rauth and Stephen Heaney, Dir. of Pub. Fin., Stifel).

232. Illinois, Securities Act Release No. 9839, 2013 WL 873208 at \*8 (Mar. 11, 2013). These remedial measures were taken into consideration by the SEC in agreeing to the settlement with Illinois. *Id.* at \*9.

233. Casey, *supra* note 230.

tions have provided numerous trainings on disclosure policies.<sup>234</sup> NABL prepared a guide to drafting disclosure policies,<sup>235</sup> the GFOA published articles emphasizing the importance of disclosure policies,<sup>236</sup> public finance law firms have disseminated articles and alerts with titles like “On the To Do List for Municipal Bond Issuers: Disclosure Policies and Procedures,”<sup>237</sup> and trade publications have published articles with titles like “Sound Continuing Disclosure Policies and Procedures are Critical.”<sup>238</sup>

### B. *The SEC’s Actions Are Costly*

While it does appear that the SEC’s recent enforcement actions have had some success in changing market practices, this success does not come without a cost. A local government that is charged with, or even investigated for, antifraud violations by the SEC is likely to incur substantial legal fees and spend many hours of staff time addressing

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234. See, e.g., Cal. Debt & Inv. Advisory Comm’n, Webinar on Disclosure Policies: What Every Issuer Should Consider (Oct. 14, 2015), <https://www.treasurer.ca.gov/cdiac/webinars/2015/20151014/agenda.pdf>;

Cal. Debt & Inv. Advisory Comm’n, Seminar in San Mateo, Cal.: Municipal Market Disclosure: The Development and Administration of Debt Disclosure Policies (Apr. 7, 2016), <https://www.treasurer.ca.gov/cdiac/seminars/2016/20160218/agenda.pdf>;

Cal. Debt & Inv. Advisory Comm’n, Seminar in Irvine, Cal.: Municipal Market Disclosure: The Development and Administration of Debt Disclosure Policies (Sept. 8, 2016), <https://www.treasurer.ca.gov/cdiac/seminars/2016/20160908/agenda.pdf>;

Cal. Debt & Inv. Advisory Comm’n, Seminar in Fresno, Cal.: Municipal Market Disclosure (Feb. 7, 2018), <https://www.treasurer.ca.gov/cdiac/seminars/2018/20180207/agenda.pdf>

(which included a session that discussed “good policies, processes and practices for initial disclosure documents”); Cal. Soc’y of Mun. Fin. Officers, “How to Develop Your Disclosure Policies and Procedures and Why They Are Important,” Feb. 2017, Sacramento, Cal.; Gov’t Fin. Officers Ass’n, Disclosure Update Webinar (Aug. 1, 2018) (covering “how to develop robust disclosure policies”).

235. NAT’L ASS’N OF BOND LAWYERS, *supra* note 152.

236. See *Understanding Your Continuing Disclosure Responsibilities*, GOV’T FIN. OFFICERS ASS’N, <https://www.gfoa.org/understanding-your-continuing-disclosure-responsibilities-0/> (last visited Aug. 23, 2019) (recommending adoption of a “thorough continuing disclosure policy” and describing policies and practices that should be considered); *Primary Market Disclosure*, GOV’T FIN. OFFICERS ASS’N, <http://www.gfoa.org/primary-market-disclosure> (last visited Aug. 24, 2019) (noting the importance of written procedures and identifying practices that should be included).

237. *On the To Do List for Municipal Bond Issuers: Disclosure Policies and Procedures*, PACIFICA L. GROUP (July 19, 2016), <http://www.pacificallawgroup.com/wp-content/uploads/2016/07/Disclosure-Policies-and-Procedures1.pdf>. See also *One Size Does Not Fit All: Written Disclosure Policies in a Time of Increased SEC Enforcement*, COZEN O’CONNOR (Oct. 5, 2015), <https://www.cozen.com/news-resources/publications/2015/one-size-does-not-fit-all-written-disclosure-policies-in-a-time-of-increased-sec-enforcement>.

238. Bienstock, *supra* note 229.

the charge or investigation, to say nothing of the emotional stress involved. The City of Victorville and its airport authority reportedly spent nearly \$20 million before reaching a settlement with the SEC in 2018.<sup>239</sup> Sweetwater Union High School District approved retaining a law firm to represent it in an SEC investigation at attorney billing rates ranging from \$560 to \$925 per hour.<sup>240</sup> SEC charges also bring reputational costs to the governments and individuals involved, and the SEC, too, incurs costs pursuing enforcement actions.

MCDC was costly for state and local governments throughout the country, and not only for those that participated. The Florida Director of Bond Finance referred to it as a “monumental waste of resources.”<sup>241</sup> A survey by the GFOA reportedly found that government issuers of different sizes spent an average of between \$2,000–\$18,000 (and an overall average of \$6,000) as well as between 20–250 hours responding to MCDC.<sup>242</sup> These figures include not only issuers that self-reported, but issuers that did not; 65% of the issuers participating in this survey ultimately did not self-report.<sup>243</sup> Underwriters also in-

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239. Shea Johnson, *Fraud Claim Dropped, Victorville OKs Settlement in Long-running SEC Case*, BOND BUYER (July 25, 2018, 11:15 AM), <https://www.bondbuyer.com/articles/fraud-claim-dropped-victorville-oks-settlement-in-long-running-sec-case>. In this matter, the SEC alleged that the city, its airport authority, and others misled investors in tax increment bonds by substantially overstating the value of real estate on which the taxes securing the bonds were paid. Complaint, SEC v. City of Victorville, No. 13-cv-00776 (C.D. Cal. filed Apr. 29, 2013), <https://www.sec.gov/litigation/complaints/2013/comp-pr2013-75.pdf>.

240. *Board Item - F.-7.*, SWEETWATER UNION HIGH SCH. DISTRICT (Jan. 28, 2019), <https://sweetwaterschools.novusagenda.com/agendapublic/CoverSheet.aspx?ItemID=5612&MeetingID=265>; Sweetwater Union High Sch. Dist., February 11, 2019, Board Item F-1, <https://sweetwaterschools.novusagenda.com/agendapublic/CoverSheet.aspx?ItemID=5693&MeetingID=271> (click on 01 28 19 minutes) (last accessed Mar. 3, 2019).

241. Casey, *supra* note 163 (quoting J. Ben Watkins, III, Dir., Fla. Div of Bond Fin.).

242. *MCDC Initiative Survey*, *supra* note 195 (tables “Hours Spent Responding to MCDC Initiative” and “Cost of Responding to MCDC Initiative”); Kyle Glazier, *GFOA’s Watkins: MCDC Cost Issuers; SEC Initiative ‘An Abuse of Power,’* BOND BUYER (June 2, 2015, 1:13 PM), <https://www.bondbuyer.com/news/gfoas-watkins-mcdc-cost-issuers-sec-initiative-an-abuse-of-power>. While the results of the survey may not be representative of issuers as a whole due to small sample size, *id.*, it is clear from the survey that expenses were incurred by issuers.

243. *MCDC Initiative Survey*, *supra* note 195 (pie chart “Did your entity self-report to the SEC under the MCDC Initiative?”). This percentage may not be representative of the market as a whole due to the small sample size, Glazier, *supra* note 242, but certainly many issuers spent time and money evaluating whether to self-report and concluded that they did not need to do so. My personal experience and anecdotal evidence from other public finance professionals with whom I am acquainted also suggests that numerous issuers retained outside experts to advise them whether to self-report and ultimately concluded that they did not need to do so.



curred costs determining how to respond to MCDC, and the SEC incurred costs processing a large number of responses.<sup>244</sup>

Complying with SEC orders or injunctions also can be costly, and not only in terms of monetary penalties. Retaining outside experts, developing and implementing policies and procedures and training programs use resources that otherwise could be used for other purposes. To the extent that governments that are not involved in SEC actions voluntarily undertake these activities, they incur costs as well.

SEC enforcement actions and remedies can also be expensive in other ways. More aggressive treatment of public officials may make government employment less attractive, which may exacerbate the lack of expertise that the SEC has identified as a problem.<sup>245</sup> Furthermore, the time and resources of issuer and underwriter personnel and outside professionals are limited, and the heightened, sometimes excessive, focus on disclosure of past noncompliance with continuing disclosure undertakings may in some cases take time and attention away from more fundamental credit issues that should be disclosed in an official statement. For example, a participant in a 2016 conference mentioned that nearly half of the 38 questions on a due diligence call had focused on disclosure.<sup>246</sup> Time and resources spent on disclosure also are not available for the state or local government's core functions. The Assistant Finance Director of Oklahoma City pointed out at a recent SEC conference that one result of past enforcement actions against other issuers has been higher legal expenses and higher costs of responding to underwriter due diligence.<sup>247</sup>

The benefits of the SEC's approach to enforcement in the municipal market may outweigh the costs, but the costs should be considered, particularly to the extent that the actions are being used to send a message rather than to punish a particular violator. Furthermore, alternative ways for the SEC, or for other entities, to achieve the same ends going forward should be considered. This is the subject of the next three sections of this article.

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244. Reportedly, at least 1,000 responses were filed. Russ, *supra* note 196.

245. Guidotti, *supra* note 8, at 2088.

246. Casey, *supra* note 230 (citing Eric Goldstein, Principal Administrative Analyst, The Metropolitan Water District of Southern California).

247. Kenton Tsoodle, U.S. Sec. & Exch. Comm'n, *The Road Ahead: Municipal Securities Disclosure in an Evolving Market* (Dec. 6, 2018), [https://www.sec.gov/video/webcast-archive-player.shtml?document\\_id=municonference120618](https://www.sec.gov/video/webcast-archive-player.shtml?document_id=municonference120618), at approx. 1:47.

### C. *What Approach Should the SEC Take in the Future?*

As is discussed in Section II.B, the SEC does not have the authority to specify the contents of official statements, to require issuers to make periodic filings, or to compel government issuers to implement particular procedures or training requirements. Nevertheless, there are several approaches that the SEC could take to send messages to the municipal market about the issues it has identified and to change practices in the municipal market.<sup>248</sup>

#### 1. *Interpretive Release and Publicity*

One option that the SEC has is to issue updated interpretive guidance and to publicize that guidance through discussions with and presentations to prominent industry groups and at conferences. The SEC last provided interpretive guidance to the municipal market in 1994 and has suggested that it could do so again.<sup>249</sup> The SEC's Investor Advisory Committee supports updated interpretive guidance,<sup>250</sup> and the GFOA has expressed interest in working with the SEC on updated guidance.<sup>251</sup>

An interpretive release could address specific aspects of disclosure and responsibilities of specific market participants for disclosure and could highlight the importance of having good disclosure practices in place and retaining qualified outside experts to assist with the transaction. Because the SEC's role is to enforce the securities laws,

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248. This article does not address the possibility of expanding the SEC's powers. However, even if the SEC did have broader power over state and local governments in the future, it would not be appropriate for it to regulate the internal procedures of state and local governments. The SEC's role is limited to protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation. Sec. & Exch. Comm'n, *The Role of the SEC*, INVESTOR.GOV, <https://www.investor.gov/introduction-investing/basics/role-sec> (last visited Feb. 18, 2019). It would be beyond the scope of this role to dictate the internal workings of state and local governments, at least to the extent that there is not a clear and direct effect on the quality of disclosure. Arguably this would also violate concepts of "intergovernmental comity," the concept that governments should respect the internal workings of other governments (or as one commentator more bluntly put it, "making nice to another government;" see Gabaldon, *supra* note 53, at 754). Furthermore, the policies and procedures that will be most effective for a particular local government will vary, and even if requirements were fairly general, enforcing the requirements likely would use a substantial amount of limited resources that could be better used elsewhere.

249. SEC. & EXCH. COMM'N, *supra* note 12, at 139.

250. Kyle Glazier, *SEC Panel Supports Narrower Muni Disclosure Proposal*, BOND BUYER (June 14, 2018, 4:49 PM), <https://www.bondbuyer.com/news/sec-panel-supports-narrower-muni-disclosure-proposal>.

251. Letter from Emily S. Brock, Dir., Fed. Liaison Ctr., Gov't Fin. Officers Ass'n, to Brent Fields, Sec'y, Sec. & Exch. Comm'n 2 (June 12, 2018), <https://www.gfoa.org/sites/default/files/SEC%20Investor%20Advocate.pdf>.

not to control the internal workings of state and local governments, it should refrain from making specific recommendations to state and local governments about their internal operations beyond what is necessary to prevent violations of the antifraud provisions.<sup>252</sup> That said, the SEC could identify problems that it has seen in the past that have led to misleading disclosure and indicate that an entity following thoughtfully developed policies and procedures—including regular training, review and discussion of disclosure by appropriate individuals within the organization—is less likely to violate Rule 10b-5, for which scienter is required.<sup>253</sup> It could also identify specific aspects of disclosure policies that it views as important, such as specifically identifying responsible individuals, including checks and balances, and retaining outside counsel.<sup>254</sup>

While an interpretive release and publicity might not have the same impact as the recent enforcement actions (particularly MCDC) have had in terms of persuading issuers to take their disclosure obligations seriously, it would have some advantages. Unlike in a cease-and-desist order, where it is constrained by the specific facts of the case, the SEC would be able to craft an interpretive release to state precisely what it believes the responsibilities of market participants are. Furthermore, the SEC would be able to gather input from market participants on an interpretive release.<sup>255</sup> Ambiguities that might be present in a cease-and-desist order could be avoided in an interpretive release, increasing the likelihood that a greater proportion of the public finance market gets the intended message, particularly as it is summarized in two or three talking points in publications geared towards the municipal market and by market participants at conferences and in newsletters and other publications. This may be particularly important for government issuers that do not have high quality experts advising them on disclosure issues.

Of course, interpretive guidance will only be effective if the SEC's message reaches government issuers. To reach the largest num-

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252. See *supra* note 248 for a discussion of some of the reasons the SEC should not regulate internal procedures of municipal issuers.

253. See *supra* note 74 and accompanying text. See also NAT'L ASS'N OF BOND LAWYERS, *supra* note 152, at 2 (noting that compliance with disclosure policies can help establish a defense of reasonable care in the event of an alleged material misstatement or omission).

254. See *supra* note 153 and accompanying text.

255. For example, the GFOA provided comments at the time the 1994 interpretive release was drafted and adopted and has indicated its desire to do so again. Brock, *supra* note 251, at 2. The 1994 interpretive release also invited comment. Statement of the Commission Regarding Disclosure Obligations, *supra* note 71, at 12758.

ber of issuers, the SEC will likely need to publicize its message through many channels, including its own conferences,<sup>256</sup> through organizations that represent categories of local governments, such as the National League of Cities, the National School Boards Association and Airports Council International North America, as well as through broader organizations like the GFOA and NABL and state organizations like CDIAC and the Oregon Municipal Debt Advisory Commission. It may be easier for the SEC to publicize a new interpretive release than a particular enforcement action or series of enforcement actions. While no amount of publicity will ensure that all local governments have heard and understand the SEC's messages,<sup>257</sup> greater dissemination of information should improve market practices generally.

## 2. *Enforcement of Existing Underwriter and Municipal Advisor Rules*

Government issuers, particularly small ones, sometimes lack the expertise necessary to understand the instruments and the financial agreements into which they are entering, much less to accurately describe the material terms and risks of these instruments and agreements to investors. The SEC has identified lack of expertise as an issue,<sup>258</sup> as have others.<sup>259</sup> While they are not perfect solutions to this

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256. For example, the SEC held a one-day conference, "The Road Ahead: Municipal Securities Disclosure in an Evolving Market" in December 2018. *See The Road Ahead: Municipal Securities Disclosure in an Evolving Market*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/municipal-securities-conference> (last modified Dec. 6, 2018) [<https://perma.cc/AD84-9JM9>].

257. A former SEC lawyer noted that SEC staff was surprised that even after they announced MCDC and after he had spoken at a GFOA conference, there were "quite a number of issuers" that had not heard of MCDC or prior SEC statements on continuing disclosure. Casey, *supra* note 162 (quoting Peter Chan).

258. *See supra* notes 164–165 and accompanying text.

259. *See supra* note 163. *See also* SAN MATEO CTY. CIV. GRAND JURY, CAPITAL APPRECIATION BONDS: TICKING TIME BOMBS 7 (2013), [http://www.sanmateocourt.org/documents/grand\\_jury/2012/bonds.pdf](http://www.sanmateocourt.org/documents/grand_jury/2012/bonds.pdf) ("A southern California school chief business officer lamented the lack of financial expertise that leaves many districts unqualified to navigate complex bond deals – or to do business with high-powered financial advisers[:] 'They're swimming with the sharks [. . .] These are principals and assistant superintendents of curriculum, and they're being promoted to the role of a chief business officer.'"); Stephan Whitaker, *Financial Innovations and Issuer Sophistication in Municipal Securities Markets* 4 (Fed. Reserve Bank of Cleveland, Working Paper No. 14-04, 2014), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2446979](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446979) (identifying the entry into contracts they didn't understand as a contributor to the Orange County, California and Detroit, Michigan bankruptcies); Bill Simonsen et al., *The Influence of Jurisdiction Size and Sale Type on Municipal Bond Interest Rates: An Empirical Analysis*, 61 PUB. ADMIN. REV. 709, 715 (2001) (reporting the conclusion of an empirical study of municipal bond sales in Oregon that small communities pay

problem, the fiduciary duty imposed on municipal advisors in 2010 and the interpretation by the MSRB of Rule G-17 that requires underwriters to explain the material aspects of the financing structures it recommends, taking into account the level of expertise of the issuer, should contribute to addressing this issue.<sup>260</sup>

The SEC has taken several enforcement actions against municipal advisors for violating their fiduciary duties to government clients, including in instances that highlighted the reliance of the government on the advisor's expertise. For example, a 2018 cease-and-desist order indicated that a municipal advisor had violated its fiduciary duty to a school district client by misrepresenting its municipal finance experience and by failing to disclose a conflict of interest (the sole member of the municipal advisory firm also worked as a paralegal at the district's bond counsel firm).<sup>261</sup> In another instance, the SEC determined that a municipal advisor violated its fiduciary duty of care by failing to advise its government client that purported amendments to the client's continuing disclosure undertakings were not legally effective, even though the individuals at the municipal advisory firm had concerns about the effectiveness of amendments; the client made continuing disclosure filings as if the amendments had taken effect and as a result violated its continuing disclosure undertakings.<sup>262</sup> The SEC should continue to enforce the fiduciary duty that municipal advisors owe to their government clients. While government issuers do not always retain municipal advisors,<sup>263</sup> when they do, they should be receiving competent advice from firms that are fulfilling their obligations to the issuer.

The SEC also has acted against underwriters that violated their Rule G-17 obligations to deal fairly with government issuers. For example, in 2018, the SEC issued a cease-and-desist order indicating that an employee of an underwriter had violated several of the antifraud provisions and numerous MSRB rules by working with unregistered brokers who posed as retail investors in order to obtain higher

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higher interest rates on their general obligation bonds than larger communities, all else being equal, and attributing this to their having more limited staffs with less expertise).

260. See *supra* notes 97–104 and accompanying text.

261. Barcelona Strategies, LLC, Exchange Act Release No. 83191, Investment Company Act Release No. 33093, 2018 SEC LEXIS 1092 (May 9, 2018) (cease-and-desist order).

262. Mun. Fin. Servs., Inc., Exchange Act Release No. 81475, 2017 SEC LEXIS 2619 (Aug. 24, 2017) (cease-and-desist order).

263. See *supra* note 40.

priority in purchasing newly issued municipal bonds.<sup>264</sup> Among these violations were breaches of the underwriter's obligation under Rule G-17 to deal fairly with municipal issuers.<sup>265</sup> The SEC and other enforcement organizations such as the Financial Industry Regulatory Authority ("FINRA") (a self-regulatory organization that has the power to enforce MSRB rules on broker-dealers) should continue to enforce the Rule G-17 requirement to deal fairly with municipal issuers, including the requirement to explain the role of the underwriter and the material aspects of the financing structures they recommend.

### 3. *Adding Additional Requirements for Continuing Disclosure Undertakings*

The National Federation of Municipal Analysts has suggested that the SEC amend Rule 15c2-12 to require that continuing disclosure undertakings include a statement regarding the issuer's policies for complying with the undertakings.<sup>266</sup> This might have the benefit of increasing the issuer's awareness of the need for policies and might encourage underwriters to ask about policies as these agreements are prepared. It also might provide an opportunity for the SEC to publicize the importance of policies. Agreements could either include a representation that there is a policy or a description of the policy.

However, as a practical matter, these provisions likely would add little value. Because policies and procedures can and should change over time as circumstances change, the policies identified in an agreement would very likely be described very generally—probably too generally to provide meaningful information about what the policies are—or would simply state that there is a policy in place. If policies were described in detail, it is not likely that this information would be meaningful to investors, who generally are not privy to the internal workings of the issuer, and neither they nor the underwriter would be in a good position to know whether the policies that the issuer has are

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264. Rosenthal, Securities Act Release No. 10587, Exchange Act Release 84841, Investment Company Release No. 33328, 2018 WL 6617781 (Dec. 18, 2018) (cease-and-desist order).

265. *Id.* at 11. *See also* Edward D. Jones & Co., L.P., Securities Act Release No. 9889, Exchange Act Release No. 75688, 2015 WL 4760902 (Aug. 13, 2015) (cease-and-desist order) (underwriter violated Rule G-17 and other provisions by surreptitiously buying bonds for its own account and then selling them at prices above the initial offering price, risking the tax-exempt status of the bonds).

266. *See* Letter from Lisa Washburn, Chair, Nat'l Fed'n of Mun. Analysts, to Mary Jo White, Chair, Sec. & Exch. Comm'n at 3 (Aug. 10, 2016), [https://www.nfma.org/assets/documents/position.stmt/ps\\_stateofdisclosure\\_aug2016white.pdf](https://www.nfma.org/assets/documents/position.stmt/ps_stateofdisclosure_aug2016white.pdf).

suitable.<sup>267</sup> Furthermore, any detailed description of the policies likely would become outdated as circumstances caused changes in policies, and the mere fact that they were in the agreement might make issuers more reluctant to change policies even when they should.<sup>268</sup> What is important to investors is that issuers prepare complete and accurate disclosure and comply with continuing disclosure undertakings, not the procedures they use to do so. What's more, the only policies that would be appropriately identified in a continuing disclosure undertaking would be those relating to continuing disclosure (not those related to the quality of disclosure in offering documents).

#### 4. *Other Additional Requirements on Underwriters or Municipal Advisors*

Theoretically, the SEC could take the position that the description in an official statement of the continuing disclosure undertaking is an implied representation that the issuer will (or at least is likely to) comply with the undertaking, that this is a material representation, and that in order for an underwriter to have a reasonable basis for believing that the representation is accurate, the underwriter must evaluate the suitability of the issuer's disclosure policies.<sup>269</sup> However, this would not be appropriate. While the SEC has suggested some characteristics that disclosure policies should have (such as being in writing, providing for periodic training and designating responsible individuals), policies must be customized for the specific issuer to be effective.<sup>270</sup> Outsiders, such as underwriters, are not in a good position to identify issues within the government's operating practices that have

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267. See *infra* Section IV.C.4 for discussion of reasons underwriters should not be required to judge the quality of issuers' disclosure policies.

268. Foreclosing or restricting the ability to change policies or requiring that changes to policies be disclosed would be worse. If issuers lose flexibility to adapt as circumstances and organizational structure change, this could actually reduce compliance in the future. If issuers are permitted to change their policies, but are required to or feel that they ought to file a notice of changes, they may be more reluctant to make changes even when they should, and giving notice would give disproportionate significance to the change (surely the significance of a change to a policy or procedure to promote compliance with continuing disclosure undertakings is not comparable to current material events such as declaring bankruptcy or failing to make a payment on bonds). Furthermore, the information provided in such a notice is no more likely to be meaningful to investors than the initial description of the policy was in the first place.

269. See *supra* notes 82-84 and accompanying text for discussion of underwriter obligations with respect to official statements.

270. See NAT'L ASS'N OF BOND LAWYERS, *supra* note 152, at 2 ("Consequently, to provide the most benefit, disclosure policies should be tailored to the size, complexity, and other relevant features of particular issuers . . . [and] should be consistent with the issuer's particular needs and capabilities.")



not even been recognized by the government itself. If, for example, issuers like the State of Illinois and the State of Kansas did not recognize that internal communication failures were leading to deficient disclosure,<sup>271</sup> it is unlikely that their underwriters, which only work with them intermittently, would be able to do so. Underwriters are not in a position to monitor and evaluate the appropriateness of the policies and procedures adopted by a particular issuer or the degree to which the issuer is complying with its policies and procedures. Requiring underwriters to do this would be unduly burdensome and inappropriate.

Similarly, it generally would not be appropriate to put this burden on municipal advisors. While there are some instances in which a municipal advisor has a long-term relationship with an issuer and may know more about the issuer than would a municipal advisor or underwriter working on a particular transaction, a municipal advisor, like an underwriter, would not have knowledge of the internal workings of the issuer sufficient to know whether the issuer's disclosure policies are appropriate. That said, there could be limited circumstances in which a failure to recommend appropriate disclosure policies would violate a municipal advisor's duty of care, particularly if the advisor has been retained by the issuer to review or prepare its policies. Even in these circumstances, the responsibility for policies or procedures should ultimately be the government issuer's, not the municipal advisor's.

##### 5. *Additional Enforcement Actions*

The SEC can and should continue to pursue enforcement actions against municipal issuers when appropriate. Enforcement actions are certainly warranted when circumstances are serious enough that an issuer or individual officials should be censured for its behavior.

However, they may be less effective as a means of delivering a message to other market participants at this time. While MCDC and recent enforcement actions, together, seem to have improved awareness of the antifraud provisions and changed practices in the municipal market,<sup>272</sup> it seems unlikely that additional enforcement actions will increase awareness any further, at least unless another specific area of concern comes to light. Furthermore, as was discussed in Section IV.C.1, interpretive releases and publicity are a better mechanism for the SEC to clearly communicate its expectations.

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271. See *supra* notes 147–151 and accompanying text.

272. See *supra* Section IV.A.1.

#### D. States

States may be able to address some of the problems highlighted by the SEC.<sup>273</sup> Local governments derive their powers from the states in which they are located.<sup>274</sup> States routinely regulate the internal behavior of local governments. For example, many states set fiscal years, mandate a particular form of budget, require uniform accounting procedures, and specify required purchasing standards for some or all local governments within the state.<sup>275</sup>

In particular, states impose restrictions and requirements on issuances of debt by local governments within their boundaries. Most states have restrictions on the amount of debt that state and local governments can issue, and typically states impose restrictions on the terms and structure of debt and the purposes for which it can be issued.<sup>276</sup> Some states require that debt issuances and/or information about outstanding debt be reported to a state agency.<sup>277</sup> California requires that local governments issuing bonds certify that they have debt policies that meet certain general standards;<sup>278</sup> Nevada requires local governments that have certain types of debt outstanding or plan to issue debt of those types file a description of the local government's debt management policy (which must include certain provisions) with the Nevada Department of Taxation and the applicable county debt

273. This section discusses ways that states could encourage local governments to improve their disclosure practices, rather than the state as an issuer. States could also apply some of these suggestions to state agencies that issue bonds.

274. GERALD E. FRUG & DAVID J. BARRON, *CITY BOUND: HOW STATES STIFLE URBAN INNOVATION* 2 (2008).

275. U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 30, at 10.

276. *See supra* note 30 and accompanying text.

277. *See, e.g.*, CAL. GOV'T. CODE § 8855(i), (j), (k) (Deering 2019) (requiring reporting of debt issuances and annual updates of certain information); FLA. STAT. ANN. § 218.38 (LexisNexis 2019); FLA. ADMIN. CODE ANN. r. 19A-1.001-008 (2019) (requiring reporting of bond issuances); NEV. REV. STAT. ANN. § 350.013 (2019) (requiring that information about general obligation debt be reported annually); OR. REV. STAT. § 287A.640 (2019), OR. ADMIN. R. 170-061-0000 (2019) (requiring reporting of debt issuances); TEX. LOC. GOV'T. CODE ANN. § 140.008 (2019) (requiring information about outstanding debt be reported to the State Comptroller's office or be posted on the issuer's website). As of 2016, seventeen states required the filing of official statements with state repositories and other disclosure requirements when bonds are issued. SEC. INDUS. & FIN. MKTS. ASS'N, *STATE DISCLOSURE REVIEW HIGHLIGHTS* (2016), [https://www.sifma.org/wp-content/uploads/2017/07/50\\_state\\_review\\_summary.pdf](https://www.sifma.org/wp-content/uploads/2017/07/50_state_review_summary.pdf) [<https://perma.cc/56JC-AQTP>].

278. CAL. GOV'T CODE § 8855(i)(1) (West 2019). Policies must include the types of debt and the purposes for which debt may be issued, the relationship of debt to the issuer's capital plan or budget, policy goals and internal control procedures to ensure that proceeds of debt are applied to the intended use. *Id.*

commission.<sup>279</sup> North Carolina requires that all bond issuances be approved by the North Carolina Local Government Commission.<sup>280</sup> Missouri and Texas require that the legality of at least some local government bonds be approved by a state official,<sup>281</sup> and Nevada requires some debt be approved by a county debt commission.<sup>282</sup>

### 1. States Have an Interest in Promoting Good Disclosure

States have an interest in protecting their residents, including by promoting compliance with federal securities laws by local governments in their states. Noncompliance with federal securities laws can hurt residents of the affected community in several ways. First, while official statements are written for the benefit of investors, rather than for members of the community, they are a source of information for community members. If they are materially inaccurate or misleading, community members may not discover the information they should. Second, if the SEC pursues an enforcement action against a local government, the government is likely to incur significant costs in defending or settling the action, costs that likely will ultimately be paid by community residents.<sup>283</sup> Third, investors may require local governments that are found to have violated federal securities laws to pay higher interest rates when they borrow in the future; higher rates that are ultimately paid by residents. Other local governments in the state or even the state government itself could also be affected if investors believe that poor disclosure practices are pervasive in the state; conversely, it is possible that if investors believe governments in a state have particularly good disclosure practices, they will be willing to purchase bonds at interest rates lower than they otherwise would.

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279. NEV. REV. STAT. ANN. § 350.013(1)(c) (2019). Policies must cover the issuer's sources to pay and the affordability specified debt and capacity to incur such debt within legal limitations, the amount of property tax-supported debt per capita and as a percentage of total assessed property values, the method by which the issuer expects to sell debt, and the expected operating costs and revenues of some projects in the issuer's capital plan. *Id.*

280. N.C. GEN. STAT. § 159-51 (Lexis 2019). For detail on the structure and history of the North Carolina Local Government Commission, see Adam C. Parker, *Positive Liberty in Public Finance: State Oversight of Local-Government Debt and the North Carolina Model*, 27 CAMPBELL L. REV. 107, 140–52 (2015).

281. See MO. REV. STAT. § 108.240 (2002); TEX. GOV'T. CODE ANN. § 1202.003 (West 2019); *Public Finance Division: Attorney General Role in Legal Review of Public Securities*, TEXASATTORNEYGENERAL.GOV <https://www2.texasattorneygeneral.gov/opinion/bond-review> (last accessed Nov. 10, 2019) [<https://perma.cc/5B7B-ECLS>].

282. NEV. REV. STAT. ANN. § 350.0145 (2019).

283. See *supra* notes 239-240 and accompanying text.

## 2. *The Problems Identified by the SEC Affect Other Government Activities*

While the SEC has identified problems and suggested solutions in the context of disclosure, some of these problems impact other government activities.

Local officials' tendency to want to avoid giving bad news can be a problem for residents of the community, as well as for bondholders. Local residents may be deprived of accurate information, which will reduce their ability to meaningfully participate in local government. Furthermore, the tendency may lead local officials to proceed with unwise projects, the costs of which are ultimately paid by local residents in one way or another.

While there are benefits to specialization, and some compartmentalization may promote transparency and accountability,<sup>284</sup> a variety of problems can be avoided, or solved more effectively, when separate groups share information and work collaboratively.<sup>285</sup> For example, the fragmented structure of Jefferson County's government was one of the (many) factors that contributed to a failing sewage system, a very expensive agreement with the U.S. Environmental Protection Agency to repair the system, risky and complex financing of those repairs, and ultimately the bankruptcy of the county.<sup>286</sup> On a more positive note, New York City increased the effectiveness of fire inspections by combining data from several departments to determine

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284. See GILLIAN TETT, *THE SILO EFFECT: THE PERIL OF EXPERTISE AND THE PROMISE OF BREAKING DOWN BARRIERS* 19, 247 (2015) (noting that we need specialization and that autonomy and accountability are essential).

285. See *id.* at 12 (quoting Mike Flowers, City of New York, noting the importance of combining fragmented information); Scott D. Pattison, *Eliminating Silos in Government*, GOV. FIN. REV. Oct. 2006 at 71 ("At the very least, government should be structured to ensure that people working in various silos are working together, communicating and pursuing broader goals together.").

286. See Bachus, note 53, at 762–68 (describing the county's governance structure and the county's path to bankruptcy and noting that "By fragmenting responsibility for county-wide problems among individual commissioners [each of whom was elected by and represented a single district and each of which was assigned a substantive area of responsibility], Jefferson County's commission form of government all but guaranteed that the county's sewer system would fall into neglect . . ."). Some of the other factors that contributed to the bankruptcy included lack of expertise of commissioners, political considerations, corruption, unregulated (at the time) municipal advisors, failures of bond insurers and credit rating agencies. See generally, *id.* See also Theresa A. Gabaldon, *The Sewers of Jefferson County: Disclosure, Trust and Truth in Modern Finance*, in *THE PANIC OF 2008: CAUSES, CONSEQUENCES AND IMPLICATIONS FOR REFORM*, 255, 257–59 (Lawrence E. Mitchell & Arthur E. Wilmarth, Jr. eds., 2010) (describing some of the systemic problems and corruption that contributed to Jefferson County's financial collapse).

which buildings were most likely to have fire hazards.<sup>287</sup> The State of Hawaii's Department of Human Services created a program to bring multigenerational services to Hawaii families in need by "tear[ing] down . . . silos, think[ing] beyond the limitations of funding streams, and work[ing] across divisions, programs, and teams."<sup>288</sup> The Department's director points to improved efficiency resulting from integration.<sup>289</sup>

The benefits of clear policies and procedures also extend beyond disclosure. While ill-considered procedures can result in inefficiency, a study involving city employees concluded that certain types of rules are helpful, particularly those that were written; had means that were logically connected to ends; provided an appropriate amount of flexibility; were applied consistently; and had purposes that were understood.<sup>290</sup> Formalized, written rules tend to be more effective than informal, unwritten practices because the rules are more carefully considered during the process of writing them, and because they are more likely to be followed.<sup>291</sup>

Similarly, many local governments lack the training and expertise relevant to debt management generally, not only regarding federal securities laws.<sup>292</sup> Arguably, "debt contracts that they did not fully understand" contributed to the bankruptcies of Orange County, California and Detroit, Michigan, both relatively large issuers.<sup>293</sup>

Failure to take post-issuance obligations seriously can lead not only to noncompliance with continuing disclosure obligations, but also to bonds losing their tax-exempt status if an issuer fails to comply with federal tax law requirements after the bonds are issued. Local governments sometimes have other important post-issuance obligations as well, such as state reporting requirements or contractual obligations to provide specified information to a third party.

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287. TETT, *supra* note 284, at 8–10.

288. *Strategic Intention: DHS Implementation of 'Ohana Nui*, HAW. DEP'T HUM. SERVS. (Dec. 5, 2016), <http://humanservices.hawaii.gov/blog/ohana-nui-kicks-off/> [<https://perma.cc/B56B-6G2H>].

289. Wayne Yoshioka, *DHS: Ohana Nui Concept to Address Sources of Poverty in Hawai'i*, HAW. PUB. RADIO (June 11, 2018), <https://www.hawaiipublicradio.org/post/dhs-ohana-nui-concept-address-sources-poverty-hawaii> [<https://perma.cc/LY4W-GQ57>] (quoting Pankaj Bhanot, Dir., Haw. Dep't Hum. Servs.).

290. Leisha DeHart-Davis, *Green Tape: A Theory of Effective Organizational Rules*, 19 J. PUB. ADMIN. RES. & THEORY 361, 379 (2008).

291. Leisha DeHart-Davis et al., *Written Versus Unwritten Rules: The Role of Rule Formalization in Green Tape*, 16 INT'L PUB. MGMT. J. 331, 346–47, 349 (2013).

292. *See supra* note 163.

293. *See* Whitaker, *supra* note 259, at 4.

### 3. *What States Could Do*

There are things states can do to encourage local governments to address some of the issues identified by the SEC.

#### *a. Requiring Adoption of Disclosure Policies and/or Debt Policies*

States could require local governments that issue debt to adopt disclosure policies, policies related to debt more generally, policies regarding compliance with post-issuance obligations (including continuing disclosure obligations), or a combination of the three.<sup>294</sup> California already requires that local governments certify that they have certain debt policies in place when they issue debt, and Nevada requires local governments that have or intend to have certain types of debt to file a copy of their debt management policies with the Nevada Department of Taxation and the relevant county debt commission; a similar requirement could be added for disclosure policies.<sup>295</sup> For other states that have reporting requirements when debt is issued, this could be added to their requirements as well. While limiting the requirement to governments that are presently issuing debt would mean that local governments that issue infrequently and already have debt outstanding would not be required to adopt policies and procedures, over time the percentage of issuers with policies in place would grow, and this approach would avoid the costs of imposing and enforcing the requirements more broadly.

Requiring the adoption of policies and procedures would have the benefit of emphasizing the importance of written disclosure and debt policies and procedures. Like California's and Nevada's debt policy requirements,<sup>296</sup> the state could specifically require that policies and procedures include certain provisions. For example, states could require that policies specifically identify individuals responsible for certain actions and include checks and balances. An additional benefit would be that at least some local governments would be thoughtful and deliberate about the policies and procedures that they adopt. Along with the imposition of such a requirement, the state could provide trainings and sample policies. The state also could provide additional guidance and support as discussed in subsection IV.D.3.d.

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294. The Securities Industry and Financial Markets Association ("SIFMA"), which represents broker dealers, investment banks and asset managers, has suggested that states require local governments to adopt disclosure policies. SEC. INDUS. & FIN. MKTS. ASS'N, *supra* note 277, at 2.

295. See *supra* notes 278–279 and accompanying text.

296. See *id.*

On the other hand, mandating policies does not mean that the policies adopted will be effective, or that they will be followed. It is likely that some local governments would simply adopt boilerplate policies and procedures without considering their specific circumstances, and state requirements could not be specific enough to address all situations (for example, a standardized policy or state requirement for inclusion couldn't specifically address the specific compartmentalization issues faced by a particular government; at best, the state could urge issuers to consider that issue). As a result, the benefit that comes from the scrutiny of written policies would be lost.<sup>297</sup> Requiring the adoption of policies would impose costs on issuers (to adopt and implement the policies) and on the state agency responsible for enforcing the law. Furthermore, having a policy and failing to comply with it could put a local government in a worse position if it is investigated by the SEC. The costs and benefits of a particular policy would need to be carefully considered before such a change in law were made.<sup>298</sup>

*b. Mandating Training*

States could mandate that local governments issuing bonds have had disclosure training for their boards and/or relevant staff within an appropriate time period, such as the last three years prior to the date of the planned issuance. States require training in other contexts. For example, many states require training for school district governing board members.<sup>299</sup> For states that already require reporting of debt issuances,<sup>300</sup> this could be another box to check on the report. The state also could provide training programs that local governments could use to meet this requirement. Although these trainings would not be tailored to the specific local government, they still could provide valuable information. There would be costs to the local governments and to the state, and again the costs and benefits of a particular proposal would need to be carefully considered before a change in law was made.

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297. See *supra* note 291 and accompanying text.

298. A good starting point would be evaluating compliance with CAL. GOV'T CODE 8855(i) (discussed *supra* note 279), and the compliance with and effectiveness of the policies adopted pursuant to that law.

299. See *Q. Which States in the Midwest Require School Board Members to Receive Training, and What Does the Training Entail?*, CSG MIDWEST, <https://www.csamidwest.org/policyresearch/1012qom.aspx> (last visited Nov. 12, 2019) [<https://perma.cc/6VPA-V5NP>] (indicating that twenty-one states have mandatory training for school board members).

300. See *supra* note 277.



*c. Promoting Continuing Disclosure Compliance*

States could promote compliance with continuing disclosure obligations by requiring that compliance be reported to the state or that financial auditors or others check compliance with continuing disclosure obligations. States could require local governments issuing bonds to indicate when annual continuing disclosure filings for the bonds are due, and to certify as to material compliance with prior continuing disclosure undertakings or disclose material noncompliance (this would be duplicative of information already disclosed in official statements).<sup>301</sup> States that wanted to go further could require reporting when continuing disclosure filings are made or an annual certification that filings were current. Some local governments might simply check the appropriate box without having made their filings, it would be burdensome for a state agency to check the accuracy of the representations made, and these requirements would not ensure that the filings that had been made were complete. However, these requirements could increase issuer awareness of continuing disclosure obligations and result in more filings being made on time (or at least being made before the next report was made to the state government), and the relative costs and benefits should be considered.

Louisiana law requires that financial auditors of local governments review a sample of continuing disclosure filings to determine whether the local government has complied with its obligations.<sup>302</sup> Other states could impose a similar requirement,<sup>303</sup> though the additional fees that would be charged by auditing firms to perform the additional work (which could be very time consuming for issuers with numerous debt issuances outstanding) likely would outweigh the benefits.

States also could identify or have issuers report to them the annual continuing disclosure obligations of their local governments and remind local governments when filings are due. This could help with compliance, but would be relatively costly, particularly when local governments could instead simply sign up for EMMA to provide them with reminders.<sup>304</sup>

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301. *See supra* note 81 and accompanying text.

302. LA. REV. STAT. ANN. § 39:1438(D)(2) (2019).

303. SIFMA has recommended this. SEC. INDUS. & FIN. MKTS. ASS'N, *supra* note 277, at 2.

304. States might instead recommend or require that local governments sign up for EMMA reminders and keep the contact information with EMMA up to date as part of their disclosure policies.

d. *Providing Training and Other Support*

One way that states could provide significant benefit to local governments would be to provide training and materials highlighting the issues identified by the SEC and ways that local governments can address them. Having sample policies and other resource material available would also be valuable. Some states already provide training and educational materials about municipal bonds to local governments. For example, California and Oregon provide trainings or educational information about municipal bonds to local governments.<sup>305</sup> The Missouri state auditor provides information to local governments about debt issuance and bidding processes and best practices, as has been required by law since 2017.<sup>306</sup> Some states already provide or have provided training on disclosure policies.<sup>307</sup>

If they have the internal expertise or access to outside expertise to do so, states could also provide consultation services about these issues to local governments on an elective basis either without charge or at a relatively low cost.<sup>308</sup> This might be particularly valuable to smaller issuers that do not have regular interaction with outside counsel and municipal advisors.

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305. See, e.g., CAL. DEBT AND INV. ADVISORY COMM'N, *supra* note 39 (a several hundred page manual describing debt financing alternatives and the issuance process); Cal. Debt and Inv. Advisory Comm'n, 2018 Debt Issuance and Public Investment Webinars, Seminars and Conferences, <https://www.treasurer.ca.gov/cdiac/seminars/2018/index.asp> (links to past training materials that are available online, including from prior years) (last accessed Mar. 2, 2019); Ore. Mun. Debt Advisory Comm'n, Oregon Bond Education Center, <https://www.oregon.gov/treasury/public-financial-services/pages/oregon-bond-education-center.aspx> (providing material about issuing bonds) (last accessed Mar. 2, 2019).

306. MO. REV. STAT. § 108.170(9) (2019); *Resources for Local Governments*, MO. ST. TREASURER, <https://treasurer.mo.gov/content/for-local-governments> (last visited Aug. 27, 2019) [<https://perma.cc/VN9Z-SQDJ>] (link to various materials, including GFOA information about issuing debt).

307. See *supra* note 234.

308. Similar suggestions have been made concerning debt issuance. See, e.g., U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, STATE TECHNICAL ASSISTANCE TO LOCAL DEBT MANAGEMENT 46–47 (1965) (suggesting that states provide advice concerning debt issuances as requested by local governments); Andrew Ang & Richard C. Green, *Lowering Borrowing Costs for States and Municipalities Through CommonMuni* 6 (The Hamilton Project, Discussion Paper 2011-01, 2011) (proposing creation of nonprofit that, among other things, would provide affordable, independent advice to municipalities issuing bonds); Darien Shanske, *The Feds are Already Here: The Federal Role in Municipal Debt Finance*, 33 REV. BANKING & FIN. L. 795, 810 (2014) (recommending that states provide expertise to local government issuers).

### E. Other Entities

In addition to state and local government issuers themselves, which should obtain training on and information about the issues identified by the SEC, work with outside experts to the extent feasible, and consider the applicability of the issues raised by the SEC to their own organizations, other entities can play a role in improving state and local government disclosure practices.

#### 1. MSRB

The MSRB launched the EMMA website in 2008 as a central repository for official statements, continuing disclosure filings and other information about municipal bonds.<sup>309</sup> Anyone can go onto the EMMA website and find this information using the site's search functions.

EMMA has dramatically improved access to information in the municipal market. While official statements were filed with the MSRB before the establishment of EMMA, they were only available for free by visiting the MSRB in Alexandria, Virginia.<sup>310</sup> Unlike the prior system, under which filings were available from four different national repositories for a fee,<sup>311</sup> continuing disclosure filings are made on EMMA and are all available from a single, free site. This makes it easier for investors to access filed information. It also makes it easier for issuers to file and makes it easier for issuers to verify that their filings appear correctly and are linked to all of the bonds they should be.<sup>312</sup>

The easy availability of these documents has the potential of improving the quality of disclosure generally because state and local government issuers and their advisors can access documents from other similar issuers on EMMA and see what they are disclosing.<sup>313</sup>

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309. *Electronic Municipal Market Access (EMMA) Website*, MUN. SEC. RULEMAKING Bd., <http://www.msrb.org/About-MSRB/Programs/EMMA.aspx> (under headings "Information on EMMA" and "EMMA in the Future") (last visited Mar. 2, 2019).

310. Stanley, *supra* note 92, at 105.

311. Amendment to Municipal Securities Disclosure, 73 FR 76103, 76106 (Dec. 5, 2008).

312. See MUN. SEC. RULEMAKING Bd., MILESTONES IN MUNICIPAL MARKET TRANSPARENCY: THE EVOLUTION OF EMMA 9-10 (2018), <http://www.msrb.org/~media/Files/Resources/MSRB-White-Paper-Evolution-of-EMMA.ashx?la=en> (describing some of the problems issuers had with the prior system).

313. Transcript of Securities and Exchange Commission Field Hearing on The State of the Municipal Securities Market at 101 (July 29, 2011), <https://www.sec.gov/spotlight/municipalsecurities/munifieldhearing072911-transcript.txt> [hereinafter Field Hearing] (statement of Hobby Presley) ("It's not at all unusual now for an issuer to search EMMA just for the purpose of determining how to structure and improve their

Their lawyers and consultants can do the same.<sup>314</sup> This may result in issuers deciding to provide fuller disclosure about topics they might not have considered otherwise. One government official suggested that EMMA has changed the culture of disclosure so that issuers now see disclosure as a way of improving relationships with investors rather than merely as a legal requirement.<sup>315</sup> Furthermore, having access to their own continuing disclosure filings on EMMA means that issuers can see tangible results of their filing preparations and may make them more likely to comply with obligations.<sup>316</sup> Issuers can also more easily make their own filings and can see that they were made correctly.

Issuers can register on the EMMA system to have reminders sent to them when annual filings are due.<sup>317</sup> Additional publicity about this service to issuers and municipal advisors may increase the use of the service, which could, in turn, increase the timeliness of continuing disclosure filings.

When issuers and others register to make filings on the EMMA website, they must provide an email address.<sup>318</sup> The MSRB could send reminders to these email addresses before and at the time annual filings are due. This would require MSRB personnel to review the summaries of continuing disclosure undertakings included in the official statements for all bonds to determine the deadlines, or require underwriters, issuers, or other registered users to provide due dates. The costs of this might outweigh the benefits, but it should be considered.

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own disclosure.”); Nikki Griffith, Bureau Chief, Cash & Debt Mgmt., Howard Cty., Md., Remarks at the Securities & Exchange Commission Municipal Securities Conference: The Road Ahead: Municipal Securities Disclosure in an Evolving Market (Dec. 6, 2018), [https://www.sec.gov/video/webcast-archive-player.shtml?document\\_id=municonference120618](https://www.sec.gov/video/webcast-archive-player.shtml?document_id=municonference120618) at approx. 2:45 (noting that she uses EMMA to see how other issuers have addressed issues in their disclosure).

314. See MUN. SEC. RULEMAKING BD., *supra* note 312, at 19 (“Meanwhile, EMMA also has provided municipal advisors, bond lawyers and other market participants—whose direct experience might be limited to particular regions or types of transactions—the ability to access information about other regions, structures and projects.”).

315. *Id.* (quoting Alan Anders, Deputy Dir., N.Y.C. Office of Budget and Mgmt.).

316. See Field Hearing, *supra* note 313, at 101 (suggesting that being able to see the results of their efforts will make issuers more likely to “accept their burdens” and “appreciate the process”).

317. *Email Reminders for Recurring Financial Disclosures*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/msrb1/pdfs/Financial-Disclosure-Email-Reminders-Fact-Sheet.pdf> (last visited Aug. 25, 2019).

318. See *Continuing Disclosure Registration—Step 1—Welcome*, MUN. SEC. RULEMAKING BD., <https://gw.msrb.org/msrb1/control/registration/cod/landing.asp> (last visited Aug. 25, 2019) [<https://perma.cc/YJ2A-MZU6>] (requiring email address to register to make filing).

The MSRB also provides a complimentary online course for municipal government employees that covers a wide range of matters related to issuing bonds, including compliance with federal securities laws.<sup>319</sup> Additional promotion of this course, as well as provision of courses focused on federal securities laws and continuing disclosure compliance and on disclosure policies could also contribute to better informed issuers and ultimately better disclosure.

## 2. *Industry Organizations and Outside Experts*

Industry organizations such as the GFOA, organizations of county treasurers, organizations representing cities, counties, school districts and other governments, and outside experts including bond counsel, disclosure counsel and municipal advisors also have important roles to play in improving state and local government disclosure practices by providing training, guidance, and educational materials. In addition, underwriters and their counsel can contribute to better disclosure by asking issuers about disclosure practices early in a transaction, causing issuers to focus more on these issues.

### CONCLUSION

In the process of enforcing the antifraud provisions of the federal securities laws, the SEC has identified several factors that are common among state and local governments and that result in inadequate disclosure, including political pressure to avoid giving bad news, compartmentalization, failure to clearly identify who is responsible for disclosure and compliance, lack of training and experience with municipal securities and disclosure, and failure to recognize the importance of compliance with disclosure obligations. These same deficiencies can also have damaging effects in other aspects of debt management and other areas of government operations. It is imperative that state and local governments consider how to mitigate these weaknesses themselves, but also that the SEC, states and others take appropriate actions to assist in this process. In particular, the SEC should consider issuing an interpretive release emphasizing the impor-

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319. *MSRB Offers Complimentary E-Learning Course for Municipal Bond Issuers*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/News-and-Events/Press-Releases/2017/MSRB-Offers-Complimentary-E-Learning-Course-For-Municipal-Bond-Issuers.aspx> (April 19, 2017) [<https://perma.cc/D4M3-K3DP>]; *Being an Informed Municipal Bond Issuer*, MUN. SEC. RULEMAKING BD., <http://www.msrb.org/EducationCenter/MuniEdPro%20Course%20Information/Course%20Outlines/General%20Courses/MuniEdPro-Course-for-Issuers.aspx> (last visited Aug. 27, 2019) [<https://perma.cc/S2HB-7A5K>].

tance of disclosure policies and some of the key contents of such policies. States should provide training and other support to local governments within their boundaries to the extent they are able to do so, and should consider taking other actions such as mandating training about disclosure and disclosure policies for local governments that issue bonds. Outside experts and trade organizations should also provide training, support and guidance to state and local governments as they work to improve their internal practices. With a little help from their friends, state and local governments will do more than just get by.<sup>320</sup>

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320. Apologies to John Lennon and Paul McCartney. *See generally* THE BEATLES, *With A Little Help From My Friends*, on SGT. PEPPER'S LONELY HEARTS CLUB BAND (Capitol Records 1990) (1967).

The first part of the document discusses the importance of maintaining accurate records of all transactions. It emphasizes that every entry, no matter how small, should be recorded to ensure the integrity of the financial data. This includes not only sales and purchases but also expenses and income. The text explains that proper record-keeping is essential for identifying trends, managing cash flow, and preparing for tax obligations. It also notes that consistent record-keeping can help in resolving any disputes or discrepancies that may arise over time.

The second section focuses on the role of the accounting system in providing a clear and concise overview of the company's financial health. It describes how a well-implemented system can automate many of the routine tasks, such as invoicing and payroll, which reduces the risk of human error and saves valuable time. The text highlights that a robust accounting system also provides real-time access to financial data, allowing management to make informed decisions quickly and effectively. Additionally, it mentions that a good system should be scalable to accommodate the company's growth and changing needs.

The final part of the document addresses the importance of regular audits and reviews. It states that periodic audits are necessary to verify the accuracy of the financial records and to ensure that all transactions are properly documented and classified. The text explains that audits can also help in identifying areas for improvement and in detecting any potential fraud or mismanagement. It concludes by emphasizing that a commitment to transparency and accountability is key to the long-term success of any business.