SEC Charges Underwriters with Violations of Rule 15c2-12

by David D. Grossklaus, James H. Smith, and Jennifer Block

Last week, the SEC entered orders against three underwriters for failing to comply with Securities Exchange Act of 1934 ("Exchange Act") Rule 15c2-12. These actions serve as a good reminder for compliance checks and policies and procedures related to exempt transactions. The SEC orders noted the following shortcomings of the parties serving as sole underwriter:

- The underwriter sold securities to broker-dealers and certain investment advisers without a reasonable belief that the broker-dealers and investment advisers were purchasing the securities for investment as required under Rule 15c2-12(d)(1)(i).
  - The underwriters did not inquire, or otherwise determine, if the broker-dealers and investment advisers were purchasing the securities for more than one account or for distribution.
  - They also failed to ascertain for whom the broker-dealers and investment advisers were purchasing the securities.
- The underwriter lacked policies and procedures reasonably designed to ensure that purchasers satisfied the exemption's requirements.
- The underwriter did not provide the investors with copies of any preliminary official statement or final official statement or determine that a continuing disclosure undertaking had been entered into by the issuer or obligated person.

Based on those circumstances, the orders found that each underwriter violated:

- Rule 15c2-12 as well as MSRB Rule G-27, which requires municipal underwriters to adopt, maintain and enforce written supervisory procedures reasonably designed to ensure compliance with Rule 15c2-12 and

- Section 15B(c)(1) of the Exchange Act for failing to comply with the MSRB rule.

The exemption provided in Rule 15c2-12(d)(1)(i) on which the underwriters were attempting to rely requires that the securities are sold to no more than 35 persons, each of whom the underwriter reasonably believes:

Related People

- David D. Grossklaus
- James H. Smith
- Jennifer Block

Related Capabilities

- Banking & Financial Institutions
- Corporate Governance & Compliance
- Public Finance
- Investment Funds

(A) Has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment; and

(B) Is not purchasing for more than one account or with a view to distributing the securities.

Each underwriter was ordered to pay disgorgement and prejudgment interest and civil penalties.

The SEC filed a complaint against a fourth underwriter alleging it failed to comply with the limited offering exemption because it did not have a reasonable belief that the municipal securities were being sold only to sophisticated investors that were each buying the securities for a single account without a plan to distribute them. The SEC alleged that the underwriter violated Rule 15c2-12, MSRB Rules G-17 and G-27 and Exchange Act Section 15B(c)(1).