# HAWKINS ADVISORY

## SEC Actions – Rule 15c2-12 Limited Offering Exemption

### *Introduction*

On September 13, 2022, the Securities and Exchange Commission (the "SEC") announced settlements with Jefferies LLC ("Jefferies"),[1] BNY Mellon Capital Markets LLC ("BNY"),[2] and TD Securities (USA) LLC ("TD"),[3] and filed a complaint against Oppenheimer & Co. Inc. ("Oppenheimer"),[4] all in connection with offerings of municipal securities utilizing the limited offering exemption provided by Rule 15c2-12 (the "Rule" or "Rule 15c2-12").[5] These actions represent the first time the SEC has brought charges against underwriters who fail to meet the legal requirements of the limited offering exemption under the Rule.

### *Rule 15c2-12 - Generally*

The Rule applies to underwriters in primary offerings of municipal securities of $1 million or more and establishes certain standards for primary and secondary market disclosures. Such provisions of the Rule are referred to herein as the "primary disclosure" and "continuing disclosure" elements, respectively.

Under the primary disclosure elements, Rule 15c2-12(b)(1)-(4) requires underwriters in primary offerings of municipal securities to:

(1) **Deemed Final OS** – obtain and review a copy of an official statement ("OS") deemed final by the issuer of the municipal securities, except for the omission of specified bond pricing information;

(2) **POS Delivery** – make available, upon request, the most recent preliminary official statement ("POS"), if any;

(3) **Delivery of OS from Issuer to Underwriter** – contract with the issuer to receive, within specified time periods, sufficient copies of the issuer's final OS; and

(4) **Underwriter OS Delivery to Customers** – provide, for a specified period of time, copies of the final OS to any potential customer upon request.[6]

Under the continuing disclosure elements, Rule 15c2-12(b)(5) requires an underwriter to reasonably determine that an issuer of municipal securities or an obligated person has entered into a contractual continuing disclosure undertaking for the benefit of holders of such securities, to provide annual reports containing certain financial information and operating data to the Municipal Securities Rulemaking Board ("MSRB"), as well as timely notice of certain specified events pertaining to the municipal securities being offered.[7]

### *Rule 15c2-12 - Limited Offering Exemption*

Rule 15c2-12(d)(1)(i) provides that the primary disclosure and continuing disclosure elements of the Rule will not apply to offerings of municipal securities issued in denominations of $100,000 or more that are sold to no more than thirty-five (35) persons if the underwriters have a reasonable belief that each purchaser: (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 (collectively, the "Limited Offering Exemption"). Items (A) and (B) are the focal points of the SEC actions described herein.

### *Key Facts and Analysis*

The key facts for each of these SEC actions are virtually identical and highlight how certain elements of the Limited Offering Exemption were overlooked or simply ignored. As described in the orders and complaint, the SEC outlines how the underwriters would sell the municipal securities to broker-dealers and/or investment advisers who purchased the securities for separately managed accounts. They did not inquire (i) whether the securities were purchased for more

[1] *In the Matter of Jefferies LLC*, SEC Rel. No. 34-95749 (Sept. 13, 2022); https://www.sec.gov/litigation/admin/2022/34-95749.pdf.

[2] *In the Matter of BNY Mellon Capital Markets LLC*, SEC Rel. No. 34-95750 (Sept. 13, 2022); https://www.sec.gov/litigation/admin/2022/34-95750.pdf.

[3] *In the Matter of TD Securities (USA) LLC*, SEC Rel. No. 34-95751 (Sept. 13, 2022); https://www.sec.gov/litigation/admin/2022/34-95751.pdf.

[4] *SEC v. Oppenheimer & Co. Inc.*, No. 1:22-cv-7801, Complaint (U.S. District Court, S.D.N.Y) (Sept. 13, 2022); https://www.sec.gov/litigation/complaints/2022/comp-pr2022-161.pdf (the "Oppenheimer Complaint"). **The reader should note that the factual allegations from the Oppenheimer Complaint that are described herein remain in dispute by the parties and may be further clarified or given additional context as the matter progresses**.

[5] 17 C.F.R. §§ 240.15c2-12; eCFR :: 17 CFR 240.15c2-12 -- Municipal securities disclosure. Offerings of municipal securities utilizing the limited offering exemption under the Rule do not have to be limited offerings under any available transactional exemptions under the Securities Act of 1933, such as offerings under Regulation A, Regulation D, and Rule 144, among others. The SEC matters discussed herein do not indicate whether any of the securities at issue could have been sold pursuant to any such transactional exemptions.

[6] 17 C.F.R. §§ 240.15c2-12(b)(1)-(4).

than one account or for distribution, (ii) whether the securities were purchased for investment, or (iii) for whom the broker-dealers and investment advisers were purchasing the securities. As a result, the underwriters could not establish a reliable factual basis adequate to support a reasonable belief that the securities were purchased for sophisticated investors who possessed the necessary knowledge and experience to evaluate the merits of the investments. Under these circumstances, none of the subject limited offerings qualified for the Limited Offering Exemption. Where a purported limited offering does not, in fact, satisfy the elements of the Limited Offering Exemption, a clear violation of Rule 15c2-12 occurs, as the securities are being sold without regard to the primary disclosure and continuing disclosure elements of the Rule.

The Oppenheimer complaint includes certain examples of municipal securities offerings with allegedly deficient processes for establishing the elements of the Limited Offering Exemption. In the complaint, the SEC states that Oppenheimer would often sell the municipal securities purchased in the limited offerings to other broker-dealers that were in the business of servicing brokerage accounts for customers. Those broker-dealers would then immediately resell the securities to one or more of their customers. In one example, Oppenheimer purchased a $1.14 million offering from a municipal issuer. The same day, Oppenheimer sold the entire offering to another broker-dealer, who then resold the securities to five different customer accounts in five different par amounts (all at least $100,000). All of the broker-dealer's customers were unknown to Oppenheimer.[8]

Under the circumstances (as alleged by the SEC in the complaint), Oppenheimer could not satisfy the elements of the Limited Offering Exemption. It would not be reasonable to believe the broker-dealers (or the investment advisers, as the case may be) were buying the securities for their own accounts when they were in the business of servicing the brokerage accounts for their customers (or managing accounts for their advisory clients). The SEC states Oppenheimer knew or should have known that such purchasers would not be buying for their own accounts, but rather, making such purchases on behalf of their customers. Even with such knowledge, the SEC alleges that Oppenheimer did not request information about: (i) how many customers would receive the securities; (ii) how much each customer was investing; (iii) each customer's level of financial experience; or (iv) whether each customer was buying for a single account.[9]

The Limited Offering Exemption is available under special circumstances where the primary disclosure and continuing disclosure elements of the Rule are waived as a result of large minimum denominations of securities being sold to a small buyer pool made up of sophisticated investors who will hold the securities as an investment. In such limited offerings, the sophistication and financial strength of the purchaser outweigh the principal objectives of the Rule – to protect the general investing public from fraudulent activity and to ensure secondary market disclosure is made available for investors to evaluate the ongoing quality of their investments. However, the Limited Offering Exemption was not intended to act as an end-around the comprehensive (and often time-consuming) primary disclosure and continuing disclosure elements of the Rule. If securities sold via the Limited Offering Exemption ultimately end up being held by the general investing public, the SEC's legitimate concerns about fraud and access to secondary market information would reemerge.

The manner in which the underwriters conducted the limited offerings in these SEC actions failed to advance the objectives of the Rule, as the underwriters did not gather the requisite information to ensure the elements of the Limited Offering Exemption would be met. In each of the subject limited offerings, the SEC alleges that the underwriters knew, or should have known, that the broker-dealers and investment advisers that were the initial purchasers of the securities would immediately sell them to their customers. Given this common fact pattern, the underwriters should have taken appropriate steps to gather the necessary information about such customers to determine whether they met the elements of the Limited Offering Exemption.

### *MSRB Rule Violations*

**MSRB Rule G-27**. In each of the subject actions, the SEC alleges MSRB Rule G-27 ("Rule G-27") violations. Such rule outlines requirements for a dealer's supervision of personnel engaged in activities involving municipal securities activities in order to ensure compliance with MSRB rules and the applicable provisions of the Securities Exchange Act of 1934, as from time to time amended (the "1934 Act"), and rules thereunder, such as Rule 15c2-12. In particular, the SEC actions allege violations of Rule G-27(c), which requires dealers to adopt, maintain, and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance with applicable rules.

The SEC actions indicate that the underwriters did not have written supervisory procedures or, if any such procedures did exist, they were inadequate. In particular, the SEC actions allege the underwriters did not have adequate policies or procedures concerning the Limited Offering Exemption that would enable them to monitor or verify whether the elements of the exemption had been satisfied.

**MSRB Rule G-17**. In the complaint against Oppenheimer, the SEC also alleges violations of MSRB Rule G-17 ("Rule G-17"), which requires that, in the conduct of municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice. The complaint states that "[i]n order to obtain and carry out its role as underwriter in the [subject limited offerings], Oppenheimer negligently

[8] *See* Oppenheimer Complaint at paragraphs 18-26.

[9] *Id*.

made deceptive statements to municipal issuers in violation of Rule G-17."

In the complaint against Oppenheimer, the SEC provides examples where the issuers published "Notices of Sale" describing the securities and certain terms on which the securities may be offered to investors. In the Notices of Sale, the issuers required underwriters to comply with the elements of the Limited Offering Exemption in selling the securities to investors. Oppenheimer submitted written bids and represented that it would comply with the terms of the Notices of Sale, including the requirement to offer the securities in accordance with the Limited Offering Exemption. In each instance, the SEC alleges that there was no evidence that Oppenheimer requested any information to learn if the requirements of the Limited Offering Exemption would be met. To further highlight these alleged deceptive practices, the SEC notes that, in some instances, Oppenheimer even provided closing certificates with representations that it had complied with the Limited Offering Exemption.

### *Penalties*

As part of the settlements with the SEC, the underwriters agreed to substantial financial penalties (rounded to the nearest dollar). BNY agreed to pay $656,834 in disgorgement plus prejudgment interest and a $300,000 penalty (related to 254 limited offerings). TD agreed to pay $52,956 in disgorgement plus prejudgment interest and a $100,000 penalty (related to 35 limited offerings). Jefferies agreed to pay $43,215 in disgorgement plus prejudgment interest and a $100,000 penalty (related to 18 limited offerings).

The complaint against Oppenheimer indicates that 354 limited offerings were being scrutinized and identifies at least $1,938,580 in net profits that could be the subject of disgorgement. The full amount of financial penalties, if any, for Oppenheimer will be determined at some point in the future as that matter progresses.

### *Next Steps*

The SEC has noted that, as a result of its findings in the aforementioned actions, it has begun investigations of other limited offerings structured by other financial institutions and has encouraged underwriters that believe their practices do not comply with the securities laws to self-report possible violations to the SEC at LimitedOfferingExemption@sec.gov.

It would be prudent for underwriters to review their written supervisory procedures (or to adopt new ones), in light of these SEC actions and the information that they contain as to the SEC's views on the type of diligence required as a prerequisite to reliance upon the Limited Offering Exemption. Further, underwriters should consider the adoption of clear guidelines for requiring investor letters, and for internal approval as to their form, to assure that the elements of the Limited Offering Exemption are met. If a limited offering were to be scrutinized in the future, having such a letter in the closing file should help support the reasonableness of the underwriter's determination that each investor met the purchaser qualifications of the Limited Offering Exemption. As part of the internal policy review, underwriters should evaluate their compliance with existing procedures and consider whether to self-report any limited offerings where underwriters may have failed to establish adequately the elements of the Limited Offering Exemption. In addition to the practical advantages of coordinating these review processes, the SEC may view a proactive response to such matters favorably as it considers any recommended action in connection with any self-reported violation.

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