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March 27, 2017

### March Madness in the Municipal Bond Market – A Focus on Gatekeepers



The month of March has brought with it the first-ever criminal municipal bond securities fraud conviction, the resolution of enforcement actions targeting banks and senior executives accused of shirking duties to oversee municipal bond issuances, and proposed rule amendments intended to improve municipal securities disclosures—continuing a trend of intensified regulatory enforcement that targets industry "gatekeepers" such as auditors, bond underwriters, and others that serve investor clients entering the municipal bond market.

***First Municipal Bond Fraud Conviction*** On March 7, 2017, the U.S. Department of Justice secured its [first municipal bond-related securities fraud conviction](#) when the former executive director of the town of Ramapo's Local Development Corporation ("RLDC"), N. Aaron Troodler, pled guilty to conspiring to defraud investors when he helped sell over \$150 million in municipal bonds on the basis of fabricated financials. RLDC was incorporated as a not-for-profit in the state of New York to undertake development initiatives in Ramapo, and was authorized to issue bonds to the public. Troodler was accused of making materially false and misleading statements (and omitting material facts) regarding the finances of the town and the RLDC in order to inflate the balance of Ramapo's primary operating fund, which concealed both the extent to which the town was funding a local stadium project as well as the RLDC's illiquidity. For example, Troodler falsely stated that the RLDC had fully reimbursed Ramapo for certain payments of principal and interest on RLDC bonds. At one point, Troodler reimbursed the town out of funds drawn from RLDC's line of credit (guaranteed by the town), as the RLDC did not have sufficient liquidity at the time to make the payment. According to prosecutors, investors in the Ramapo and RLDC bonds suffered millions of dollars in losses. The prosecution—which then-U.S. Attorney for the Southern District of New York, Preet Bharara, described as "a big step in policing and bringing accountability to the \$3.7 trillion municipal bond market"—stemmed from the SEC's 2016 [fraud action against Ramapo, RLDC, and four town officials \(including Troodler\)](#) for concealing the Ramapo's financial struggles from municipal bond investors. Troodler, along with the RLDC's former president, were charged with liability as "control persons" under Section 20(a) of the Securities Exchange Act of 1934. Furthermore, demonstrating the SEC's focus on "gatekeeper" liability, Ramapo's audit firm—and a senior partner at that firm—[settled SEC charges late last year](#) based on allegations that they allowed Ramapo to record \$3.08 million as receivable in a general fund

for a property sale that the auditors were aware did *not* occur. The SEC found the auditor "ignored red flags," failed to exercise professional skepticism, and failed to follow measures in place to prevent any material misstatements—even after senior management at the firm became aware that the town's financial statements were the subject of various fraud complaints and multiple law enforcement investigations. ***SEC Holds Bank and Bank Exec Accountable as Gatekeepers*** In another municipal bond fraud gatekeeper liability case, on March 7, 2017, the SEC obtained a [final judgment against Marrien Neilson](#), a former senior vice president at BOK Financial Corporation ("BOKF"), who was held responsible for the failures of the bank's corporate trust department when overseeing fraudulent bond offerings managed by Christopher Brogdon—an Atlanta businessman accused of misusing investor funds raised to purchase and renovate senior living facilities. In 2015, the SEC filed an [action against Brogdon](#), alleging that he raised over \$190 million for senior living facility projects through 54 conduit municipal bond and private placement offerings. Characterizing BOKF as a "crucial gatekeeper to stand up for bondholders and notify them about material problems with the bonds," the SEC charged BOKF with concealing numerous problems and red flags from investors in Brogdon's bonds. For example, Brogdon routinely drew down on the debt service reserve funds held at BOKF to make debt service payments to investors, without replenishing the funds as required by the offerings' trust indentures and without making required disclosures on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access website ("EMMA"). Brogdon also routinely failed to file required annual financial statements for the bond offerings for which BOKF was named as dissemination agent. In September 2016, BOKF agreed to pay more than \$1.6 million to settle those charges. In its [complaint](#) against BOKF's former senior vice president Neilson, the SEC identified her as "the primary decisionmaker" regarding the Brogdon bond offerings, who was also the primary recipient of bonus compensation awarded on the basis of fees paid to BOKF for the offerings. According to the SEC, Neilson concealed Brogdon's disclosure failures across more than two-dozen offerings for over a decade because she knew, or recklessly disregarded, that such disclosures could impair the viability of new Brogdon offerings. The SEC's final judgment against Neilson ordered her to pay \$55,000 in monetary relief and prohibits her from engaging in corporate trust work related to municipal securities. ***Proposed Rule Amendments for Disclosure Obligations to Improve Investor Access*** As further indication that the SEC's focus on improving transparency in the municipal market will continue unabated, on March 1, 2017, the [SEC released its proposed rule amendments](#) to improve municipal securities disclosures, which create new disclosure obligations for issuers. In particular, brokers, dealers, and municipal securities dealers acting as underwriters must provide to the Municipal Securities Rulemaking Board timely notice of, among other things, the incurrence of material financial obligations, events of default, modification of terms, or other similar events that reflect financial difficulties. These additional disclosures are designed to provide timely access to information regarding specific financial obligations incurred by bond issuers that could impact an entity's liquidity and creditworthiness. SEC Acting Chairman Michael Piwowar stated the proposed amendments will "empower investors by improving their access to current information about the financial obligations incurred by municipal issuers and conduit borrowers." Early critics of the proposed amendments argue that such burdensome proposals will limit capital growth through investment, and shift the banks' role to that of compliance officers. While addressing the topic at a recent industry conference in February 2017, Chief of the SEC's Public Finance Abuse Unit, LeeAnn Gaunt, emphasized the need to protect the retail investors—who tend to be senior citizens—investing in the municipal bond market. Gaunt indicated that the Unit's top priority remains combating offering and disclosure fraud, in addition to increasing its focus on public corruption. The latter initiative was underscored by the [SEC's first-ever breach of fiduciary duty enforcement action](#) brought in 2016 against municipal advisors who failed to disclose material conflicts of interest. According to Gaunt, the SEC will continue to bring actions in the financial fraud space, targeting issuers that fail to disclose known material risks and identifying fraudulent statements that mask issues or deficits in municipality general funds. ***Conclusion*** The recent flurry of regulatory and enforcement activity in the municipal bond market is, in reality, the continuation of a trend that has been growing in intensity over the last two years. The government's focus on control person and gatekeeper liability in cases involving municipal bond fraud is expected to remain aggressive, suggesting that individuals in such roles should revisit and assess whether there exist red flags that should be promptly

addressed, and whether disclosure obligations are being appropriately met.

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