

SEC Focuses on Municipal Underwriter Compliance with Due Diligence Obligations

Article By:

Leonard Weiser-Varon

On March 19, the **SEC's Office of Compliance Inspections and Examinations** released a [National Examination Risk Alert](#) reporting on its examinations of broker-dealers for compliance with municipal bond underwriter due diligence obligations under the SEC's prior interpretive releases and under SEC Rule 15c2-12.

The release of the Risk Alert dovetails with remarks made by SEC officials at recent municipal bond conferences to the effect that the SEC is ramping up its enforcement-related reviews of municipal bond underwriters' due diligence practices.

Findings in the Risk Alert include:

- The compliance examinations revealed instances where underwriters neither maintained nor had policies requiring the maintenance of written documentation regarding due diligence efforts. The Risk Alert notes that some underwriters asserted that it is not industry practice to maintain such written records and that their outside counsel had recommended that such records not be maintained. The Risk Alert states that such a practice of intentional non-documentation makes it difficult for underwriters to demonstrate that they have complied with their due diligence obligations and their supervisory obligations relating to conduct of due diligence. The Risk Alert indicates that "[t]his approach might lead to lax due diligence practices at a time when there are growing concerns over the fiscal well-being of some municipalities."
- The Risk Alert identified examples of certain practices used by certain underwriters that "evidence some due diligence and supervisory review" and that could assist underwriters in compliance/ enforcement examinations regarding whether and how they are meeting their due diligence obligations:
 - detailed written policies and procedures addressing the nature of due diligence requirements under Rule 15c2-12 and the firm's expectations as to how its personnel can develop the reasonable belief in the truthfulness and completeness of key representations in an offering document required under SEC interpretive guidance;
 - senior level "commitment committees" that review and approve categories of underwritten deals, including review of due diligence memoranda describing

diligence calls and documentary due diligence, and, for categories of transactions that are exempted from committee review based on ratings or recent prior review by the committee of a transaction involving the same issuer, review of such memoranda by the committee chairman or another committee member;

- firm-developed diligence checklists, which may include narrative responses relating to past familiarity with the issuer and other factors relevant to the requisite reasonable belief relating to the offering document;
- due diligence memoranda prepared by bankers detailing the subjects discussed in due diligence calls, issues noted and how such issues were resolved;
- outlines for diligence calls prepared by counsel;
- records regarding on-site examination activities such as site visits, discussions with issuer personnel and examinations of issuer records and forecasts; and
- recordkeeping checklists that assist personnel in generating and preserving due diligence documentation.

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