

INSIGHTS

Municipal Advisor Firm and Principal Charged with Fraudulent Practices and Breach of Fiduciary Duty as SEC Continues Enforcement Focus

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The SEC charged registered municipal advisor Malachi Financial Products, Inc. and its principal Porter B. Bingham with violations of Sections 15B(a)(5) and 15B(c)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) and Municipal Securities Rulemaking Board (“MSRB”) Rule G-17 thereunder, and Bingham with aiding and abetting Malachi’s violations of these provisions in a complaint filed January 2, 2018 in U.S. District Court for the Southern District of Mississippi, Northern Division. In the complaint, the SEC seeks permanent injunctive relief against Malachi and Bingham along with disgorgement of ill-gotten gains, pre-judgment interest thereon, and civil money penalties. As described below, the complaint highlights alleged conduct as violative of the Exchange Act Municipal Advisor provisions and MSRB Rule G-17 that subsequently would be addressed under MSRB Rule G-42 upon its June 23, 2016 effective date, including disclosure to the client of payments received from a third party to enlist the municipal advisor’s recommendation and excessive compensation. This matter is noteworthy because it demonstrates the Commission’s continued enforcement focus on municipal advisors.

According to the complaint, Rolling Fork, Mississippi, a small municipality with a population of just over 2,000 (the “City”), sought to raise funds for certain improvement projects, including paving streets and public parking areas, repairing municipal buildings, and constructing a municipal swimming pool. In January 2015, the City hired Malachi as the municipal advisor for a proposed bond offering to fund the necessary improvements under an “Agreement for Professional Financial Advisory Services” (“MA Agreement”). Bingham, as Malachi’s president and sole principal, signed the MA Agreement on behalf of Malachi.

The complaint alleges that in May 2015, Bingham accepted two payments totaling \$2,500 from a registered representative who was associated with a broker-dealer and municipal securities dealer. Approximately two weeks after receiving those payments, a Malachi employee recommended that the City hire the registered representative and his firm to underwrite the anticipated bond offering. Neither Bingham nor the registered representative disclosed the payments or the resulting conflicts of interest to the City. Under the terms of the MA Agreement, Malachi was to be paid an amount not to exceed 2% of the debt issuance. While the City’s Offering was originally contemplated to be for \$2 million, statutory offering limits required reduction of the offering to \$1.1 million and, pursuant to the 2% cap, Malachi’s compensation was reduced from \$40,000 to \$22,000.

As alleged, Malachi and Bingham attempted to recoup this lost revenue by fraudulently charging the City for purported “additional services” that they did not actually provide. The day after the Offering closed, Bingham directed Malachi’s employee to prepare and send two invoices totaling \$55,000 to the bond trustee for payment. One invoice was for \$22,000, which was Malachi’s contractual fee for the municipal advisory services provided to Rolling Fork (2% of the \$1.1 million issuance). The other invoice was for \$33,000 and, according to the invoice, was purportedly for services related to the “investment of bond proceeds.” This invoice, the complaint states, was false and fraudulent and was not authorized or agreed to by the City. Although addressed to the City’s Mayor, Malachi only transmitted them to the bond trustee and never sent them to the Mayor or the City. As a result, the bond trustee paid the full \$55,000 to Malachi before the City became aware of the invoices.

Malachi allegedly provided no services relating to the investment of bond proceeds to the City and the bond proceeds had not, in fact, been invested by the time of the second invoice. Neither Bingham nor Malachi has any documentation reflecting any investment services they purportedly provided the City in connection with the proceeds from the Offering. Although Malachi and Bingham may have also created some post-bond issuance compliance policies for the City and examined the City tax rolls to determine the City’s legal lending limit, the complaint asserts neither of those services, even if provided, justified the \$33,000 invoice. Rather, the post-issuance compliance policies purportedly created for the City contained nothing but standard boilerplate language, much of which can be found merely by doing an internet search. As such, it would have been unreasonable to bill the City \$33,000 for preparing these policies. More importantly, as the complaint notes, Malachi and Bingham never provided those written policies to the City.

The complaint alleges six counts: that (i) Malachi and Bingham violated Section 15B(a)(5) of the Exchange Act by using the means or instrumentalities of interstate commerce or the mails while engaging in fraudulent, deceptive, and/or manipulative acts or practices in providing advice to a municipal entity; (ii) Malachi and Bingham breached their fiduciary duty to the City in violation of Section 15B(c)(1) of the Exchange Act; (iii) Malachi and Bingham, while acting as a municipal advisor, engaged in acts, practices, and courses of business that violated Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17; (iv) Bingham aided and abetted Malachi’s violations of Section 15B(a)(5) of the Exchange Act; (v) Bingham aided and abetted Malachi’s violations of Section 15B(c)(1) of the Exchange Act; and (vi) Bingham aided and abetted Malachi’s violations of Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17. As relief for the alleged violations, the complaint seeks, among other relief, findings of fact and conclusions of law that Bingham and Malachi committed the violations alleged; permanent injunctions enjoining Malachi and Bingham from violating Sections 15B(a)(5) and 15B(c)(1) of the Exchange Act and MSRB Rule G-17; permanent injunctions enjoining Bingham from aiding and abetting Malachi’s violations of Sections 15B(a)(5) and 15B(c)(1) of the Exchange Act and MSRB Rule G-17; an order directing Malachi and Bingham to pay disgorgement of all ill-gotten gains or unjust enrichment and to pay prejudgment interest on the amount ordered to be disgorged, to effect the remedial purposes of the federal securities laws; and an order imposing civil penalties against Malachi and Bingham.

A copy of the complaint may be found [here](#).

Should you have any questions about SEC, DOJ, FINRA or other governmental enforcement issues, please reach out to [Paul Maco](#), [Ed Fierro](#) or [Britt Steckman](#).