

SEC MUNICIPAL ENFORCEMENT

What You Need To Know

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What do you need to know?

- 1) SEC is serious about municipal market enforcement.
- 2) Protect your clients (the entity and the individual).
- 3) Have good policies and procedures in place and follow them – including training and diligent review.
- 4) Look at the big financial picture – particularly financial liabilities and financings based on “valuations.”
- 5) Elected officials should review disclosure or set up proper delegations of responsibility.

- How has the SEC gone about the enforcement business in the past?
 - Seminal enforcement action in 1996 was Orange County, CA.
 - *Takeaway*: Governing body is responsible for the review and approval of the offering document.



City of San Diego, 2006:

- \$260 million in bond offerings in 2002 and 2003.
- City was facing a looming financial crisis, resulting from:
 - intentional underfunding of its pension plan for 5 years.
 - retroactive increases in pension benefits.
 - use of surplus earnings to pay additional benefits to plan beneficiaries.
- City failed to disclose these problems in its bond offerings.

States of New Jersey 2010 and Illinois 2013

- In connection with offerings, states misrepresented and omitted material information about underfunding of pension funds.

City of Victorville, April 2013

- Tax increment bonds issued by Authority in 2006, 2007, and 2008 used to fund redevelopment projects on former Air Force base.
- In constructing Project, underwriter and developer misappropriated \$2.75 million in bond proceeds to pay excessive construction and management fees.
- Authority's 2008 Official Statement was also false and misleading, as it misstated tax increment available to repay bondholders and debt service ratio for bonds.
- Calculations of tax increment and debt service ratio were based on inflated valuations.
- Beware of deals premised on some kind of valuation.
- Personal liability by officials and other transaction participants likely to become more common.

City of Harrisburg, May 2013

- First SEC action against municipality based upon statements made publicly as opposed to in securities disclosure documents.
- City was charged with misleading investors about financial health in annual State of the City address, as well as in financial and budget reports.

City of Miami, July 2013

- SEC focused on alleged improper conduct involving interfund transfers. Transfers masks deficits in the general fund and falsely inflated the general fund balance, which led to more favorable ratings by credit ratings agencies on City's 2009 bonds.
- Alleged former budget director arranged transfers, misrepresented true nature to City officials and others, and falsified justification for transfers in the City's internal records.
- Alleged City made numerous material misrepresentations and omissions about the interfund transfers in its bond offering documents and its 2007 and 2008 annual financials.

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“Our books are balanced. 50% of our numbers are real and 50% are made up.”

West Clark Community Schools, July 2013

- First action charging a municipal issuer with falsely claiming in a bond offering's official statement that it was fully compliant with continuing disclosure obligations and an underwriter for not doing the necessary due diligence.
- However, West Clark had not submitted any of the required annual reports or notices for a 2005 bond offering.
- Policies and procedures and training of officials and employees should have caught this.

Greater Wenatchee Regional Events Center Public Facilities District, November 2013

- Issuer charged with negligently misleading investors in a bond offering that financed the construction of a regional events center and ice hockey arena.
- Wrongly stated there had been no independent reviews of the financial projections for the events center.
- Failed to inform investors that the Mayor and the senior staffer had influenced the financial projections, rendering them unduly optimistic.

**SEC Enforcement Division
Encourages Self-Reporting by
Municipal Securities Issuers and
Underwriters**

SEC Municipal Market Enforcement

- March 10, 2014, SEC Enforcement Division introduced an initiative to encourage self-reporting by municipal securities issuers and underwriters of possible securities law violations related to misrepresentations in offering documents concerning an issuer's prior compliance with its continuing disclosure obligations.
- Facts of *West Clark Community Schools*.
- Under the Municipalities Continuing Disclosure Cooperation Initiative, Enforcement Division will recommend “favorable settlement terms” upon self-reporting.

- The Enforcement Division will recommend not levying a financial penalty against issuers. Issuers will be required to take remedial actions including:
 - Establishing compliance policies and procedures.
 - Complying with prior and existing continuing disclosure obligations.
 - Cooperating with subsequent SEC investigations.
 - Disclosing terms of the settlement in its official statement for five years.
 - Providing a compliance certificate to the SEC regarding the above actions one year from the date on which the cease-and-desist proceeding is instituted.

SEC Municipal Market Enforcement

- Individuals may not self-report through the MCDC Initiative.
- Enforcement Division indicates that the remedies it seeks will be more severe for eligible issuers and underwriters who fail to self-report through the MCDC Initiative.
- The Division states that it will likely recommend financial penalties for such non-reporting issuers and financial penalties higher than those set forth in the MCDC Initiative for such non-reporting underwriters.



"Of course you feel great. These things are loaded with antidepressants."

SEC Municipal Market Enforcement — Links

- <http://www.sec.gov/>
- <http://www.msrb.org/>