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Reuters: Wielding Harrisburg Example, SEC Cajoles Cities Nationwide.

At first glance, a federal regulator's rebuke of the city of Harrisburg this month over fraudulent statements and long overdue disclosures to its bondholders could be seen as a warning to state and local politicians who offer too rosy a view of their financial health.

But clear-cut cases such as Harrisburg of officials mis-stating their city's finances remain relatively rare, and the main goal of the U.S. Securities and Exchange Commission is far more basic – cajoling thousands of cities, counties and other organizations that sell bonds into complying with its disclosure rules.

When on May 6 the SEC charged the cash-strapped capital city of Pennsylvania, it effectively put officials across the country on notice that even political statements like annual state of the city addresses must not overstate financial conditions.

The message was “what you say can and will be used against you,” said Ben Watkins, head of Florida's Division of Bond Finance. “What makes it precedent-setting is that it's the first time there's been an enforcement action on statements made by public officials.”

The SEC said Harrisburg had defrauded its creditors because numerous officials glossed over its disastrous finances and the city was overdue in its disclosures. While no individuals were held to account, a commissioner of the SEC said it would not show such restraint in future.

In a typical conclusion to SEC civil investigations, Harrisburg agreed to settle the charges without admitting or denying the regulator's findings.

Now that the city of nearly 50,000 has become an example of mismanaged public finances and has a mountain of debt to clear while providing basic services, whoever is Harrisburg's next mayor will be closely watched by the \$3.7 trillion U.S. municipal bond market. On Tuesday, Democratic Party voters will choose their candidate in a primary election. There is no Republican mayoral primary.

DIVERSE POOL OF ISSUERS, THOUSANDS MISS DEADLINES

Compliance is sketchy given the diverse pool of issuers in the municipal bond market, some 50,000 entities ranging from states selling billions of dollars of bonds a year to tiny, quasi-governmental authorities that raise less than \$1 million at a time. In the three financial years from mid-2009 to mid-2012, local issuers sent more than 5,000 notices of failure in providing financial information.

Moreover, that number does not capture the number of issuers behind schedule that have not reported even that fact to investors. That figure is unknown, according to regulators, because there is no central mechanism for automatically triggering a notice of a passed deadline.

And, adding to the confusion, filing deadlines are not standardized as they are with financial statements of publicly traded companies. Typically they are specified within individual underwriting

contracts.

In the last month alone, 243 late report notices were posted on EMMA, the Electronic Municipal Market Access website.

The greatest number came from Puerto Rico, which aims to have its financial statements completed before a \$770 million debt refinancing before June 30, according to Government Development Bank for Puerto Rico communications director Betsy Nazario. The island's employee retirement system delayed its report while hammering out major pension reforms, according to a notice filed by its administrator Hector Mayol Kauffmann.

In some cases, a missed deadline simply reflects the mundane rather than raising a financial red flag. Zion, Illinois, population 24,400 and 50 miles north of Chicago along the Lake Michigan shore, has run into scheduling conflicts with its outside auditor in past years, forcing it to miss deadlines for a day or two. The city, with about \$31 million in bonds, recently enacted measures to have the audit completed earlier, said financial director David Knabe.

HARRISBURG REVERBERATES

Nevertheless, the SEC's move against Harrisburg, which did not release its fiscal 2009 audit until July 2012, has clearly caught the eye of local officials across the country. The get-tough pledge is now a top agenda item for the Government Finance Officers Association when its members, who oversee many debt sales each year, gather in early June for an annual meeting.

The SEC presents officials a clear trade-off: either deliver timely information to investors or be held responsible for every bit of information in public speeches.

"Public statements, if they are materially misleading or omit material information, can lead to potential liability under the anti-fraud provisions of the federal securities laws," the SEC report said.

Those statements can be written or oral, it added. While it remains to be seen if that report will muzzle political speech, some expect officials to vet their references to finances in speeches and look into disclaimers for written statements.

"I don't think public officials should view this order as inhibiting anything they may want to say," said bond lawyer John McNally of the firm Hawkins Delafield & Wood LLP. "I think they should view it as caution that any statements expected to reach the market can be used for anti-fraud liability."

SEC'S AUTHORITY IS LIMITED

The SEC's authority in the muni market remains limited because of constraints on federal oversight of state and local governments. Its main tool is the authority to require underwriters to create agreements with issuers for annual financial updates and to disclose other events that may affect their bonds.

"The SEC used the authority that it has to enforce issuers' obligations, and I think they sent a useful message to the market that issuers in distressed situations should take care," said Michael Decker, co-head of the municipal division at the Securities Industry and Financial Markets Association.

In a report last summer, the SEC said it would seek greater authority over issuers, but Congress has yet to approve those powers. Still, the agency is trying to have a bigger impact in the market.

Three years ago it created a unit dedicated to municipal bonds and public pensions and has since

taken on big-name cases such as the state of Illinois, delivering a rebuke comparable to Harrisburg.

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