# Bond Case Briefs

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## Getting Serious About Government Fraud.

In April, an unprecedented criminal trial will kick off in federal court in New York, with two representatives of the town of Ramapo facing multiple counts of securities fraud.

Prosecutors have frequently indicted public officials for embezzling taxpayer money or taking bribes, but this case marks the first attempt to convict officials for fabricating a town's financial statement to raise money in the bond market — in this instance, to pay for a new minor-league-baseball stadium.

Ramapo Town Supervisor Christopher St. Lawrence and Ramapo Local Development Corp. Executive Director N. Aaron Troodler "kicked truth and transparency to the curb," alleges the indictment, by misleading investors about the town's finances.

The trial will receive intense scrutiny in government circles. Tens of thousands of local government entities issue bonds, and some employ dubious accounting techniques "that obscure their true financial position," according to a 2015 report of the Volcker Alliance, a good-government group led by former Federal Reserve Chairman Paul Volcker.

For decades, officials rarely paid a price for using such suspect fiscal moves, and some have even grown bold in the practice. But since the middle of the last decade, the Securities and Exchange Commission and the Department of Justice have started to crack down on misleading financial reporting by local governments. The potentially groundbreaking outcome of the Ramapo trial could shake up municipal finance across America.

Consecutive acts of Congress, passed in 1933 and 1934, fashioned securities law in the United States and created the Securities and Exchange Commission, which required firms that issued securities to register with the commission and to produce periodic financial reports.

Congress exempted municipalities that issued securities from the same disclosure rules, however. But the SEC did warn state and local officials that anti-fraud statutes made it illegal to mislead investors by making untrue statements in, or omitting significant facts from, financial reports.

Since then, the SEC and some elected officials and investor groups have lobbied to tighten restrictions on municipalities that issue debt, but they've made little progress.

**Increased Scrutiny**

In a 2007 speech, former SEC Chairman Christopher Cox warned about the inadequacy of investor protections in the increasingly complex municipal bond market. For decades, he noted, the SEC could intervene in cases only after evidence of fraud emerged.

He warned about the "lack of uniformly applied, generally accepted accounting standards" for governments, which he argued threatened "the integrity of the municipal market."

In the aftermath of rising defaults in the municipal market that began in late 2007, the SEC began scrutinizing what governments said in their financial statements and whether it matched their actual practices.

The commission first signaled its intentions in April 2008, when it charged five San Diego officials, including the former city manager and auditor, with fraud in connection with a pension scandal. Investigators accused the officials of certifying financial statements in 2002 and 2003 that they knew were false; they had failed to disclose that the city was purposely underfunding its pension system.

The accused eventually agreed to pay penalties ranging from $5,000 to $25,000 — the first such fines levied against officials in a muni-fraud case.

The commission broke new ground in 2010 by establishing a unit to investigate misconduct in municipal finance, with an emphasis on pension funding.

In August of that year, for the first time, it charged a state with fraud, contending that New Jersey had issued documents during bond offerings between 2001 and 2007 that gave the impression that its government-employee pension system was well-funded; in reality, the state couldn't afford to make adequate contributions to the system.

In March 2013, the commission similarly charged Illinois with fraud — again, largely due to misrepresentations about pensions. The SEC again chose not to fine the state, and it singled out no one in government as responsible for the mess. Instead, the commission blamed poor staff training and accepted Illinois' pledge to rectify the situation.

Since then, the SEC has started to more frequently file actions against municipal officials.

From 2008 through 2010, the Chicago suburb of Harvey, Ill., floated several bond offerings to raise money to help investors develop a hotel in town.

When the investors ran into trouble advancing the project, Harvey used some of the money instead to fund the city's payroll and other operating costs, which violated bond covenants. For his role in the affair in May 2016, Harvey Mayor Eric Kellogg agreed to pay a $10,000 fine and never participate again in a bond offering.

Regulators have taken a particularly tough stand against municipalities with a pattern of wrongdoing. In September, SEC lawyers won an unprecedented trial seeking fines and penalties against Miami and its former budget director over allegations that they misled investors in 2009 bond offerings.

Afterward the SEC warned that "We will continue to hold municipalities and their officers accountable, including through trials, if they engage in financial fraud or other conduct that violates the federal securities laws."

**Ramapo's Field Of Dreams**

In Ramapo, federal prosecutors have turned a municipal securities case into a criminal conspiracy indictment.

The U.S. attorney for the Southern District of Manhattan, Preet Bharara, alleges that former Ramapo supervisor St. Lawrence and Troodler, who ran the town's local development nonprofit organization, colluded to hide the town's involvement in a $58 million minor-league-stadium project, after voters had overwhelmingly rejected a resolution to back bonds to help build the facility. The defendants have pleaded not guilty, claiming that they relied on the advice of professionals for the various moves made.

With a Republican-led SEC under President Trump about to debut, the question is whether investors and, by extension, taxpayers should demand more reforms and greater supervision of local government accounting.

Among potential reforms that might offer better protection would be giving the SEC the right to designate what information municipal governments should include in their financial reports, and how they should present it.

It may also be time to designate an independent body to set proper accounting standards for governments with public debt — something that the Financial Accounting Standards Board does for private firms that issue securities.

A shake-up is overdue.

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