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SEC Charges City of Harrisburg for Fraudulent Public Statements.

The Securities and Exchange Commission has charged the City of Harrisburg, Pa., with securities fraud for its misleading public statements when its financial condition was deteriorating and financial information available to municipal bond investors was either incomplete or outdated.

An SEC investigation found that the misleading statements were made in the city's budget report, annual and mid-year financial statements, and a State of the City address. This marks the first time that the SEC has charged a municipality for misleading statements made outside of its securities disclosure documents. Harrisburg has agreed to settle the charges.

The SEC found that Harrisburg failed to comply with requirements to provide certain ongoing financial information and audited financial statements for the benefit of investors holding hundreds of millions of dollars in bonds issued or guaranteed by the city. As a result of Harrisburg's non-compliance from 2009 to 2011, investors had to seek out Harrisburg's other public statements in order to obtain current information about the city's finances. However, very little information about the city's fiscal situation was publicly available elsewhere. Information that was accessible on the city's website such as its 2009 budget, 2009 State of the City address, and 2009 mid-year fiscal report either misstated or failed to disclose critical information about Harrisburg's financial condition and credit ratings.

The SEC separately issued a report today addressing the disclosure obligations of public officials and their potential liability under the federal securities laws for public statements made in the secondary market for municipal securities.

"In an information vacuum caused by Harrisburg's failure to provide accurate information about its deteriorating financial condition, municipal investors had to rely on other public statements misrepresenting city finances," said George S. Canellos, Co-Director of the SEC's Division of Enforcement. "Statements that are reasonably expected to reach the securities markets, even if not prepared for that purpose, cannot be materially misleading."

Elaine C. Greenberg, Chief of the SEC's Enforcement Division's Municipal Securities and Public Pensions Unit, said, "A municipal issuer's obligation to provide accurate and timely material information to investors is an ongoing one. Because of Harrisburg's misrepresentations, secondary market investors made trading decisions based on inaccurate and stale information."

According to the SEC's order instituting settled administrative proceedings, Harrisburg is a near-bankrupt city under state receivership largely due to approximately $260 million in debt the city had guaranteed for upgrades and repairs to a municipal resource recovery facility owned by The Harrisburg Authority. As of March 15, 2013, Harrisburg has missed approximately $13.9 million in general obligation debt service payments.

According to the SEC's order, Harrisburg had not submitted annual financial information or audited financial statements since submitting its 2007 Comprehensive Annual Financial Report (CAFR) to a

Nationally Recognized Municipal Securities Information Repository (NRMSIR) in January 2009.

Beginning in July 2009, Harrisburg was obligated to submit financial information and notices such as principal and interest payment delinquencies and changes in bond ratings to a central repository known as the Electronic Municipal Market Access (EMMA) system maintained by the Municipal Securities Rulemaking Board (MSRB). Harrisburg did not submit its 2008 CAFR to EMMA, instead erroneously submitting it to a former NRMSIR on March 2, 2010. Harrisburg did not submit its 2009 CAFR to EMMA until Aug. 6, 2012, and did not submit its 2010 CAFR to EMMA until Dec. 20, 2012. The city did not submit material event notices about its failure to submit annual financial information or its credit rating downgrades until March 29, 2011, after the SEC had commenced its investigation.

Therefore, the SEC's order finds that at a time of increased interest in the Harrisburg's financial health due to the deteriorating financial condition of The Harrisburg Authority, the city created a risk that investors could purchase or sell securities in the secondary market on the basis of incomplete and outdated information. For current information, investors had to review other public statements from the city about its fiscal situation. For example, Harrisburg's 2009 budget and its accompanying transmittal letter were accessible on Harrisburg's website. By the time the 2009 budget was passed, Harrisburg was aware of the Authority's projected budget deficits and that Dauphin County was challenging a rate increase. As a result, the Authority was unlikely to have sufficient revenues to pay its 2009 debt service obligations. However, Harrisburg's 2009 budget as adopted did not include funds for debt guarantee payments. The 2009 budget also misstated Harrisburg's credit as being rated "Aaa" by Moody's when in fact Moody's had downgraded Harrisburg's general obligation credit rating to Baa1 by December 2008.

According to the SEC's order, another public statement available to investors on the city's website was the annual State of the City address delivered on April 9, 2009. The address only discussed the municipal resource recovery facility as a situation that was an "additional challenge" and an "issue that can be resolved." The address was misleading because it failed to mention that by this time, Harrisburg had already made $1.8 million in guarantee payments on the resource recovery facility bond debt. It also omitted the total amount of the debt that the city would likely have to repay from its general fund. By this time, Harrisburg knew that the Authority had failed to secure the requested rate increase, making it likely that Harrisburg would have to repay $260 million of the debt as guarantor.

According to the SEC's order, Harrisburg's 2009 mid-year fiscal report available on its website was designed to provide a snapshot of budget-to-actual figures at the middle of the year. However, the report did not reference any of the guarantee payments the city had made on the municipal resource recovery facility debt, which at this mid-year point totaled $2.3 million (7 percent of its general fund expenditures).

The SEC's order requires Harrisburg to cease and desist from committing or causing violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The city neither admits nor denies the findings in the order. In the settlement, the SEC considered Harrisburg's cooperation in the investigation and the various remedial measures implemented by the city to prevent further securities laws violations.

The SEC's investigation was conducted by members of the Enforcement Division's Municipal Securities and Public Pensions Unit including Senior Enforcement Counsel Yolanda Gonzalez and Assistant Director Ivonia K. Slade with assistance from Municipal Securities Specialist Jonathan D. Wilcox. The investigation was supervised by Unit Chief Elaine C. Greenberg and Deputy Chief Mark R. Zehner.

In its Report of Investigation to address the secondary market disclosure responsibilities of public officials when they make public statements about a municipal issuer, the SEC notes that public officials should be mindful that their written or oral public statements may affect the total mix of information available to investors. This could result in anti-fraud liability under the federal securities laws for the public officials making such statements if they are materially misleading or omit material information.

The report further states that public officials should consider taking steps to reduce the risk of misleading investors. At a minimum, they should consider adopting policies and procedures that are reasonably designed to result in accurate, timely, and complete public disclosures; identifying those persons involved in the disclosure process; evaluating other public disclosures including financial information made by the municipal issuer; and assuring that responsible individuals receive adequate training about their obligations under the federal securities laws.

The SEC order is available at:

http://www.sec.gov/litigation/admin/2013/34-69515.pdf

The investigation of the report is available at:

http://www.sec.gov/litigation/investreport/34-69516.htm