

Bond Case Briefs

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Public Officials Beware: The SEC Will Hold You Liable.

The Securities and Exchange Commission is making it clear: Government leaders who issue misleading financial information are putting themselves at risk.

Several recent actions by the Securities and Exchange Commission (SEC) against states and municipalities have highlighted the potential risk to government leaders who fail to disclose financial information on a timely basis or who issue information that might mislead investors. And the risk goes beyond liability for their jurisdictions: In some cases the federal regulator could hold public officials personally liable.

This March, the SEC charged the state of Illinois with securities fraud for misleading investors about serious problems with the state's pension fund. A month later, the SEC accused the city of Victorville, Calif., a city official, the related Airport Authority and the city's bond underwriter of securities fraud in connection with a \$13.3 million bond sale in 2008. In May, the SEC brought actions against the cities of South Miami, Fla., and Harrisburg, Pa., alleging that investors were harmed by incomplete and misleading financial disclosures. And in July the SEC accused the city of Miami and its former budget director of securities fraud.

In a warning to government leaders across the country issued in connection with the Harrisburg case, the SEC took the unusual step of issuing a strongly worded report that clarifies and strengthens disclosure requirements under federal securities laws. That report explicitly highlights the risk to government officials of being held personally liable for securities fraud in connection with secondary market trading of municipal securities.

That was not an idle threat, as the charges of security fraud against the city of Miami and its former budget director demonstrate. The SEC alleged that the former budget director had sought to deceive investors and bond-rating agencies regarding the city's financial health by transferring funds from other city accounts to hide deficits in the city's general fund. The SEC also alleged that Miami had made material misrepresentations in its 2007 and 2008 Comprehensive Annual Financial Report (CAFR) and in communications with rating agencies in 2009.

The SEC's actions come at a time of increased public focus on the strength of the municipal bond market. Investors have been attracted to municipal bonds because they were seen as relatively safe and in some cases had tax benefits. But as the 2008 financial crisis spread, the financial contagion quickly had an impact on state and local tax bases, with a devastating effect on the financial positions of states and municipalities. Because of the risk of harm to investors in municipal bonds, the SEC has turned an increasing focus on state and local governments — and on their leaders and executives.

What does this all mean for state and local government officials?

- It's never been more important to create — and maintain — institutional awareness of continuing disclosure obligations. States and municipalities should have complete and updated securities disclosure policies in place, and they should regularly train relevant employees and officials on the

policies and related legal requirements under the federal securities laws.

- The CAFRs and Material Event Notices required under Municipal Securities Rulemaking Board rules and other continuing disclosure obligations must be filed on a timely basis.
- Government leaders and executives must be mindful of their obligations under federal securities laws, including the risk of personal liability for securities fraud. Public statements on financial matters should be balanced, measured and accurate.

The SEC's recent actions highlight a sea change in the agency's approach to enforcement regarding state and municipal securities issuers. Government leaders and executives should embrace the SEC's recent actions as a teaching moment — an opportunity to recalibrate their understanding of their responsibilities under the federal securities laws.

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