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Investors Want Details on Bonds that Pay for Police Misconduct.

Bond investors seek details on police settlements

As Black Lives Matter protests march on around the U.S., some investment advisers and asset managers are pushing for more disclosure on so-called judgment allocation bonds issued by cities and states to fund payouts for settlements of lawsuits against police.

Protests against police brutality sparked by George Floyd's killing in Minneapolis in May have drawn attention to the role of municipal bonds in covering the costs of police misconduct. When governments lack the budget to pay settlements, they often turn to Wall Street to raise money with judgment allocation bonds.

The City of Los Angeles used Judgement Obligation Bond, Series 2009-A to cover $20.5 million of the $95 million paid out to settle lawsuits connected with the Rampart Police corruption scandal of the 1990s and 2000s, according to a 2018 report by the Action Center for Race and the Economy. The scandal involved members of the city's anti-gang Rampart Division, who allegedly abused suspects.

Such bonds defray immediate costs to the government, though taxpayers end up footing the legal bill over time as the bonds are repaid with interest. They are also on the hook for fees paid to underwrite them. Banks hired by Los Angeles to underwrite 2009 and 2010 judgment obligation bonds collected more than $1 million in fees.

"This is just starting to filter into investors' consciousness," said Maya Philipson, a partner at wealth management firm Robasciotti & Philipson, which has studied the role bonds play in funding police lawsuit payouts for its clients. "As soon as we start giving them education, they get really up in arms about it. It's not something they want to support."

Rachel Robasciotti, the firm's founder, added that more disclosure would empower investors.

"The trouble with municipal bonds is that people tend to think of them as wholly good," she said in an interview. "But if they are paying out settlements for police misconduct, what they're doing is enabling that behavior by offering a credit line to those who are abusing their citizens.

"If the municipality as a whole saw police conduct as something that impacts their ability to do long-term investment there, I think the pressure would come in for policy reform from all sides," she said.

Cities, states and utilities traditionally use municipal bonds to fund public works, including updates to school facilities, switches to renewable energy sources, expansions of public transportation networks, or building healthcare infrastructure. They are also used to cover budget shortfalls.

Eric Glass, a portfolio manager for AllianceBernstein, said it can be difficult to discern between bonds funding settlements and those raising money for public projects because municipalities rarely provide details. AllianceBernstein manages $542 billion in assets including municipal bonds.

“You get to pick and choose what you invest in, but it isn’t always clear,” Glass told CQ Roll Call in an interview, adding that funds tied to settlements are often lumped into general obligation bonds. “If investors knew they were paying off judgments against police departments, I don’t think they would buy the bonds.”

‘No visibility’

The absence of disclosures means there’s not much widely available data on how common it is for cities to pay for civil rights abuse settlements through bonds. The Action Center on Race and the Economy in 2018 released a report detailing settlements paid for through bonds by 12 cities and counties, totaling well into millions of dollars.

From 2008 to 2017, Los Angeles raised $71.4 million through municipal bonds to pay for settlements involving police misconduct. During that period, Milwaukee raised about $26 million, the study said.

For Chicago, the center found it difficult to confirm an exact payout amount funded by bonds because the city doesn’t track the specific settlements that bond proceeds are used for, though it’s transparent about the use of bonds to pay for legal costs in general. The center estimated that from 2010 to 2017 the city raised almost $710 million in bonds to fund settlements.

City officials didn’t immediately return CQ Roll Call’s requests for comment.

Maurice BP-Weeks, co-executive director of the center, told CQ Roll Call that the research isn’t meant to discourage the settlements. Rather, he said his goal is to draw attention to the cost of misconduct to the cities and pressure municipalities to deduct payouts from police department budgets.

Collecting data on even 12 municipalities is labor intensive.

Action Center on Race and the Economy researchers cross-referenced news reports of settlements with amounts raised through bonds reported to the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access system, which houses munibond data and disclosures. They also spoke directly with city officials, poured over municipal documents, and used Freedom of Information Act requests to access the data.

Ryan Bowers, co-founder of Activest, a policy group that seeks to pressure bond issuers and investors on social issues, said the bonds shift the settlement costs onto future taxpayers and protects police departments. He said investors and city residents lack basic information about the number of police misconduct incidents, how many result in lawsuits, or how many end in settlements or their amounts.

“We have no visibility on that,” he said.

‘Each and every dollar’

AllianceBernstein’s Glass says he wants to see cities disclose an itemized list of what “each and every dollar” raised through a bond pays for. Disclosures about the settlements paid out by the city or structures in place to oversee police departments would also benefit investors, he said.

In addition to a moral case, there are financial reasons for more disclosure around the use of municipal bonds, Glass said. When settlements are paid out, that has a direct impact on the profit and loss statement of a city. If a company uses insurance to pay its legal costs, those premiums will increase. A smaller community could be bankrupted by a hefty settlement. All of those considerations influence whether a city’s bonds are a smart investment, he said.

Maggie Kulyk, CEO of the sustainable asset management firm Chicory Wealth, said she would like to see more disclosure from cities, and a trail of expensive bond-funded settlements would make her think twice about advising a client to invest in a municipality. The wealth management firm works with clients who want their investments to align with progressive values.

“I think it does speak to the financial viability of a community,” she said. “I would be very hesitant to invest in that city or state for fear that it would not have a good long-term trajectory.”

An analysis released last month by credit rating company Moody’s on the potential effects of the Black Lives Matter protests supports that assessment. Cities that fail to address the root causes of the protests could take an economic hit, it said, adding that long-term credit health will depend on whether unrest recurs and whether a municipality can adopt policies that improve racial and income inequality.

“These solutions could take multiple years to implement and could be costly,” Moody’s said.

Pending legislation

Investors could push for greater transparency on the local, state, or federal level. Bowers pointed to city auditors or state treasurers as officials who could require more disclosure of police misconduct cases.

The Governmental Accounting Standards Board, an independent regulator that sets standards for state and local governments, is another possibility. The board could require municipal governments to share their expected exposure to litigation tied to police misconduct as part of risk disclosures, he said.

In Congress, Rep. Gregory W. Meeks introduced a bill in June that would push for more transparency on Wall Street’s role in the process. The proposal would require banks to report if they underwrite a municipal bond that funds police payouts and disclose what they earned from the work.

The New York Democrat told CQ Roll Call that the proposal is about creating more transparency and accountability for cities, their police departments, and banks. The bill includes a provision that would require banks to disclose whether they partnered with a minority- or woman-owned business on the work.

“That money should be further invested in communities that have been victimized by this bad behavior,” he said.

Roll Call

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