# Risky CPS debt raises questions about SEC protections for governments

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Many investors in the auction-rate market — who were unable to cash out when the market collapsed — got their money back after the Securities and Exchange Commission alleged that bank officials had hidden how precarious the market was.

Banks also kept government borrowers like Chicago Public Schools in the dark, according to interviews and court claims. But governments got almost nothing from the SEC settlement, even though the SEC is charged with making sure banks deal fairly not only with investors but also with borrowers.

One former SEC official said investment banks violated their fair dealing duty — in what he called a pattern of "systemic misbehavior" — when they marketed auction-rate securities to governments.

The former official, Dave Sanchez, said the agency's failure to take any significant action on behalf of governments that issued auction-rate debt is a symptom of a bigger problem: The SEC has largely limited its actions to protecting investors, even as the growing complexity of the bond market has made issuers increasingly vulnerable.

"It's not just the investors who are potential victims," said Sanchez, who worked at the SEC's Office of Municipal Securities from 2010 to 2013. "The issuer is a potential victim, and when the issuer is a victim, that means the taxpayer is a victim."

In response to a request by the Tribune for examples of the SEC taking action against banks for dealing unfairly with governments during the borrowing process, an agency spokeswoman sent the Tribune seven cases.

After reviewing the cases and sharing them with Sanchez, the Tribune determined that only one of the seven cases alleged misconduct during the borrowing process. The six other cases addressed situations in which governments acted as investors, with the SEC alleging wrongdoing by banks charged with investing government funds, including borrowed money.

When the Tribune brought that to the attention of an SEC spokeswoman, the agency declined further comment.

In the one case concerning borrowing, the SEC alleged that a bank official had manipulated his analysis of a 1994 borrowing deal by Dade County, Fla., in order to make the savings look greater. The official was fined $30,000 and banned for five years from many municipal securities jobs as part of a settlement that involved no admission of guilt.

Government borrowers — like investors — can also file individual actions against banks. But Joseph S. Fichera, CEO of the New York-based financial advisory firm Saber Partners, said that when it comes to auction-rate securities, that may not be enough to deter bad behavior.

"The costs of litigation are high, and this appears to be a systemic problem," said Fichera, who has served as an expert adviser in auction-rate litigation and arbitration and who advised the SEC on auction-rate securities in the mid-2000s. "You don't want rules that only get enforced by private litigation because that doesn't solve the problem.

"Now that more information about potential violations against municipal issuers has come to light, a fair question to ask is, 'Where are the regulators?'"

Sanchez noted that the SEC has another option, less extreme than legal action, for condemning banks' behavior in the auction rate market: Officials could issue a report of investigation, which essentially allows the agency to state a position on activity that has taken place in the market without levying charges. That has not happened.

In the nearly $6.7 billion settlement the SEC secured for auction-rate investors, there was one small concession for borrowers. But it did not benefit Chicago's schools.

The 2009 settlement, which the Illinois secretary of state's office also worked on, required Bank of America to pay some costs related to auction-rate securities issued between Aug. 1, 2007, and the February 2008 market collapse.

Under the settlement, BofA would pay back borrowers for refinancing costs, but only if BofA had done the refinancing. CPS did an auction-rate deal in September 2007 and refinanced the bond months later to escape the collapsing market, but it did not use BofA for the refinancing. So there was no settlement money for CPS.

In an interview about the settlement earlier this year, an attorney with the secretary of state's office noted that CPS could have taken further action on its own.



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