

The Basics for Local Officials Concerned with SEC Actions

For all local governments, not just those currently under investigation, the SEC enforcement actions and policies raise questions for elected and appointed officials. What is the SEC? What action by a local government might trigger an investigation, and what happens if there is an investigation?

In order to help answer some of these questions, Susan Golden, deputy director of the Office of Municipal Securities at the Securities and Exchange Commission, responds to some of the questions raised in the wake of enforcement actions against local governments in a two-part series of articles.

The first part focuses on the mechanics of what the SEC is, what an investigation is, and some of what happens during an investigation. The second part will discuss what the anti-fraud provisions are, the SEC's view on the responsibilities of municipal officials, and what might constitute federal securities fraud violations.

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Investigation?

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Susan Golden

Why Is the SEC Involved in the Municipal Securities Market?

Municipal securities are one of the most important sources of funds for state and local governments to build facilities or otherwise finance operations. In recent years, the size of the market has grown dramatically. Today there are more than 150,000 different issues of municipal securities that are outstanding, with a market capitalization well in excess of one trillion dollars. The investors in these securities, both through direct holdings and mutual funds, tend to be individuals, as compared with a decade ago, when such institutional holders as banks and insurance companies were the predominant investors. Also, today's market is both more liquid and more national in scope.

The Securities and Exchange Commission (SEC), the federal agency charged with overseeing the nation's capital markets and administering the federal securities laws, plays a more limited role in the market for municipal securities than in other capital markets. For instance, unlike issuers of corporate securities, issuers of municipal securities are not subject to the registration and reporting provisions of the securities laws. However, the antifraud provisions of the federal securities laws apply to any person participating in any securities transaction, including issuers of municipal securities.

The evidence available, including the historically low rate of default on municipal securities, shows that the vast majority of cities and towns have been playing by the rules. However, as demonstrated by the 20 proceedings recently brought by the SEC, this is not always the case. Enforcement actions are a necessary part of the commission's work in all capital markets, including the municipal market. The commission's enforcement program is designed to protect investors and foster confidence by preserving the integrity and efficiency of the securities markets. Recent SEC enforcement activity in the municipal securities market should be viewed in that perspective.

What Is the Securities and Exchange Commission?

SEC is an independent regulatory agency that administers the federal securities laws. It has authority to make rules and to enforce those rules through civil enforcement actions and administrative proceedings. The commission also has oversight authority over the Municipal Securities Rulemaking Board, the National Association of Securities Dealers, and other self-regulatory organizations (each an "SRO").

What Is the Difference Between the Commission And Commission Staff?

The commission consists of five commissioners, appointed by the president and confirmed by the Senate. The commissioners serve staggered five-year terms and exercise rulemaking, enforcement, and adjudicatory powers. The staff of the SEC works for the commission. The staff is organized into offices, including general counsel and municipal securities) and divisions (corporation finance, enforcement, investment management, and market regulation). Generally, commissioners vote on official actions of the commission with input from the staff.

What Is an SEC Investigation?

The commission is responsible for investigating possible violations of the federal securities laws. The commission staff, through its division of enforcement, conducts fact-finding investigations to determine whether any violations of the federal securities laws have occurred, are occurring, or are likely to occur.

What Prompts an SEC Investigation?

SEC investigations are prompted by a variety of sources, including, but not limited to, complaints from the public (investors, competitors, and former and/or current employees of an issuer or underwriter), news stories, referrals from other government agencies, other SEC investigations, and market surveillance by either the commission or an SRO.

What Is the Difference Between an Informal and a Formal Investigation?

Generally, SEC investigations begin as informal inquiries. The staff relies

on the cooperation of individuals and entities to obtain information during an informal investigation because the staff does not have the power to issue subpoenas to compel the production of documents or the appearance of witnesses. In most cases, the staff requests a formal order if it cannot obtain information voluntarily, for example, when the staff needs certain records, such as telephone or an individual's bank records, that can only be obtained with a subpoena.

The staff also seeks subpoena authority when witnesses refuse to provide records or testimony through voluntary requests. Once a formal order is issued, the staff may subpoena a witness or documents and enforce the subpoena in court.

All commission investigations, including informal ones, are non-public. (That is, the SEC will neither confirm, nor deny there is an investigation in process, as has been the case with the cities in northern California, unless ordered public by the commission, which is a rare case.) All of the procedural safeguards provided by the commission apply to both formal and informal investigations.

An informal investigation concludes (1) without enforcement action, (2) by the staff obtaining a formal order to continue its investigation, or (3) by the staff recommending to the commission that it institute enforcement proceedings.

An investigation becomes formal when the commission issues a Formal Order of Investigation. The Formal Order is important for two reasons: the order directs that an investigation be made and generally outlines the scope of the investigation that the commission is authorizing, and it appoints members of the staff as officers of the commission for the purpose of the investigation, granting them the power to administer oaths and subpoena documents and witnesses.

The caption of the order contains the name and file number of the investigation. The order also contains, in summary form, the information that the staff believes tends to show that a violation of the federal securities laws may have occurred. Any person compelled to produce documents or to give testimony in a formal investigation has the right to review a copy of the Formal Order and subject to express approval by certain SEC supervisory officials, may receive a copy from the staff.

How Does Someone Contacted by the SEC Determine Whether They Are the Target of an SEC Investigation?

Unlike criminal investigations, there are no targets in SEC investigations. They are fact-finding investigations;

the staff collects information from a variety of persons and entities with a view towards determining whether a violation has occurred, and, if so, who is responsible.

How Does the Staff Conduct Its Investigations?

Staff members can obtain information from the public in the form of the production of documents and interviews of witnesses, including sworn testimony. In contacting individuals and entities, staff members will identify themselves and their positions at the SEC and will briefly describe what information they are seeking. The staff will almost always request information in writing.

If the request (whether voluntary or by subpoena) is for documents, the staff will outline the documents requested and provide a due date.

The request is sent together with a form that advises the recipient of their rights, the uses to which the commission may put the information, and how to request confidential treatment of information. The staff and the recipient of the request or subpoena may agree to the production of documents in a variety of ways. The documents can be collected and made available to the staff for review, the originals can be sent to the staff and returned at the end of an investigation, or copies of the documents can be provided to the staff at the expense of the witness.

The staff typically obtains much of its information from interviews with relevant parties. The staff interviews witnesses by telephone or in person. If the testimony is in person and "on the record," the witness will be advised orally and in writing of his or her right to coun-

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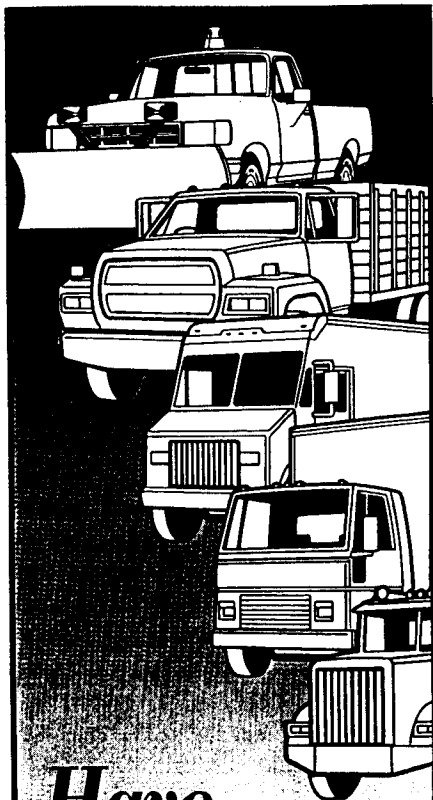
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sel (at the witness' expense), liability for false statements and perjury, the application of a witness' Fifth Amendment rights, and transcript availability. All information received, whether in a formal or informal investigation, may be used in subsequent proceedings. Additionally, a witness may be charged with perjury for false statements given under oath and may be liable for making false statements or providing false documents to the SEC.

A witness may discuss with the staff the best location for the testimony to take place. Generally, if a witness travels to the SEC to provide testimony, the witness may request certain travel expenses. Otherwise, the staff travels to meet the witness in a mutually agreeable location.

What Procedural Safeguards Are Provided During Investigations?

The rights of witnesses are governed by commission rules relating to investigations. As discussed below, SEC investigations are conducted on a confidential basis, in part to protect the privacy of individuals and entities against whom no charges are brought. Additionally, every witness has the right to be accompanied, represented, and advised by counsel of his or her choice. Counsel may advise a witness before, during, and after testimony; question the witness briefly at the conclusion of testimony to clarify any answers; and to make summary notes during testimony, solely for the witness' use. A witness and his or her counsel may always consult privately.

How Can a Witness Obtain A Copy of His or Her Transcript?

A witness always has a right to inspect a copy of his or her transcript. Generally, a witness obtains a copy of his or her transcript from the reporting

company, with staff approval, upon written request and the payment of the appropriate fees. However, a witness does not have the right to obtain or review the transcript of anyone else's testimony from the staff.

What Happens If Someone Does Not Respond to the SEC?

Generally, if a witness does not respond to a request for the voluntary production of documents or a request for an interview during an informal investigation, there are no sanctions. In a formal investigation, if an individual or entity fails to comply with a subpoena, the staff, with commission authorization, may apply to the appropriate United States District Court to obtain an order enforcing the subpoena. If the court issues the order, and the party still fails to comply, the staff may request that the court enter an order of contempt against that party.

What Is a Wells Notice?

A Wells Notice is a procedure through which the SEC staff gives potential defendants an opportunity to tell the staff why they should not recommend enforcement action to the full SEC commission. At the conclusion of an investigation, the staff typically offers parties against whom it contemplates recommending enforcement action an opportunity to present a statement setting forth their view of the facts and whether an enforcement action should be commenced. Many wells submissions address factual issues, including factual disagreements with the staff, evidentiary matters, and the weight and inference that should be given the evidence. After review of the wells submissions, the staff may determine not to recommend enforcement action. If the staff believes that enforcement action is appropriate, the staff supplies the commission with an en-

forcement recommendation, accompanied by the wells submissions.

Who Decides Whether The Commission Will Bring An Enforcement Action?

The commission staff makes a recommendation of enforcement action to the commission. Then the commissioners, after a review of the staff's proposal and the relevant wells submissions, vote on whether to institute an enforcement action. The commission may accept, modify, or reject the staff's recommendation.

Which Members of the Staff Determine Whether to Recommend Enforcement Action?

Investigations are conducted by the staff of the division of enforcement at headquarters in Washington, D.C., and in the various regional offices. During an investigation and before recommending an action to the commission, the division of enforcement staff may consult with other offices and divisions of the commission, for example, the office of municipal securities, on technical issues relating to municipal securities matters. Supervisory officials of the enforcement division approve each recommendation before the recommendation is sent to the commission. Prior to any recommendation being made by the division of enforcement, all interested offices and divisions may review the proposed recommendation and any wells submissions and provide comments to the division of enforcement.

If There Is a Violation, What Will the SEC Do?

The commission has a number of options to address a violation of the federal securities laws. It may accept a settlement with a party at the time

a proceeding is instituted. Alternatively, it may bring an administrative proceeding before an administrative law judge (an ALJ). The ALJ, after a hearing and review of the record, may order a party to "cease-and-desist" from committing or causing securities law violations in the future.

In addition, in the case of a person or entity, such as a broker-dealer, which is registered with the commission, an ALJ may issue a censure, suspend or bar a person from certain activities in the securities industry, or order disgorgement and money penalties may be ordered. All actions by an ALJ are appealable to the commission and then to the United States Court of Appeals.


The commission also may seek an injunction, disgorgement, and penalties by filing a civil action in federal court. Additionally, it may issue a report of investigation or refer the matter to federal or state criminal authorities for criminal investigation and possible prosecution.

Will I Ever Know if the Matter Has Concluded?

As a matter of policy, the staff informs parties identified in the caption of a Formal Order, or who received a Wells Notice, of the termination of the investigation, if no action has been authorized or taken as to that person or entity. The staff has the discretion to inform other witnesses or parties that an investigation has ended. However, such notice does not mean that a securities law violation did not occur or that no action will be taken in the future; it simply means that no action will be taken at that time.

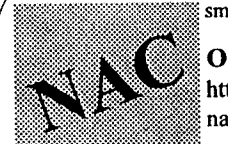
Why Doesn't the Staff Discuss Investigations Publicly?

Until an enforcement action has been instituted by the commission, the staff's investigation remains non-

public. The nonpublic nature of an SEC investigation is designed to protect the rights of all parties, in particular those parties contacted during the fact-finding portion of the investigation against whom no charges are brought, and to safeguard the integrity of the investigation. 

Susan Golden is deputy director of the Office of Municipal Securities at the Securities and Exchange Commission. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the commission or of the author's colleagues upon the staff of the commission. 17 CFR Sec. 200.735-4(e)(2)(ii).

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