

CDIAC

**CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION**

INTRODUCTION: SHORT STORIES OF PUBLIC FUNDS INVESTING IN CALIFORNIA

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Events that changed Public Funds Investing in California

Investment Tales from The Crypt

- “The stories you are about to hear are true. Only the names have been changed to protect the innocent.” Dragnet TV Series 1951

1984 San Jose

- Treasurer bet on the direction of interest rates
- Invested heavily in the “long-end” of the curve
- “Reversed” portfolio to raise cash to purchase more long-term investments, reverses were not matched
- When rates began to rise, positions went quickly underwater, no cash for margin calls or daily operations
- \$60MM loss booked to unwind positions

Resulting Changes to 53600

- Reverse repurchase limits were introduced

1987 Camarillo

- Bet on lower interest rates
- Bought “when issued” securities with expectation that securities would be sold before settlement day
- Rates rose going against the trade
- Comingled funds from the City, the Sanitation District and 3 Employee pension funds.
- Bought real estate private placements
- \$20MM loss on a \$24MM portfolio
- Discovered when a \$16M check bounced

1988 Lawndale, Palmdale, San Marino

- Invested in “forward contracts” strategy
- Brokers engaged in excessive and unsuitable trading
- Losses were not recognized or disclosed when they occurred

1988 5-year final maturity

- In 1988, the 5-year final maturity with special approval requirement was added to 53601

1991 Wymer Investment Fraud

- 1991 Multiple California public agencies affected \$105MM in losses
- Steve Wymer was unknown but hired retired treasurers to open doors
- Touted sophisticated investment strategy using US treasuries
 - Promised high returns with little/no risk; Ponzi Scheme
 - Reportedly used options strategy to achieve returns
 - Account funds were co-mingled; assets held by a Wymer account, Institutional Treasury Management (ITM) at Refco Securities
- Client accounts at Refco Securities were transferred days before the SEC obtained a court order freezing the assets
- Pleads guilty in September 1992; 14-year, 7 months prison sentence
- In six years, Wymer spent \$29 million in clients' money on himself

1994 Orange County Bankruptcy

- County Treasurer vowed to provide 11% of budget from portfolio returns; secretive; no reporting
- Treasurer invested heavily in “inverse floaters”
- Reversed portfolio to raise cash to invest in more inverse floaters.
- Reverses were not matched; portfolio not hedged
- Fed began to tighten and County could not make its margin calls; losses of \$1.64 billion.

1995 Changes in Oversight and Limits

- Legislation was introduced and passed that addressed professional qualifications, oversight committees and regular reporting.

1995 Vista

- Experienced Finance Director invested the portfolio
- Began taking gratuities from broker
- Invested in interest-only strips, equity mutual funds and limited partnerships
- Finance Director pleads guilty to fraud after millions in losses

1999 Oceanside Prime Bank Notes

- Mayor approached Treasurer with investment that was “risk free” and chance for 130% monthly return:
 - ▣ International Monetary Fund
 - ▣ Required Power of Attorney on \$100MM and secrecy
 - ▣ Mayor signed a “Letter of Intent”
- Elected Treasurer refused to sign documentation
- Matter brought to the attention of Council and press
- Deal was dropped; Mayor was not re-elected.

1999 “Futures” changes through securities lending limitations

- In 1999, the “futures” changes were introduced in the text of Section 53601 through the addition of language in the reverse repo sections identifying “securities lending agreements” as subject to similar limitations. The statute was AB 530 (Ch. 644, Stat.s 1999)

2016 Beaumont

- FBI raids City Hall in April 2015; year-long investigation
- May 2017, 7 charged with embezzlement and 6 jailed in \$43 million corruption case (one was out of town)
- Jailed: former City Manager, former Police Chief, former Public Works Director, former City Attorney, former Economic Development Director, former Finance Director and former City Planner
- Heavily outsourced to Urban Logic Consultants for planning, economic development and public works

2016 Placentia

- Finance Services Manager embezzled \$5.2MM bypassing accounting safeguards when transferring money to personal accounts; bank statements and ledgers manipulated with software
- As of July 2016 \$3.16MM of the stolen funds have been returned to the city

2016 Compton

- Deputy City Treasurer was arrested in December 2016 for embezzling City funds; handling cash for 22-years
- City Treasurer noticed discrepancies in ledgers
- Admits stealing money for years to another city employee
- The amount of money and how long the embezzlement are unknown at this time

Internal Control Procedures

- Separation of Duties
- Access Controls
- Physical Audits
- Documentation
- Trial Balances
- Reconciliations
- Approval Authority

Disclosure

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