

CDIAC

**CALIFORNIA
DEBT AND
INVESTMENT
ADVISORY
COMMISSION**

WHAT WENT WRONG AND WHAT WAS DONE ABOUT IT

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Public Funds Investing: Yesterday and Today

San Jose

- 1984 San Jose
- 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
- Prompted changes to CA Code

1985 Reverse Repo limits

- In 1985, reverse repurchase limits were introduced to Section 53601 in SB 115 (Chapter 1526)

Camarillo

- 1987 Camarillo
- Bet on direction of interest rates
- Bought “when issued” securities with expectation that securities would be sold before settlement day
- Rates rose, did not book a loss
- Rates rose further, scenario repeated
- Total portfolio of \$24mm; total losses of \$30mm
- Bought private placements for pension, lost all the money; Salton Sea real estate private placement

Lawndale, Palmdale & San Marino

- 1988 Lawndale, Palmdale and San Marino
- Invested in “forward contracts” strategy
- Brokers engaged in excessive and unsuitable trading
- Losses were not recognized or disclosed when they occurred
- Prompted changes to CA Code

1988 5-year final maturity

- In 1988, the 5-year special approval requirement was first added to Section 53601 (in the preamble) by AB 4089 (Ch. 491, Stat.s 1988)

Wymer Investment Fraud

- 1991 Multiple CA public agencies affected
- Steven D. Wymer was unknown to California public agencies, but he hired retired treasurers to open doors
- Touted sophisticated investment strategy using US treasuries
 - Promised high returns with little/no risk
 - Reported 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 out to Shearson Lehman days before the SEC obtained a court order freezing the assets
- Pleads guilty on September 30, 1992 to 9 counts of fraud; misappropriation of >\$100mm
- Receives a 14-year, 7 months prison sentence

Orange County

- 1994 Orange County Bankruptcy
- Details addressed in the Yaeger Bankruptcy Presentation
- Treasurer invested heavily in “inverse floaters”
- Reversed portfolio to raise cash to invest in more inverse floaters
- Pressured to maintain “returns”
- Reverses were not matched; portfolio not hedged
- Fed began to tighten and county could not make its margin calls
- County declared bankruptcy
- Assistant Treasurer received prison time
- Prompted Changes to CA Code

1994/1995 changes in oversight and limits

- 1994 & 1995 Orange County
- SB 1804 was introduced in 1994 and SB 866 was introduced in 1995 in response to the OC bankruptcy for more oversight and limits on the treasurer and investments

Vista

- 1995 Vista
- Experienced FD invested the portfolio
- Began taking gratuities from broker
- Invested in interest-only strips, equity mutual funds, limited partnerships, etc.
- FD pleads guilty to fraud after millions in losses

Oceanside and Prime Bank Notes

- 1999 Oceanside
- Mayor approached Treasurer with investment that was “risk free” and chance for 130% monthly return:
 - ▣ International Monetary Fund Scam
 - ▣ Required POA 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
- Bond-buyer article: April 12, 1999, *Municipalities Warned of High-Yield Investment Scheme*

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)
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