INVESTMENT COMPANY INSTITUTE

MEMO# 10671

January 26, 1999

SEC SANCTIONS ORANGE COUNTY BOND COUNSEL

1 Securities Act Release No. 7621, January 6, 1999. [10671] January 26, 1999 TO: FIXED-INCOME ADVISORY COMMITTEE No. 1-99 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 1-99 RE: SEC SANCTIONS ORANGE COUNTY BOND COUNSEL

____ The Securities and Exchange Commission ("SEC") has sanctioned bond counsel for eight municipal securities offerings related to the Orange County investment pools.1 According to the SEC's order (attached), bond counsel issued opinions regarding the legality and tax-exempt status of the securities, prepared resolutions authorizing the issuance of the securities, and coordinated the documents for closing the transaction. In seven of the securities offerings, counsel also participated in drafting the official statements, including the disclosure concerning the investment pools. The SEC found that the disclosure in the official statements that bond counsel participated in drafting omitted material facts about the investment pools' investment strategy, including that (1) the pools' investment strategy was predicated on the assumption that prevailing interest rates would remain at relatively low levels; (2) the pools' use of leverage through reverse repurchase agreements was constant, high, and a major part of the pools' investment strategy; and (3) the pools had a substantial investment in derivative securities. In addition, the SEC found that the disclosure in the official statements regarding the risks of the pools' investment strategy was misleading because it omitted material information about the pools' sensitivity to rises in interest rates and that the disclosure regarding the pools' historic investment results was misleading because it omitted material information about the pools' investment results during the first half of 1994 when interest rates were rising. The SEC also found that the official statements for three offerings omitted to disclose that the variable interest rate paid on the securities was subject to a cap. This information was material to investors that had adopted policies against investing in these types of securities. In addition, the official statements for four offerings omitted to disclose material information about the securities offerings tax- exempt status, specifically that the issuers had improperly increased the size of the offering and, as a result, had jeopardized the offerings' tax-exempt status. The order found that bond counsel, as a result of participating in drafting the official statements and issuing the tax opinions, knew or should have known, among other things, that the official statements omitted to disclose material information and therefore were materially misleading. The SEC found that, as a result, bond counsel violated the antifraud provisions of Sections 17(a)(2) and (3) of the Securities Act of 1933 in the offer and sale of the securities. The Commission, accordingly, ordered bond counsel to cease and desist from committing or causing any violation and any future violations of those antifraud provisions. - 2 - Ari Burstein Assistant Counsel Attachment