Written by **Raven Clabough** on January 7, 2011

SEC Prepares to Investigate California

The Securities and Exchange Commission is preparing to investigate the State of California for alleged failure to disclose information on its enormous public pension fund. The Golden State will be the second ever to have enforcement actions taken against it by the SEC, after New Jersey was charged with securities fraud last year. The SEC is attempting to make the case that California's public pension funds were a risky investment and that California misled the investors about the risk. If the SEC is able to prove their case, it may have an impact on the financial reporting of other public funds. The New York Times reports:

> The fund, the California Public Employees' Retirement System, known as Calpers, lost about a quarter of its total investment portfolio during the financial crisis, leaving the state responsible for replacing billions of dollars each year and contributing to its huge deficit. The question is whether California adequately disclosed in the preceding years how risky the pension investments were and how much it might need to cover any shortfall.
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> But it is unclear whether investigators are focusing on those risks or on possible conflicts of interest in steering investments to related parties, the subject of a separate investigation by the attorney general of California.

An anonymous official adept of the proceedings asserts that the investigation is one of the agency's top priorities.

Patricia Macht, a spokeswoman for Calpers, America's largest pension fund with $220 billion in assets, indicates that the SEC has not yet contacted Calpers about its financial disclosures.

Macht instead contends, "The SEC has an ongoing look at pension funds in California" because it became aware of the use of placement agents who recommended investment managers. Likewise, SEC regulators fear alleged financial weaknesses in the pension portfolios and that investors may be unaware of the inherent risks. According to a spokesman for the California state treasurer's office, the office "provided all material information about pension fund issues at all times."

Though California continues to assert that it has not defaulted on any of its debts and that its bonds are safe, the overwhelming budget deficits plaguing the state may pose some problems for the pension funds. Likewise, voter-approved tax caps make it relatively impossible for the state to generate any further revenue.

Furthermore, California's credit has been diminished. The SEC claims that investors may not have been fully aware of the pension risks prior to making their investments. *The New York Times* writes, "The SEC's goal is to force public pension funds to be more open, not just about their investments but about how their risk may affect the finances of the state." However, the SEC is unlikely to impose any penalties on the state, as it would hurt taxpayers. Like the New Jersey case, the SEC will most likely publicize the case in order to discourage similar behaviors elsewhere.

There is a certain level of irony about the SEC investigation into California's pension funds.

First Calpers was one of the leading proponents of boardroom reforms at JPMorgan Chase, Goldman Sachs, Apple, BP and a number of other large companies. Additionally, Calpers sued several companies, such as Standard & Poor's, accusing them of providing "untrue, inaccurate and unjustifiably high" ratings to investments that ultimately failed. The very possibility that Calpers is in fact guilty of that which they have accused other companies is ironic.

Perhaps even more ironic is the possibility that the SEC would be the agency to determine whether Calpers engaged in full disclosure, since the Securities and Exchange Commission worked alongside AIG to keep the terms of its bailout sealed. Likewise, the SEC has been granted "confidential treatment" as well as a "secrecy order," which is in place until November 2018. Word Press reports:

> In May, the SEC approved a request by AIG to keep secret an exhibit to a year-old regulatory filing that includes some of the details on the most controversial part of the AIG bailout: the funneling of tens of billions of dollars to big banks like Societe Generale, Goldman Sachs, Deutsche Bank, and Merrill Lynch.
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> The SEC's Division of Corporation Finance, in granting AIG's request for confidential treatment, said the "excluded information" will not be made public until November 25, 2018, according to a copy of the agency's May 22 order.

Furthermore, the SEC managed to exempt itself from the Freedom of Information Act this past year, angering critics of the agency even further.

Nevertheless, David Crane, an aide to former California Governor Arnold Schwarzenegger, is on board with the investigation, asserting that Calpers "promoted the largest nonvoter-approved debt issuance in California history" without disclosing the risks involved.

Crane declares, "Frankly, I've never seen anything like the Calpers sales document, which makes even more Goldman Sach's alleged disclosure look like child's play."

The SEC has failed to provide a comment on the investigation.

Photo: SEC headquarters in Washington, D.C.

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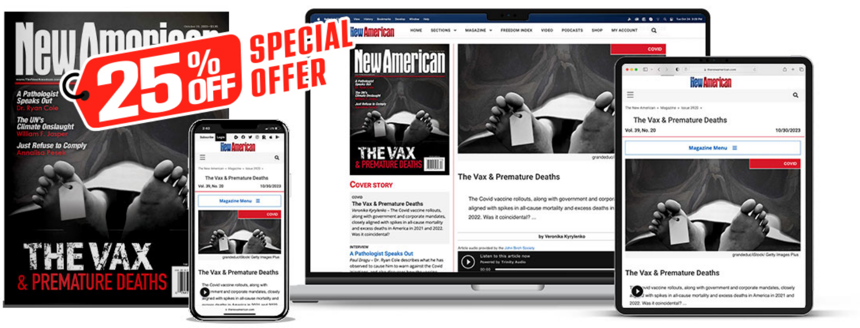

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