Continuing Disclosure Part 1:
External Communication with the Market

Basic Principles of Municipal Disclosure (Review)

- While Municipal Securities are exempt from the registration requirements of the Securities Act of 1933 they are <u>not-exempt</u> from the anti-fraud provisions of Section 17(a) of the 1933 Act or Rule 10b-5 of the SEC Act of 1934
- In an effort to comply with this requirement an Official Statement is prepared in connection with the sale of municipal securities
- Underwriters require certification of the municipal issuer's compliance with these provisions of the securities law
- In 1995, the SEC adopts Rule 15c2-12 to extend these principles to Continuing Disclosure, with annual and event compliance

Further Investor Disclosure and Oversight

- The 1933 Act requires underwriter due diligence to affirm a "reasonable investigation" that the OS does not contain any material misstatements or omissions
  - Underwriters may affirm a "due diligence defense" to legal claims that they did not disclose adequately issues affecting the Issuer's bonds
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 seeks to provide additional SEC oversight responsibility for issuers of municipal securities
  - The Act establishes a new Municipal Securities Office of the SEC with resources for increased investigation and prosecution of municipal securities issuers
  - Authorizes the SEC (and requires the GAO) to evaluate increased municipal disclosure, including the potential repeal of 1933 Act registration exemption

Noncompliance with Rule 15c2-12

- Indirect regulation of municipal issuer disclosure through underwriters
  - Underwriters not issuers, directly bound by Rule 15c2-12
  - For <u>initial sale</u>, accomplished through a required continuing disclosure agreement
- On a <u>post-sale</u> basis, the issuer must be brought into compliance with continuing disclosure of outstanding bonds before new securities can be underwritten
- "Material noncompliance" with continuing disclosure must be disclosed in each of the issuer's official statements for <u>five years</u> following the noncompliance – *even if the noncompliance has been cured*
- *In the 2010 amendments to the Rule, for <u>negotiated sales</u> the underwriter must evaluate the likelihood that the Issuer will comply with continuing disclosure*
- For <u>competitive sales</u> some underwriters now unwilling to bid if there is *any* evidence of prior noncompliance

External Communication with the Market

- Credit downgrades or rating recalibrations
- Liquidity facility modifications, extensions or replacements
- **Pension and OPEB liabilities**
- EMMA as a vehicle for efficient market disclosure dissemination

Pension and OPEB Liabilities

- GASB approves Statement 68 requiring disclosure of net pension liability for fiscal years beginning after June 15, 2014
- Net liability = total pension liability – assets set aside in plan
- Change from current practice of recording only the difference between required annual contributions and what is actually funded
- Designed to reflect the earned benefit of pension liability, rather than as government contributes to a plan or as retirees receive benefits

Pension Impact on Continuing Disclosure

- Across Moody's universe of 8,000 rated credits, net pension liabilities represent <u>150% of debt outstanding</u>

- Moody's cites pension liability pressures having contributed to rating downgrades in Illinois, Connecticut, NJ, Penn and the cities of Chicago, Cincinnati and Minneapolis

- New Moody's methodology will <u>increase</u> the adjusted pension liability relative to as reported

Moody’s Adjustments to Local Gov’t Reported Pension Data

- Beginning in 2014 Moody’s will be making several adjustments to reported pension data
  - Actuarial liabilities will be discounted using the high grade taxable bond index (currently 4.81%) rather than PERS accrual rate (7.5%)
- The impact could be as much as 150% adjustment to actuarial accrued liability and a <u>doubling</u> of GASB reported net pension liability

Hypothetical Net Pension Liability

As Reported on Statements		Moody's Adjusted	
Plan Discount Rate	7.75%	Discount Rate (6/30/13)	4.81%
Actuarial Accrued Liability	1,000,000	Moody's Adjusted Liability	1,432,812
Plan Assets	750,000	Plan Assets	750,000
Unfunded Accrued Liability	**250,000**	Adjusted Pension Liability	**682,812**