California Debt and Investment Advisory Commission

Municipal Market Disclosure: Applications to Pension Disclosure

A Financial Advisor's Perspective on Disclosure

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My Personal Path to Understanding Disclosure

- An inexperienced issuer with the City of Los Angeles
- An experienced issuer with the City of Los Angeles
- A rating analyst during the Orange County bankruptcy
- A rating analyst after the passage of Proposition 218
- A financial advisor observing the City of San Diego
- A financial advisor “going home again” to work on the City of Los Angeles’s disclosure

Minimal Definitive Guidance is Available

- Municipal bonds have historically been a minimally regulated industry, the downside of which is that there are minimal written regulations
- The old "Bible", GFOA's *Disclosure Guidelines for State and Local Government Securities*, last published in 1991
  - Out of print, and does not reflect the last 20 years of experience
  - GFOA has published "Making Good Disclosure;" helpful, but far from definitive
  - Is GFOA really the right authority?
- National Federation of Municipal Analysts (NFMA.org) has published a series of "Recommended Best Practices in Disclosure," which provide good guidance, but are not heavily relied on by drafters of disclosure documents
- NABL white paper on pension disclosure
- Best guidance comes from reading SEC actions and drawing conclusions

Good Disclosure is an Art, Not a Science

- There is not a "one-size-fits-all" standard
  - Depends on the transaction, its complexities and risks
  - Depends on the personalities in the room
- Disclosure has become the job of lawyers, who don't necessarily have particular insight into what is material in the eyes of potential and actual investors
  - Does disclosure counsel listen to the rating presentation?
  - Do they listen to investor briefings?
- Good judgment is more important than learning a fixed set of rules
- Written disclosures for policies and procedures are helpful, but there is no substitute for the right culture

The Disclosure Dashboard: Some "Idiot Lights"

- Cognitive dissonance
  - Pay attention to things that you don't personally understand (this is equally true for issuers and outside professionals)
  - Don't simply assume that investors know more than you do, especially in the discussion of legal and governmental factors
- Inaccuracies
  - Pay attention to language that seems to not quite get it right
  - The act of "due diligence" includes fact checking
- Things that might make you look bad
  - If you think that information might negatively effect an investor's decision to invest or result in a lower bond rating, and
  - You think that would be a reasonable reaction, then
  - That is precisely the kind of information that is probably "material," and should be included in the disclosure document

More "Idiot Lights"

- Things that you don't think are relevant
  - Irrelevant disclosure is in itself misleading in that it distracts the reader, and should be deleted
- Boilerplate
  - Always suspect to me, because often not carefully read by preparers or reviewers of the document
  - A real life example: two full pages on how one calculates the Gann limit, but no information on the specific issuer's limit and its appropriations subject to the limit
  - A disclosure document is like my garage: things keep getting added, and every once in a while you have to clean it out
- Consistency
  - Does the Official Statement (OS) agree with the CAFR?
  - Are there other official documents with conflicting information or messages floating around?

Listening to Investor Feedback

- Since most issuers don't actually talk with investors, the rating agencies and bond insurance companies are often your best proxy
- Consider incorporating in your disclosure document information that you have provided to the rating agencies and insurance companies that is not in your OS
  - Projections
  - Details on assumptions (often best handled as footnotes to tables)
  - Financial information that is more current than your last audit
  - Preliminary debt service numbers
  - The answers to (relevant) rating agency questions
  - Facts or observations included in a rating agency credit report that weren't included in your OS

Thoughts on Audits

- *In theory*, the CAFR is itself a principal disclosure document
- What is the relationship between the CAFR and the Official Statement?
  - Is the role of the OS to summarize or repeat CAFR disclosure?
  - Does the CAFR undergo the same level of due diligence as the OS (and visa versa)?
  - Do the debt people understand the CAFR (se habla GAAP?)
  - Do the people who prepare the CAFR (staff and outside auditors) participate in the preparation of the OS?
  - What about the actuaries and staff who prepare the pension disclosure?
- Should the auditor's consent be reinstituted to help protect the issuer?

More Thoughts on Audits

- Audits are never fully satisfying to the experienced analyst
- Good disclosure supplements the audit. Some examples:
  - Analysts want more information on the types of “tax” revenues (audits often consolidate property tax, sales tax and other taxes into a single “taxes” line item)
  - Detailed information on transfers in and out
  - Translating between budget (the language of managers) and GAAP (the language of analysts), especially when discussing budget “reserves” and fund balance
  - What items are in the various fund balance categories?
- Sobering fact: the risks relating to pre-bankruptcy Orange County were in the fiduciary funds section of the audit (and who reads *that*?)

Other Thoughts

- The issuer's lead staff person should not shoulder full responsibility for the accuracy of the official statement
  - Create a process were multiple eyes share responsibility for the accuracy of what is written
  - Circulate sections to appropriate peers for review and comment (e.g., the budget officer, the pension manager, etc.)
  - I'm a big fan of "real" diligence meetings
- Despite the crises of Orange County, San Diego and New Jersey, there is still great resistance to "hard thinking"
  - Is your finance team leading you forward, or serving as an "enabler" of bad habits?

Final Observations

- Remember that the biggest risks are to the public agency, and the staff that works there
- Think of the OS less of a sales document and more as your defense if you are ever sued or investigated
  - In a securities action, the OS is Exhibit 1. Think about what you wish it would have said
  - There is little downside to good disclosure; there is a lot of downside risk to bad disclosure
- Strive for a culture that identifies what is missing and needs to be added
- Like all processes of self-knowledge, it is never done
  - I have never seen a perfect OS. There is always room for improvement