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SEC Charges Kansas for Faulty Pension Disclosure.

WASHINGTON — The Securities and Exchange Commission has charged the state of Kansas with violating federal securities laws by failing to disclose in bond documents that the state's pension system was significantly underfunded, creating a repayment risk for investors.

According to the SEC order settling administrative proceedings against the state, the Kansas Development Finance Authority raised \$273 million through eight series of bonds from August 2009 to July 2010 without disclosing in bond documents that the Kansas Public Employees Retirement System was among the most underfunded state pension systems in the U.S. At the end of the 2008 calendar year, the SEC said in court documents, KPERS had a total unfunded actuarial accrued liability of \$8.3 billion and was only 59% funded. The underfunding was not disclosed in the state's annual financial information or in official statements for the series of bond offerings, though KPERS did disclose it in its own annual financials.

That behavior violated the antifraud provisions of Section 17(a) of the Securities Act of 1933, the SEC charged. Part of that section of the law makes it illegal to obtain money by omitting a material fact. The SEC alleged that the materiality of the omitted information is clear because in 2009 the state informed both Standard & Poor's and Moody's Investors Service about the pension fund's 2008 investment losses, and both agencies referenced it in their reports.

"We're pleased that our actions have resulted in improved disclosure of pension liabilities in states that were not making investors aware of a significant repayment risk," said Andrew Ceresney, director of the SEC Enforcement Division. "Investors must be given adequate information to evaluate the impact of pension fund liability on a state's overall financial condition."

The action emerged from a nationwide review of muni bond disclosure that had previously produced similar charges against New Jersey and Illinois. The KDFA had been disclosing in recent bond documents that it was under investigation by, and cooperating with, the SEC. Like the two states charged before it, Kansas agreed to settle the charges by adopting new policies and procedures to "help ensure that appropriate disclosures about pension liabilities are being made in its offering documents." The SEC investigation found that the failure to disclose the liability resulted from "insufficient procedures" and faulty communications between the KDFA and the Kansas Department of Administration, which provided the KDFA with the information for its offering documents.

The remedial measures, which the state has fully implemented, included designating responsible individuals in relevant state agencies, mandating more effective communications among those agencies, the establishment of a disclosure committee, and annual training of key personnel.

"Kansas failed to adequately disclose its multi-billion-dollar pension liability in bond offering documents, leaving investors with an incomplete picture of the state's finances and its ability to repay the bonds amid competing strains on the state budget," said SEC muni enforcement chief LeeAnn Gaunt. "In determining the settlement, the commission considered Kansas's significant remedial actions to mitigate these issues as well as the cooperation of state officials with SEC staff during the investigation."

The KDFA declined to talk about the SEC's action, and the office of Gov. Sam Brownback did not respond to a request for comment.

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