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WSJ: Kansas Settles Charges it Hid a Risk to Muni Bonds.

SEC Claimed State Misled Investors by Failing to Disclose Underfunding of Pension System

Kansas has agreed to settle a fraud case in which the Securities and Exchange Commission charged the state misled investors when it failed to disclose that its underfunded pension system posed a risk to the repayment of some municipal bonds.

Kansas officials didn't provide important information about the state's pension system in eight bond offerings totaling $273 million in 2009 and 2010, the SEC had said in a cease-and-desist order. Kansas has since adopted new policies to ensure its finances are more transparent in offering documents, the agency said in a news release Monday. The state neither admitted nor denied any wrongdoing, the agency said. There were no penalties or fines.

The action is the third the SEC has taken against states as part of a nationwide review to determine if municipalities are properly disclosing pension liabilities or other risks to investors, who are predominantly retail, in the $3.7 trillion municipal bond market. New Jersey and Illinois also reached similar settlements with the agency without paying a penalty or admitting wrongdoing, and Kansas began to improve its practices even as the agency began questioning them, the SEC said in a news release.

"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," Andrew Ceresney, director of the SEC Enforcement Division, said in the release. "Investors must be given adequate information to evaluate the impact of pension fund liability on a state's overall financial condition."

The bonds were issued by the Kansas Development Finance Authority at a time when one study found that Kansas' pension system for public employees was the second-most underfunded in the U.S., the SEC said. Because of "insufficient procedures and poor communications" between state agencies, that information wasn't provided to bondholders, who also didn't learn that the liability posed risks to the repayment of their bonds, the agency said.

In response to the SEC action, Kansas Gov. Sam Brownback said in a statement that such reforms as boosting employer and employee contributions have reduced the projected pension deficit. Jim Clark, secretary of administration, said state officials acted promptly in 2011 to improve transparency in bond offerings.

"The SEC has considered these changes and we are pleased that the SEC did not seek any financial penalties," Mr. Clark said in a statement. "We remain committed to complying with all disclosure requirements and require training and updating of the policies and procedures annually."

Cities and states have historically received mixed messages about how seriously to treat pension liabilities, and the SEC has taken the position that understating those liabilities is prohibited, said Matt Fabian, managing director at Municipal Market Advisors. Because investors are growing accustomed to such actions by the SEC, the move was unlikely to roil the market, he said.

“If anything, this should improve market function, because you have prospects for better disclosure in the future,” Mr. Fabian said.

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