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GFOA Members Warn Disclosure Bill Could Push Some Issuers Out of Market.

WASHINGTON – A bill introduced by Rep. Gwen Moore, D-Wis., that would shift municipal disclosure responsibilities to issuers and borrowers from underwriters could drive some localities out of the market, issuer officials warned Moore's chief of staff on Thursday.

The warnings came from members of the Government Finance Officers Association's debt committee at a meeting here after the bill was introduced earlier in the day.

Jonas Biery, the debt committee's chair, said that hears from small issuers throughout the nation that over the past three or four years there has been continued confusion and fear about the increased complexity of regulatory and enforcement actions in the muni industry.

"I think there's some anecdotal, if not data supported, evidence that some of those issuers are backing out of the market," Biery said. "Smaller, typically rural issuers are saying they can't comply and take the risk so they're not going to enter the market."

He added that he thinks there is a valid concern that initiatives like the bill are going to continue to push this "important sector" out of the market.

Ben Watkins, an ex-officio member of the committee and the bond finance director for Florida, said that the bill is "obviously something that from an institutional standpoint [GFOA has] a long history of resisting." GFOA's position won't change, he said.

"It's very difficult for us to reconcile what has historically been a record of support for the muni industry and state and local governments with this proposal," Watkins said. "I believe the consensus in the room would be that this is extraordinarily misguided and counterproductive."

Watkins said the bill is the beginning of a snowball that rolls downhill and has a logical conclusion of creating "a tremendous obstacle and impediment for state and local governments' access to very efficient and inexpensive financing, which really finances the infrastructure of the country."

Moore's bill would authorize the SEC to establish baseline mandatory disclosure requirements, including on content and timing, for primary offerings. But it would leave room for the commission to vary the requirements for different classes of issuers or borrowers.

That is a complete reorientation from the current disclosure regime, which puts disclosure responsibilities on underwriters. Under the Securities and Exchange Commission Rule 15c2-12, firms cannot underwrite an issuer's bonds unless that issuer has contractually agreed to disclose financial and operating information at least annually as well as material events as they occur.

Sean Gard, Moore's chief of staff, told the committee members that the bill didn't come out of Moore's mind all of a sudden because she wanted to come down hard on the muni market. Instead, Moore sees the bill as a way to strengthen the market, he said.

“If you look at the legislation, you will see that it is well-drafted. It’s not a Hail Mary,” Gard said. “For most issuers, there’s nothing in this legislation that comes out of left field,” Gard said.

He also cited ongoing conversations among a number of market groups, including GFOA through its best practices, that there is market focus on improving disclosure.

“This is just our addition to that [disclosure] discussion,” Gard said.

He noted that the bill and industry discussions follow SEC enforcement division findings through its Municipalities Continuing Disclosure Cooperation initiative that found 72 issuers, including two states, did not comply with their continuing disclosure requirements and then lied to investors about that.

“The industry wouldn’t be having these conversations around disclosure if there wasn’t something there,” Gard said.

At the same time, Gard said, it is important for industry participants to recognize that the bill was introduced on the last day of the congressional session, meaning it will not get a committee hearing in the session and won’t move forward.

“[Moore] doesn’t have any plans to sneak this in,” Gard said. “She does want to engage the issuer community and have this conversation.”

The legislation, which aims to codify recommendations made in the SEC’s 2012 Report on the Municipal market, would not repeal the Tower Amendment of the Securities Exchange Act of 1934, which prohibits the SEC and Municipal Securities Rulemaking Board from requiring issuers to file bond-related documents with them before the sale of those bonds.

Issuers and borrowers with more than $10 million of outstanding municipal securities would have to adopt internal controls and systems, including written policies and procedures that, at a minimum, identify each official responsible for each aspect of disclosure as well as the process by which official statements are drafted and reviewed.

The bill would authorize the SEC to adopt a rule allowing issuers and borrowers to comply with those provisions through a state-wide system of disclosure controls and education.

It would also authorize the SEC to prescribe accounting methods for state and local bond documents and bond-related financial information. Alternatively, the SEC could require issuers to use the reporting and accounting standards from a standards-setting body, such as the Government Accounting Standards Board. The bill does not specifically mention GASB or any other standards-setting body.

The bill as drafted provides a safe harbor for forward-looking statements made by issuers and borrowers.

In addition to the new disclosure requirements, the bill would remove the muni exemption from registration for private activity bonds so PAB transactions would either have to be registered with the SEC or fall under some other exemption such as the one for private placements. Bonds for nonprofit hospitals and universities would continue to be exempted from registration under their 501(c)(3) exemption.

The SEC has recommended that PAB or conduit deals that involve corporate borrowers be registered, since corporations must register corporate deals.

Laura Lockwood-McCall, director of the debt management division of the Oregon State Treasury, questioned why corporate deals would need to be registered.

“You just increase the cost to communities across the country that are working with the private sector to spur our economies,” she said.

The legislation includes twelve types of information an issuer would be required to include in an official statement but gives the SEC the discretion to require more disclosures.

The OS would need to identify and describe any issuer or other borrower with respect to the securities being offered as well as provide a description of any legal limitations on the incurrence of indebtedness by the issuer, borrower, or taxing authority of the issuer. It would also need to describe the issuer’s or borrower’s debt structure, including information with respect to amounts of authorized and outstanding debt, estimated short-term debt, security of debt, and debt service requirements, as well as the nature and extent of their other material contingent liabilities or commitments.

Other information would have to be disclosed about: defaults; whether securities are supported by taxes; the issuers’ financial statements if they are material; the intended use of the proceeds of the offering; and any material conflicts of interest of the issuer or other obligated person and any other party involved in the offering.

The Bond Buyer

By Jack Casey

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