On March 10, 2017, C. Wallace DeWitt, Senior Advisor to Acting Chairman Piwowar, and Elizabeth Blase met with the following individuals (collectively the “GFOA Representatives”):

- Emily S. Brock, Government Finance Officers Association; and

Among the topics discussed was the SEC’s proposal to amend Rule 15c2-12 under the Securities Exchange Act of 1934 (“Exchange Act”) to amend the list of event notices that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities subject to the Rule must reasonably determine that an issuer or obligated person has undertaken, in a written agreement for the benefit of holders of municipal securities, to provide to the Municipal Securities Rulemaking Board within ten business days of the event’s occurrence.

The GFOA Representatives provided the materials included in Appendix A hereto.
Primary Disclosure

SEC Rules

- Securities Act of 1933
  - Registration Exemption for Municipal Securities
  - Antifraud Provisions Applied to Munis
- Securities Exchange Act of 1934
  - Reporting Exemption for Municipal Securities
  - Antifraud Provisions Applied to Munis (especially Rule 10b-5)
  - Disclosure statements must be accurate and not suffer from any "material omission"
- Tower Amendment 1975
  - Neither the SEC nor the MSRB may require issuers, directly or indirectly, to make a filing to either body prior to the sale of securities
  - Indirect application through underwriters of rules that, in effect, place ongoing information requirements on issuers

SEC Rules

- SEC Rule 15c2-12
  - Amendments made in 1994 — See change to Muni Disclosure
  - Underwriters may not purchase bonds unless issuer has contractually promised to provide specific continuing disclosure for the lifetime of the bonds.
  - Ongoing financial information
  - Filing notice of specified material events
  - Timing for Making Filings
    - Annual Financial Information: no SEC standards, GFOA recommends no later than 6 months following end of FY
    - Material Events
      - Bonds issued < 12/31/11: "in a timely manner"
      - Bonds issued > 12/31/11: 15 days from the date of the event
Primary Market Disclosure

• The Official Statement (and Preliminary OS)
  • Purpose
    • Help Sell Bonds
    • Protections to issuers and Underwriter under Federal Securities Laws
  • Role of Professionals
  • Credit Ratings
  • Credit Enhancements
  • Financial Information
  • Private Placements
  • Bank Loans and Other
  • Conduit Borrowers
  • Refundings

Preparing the Preliminary Statement

• Disclosure is the Responsibility of the Issuer
  • Within the Government, Engage the Appropriate Departments, Agencies to Identify, Describe and Confirm Material Information
    • State: economist, Office of Financial Management, actuary, Dept. of Transportation, etc.
    • City: Budget director, other senior directors
  • Determine the Role of Outside Professionals
  • Determine the Context and Organization of Material for the POS and OS and the Frequency of Updates

From POS to OS

• Make POS Available to Prospective Investors
  • Electronically
  • On the Issuer’s website
  • Through a printer distribution system
  • Through the underwriter (if negotiated transaction)
• Underwriters are not Permitted to Purchase the Bonds Until the POS has Been Distributed
From POS to OS

- Once the Bonds Have Been Sold, Update the POS and Complete the Final Sizing and Pricing Information in a Final Official Statement
- Post the OS on EMMA
- Issuers Must Inform Underwriters of Material Changes for 25 Days After the Closing

Continuing Disclosure Agreement

- Developing the CDA
- Understanding the Requirements Set Within Document for Ongoing Disclosure Filings
- Annual Financial Information filed by a certain date
- Material Event Notice Filings
- Notice of Failure to Provide Required Disclosures
- Who Makes Filing – Issuer
- Required to File at EMMA and State Information Depositories (MI, OH, TX)

Continuing Disclosure
Best Practices: Disclosure

- Understanding Your Continuing Disclosure Responsibilities
- Using CAFR for Disclosure Requirements
- Using a Website for Disclosure
- Including Disclosures in Official Statements Related to Pension Funding Obligations
- Maintaining an Investor Relations Program

Disclosure Policies and Procedures

- Prepare written documentation to:
  - Identify key players (by title and name)
  - Responsibilities of key players
  - Identify key documents/reports
  - Set up reminder system of when documents are due
  - Memorialize the annual reporting requirements per the CDA
- Create centralized contact information
  - Central phone number with voice mail
  - Email address - debtmanagement@mygovernment.gov
  - Ensure multiple employees with ability to access and respond to email/voice mail inquiries - check daily
- Develop process for speaking to entire market
  - Encourage use of general email for investors to communicate
  - Develop a process to speak to the market
  - Identify one individual responsible for speaking on behalf of government regarding bonds
### Understanding Your Continuing Disclosure Responsibilities

- **Continuing Disclosure Agreement (SEC Rule 15c2-12)**
  - Timeline:
  - Type of information to be provided
  - Material Events
- For many governments, a Comprehensive Annual Financial Report (CAFR) may fulfill annual financial disclosure requirements.
- If a government’s CDA states that information will be provided that is outside the scope of the CAFR, that information may be included as a supplement to the CAFR when filing with EMMA.

#### Timeline

<table>
<thead>
<tr>
<th>Event</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material Events</td>
<td>Within 30 days</td>
</tr>
<tr>
<td>CAFR</td>
<td>Within 90 days</td>
</tr>
</tbody>
</table>

#### Voluntary Disclosures

- After consulting with internal and external legal counsel:
  - A government may wish to provide other financial information to investors via their website and link to EMMA that goes beyond what is specified in the CDA.

#### Examples of additional information that could be disclosed:

- Annual budgets, financial plans, revenue forecasts, development information, monthly financial reports.

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**Government Finance Officers Association**

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Understanding Your Continuing Disclosure Responsibilities

- Voluntary Disclosures
  - If an entity chooses to post unaudited interim financial information as part of its voluntary disclosures:
    - It must be clearly described as such on the document
    - A government may wish to include additional disclaimer language regarding unaudited information
  - Issuer’s should design a system of internal controls to ensure the accuracy, completeness, consistency, and freshness of information posted

Using Technology for Disclosure

- Enhanced EMMA System
  - Posting Both Required and Voluntary Disclosures on EMMA
    - Budget Information
    - Bank Loans
    - Other Prepared Financials/Unaudited
  - Setting EMMA Tickler to Remind You of Filing Dates
  - Provide Links to Your Web Site Disclosure Materials
  - Creating a Specific Issuer Web Site in EMMA

Using Technology for Disclosure

- When using web sites to disseminate information electronically:
  - Keep it simple
  - Ensure proper security of web site
  - Use proper disclaimers about the information being presented
    - Unaudited Information
    - Stale Information
  - The SEC has embraced and promoted electronic disclosure
Using Technology for Disclosure

Governments and bond issuers use their websites to disseminate information to the municipal securities market regarding:
- The entity's debt,
- The entity's financial condition, and
- Other related information

Your website is an integral part of effective communication with investors and the marketplace and should be a part of an investor relations program.

Considerations for Web Site Disclosure:
- Information solely intended for investors should be segregated from other information and clearly identified as being intended for investors.
- A formal process for reviewing and approving any information posted on the website should be required to ensure accuracy, consistency, and completeness of the information.
- Historical or outdated information should be marked and segregated from current information through the use of a "library" or "archive" accessible on the site.

Items governments should consider posting on their websites include:
- Preliminary Official Statements (POS),
- Audited financial statements,
- Feasibility reports, and
- Other related documents to a bond sale

Information to report post-sale of bonds:
- Continuing disclosure filings
- Already prepared budgetary information
Using Technology for Disclosure

- Costs to consider are:
  - Staff time to prepare information for electronic posting,
  - Software necessary to convert files to a searchable portable document format (PDF), and
  - Effort and expense necessary to design, deploy and maintain a web page solely for disclosure

Using Technology for Disclosure

- Issuers should be familiar with the SEC’s Interpretive Release on Use of Electronic Media or
- See www.sec.gov/rules/interp/34-42728.htm
- Have all information that is posted on a government’s web site reviewed by legal counsel

Web Site Presentation of Official Financial Documents

- While posting financial documents on a web site is a tremendous resource to citizens and an important investor relations tool
- Governments should be reminded that web site posting DOES NOT meet the continuing disclosure responsibilities for issuers of municipal debt set forth in Securities and Exchange Commission Rule 15c2-12
Maintaining an Investor Relations Program

- GFOA recommends that governmental bond issuers consider developing an investor relations program.
- Benefits of developing a program:
  - Better investor awareness of the credit
  - Possible better pricing
  - Assists with public's awareness

- Assists with providing full and comprehensive disclosure of annual financial, operating, and other significant information in a timely manner consistent with federal, state and local laws
- How to establish an investor relations program:
  - Determine who should be responsible for external communications about the entity's debt issues
  - Develop a "Disclosure Board" that will help determine what kind of information should be disclosed and provided to issuers
  - Implement a process for handling investor calls

- Determine what information to post on website
- Understand the appropriate communications of investors
- Identify issuers with the use of CUSIP numbers
- Use your website and post a link to your financial info on EMMA
- Create documents in searchable PDF format
- Determine timing of the release of information related to any debt sales
- When a single investor poses a question, it should be answered in a manner so that all investors can learn the information
- Keep a database of investors/interested parties
- Alert database members of upcoming bond sales, new information, etc
Bank Loan Disclosures

- Disclosure of bank loan information is not required in and of itself, but issuer and counsel need to determine if the bank loan and the priority of repayment count as being a material issue for outstanding bond deals.
- Rating Agencies Encourage Voluntary Disclosure of Bank Loans
- Can Be Filed in EMMA

Disclosure of Pension Obligations

- Growing interest to investors and rating agencies
- Much of the information about a government's pension obligations can already be found in the CAFR and budget
- Issuers need to determine if their pension liabilities could affect their ability to make debt service payments
- Issuers should discuss with counsel how much information about their pension funding liabilities are 'material' information to investors
  - Are debt service payments and pension plan funding coming from the same revenue source?
  - Is there potential does the need that pension plan funding could 'crowd out' debt service payments?
  - Is the priority of payment to the payment fund superior to debt service payments?

EMMA

- Electronic Municipal Market Access System - Replaced Numerous NRMSIRs
- All Submissions Must Be Made Electronically in PDF-Readable and Searchable Format
- Mandatory and Voluntary Submissions
- Numerous Resources on Site Regarding How to Use System
- State and Local Government Toolkit
  - www.emma.msrb.org
MCDC Aftermath
- Numerous Governments Made MCDC Filings
  - GFOA Survey
    - 79% of responders said they had to hire outside consultants at a cost ranging from $2,500-$12,000
    - Overall issuer costs related to MCDC $2,000 - $18,000
    - Governments spent 25-250 hours in responding to the initiative
  - Some Governments Did Not Make Filings, but UW Did
  - Waiting to See How SEC Comes Down on Issuers
  - Elevated the Concerns Regarding the Need for Good Disclosure
  - Concerns About the Program Expressed by Some Issuers

MCDC - Underwriter Settlements Likely Effect on Issuers
- Increased Underwriter Scrutiny of Issuer Practices and History Regarding Continuing Disclosure
- Underwriter Insistence on Disclosure of All CDA Failures, Large or Small
- Risk that Underwriter Will Not Be Your Underwriter Because of Bad History – Find Out Early!

MCDC - Lessons to What Constitutes Noncompliance
- No Safe Harbors
- Brief Infrequent Delays Are Probably Not Material Noncompliance
- Complete Failure to File Is Material Noncompliance
- Subsequent Corrective Filings Do Not Eliminate the Need to Disclose Earlier Failures or Late Filings
- EMMA Filings May be Necessary Regarding Past Failures
MCDC – Lessons to What Constitutes Noncompliance

- Leaving Out a Single Statistic or Table May Be Material Noncompliance
- Failure to Make Quarterly Filings (NOT required in Rule 15c2-12) May Be Material Noncompliance if Contained in Your CDA
BACKGROUND:

Securities and Exchange Commission (SEC) Rule 15c2-12 requires that issuers of municipal securities or obligated persons undertake in a written agreement or contract for the benefit of holders of such securities to provide certain annual financial information to various information repositories. Rule 15c2-12 does not establish a standardized format for the presentation of periodic financial disclosures. Rather, the required annual financial information may be presented through any disclosure document or set of documents, whatever their form or principal purpose, that includes the necessary information. The appropriate means of meeting periodic disclosure requirements is determined by each government in consultation with appropriate legal counsel.

The Government Finance Officers Association (GFOA) is on record recommending that all state and local governments prepare and publish a comprehensive annual financial report (CAFR). GFOA believes that the CAFR should be the normal means for a government to meet its financial reporting responsibilities.

RECOMMENDATION:

GFOA recommends that governments subject to SEC Rule 15c2-12 consider using the CAFR as their disclosure document for providing information useful to existing and potential investors in the secondary market and meeting their obligation to provide annual disclosure for the secondary market, as required by Rule 15c2-12. All the same, for practical reasons, governments that elect to use the CAFR in this manner should be sure that the undertaking commits the government only to the periodic disclosure of specified annual financial information as provided in the amendments to Rule 15c2-12, and not to the periodic issuance of a CAFR.

Notes:

BACKGROUND:

Governments or governmental entities issuing bonds generally have an obligation to meet specific continuing disclosure standards set forth in continuing disclosure agreements (CDAs, also called continuing disclosure certificates or undertakings). Issuers enter into CDAs at the time of bond issuance to enable their underwriters to comply with Securities and Exchange Commission (SEC) Rule 15c2-12. This rule, which is under the Securities Exchange Act of 1934, sets forth certain obligations of (i) underwriters to receive, review and disseminate official statements prepared by issuers of most primary offerings of municipal securities, (ii) underwriters to obtain CDAs from issuers and other obligated persons to provide material event disclosures and annual financial information on a continuing basis, and (iii) broker-dealers to have access to such continuing disclosure in order to make recommendations of municipal securities in the secondary market.1

When bonds are issued, the issuer commits (via the CDA) to provide certain annual financial information and material event notices to the public. In accordance with SEC Rule 15c2-12, those filings must be made electronically at the Electronic Municipal Market Access (EMMA) portal.

The SEC's Municipalities Continuing Disclosure Cooperation (MCDC) initiative in 2014, along with other recent federal regulatory actions, have highlighted the importance of maintaining a reliable system to adequately manage continuing disclosure.

Issuers may choose to provide periodic voluntary financial information to investors in addition to fulfilling the specific SEC Rule 15c2-12 responsibilities undertaken in their CDA. It is important to note that issuers should disseminate any financial information to the market as a whole and not give any one investor certain information that is not readily available to all investors. Issuers should also be aware that any information determined to be “communicating to the market” can be subject to regulatory scrutiny.

In addition to filing information via EMMA, a government may choose to post its annual financial information and other financial reports and information on the investor section of its web site.

RECOMMENDATION:

GFOA recommends that finance officers responsible for their government’s debt management program adopt a thorough continuing disclosure policy and adhere to the following best practices. Issuers should determine how to apply best practices in the manner that is relevant and most practical for their entity. Incorporating robust disclosure practices and demonstrating a solid disclosure track record will benefit an issuer by encouraging regulatory compliance and by enhancing credibility among investors, credit rating agencies and the public, thereby resulting in
optimal bond issuance results. Issuers should consider the following elements in creating policies and practices related to required continuing disclosure responsibilities:

1. Issuers should have a clear understanding of their specific reporting responsibilities as defined in the bond's CDA. If the issuer has determined that financial information is material and must be included in its official statement, its CDA must require that the information be updated annually. Issuers should work with their bond counsel, underwriter and municipal advisor to determine the appropriate information and detail to be included in a CDA, and should be aware of the events that must be disclosed. Prior to execution, CDAs should be discussed with the issuer's bond counsel, underwriter and financial advisor to ensure a full understanding of issuer obligations.

2. Governments should develop continuing disclosure procedures that:
   - identify the information that is obligated to be submitted in an annual filing;
   - disclose the dates on which filings are to be made;
   - list the required reporting events as stated by the SEC and your CDA;
   - ensure accuracy and timeliness of reported information; and
   - identify the person who is designated to be responsible for making the filings.

3. Issuer representatives responsible for filing continuing disclosure should carefully review and understand the specific requirements in the CDA for each individual bond issue. For some governments, filing the complete Comprehensive Annual Financial Report (CAFR) on EMMA may fulfill annual financial information obligations. Issuers should carefully compare information in their CAFR to information required by a CDA to ensure full compliance. If a government has agreed in the CDA to furnish information that is outside the scope of its CAFR, that information may be included as a supplement to the CAFR when filing with EMMA. Some governments – especially those with multiple types of bond issues – may choose to prepare a supplemental annual disclosure document that provides the specific information identified in a CDA (in addition to filing the CAFR).

4. As recommended in the GFOA's Certificate of Achievement for Excellence in Financial Reporting program, a government should complete its audited annual financial information within six months of the end of its fiscal year. Upon its completion, the CAFR should immediately be submitted to EMMA.

5. EMMA allows an option for governments to indicate if they make their filing of annual financial information within 120 or 150 days of the end of the year; however, governments might need a longer timeline to ensure compliance. Governments should only select the EMMA-provided timing options if those dates are consistent with the specific maximum timing commitment in the CDA. The GFOA supports use of required timing commitments within a government's CDA that are reasonable to achieve, which in many cases may be longer than 120 or 150 days. Identifying unreasonably short timelines can be very difficult to meet, and failure to adhere to such a timeframe would result in violation of the CDA.

6. Event notices should be filed for events specifically identified in accordance with SEC Rule 15c2-12:
   - For bonds issued after December 1, 2010, the SEC requires issuers to file event notices within 10 business days of the event.
   - For bonds issued before December 1, 2010, the rule states that governments should file event notices in a "timely manner." However, governments are encouraged to adopt a policy to submit all event notices within 10 business days of the event to prevent any confusion regarding timeliness.

7. Issuers may be expected to include language in their Official Statements for new bond issues regarding any material non-compliance with continuing disclosure requirements within the past five years. Issuers should consult carefully with bond counsel and their municipal advisor regarding
appropriate language to include in this primary disclosure, which is heavily subject to regulatory scrutiny.

Governments, in consultation with internal and external counsel, may wish to submit other financial information to EMMA (and post it on their websites) that goes beyond the minimum requirements in the CDA. Issuers who choose to disclose information above and beyond the minimum requirements in a CDA should consider the following:

1. Types of additional information to be disclosed may include annual budgets, financial plans, financial materials sent to governing bodies for council or board meetings, monthly financial summaries, investment information, and economic and revenue forecasts. Governments are encouraged to place this additional or interim financial information on the investor section of their websites, including use of a feature within EMMA that allows governments to post a link directly to their website so that investors and the public can directly access the information.

2. Issuers may want to provide additional information to investors about other debt-related agreements. Rating agencies and investors may expect these disclosures to be publicly communicated, and issuers are advised of the benefits of providing this additional voluntary disclosure. These disclosures should provide information that will enable investors to make judgments about the volatility and risk exposure of agreements that may include financial risks that should be disclosed and quantified. Examples of agreements for which voluntary disclosure is recommended include:
   - Direct placements, loans, lines of credit or other credit arrangements with private lenders or commercial banks. Example of the type of information to be disclosed include an interest rate or debt service schedule, legal security pledge, legal covenants, call options and other key terms.
   - Letters of credit issued in connection with variable rate debt issuance;
   - Interest rate swaps entered into in connection with debt issuance;
   - Investment agreements for bond proceeds, including reserve funds, particularly where such investments may be pledged or anticipated bond security; and
   - Insurance sureties used to fund reserve fund requirements.

Any sensitive information (such as bank accounts and wire information) should be redacted from documents prior to posting.

3. Legal and regulatory implications of voluntary postings remain uncertain. Issuers should consult with bond counsel and their municipal advisor to determine the best strategy to support the market benefits of additional communication without harming the issuer's ability to meet regulatory expectations.

Upon implementation of a formal set of continuing disclosure policies and procedures, issuers should also take steps to ensure standards are being diligently followed. Continuing disclosure policies and practices should be periodically reviewed to ensure consistency with market and regulatory expectations.

Notes:
1. MSRB Glossary of Terms, www.msrb.org

References:
- Making Good Disclosure, Government Finance Officers Association, 2002
- GFOA Best Practice: Using Technology for Disclosure, 2015
- GFOA Best Practice: Maintaining an Investor Relations Program, 2010
- GFOA Best Practice: Using the Comprehensive Annual Financial Report to Meet SEC Requirements for Periodic Disclosure, 2006
- GFOA Alert: The SEC MCDC Initiative and Issuers, 2014
- SEC Rule 15c2-12
- Electronic Municipal Market Access (EMMA)
Using Technology for Disclosure

BACKGROUND:

Technology has fundamentally changed the way information is communicated and the manner in which municipal bond investors expect to receive information. Use of technology allows governments to efficiently communicate with municipal market participants and more effectively ensure compliance with disclosure requirements. Many governments use their websites to provide disclosure information electronically, including Preliminary Official Statements (POS), audited financial statements, feasibility reports, continuing disclosure filings and other important financial and budgetary information. Issuer websites are commonly used to post Independent Registered Municipal Advisor letters, for issuers who choose to utilize the Independent Registered Municipal Advisor (IRMA) exemption to the Securities and Exchange Commissions Municipal Advisor Rule. Issuer websites have also been used in addition to, or in lieu of, traditional press releases to communicate important events.

The use of issuer websites, electronic distribution of Preliminary and Final Official Statements, and the Municipal Securities Rulemaking Board’s (MSRB) Electronic Municipal Market Access platform (EMMA) have become important tools in promoting transparency, liquidity and efficiency in the credit markets. Guidance to governments on how to best incorporate web-based technology into their normal disclosure practices is important as delivery of electronic information becomes the norm.

RECOMMENDATION:

GFOA recommends that bond issuers use technology - including both their own websites and additional features of the EMMA platform - to disseminate information to the municipal securities market regarding their debt, financial condition and other related information. As of July 1, 2009, electronic posting of annual continuing disclosure information associated with a bond issue is required to be submitted via the MSRB’s Electronic Municipal Market Access (EMMA) system. In addition to making bond sale documents, required disclosure, archived information and periodic financial information available to the market, websites can be an integral part of an effective investor relations program, (see GFOA Best Practice: Maintaining an Investor Relations Program).

If choosing to publish information on their own website, issuers are encouraged to also make a voluntary submission to EMMA with a hyperlink to the specific pages on your website that contains this information in order to assist investors and the public with finding your financial and disclosure information.

Making disclosure information more accessible will help improve the efficiency of the municipal market and can possibly lower borrowing costs by improving access to information relevant to determining the credit quality of an issuer’s bonds. Advantages to issuers in using web-based technology for disseminating disclosure information include:

http://gfoa.org/print/5034
1. An efficient, low-cost medium for communicating timely information to investors.
2. Simultaneous release of disclosure information to the entire market, thus avoiding inappropriate preferential treatment of investors.
3. Retaining control of the content and timing of the formal release of information, assuring accuracy and completeness of information.
4. Availability of the most current information, which can be provided to the market and updated as circumstances warrant.
5. Utility of websites in addition to or, depending on the circumstances, in lieu of, press releases to notify investors of significant events.
6. Acceleration and broadening the distribution of timely disclosure information to the market.
7. Enhancing an issuer's reputation in the credit markets and the strengthening of investor confidence in an issuer.
8. The consistent and ready availability of complete and timely disclosure information, which can make issuer bond offerings more attractive to investors.
9. Reduction of investor inquiries and improvement in the satisfaction of investor requests resulting in more accessible and less costly disclosure.

A government may also consider using electronic means to post interim unaudited and/or operating financial information that otherwise routinely prepared by your entity, to help investors and the public understand the finances of your government between annual filings. (See GFOA Best Practice: Understanding your Continuing Disclosure Responsibilities).

Issuers should evaluate cost considerations associated with providing disclosure information via an issuer-controlled website, such as the administrative time, effort and expense necessary to design, deploy and maintain a website used for disclosure. Typically, a government’s website is developed to provide a wide variety of information for very different purposes. As such, it may be valuable to identify an area of the issuer’s website exclusively dedicated to information specifically designed for investors. In any case, issuers should evaluate the costs and benefits of using their website for disclosure based on their own unique circumstances.

If an issuer-controlled website is used for disclosure purposes (in addition to EMMA), the government should consider the following issues related to design, deployment and monitoring of disclosure:

1. Terms of use should be included on the front page or access point to the website so that information users are aware of – or preferably required to acknowledge – limits on how the website is intended to be used. For example, this disclaimer should acknowledge that the information does not constitute an offer to sell bonds, the information speaks only as of its stated date, and the issuer has no express or implied obligation to continuously update information. It is strongly advised to consult with your legal counsel in determining appropriate disclaimer language to be included and periodically reviewing and/or updating language as needed.
2. Information that is solely intended for investors should be segregated from other information and clearly identified as being intended for investors.
3. A formal process for reviewing and approving any information posted on the website should be required to ensure the accuracy, consistency and completeness of the information. Issuers should design internal controls to ensure that the information posted on the website is accurate, complete, consistent and current.
4. Outdated reports and other stale information (such as prior years CAFRs or audited financial statements and final Official Statements) should be clearly identified as for historical reference only. Historical information should be segregated from current information in a “Library” or “Archive” section of the website.
5. Issuers should review the SEC’s Interpretive Release on Use of Electronic Media. Any information that is posted on the portion of a government’s website dedicated to investors
should be reviewed by counsel.

6. Issuers choosing to publish their rating agency reports on their issuer-controlled website should ensure that posting is consistent with rating agency policies (i.e., permission may be required). Additionally, old reports should be removed at the time that new rating reports are published.

7. If a government chooses to post unaudited interim financial information, the posting should clearly state that the information is unaudited and the government may wish to include additional disclaimer language regarding use of unaudited information.

8. The security of an issuer’s website should be evaluated to protect it from manipulation by external or unauthorized persons.

9. Documents on the website used in connection with a sale of bonds (e.g., POSs, audited financial statements and feasibility reports) should be identical to versions distributed in hard copy. In addition, information on an issuer’s website intended for use in a bond sale should be clearly identified as such, and segregated from other information.

10. Issuers should consider the need to involve other departments and professionals to ensure that all necessary parties are involved in developing and deploying disclosure information on the website.

11. Issuers should consider ease of use and accessibility in designing a website for investors and be specific when referencing or addressing a specific place on the issuer’s website intended for investors. Issuers should also include a contact person to answer questions related to information on the website.

12. Issuers should post their continuing disclosure filings on their disclosure website in addition to submitting the postings via EMMA as required.

13. Issuers should consider the possibility of increased exposure to liability under the securities laws when evaluating the cost/benefit of using a website for disclosure. However, in nearly all circumstances, appropriate disclaimers and procedures can adequately protect an issuer against undue regulatory risk.

14. Issuers should not use social media to communicate investor-related information that is not also included on the centralized investor information area of the issuer’s website. In the absence of accurate and timely official disclosure, financial information communicated via social media could be considered of material importance to investors.

15. Posting of information related to regulatory actions (including documents related to the SEC MCDC Initiative or the IRS VCAP program) is not recommended, unless specifically required as part of a CDA or other legal obligation.

References:

- GFOA Best Practice, Understanding Your Continuing Disclosure Responsibilities, 2015
- GFOA Best Practice, Maintaining an Investor Relations Program, 2010
- SEC Rule 15c2-12
- MSRB’s Electronic Municipal Market Access (EMMA)
Best Practice

Monitoring and Disclosure of Fees for Defined Contribution Plans

Background:

In carrying out their responsibilities as fiduciaries, sponsors of state and local government defined contribution (DC) plans make decisions in the best interests of plan participants and beneficiaries. In making these fiduciary decisions, plan sponsors need to understand all the fees and expenses that are charged to the plan and to participants, and ensure that these costs are reasonable. Plan sponsors also need to give participants adequate and accurate information about the fees and expenses that affect their account balances.

The fees paid by public and private DC plans have been the focus of congressional, regulatory, and public scrutiny. In particular, the U.S. Department of Labor (DOL) has issued rules under the Employee Retirement Income Security Act (ERISA) about the disclosure and transparency of fees charged to DC plans and participants. And while the ERISA rules are not binding in the public sector, they may provide guidance for best practices. GFOA members are encouraged to review the DOL's rules on fees and disclosures when developing these practices, as well as the following recommendations below.

Recommendation:

GFOA recommends that plan sponsors make sure that DC plan costs are reasonable and appropriate, compared with plans of similar size, structure, and service levels, and that they provide plan participants with meaningful and accessible information about fees and expenses. These policies and practices should ensure that plan sponsors:

1. Thoroughly review and document the process used in selecting DC plan service providers and the types of fees charged.
   1. Require service providers to disclose:
      1. All compensation arrangements, both direct and indirect, for themselves, their affiliates, and/or subcontractors. Require the service provider to fully disclose such arrangements on plan websites and in plan documents and investment materials sent to participants.
   2. Fee-related disclosures should include:
      1. Investment fees, which include fees associated with management of the plan's investments.
      2. Plan administration fees (including fees for record keeping, communications, education, and the plan's professional advisors).
      3. Transactional fees, which include expenses charged against a participant's or beneficiary's individual account (such as loans,
The Pension Protection Act of 2006 requires quarterly benefit statements to include a notice directing participants to a U.S. Department of Labor website on individual investing and diversification (http://www.dol.gov/ebsa/investing.html).

References:

- U.S. Department of Labor Fact Sheet, Final Rule to Improve Transparency of Fees and Expenses to Workers in 401(k)-Type Retirement Plans, February 2012 (http://www.dol.gov/ebsa/newsroom/fsparticipantfeerule.html).

- U.S. Department of Labor Fact Sheet, Final Regulation Relating to Service Provider Disclosures Under Section 408(b)(2), February 2012 (http://www.dol.gov/ebsa/newsroom/fs408b2finalreg.html).


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annuities, brokerage accounts, qualified domestic relations orders, front or back-end loads or sales charges, and redemption fees).

2. Service providers, especially providers that are experienced with ERISA plans, can help with developing disclosure policies and procedures. Plan sponsors might also want to reconsider a relationship with a provider that refuses to provide disclosures or to assist with disclosure policies and practices.

3. Reevaluate fee disclosure practices regularly to assure compliance with applicable state and federal regulatory requirements and best practices.

2. Review and verify actual fees at least once a year to make sure the provider is not overcharging.
   1. Consider issuing a request for proposal (RFP) to ensure the plan is getting competitive fees.
   2. Consider using an independent consultant to review and report on the reasonableness of the service provider's fees. Independent benchmark studies provide one way to evaluate fees.
   3. Monitor plan service providers for potential conflicts of interest at least once a year, or when there is a material change in circumstances (such as a merger). Plan sponsors might also want to request an affidavit from the service provider that affirms there are no conflicts of interest or reveals any actual or potential conflicts.

3. Provide plan participants with meaningful and accessible information about fees and expenses at least once a year, along with other information participants need to make sound investment decisions.
   1. Fee-related information, including the role fees play in investment returns, should be disclosed and communicated in a way that non-investment personnel can understand. One way to provide this information is to send individual participants annual statements with personalized fee disclosures.
   2. Include whatever additional disclosures participants will need to evaluate the investment products offered:
      1. Past investment performance.
      2. Risk and investment objectives.
      3. Appropriate fee benchmarks for each investment category (domestic bonds, domestic large cap equities, emerging markets, etc.).
      4. A glossary of terms.
   3. Provide information on Web sites for easy access.
   4. Communicate fee information when participants enroll in the plan and inform them annually about how they can receive updated information.
   5. Review the effectiveness of these communications regularly, perhaps using an outside consultant.

Notes:


2 Direct compensation is compensation received from the plan sponsor or paid directly from the participants' accounts. Indirect compensation comes from any source other than the plan sponsor, participants' accounts, or the service provider's affiliate or subcontractor.
Disclosures of Pension Funding Obligations in Official Statements

BACKGROUND:

Issuers of municipal securities, with the advice of legal counsel, financial advisors and other professionals, make numerous judgments as to what information should be included in an Official Statement (OS) for a public offering of state and local government debt. Materiality is the guiding principle as to the content and extent of the disclosure that is provided in the OS. Disclosure related to an issuer's pension funding obligations is just one type of information that should be included in an issuer's OS, and the pension obligation should be considered in the broader context of the issuer's resources. While disclosures about pension funding obligations will vary among issuers and types of bonds being issued, all issuers should be aware of the type of information that should be included in the OS, most of which already may be presented within other financial documents (e.g., the comprehensive annual financial report, CAFR). Additionally, the type of pension plan that is used by a government will dictate the amount of disclosure. For instance, those governments that participate in defined benefit (DB) pension plans likely will have more extensive disclosures than those participating in other pension plans, such as defined contribution (DC) plans.

To assist with the development of appropriate disclosures related to pension funding obligations for DB pension plans, the National Association of Bond Lawyers (NABL) issued guidance in May 2012 regarding the application of the federal securities laws to the disclosure of pension funding obligations for DB pension plans. NABL published this guidance following a process that included input from numerous experts in the fields of pensions and debt, including representatives of the Government Finance Officers Association (GFOA). While the guidance is aimed at assisting government issuers that sponsor or participate in DB plans, governments that sponsor hybrid and DC plans may also wish to review and consult the NABL guidance regarding disclosures that might be applicable and appropriate for their jurisdictions.

Of particular significance, the guidance offers the following recommendation regarding the preparation of pension disclosure for an OS:

"Official Statement disclosure is about the credit quality of the bonds being offered. Disclosure about an issuer's pension obligations that is included in the OS should reflect the degree to which such obligations could affect the issuer's ability to make bond payments to investors, or place pressures on the basic functions of government that would affect the creditworthiness of the bonds. This may depend, to varying degrees, on matters such as size of those obligations relative to the issuer's overall budget, the funding status of the pension plan, and identifiable trends and problems that are material to an investor. It will also depend on the degree to which the pension obligation payments and debt service payments are..."
payable from the same source of revenue. The goal of this disclosure, as with all disclosure in an OS, is the appropriate level of information for the issuer's specific situation. Neither too much information nor too little information is helpful to the investor."

In many cases, the government's preparation of its pension disclosure for an OS will be straightforward and the information will already be present in the government's financial documents. However, there may be situations in which a government's pension funding obligations are significant and additional disclosures may become material.

RECOMMENDATION:

GFOA recommends that issuers implement appropriate procedures when determining the level of information that needs to be disclosed about their pension funding obligations relative to their financial position. To help determine the appropriate level of disclosure about the government's pension funding obligations in the OS - including the possibility that more extensive disclosures may be material and may need to be included in the OS - issuers should address, along with the assistance of legal counsel and others on their financing team, the following questions:

1. Is the debt service on the proposed bond issue and the funding of the issuer's pension plan dependent on the same specifically identified revenue source or sources?
2. Is the current and future funding of the pension plan material in relation to the issuer's current and projected budgets?
3. Is the funding of pension obligations currently stressing the issuer's budget or "crowding out" other expenditures, or have the potential of doing so in the future?
4. Are there legal restrictions or requirements related to pension funding that reasonably might be considered placing pension funding senior to debt service payments?
5. Are there known and determinable trends or issues related to pension funding that may be considered material to investors?

If the answers to these questions indicate that pension funding could adversely affect the jurisdiction's ability to pay its debt service, more extensive disclosures may be required. In these instances, the GFOA recommends that issuers consult the NABL guidance, especially Appendix D, to determine what disclosures should be included in an OS. If necessary, sources for additional disclosures may include:

1. Statements and schedules in the issuers' CAFRs or audited financial reports such as financial statements, Required Supplementary Information (RSI), footnote disclosures, statistical tables or Management Discussion and Analysis (MD&A).
2. Pension information included in the issuer's adopted budget.
3. Other publicly available reports, including actuarial reports of the pension plan.
4. Relevant laws, statutes, regulations or other completed legislative actions that affect pension funding and obligations, or the pension plan itself.
5. Information from the pension plan related to specific plan investments and other policies and procedures that could be material to bondholders.

References:

BEST PRACTICE

Maintaining an Investor Relations Program

BACKGROUND:

Investors are a primary source of capital for state and local governments. When a governmental entity sells debt, it enters into a long-term contract to make timely debt service payments to investors. Other stakeholders, such as bond insurers, liquidity providers, rating analysts, trustees, credit enhancers, counterparties, and constituents are interested in obtaining financial and operation information on issuers. An effective investor relations program that responds to the informational needs of these diverse groups may lower borrowing costs for issuers.

RECOMMENDATION:

GFOA recommends that governmental bond issuers consider developing an investor relations program. The centerpiece of such a program is a commitment to provide full and comprehensive disclosure of annual financial, operating, and other significant information in a timely manner consistent with federal, state and local laws. Issuers may consider and are encouraged to provide additional information to investors beyond that provided for in their contractual commitments. An investor relations program should address the following:

1. Identify the individual(s) who is (are) responsible for speaking on behalf of the issuer. Establish steps to ensure that all external communication regarding disclosure is approved by this (these) person(s).

2. After giving consideration to the size and organizational structure of the entity, consider creating a “Disclosure Board” or other appropriate group, to establish the events to be disclosed and periodicity of disclosure items. Positions on the Disclosure Board may include: the debt manager, the chief financial officer, a representative of the legislative body, an administrative officer, the financial advisor, and bond counsel or issuer’s counsel.

3. The Disclosure Board, or other appropriate group, should establish policies and procedures for the Investor Relations Program. Policies and procedures should be simple and clear, and should address:

   a) Identification and selection of information, both positive and negative, to be made available to investors, including material events, changes in financial or operating position, and changes in government policies. Documents that could be a source of such information include:

      • Annual budgets, financial plans or comprehensive annual financial reports,
      • Interim financial information that is sent to governing bodies for council or board meetings, and
      • Ordinances or resolutions adopted by a governing body.
b) Identification of ways to stay abreast of issues that are likely to be of concern to investors, such as issuer policies and practices pertaining to investments, fund balance, and accounting practices.

c) Identification and maintenance of a database of investors and analysts who review the purchase of the issuer's debt instruments.

d) Use of CUSIP (Committee on Uniform Securities Identification Procedures) numbers.

e) Identification of means of disseminating information. Consideration should be given to: the Electronic Municipal Market Access system (EMMA), e-mail, websites, postal distribution, and investor meetings.

f) Format of the document (e.g., .html or .pdf if electronically disseminated).

g) Timing of a release of information with any sale of debt instruments, if necessary.

h) Responding to investor questions. Consideration should be given to means of communication to all investors when a single investor poses a question.

i) Ensuring the majority of investors have access to the information.

j) Ensuring that preliminary official statements are received one week in advance of a bond sale.

k) Maintaining a good relationship with the rating agencies and fund analysts including distribution of disclosure information and keeping them informed of any changes that could affect credit quality and actions to address financial problems.

l) Ensuring that financial statements or other information needed for disclosure purposes are completed on a consistent schedule from year-to-year and prior to the date established in any contractual commitments.

m) Engaging in marketing activities to alert investors of a pending bond sale, especially if the debt instruments are sold competitively. Such activities may include preparation of special reports for investors, the scheduling of investor meetings, conference calls, and webcasting of issuer conference calls and on-site visits.

4. Consideration should be given to the fact that any record created as a result of the Investor Relations Program may be subject to internal policies and/or federal, state and local laws concerning document retention and freedom of information.

The municipal marketplace is changing, and the need to provide additional information with greater frequency is significant. Issuers should maintain an awareness of changes in current practice in the area of investor relations. Investor Relations Programs that go beyond the legally mandated requirements of Securities and Exchange Commission (SEC) Rule 15c2-12 promote the efficient sale of debt instruments in both the primary and secondary markets and improve the reception of debt offerings. Expansive disclosure practices are encouraged, especially the availability of interim financial information between your annual filings.

References:

• Disclosure Roles of Counsel, John McNally, Project Coordinator, ABA/National Association of Bond Lawyers, 2009.
• EMMA - http://emma.msrb.org/
BACKGROUND:

Bank loans are an important tool in a government's financing toolkit. For purposes of this Best Practice, the term “bank loans” includes fixed-rate loans with defined maturities and loans or lines of credit that have variable interest rates and flexible payment provisions.

One potential advantage of bank loans is that the process for execution of bank loans generally is simpler than a bond issue that is marketed to the public market, with fewer issuance costs and ongoing compliance requirements. Additionally, bank loans can often be structured in a manner that more closely conforms to specific project or repayment considerations than is the case with bond issues. However, because bank loans are typically not executed in an environment that is as transparent as the bond market, an issuer may have limited ability to assess whether the proposed interest rate(s), fees and terms are consistent with reasonable market comparables.

Governments should develop specific policies and procedures that address the proper legal and financial aspects of using bank loans for their jurisdiction. Governments also should become familiar with the various types of terms used in these financial products. Governments need to know how bank loans are characterized for legal and accounting purposes, including how they are treated in your financial statements, and what types of disclosures should be made about these loans. State and local laws should be reviewed to ensure these financings are within legal limits and the financing is characterized appropriately.

Public disclosure of bank loans currently is not required beyond the reporting requirements in the government’s financial statements. However, many market participants have suggested that providing information about outstanding bank loans is necessary to assess an issuer’s outstanding debt obligations and general credit quality.

RECOMMENDATION:

GFOA recommends that governments considering the possibility of entering into bank loans should develop policies and procedures related to these debt obligations. When developing these policies and procedures, and when evaluating the various debt alternatives available to it, governments should consult with their financial advisor and legal counsel. These professionals should be engaged by the government prior to and throughout the negotiations for a bank loan. Outside professionals including financial advisors and pricing agents can assist with making an assessment of proposed structures, terms and pricing.

Some of the questions that should be addressed before a government pursues a bank loan include:

- Has the government retained outside professionals to help determine the legality and fiscal prudence of a bank loan?
• Does the government have the legal authority by state and local statute to enter into the contemplated financings?
• For transactions less than $10 million, has the government considered or discussed with its professional team the option of issuing bank qualified debt?
• From a statutory standpoint, is the bank loan considered to be debt, and if so, does it apply against the government’s debt capacity or other considerations?
• Does a bank loan offer a better solution to the issuer’s needs than a financing offered in the public bond markets? What are the terms that best fit these specific borrowing needs (including fixed vs. variable interest rates)?
• How will the bank loan provider be solicited, evaluated and selected?
• Is the government using competitive means to obtain a bank loan? How can the government best negotiate the final terms with the selected financing provider?
• Has the government thoroughly reviewed and discussed the term sheet of the loan prior to its execution, and does the term sheet have comprehensive information about the loan?
• What is the interest rate on the bank loan? Is it fixed for the term of the loan or does it reset prior to the maturity of the loan? Is the interest rate a variable rate with predetermined interest reset dates or an index upon which it is based? Can the government manage the risk of an increase in the interest rate, and to what extent?
• Is the loan a fully amortizing loan, or does it incorporate a non-amortizing bullet maturity? How is the debt service schedule structured - level or ascending? Can additional debt be incurred by the government, if necessary? If so, what is the formula for determining how much additional debt can be incurred? Is there a coverage ratio requirement in the loan? Are there penalties for prepaying the loan prior to maturity?
• What are the covenants included in the bank loan, and who within the government is responsible for ongoing compliance?

Disclosure Considerations

In order to enhance communication to its citizens and other parties interested in reviewing a government's credit profile, governments should voluntarily disclose information about bank loans. While disclosure of bank loans currently is not required under Securities and Exchange Commission’s Rule 15c2-12, any voluntary disclosure may be held to same standards of materiality and timeliness as information disclosed under Rule 15c2-12.

A bank loan that does not have a security-based or other financial connection to any outstanding public-market debt may not be relevant to investors, rating agencies, the public, or other entities. Therefore, if a government chooses to disclose information regarding a bank loan, GFOA recommends that those governments disclose information regarding those bank loans that may be relevant to current or prospective bondholders. Disclosure of bank loans would be important to bond holders if the bank loan(s) is (are) secured by any or all of the same revenues as the outstanding bonds, and is/are large enough to be material to the creditworthiness of the government. Additionally, if a government executes numerous bank loans, the combination of those loans may be material. If the government has outstanding bonds, it is important for the issuer to discuss with its counsel any possible material issues related to a bank loan, especially if it could interfere with debt service payments, or is a large financial transaction.

Voluntary disclosure of bank loans may be accomplished in a variety of ways - either by posting the entire financing agreement documentation, through the normal disclosure mechanisms used by the government, (which would include placing this information in the government's financial statements) or by preparing a summary of material terms. The government along with its professional team should determine both the extent of information it provides and the manner in
which it is disseminated. Some information that should be considered for summarization and disclosure include:

- Loan amount and date incurred
- Final maturity date of the loan
- Debt service schedule, if including principal amortization, interest rate(s), interest calculations
- Interest rate method of calculation, if variable
- Use of loan proceeds
- Legal security and/ or source of payment
- Covenants, events of defaults and remedies
- Term-out provisions, or information about payment acceleration or other non-standard payment considerations
- Any other information that an issuer believes to be important

Governments also should consult with legal counsel to ensure that any voluntary disclosures contain an appropriate disclaimer identifying the one-time nature of the information as of the posting date, issuer limits on responsibility and other relevant information as advisable. A government may wish to update the information particularly if the loan is repaid before its maturity, or if the loan terms are extended or otherwise modified – items that may be material as determined by the government, legal counsel and other members of the financing team.

When utilizing the MSRB’s Electronic Municipal Market Access (EMMA) system to disclose bank loan information, governments need to be aware that the bank loan will not have a CUSIP number associated with it. Therefore the information will need to be uploaded as “other information” connected with a bond issue already established in EMMA. As with all disclosure decisions, issuers should consult with counsel and others on the financing team about how best to disseminate this information. Bank loan disclosures would normally be handled in the same way the issuer provides other disclosure information (e.g., EMMA, issuer web site).

References:

BEST PRACTICE

Issuer's Role in Selection of Underwriter's Counsel

BACKGROUND:

Underwriter's counsel is employed to represent the underwriter in the offering of bonds. The duties of such counsel include drafting bond purchase agreements, and may include drafting official statements and coordinating disclosure documents. Such counsel also assists the underwriter in meeting its legal responsibilities generally in the issuance and sale of the bonds. While underwriter's counsel represents the underwriter, in some cases issuers have assumed a direct role in selecting or approving underwriter's counsel. Among the reasons cited by issuers for being involved in the selection or approval of underwriter's counsel are the issuer's (1) need for assurance that underwriter's counsel is qualified and experienced and will give the highest priority to the transaction, (2) need for assurance that underwriter's counsel understands the issuer’s finances and operations, disclosure practices, and other pertinent information, and will help promote full and complete disclosure, (3) desire to control the costs of the underwriter's counsel, which are typically paid directly or indirectly by the issuer, (4) desire to avoid the use of firms where conflicts of interest or pending regulatory enforcement may exist, and (5) compliance with state and local legal or policy requirements.

RECOMMENDATION:

GFOA recommends that issuers minimize their involvement in the selection of underwriter's counsel. The GFOA believes that issuers have a legitimate but limited role in the engagement of underwriter's counsel. Specifically, the role of the issuer should be to ensure that underwriter’s counsel is qualified and experienced and will give the highest priority to the transaction, (2) need for assurance that underwriter's counsel understands the issuer’s finances and operations, disclosure practices, and other pertinent information, and will help promote full and complete disclosure, (3) desire to control the costs of the underwriter’s counsel, which are typically paid directly or indirectly by the issuer, (4) desire to avoid the use of firms where conflicts of interest or pending regulatory enforcement may exist, and (5) compliance with state and local legal or policy requirements.

The issuer may draw up a list of general criteria and qualifications to be used by the underwriter and other professionals in the selection of counsel.

Working with the underwriter, the issuer can prepare a list of acceptable firms and leave the final selection to the underwriter.

The issuer may ask to review the qualifications of a firm proposed by the underwriter and provide feedback on the selection including retaining the ability to exercise a veto due to concerns relating to cost, qualifications, or conflicts of interest.

Firms should be evaluated based on:
• their general knowledge and experience with disclosure requirements,

• their understanding of and, if applicable, past performance with the issuer, expertise with the securities being offered,

• their ability to complete the transaction in an orderly manner, and

• the absence of any conflicts of interest that might jeopardize the ability of the firm to carry out its responsibilities.

Governmental issuers should also have a role in negotiating with the underwriter the cost of services performed by underwriter's counsel by reviewing the scope of legal services to be provided and obtaining a fixed, not-to-exceed, hourly rate, or other appropriate fee arrangement that takes into account the complexity of the transaction and the scope of counsel's work.

The underwriter bears the ultimate responsibility for the adequacy of its own counsel. Any undue influence by an issuer, however, that calls into question the qualifications or independence of underwriter's counsel may create risk to the issuer and to the underwriter because of the increased potential of inadequate disclosure in the offering of the issuer's bonds and a reduced ability of the issuer to claim reliance on the expertise of its financing team.

References:


• GFOA Best Practice, "Selecting Bond Counsel," 2006.


BACKGROUND:

State and local governments incur various costs and fees in conjunction with publicly offered bond transactions. This Best Practice provides an overview of the types of costs and fees that an issuer can expect to pay in a typical bond transaction. Finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable and for legitimate services provided to the issuer.

There are two types of costs that issuers incur in the debt issuance process:

Direct Costs of Issuance: Costs that the debt issuer pays directly to financial and legal advisors, the trustee (if any), paying agents, auditors, rating agencies and other providers of services to the issuer. This is in addition to internal costs incurred by your government for staff work or fees to other government departments.

Underwriter’s Discount: Costs paid indirectly by the issuer to the underwriter of the bonds for services relating to selling the bonds to investors and managing elements of the transaction. These costs are deducted from the proceeds of the bonds by the underwriters at closing and therefore issuers typically do not “write a check” for these services.

Finance officers also should be aware that certain costs are embedded within the bids received from underwriters in a competitive sale. These costs and fees are usually not specified in a competitive bid and are outside of the issuer’s control. Such costs include CUSIP fees, DTC fees and certain internal expenses of the bidder.

This Best Practice focuses on direct costs of issuance. Best Practices relating to costs paid by issuers through the underwriter’s discount may be found in the following Best Practices:

- Selecting Underwriters for Negotiated Bond Sales
- Expenses Charged by Underwriters in Negotiated Sales

Finance officers, working with their financial advisor, should understand all costs and fees, so that they can be controlled and managed throughout the financing process. A thorough discussion with the financial advisor and other professionals involved in the transaction should be expected. These discussions should occur at the time that compensation is being determined for key members of the financing team, including the financial advisor, bond counsel and other service providers. As always, cost must be balanced with quality, as it is of critical importance that the issuer receives high quality services and work products from all parties.

RECOMMENDATION:
GFOA recommends that finance officers be aware of the parties likely and necessary to be involved in the transactions and be prepared to select these parties in a manner that ensures that needed services are obtained at a fair and reasonable cost. Additionally, an issuer should carefully review all invoices to ensure that an expense is not billed to multiple parties.

1. **Financial Advisor.** Financial advisors assist the issuer on matters such as selecting the method of sale (competitive, negotiated, private placement, direct bank loan, etc.), structuring the financings, sale timing, marketing, fairness of pricing, obtaining credit ratings, evaluating cost effectiveness of credit enhancement and other matters. Unlike the underwriter of the bonds, the financial advisor has a fiduciary obligation to represent the interests of the issuer and therefore, should be one of the first financing team members retained by the issuer.

The financial advisor should typically be retained prior to selection of the remainder of the financing team and should assist the issuer in determining the appropriate method sale, the selection of other members of the financing team and the negotiation of fees of the financing team members. GFOA recommends that financial advisors be selected as the result of an RFP or RFQ process. Compensation paid to financial advisors can vary based on the scope of services to be provided. If an advisor is being retained for services related to a bond transaction only, then the complexity of the transaction, the type of security and the type of issuer will have an impact on the fees charged. Fees can be paid on an hourly, or fixed fee bases. However, the FA fee may also be based on an $/1,000 of par value. However, an issuer should use caution if using this payment method, as it could impact the overall size and structure of the transaction.

2. **Legal Counsel.**
   1. **Bond Counsel.** Bond counsel's duty is to represent the interests of the bondholders. Bond counsel is retained by the issuer to give a legal opinion that:
      1. Issuer is authorized to issue proposed municipal securities and has met all legal and procedural requirements necessary for issuance.
      2. If interest on the proposed securities will be excluded from gross income of the holders (Federal and/or State and or local)
      3. Generally responsible for the preparation of financing documents including Trust Indenture and Bond Resolution; assists with preparation of the Official Statement
      Compensation paid to bond counsel varies depending on complexity of the transaction, the type of security and the type of issuer. These fees can be assessed based on a flat fee or by hourly billing. If the fee is paid by $/1,000 of par value of the issuance, an issuer should use caution and ensure a reasonable cap is in place.
   2. **Issuer Counsel.** Government's may have in house counsel or may hire outside counsel to represent only the interest of the issuer.
   3. **Disclosure or Tax Counsel.** In addition to bond counsel, some transactions will involve the use of disclosure counsel and tax counsel.

3. **Bond Trustee.** A financial institution or other required entity with trust powers that acts in a fiduciary capacity for the benefit of the bondholders, enforcing the terms of the trust indenture and often acting as:
   1. Paying agent (transmitting payments from issuer to bondholder)
   2. Dissemination agent (for ongoing disclosure requirements)
   3. Escrow agent on refunding transactions (hold funds in escrow account until time of disbursement)
   4. Disburse bond proceeds based upon procedures established by trust indenture or bond resolution.
5. Place investment of bond proceeds based on instruction of issuer.

6. Trustee fees frequently include a one-time upfront fee (acceptance fee), an annual fee (trusteeship fee), and often transaction fees. The selection of the Trustee should be done through an RFP process, with price not being the sole determining factor.

4. Escrow Verification Agent. An escrow verification agent should be hired in conjunction with a refunding transaction. The role of the escrow verification agent is to determine that the cash flow from the securities purchased to defease the refunded bonds will be sufficient to make remaining debt service payments on the refunded bonds until the bonds are called, if applicable, or to maturity. It is recommended that the selection of an escrow verification agent is competitively procured.

5. Auditor. Under auditing standards generally accepted in the United States of America, independent auditors are presumed not to be associated with financial statements included in an offering statement. Still, an "association" may be created between the independent auditor and the offering statement if the auditor takes one of several actions specified in the auditing standards, such as inserting a provision in the audit contract that requires prior approval before including audited financial statements in an offering statement. It is important to note that the audited financial statements belong to the issuer, which GFOA believes should be free to publish in offering statements. Audit contracts in general should be negotiated to reflect this, but to the extent that consent is required, the level of effort required is minimal and no additional fee should be required.

6. Rating Agencies. Rating agency fee quotes can be obtained by your financial advisor or a member of your staff. The fees are and should be considered negotiable. Fees vary by bond size and security type. Consideration should be given to how many ratings are necessary, through discussion with your financial advisor and underwriter. Additionally, considerable caution should be exercised if a rating agency requests that an issuer sign a rating application or rating engagement letter. Legal counsel must be consulted if an issuer is inclined to sign such documents, because they are binding contracts.

7. Printing and Distribution Costs. Issuers will typically incur costs relating to electronically posting their official statement to websites and information services that potential underwriters and investors rely upon to access information about proposed bond offerings. In some cases, traditional hard copy printing costs may also be incurred. It has become more common for POS to be electronically posted and for a small number of final OS to be printed. The use of electronic only copies for the POS can save on printing costs.

8. Pricing Verification Agent. Issuers should use the services of the financial advisor for the transaction, or obtain the services of a separate financial advisor or other outside professional to review the pricing of a transaction and the underwriter’s discount. This fee is usually based on a fixed rate basis.

References:

- GFOA Best Practice, Expenses Charged by Underwriters in Negotiated Sales (2012)
- GFOA Best Practice, Pricing Bonds in a Negotiated Sale (2009)
- GFOA Best Practice, Issuer’s Role in Selecting Underwriter’s Counsel (2009)
- GFOA Best Practice, Selecting Underwriters for Negotiated Bond Sales (2008)
- GFOA Best Practice, Selecting Bond Counsel (2008)
- GFOA Best Practice, Selecting Financial Advisors (2008)
- GFOA Best Practice, Selecting and Managing the Method of Sale of State and Local Government Bonds (2007)
- GFOA Advisory, Auditor Association with Financial Statements Included in Offering Statements or Posted on Web Sites (2006)
When governments issue bonds they deposit the bond proceeds (and occasionally other monies) in various funds, which may include a construction fund, debt service fund, capitalized interest fund, debt service reserve, or in the case of a refunding, an escrow fund. In some cases these funds may be held by a third party trustee. Monies allocated to these funds usually are invested until needed. The investment strategy for each fund will depend, in part, on federal or state statutes and regulations governing the types of instruments permitted to be used for the investments, the arbitrage yield permitted for the fund, requirements from rating agencies and/or credit enhancement providers, and the anticipated drawdown of bond proceeds. Additionally, each of these funds will have different investment objectives, so there are many factors that must be considered by the government when selecting the investment instrument. Governments need to be mindful that cash flow analyses are critical components of the process and are useful in reducing the possibility of negative arbitrage that may occur. Furthermore, the presence or lack of arbitrage could affect the entire structure and sizing of the debt financing.

Due to the Dodd Frank Act and the Securities and Exchange Commission’s (SEC) Municipal Advisor Rule (the “Rule”), brokers may be considered municipal advisors if they provide advice on investments of bond proceeds to governments. Under the Rule, municipal advisors have a fiduciary duty to their government clients, and, if brokers wish to avoid becoming fiduciaries, they will be unable to provide advice to government clients unless they meet one of the exemptions to the Rule, which are described in this section. Broker-dealers will be deemed to have provided “advice” when they make a recommendation to their government clients to buy a particular security. However, brokers may provide certain information without it being considered advice. For example, the SEC has said that brokers may provide information about their firm’s currently available investments (e.g., the terms, maturities, and interest rates at which the firm offers these investments) or price quotes for investments available for purchase or sale in the market that meet criteria specified by a municipal entity. This is considered general information and therefore is not considered advice. Also, a broker may respond to requests for offers for investments of bond proceeds and escrows as long as the broker is just quoting a price and not otherwise commenting on the advisability of those investments.

There are also two exemptions that will allow a broker to provide advice without becoming a municipal advisor with a fiduciary duty. The first is the RFP exemption. Under this exemption an issuer could send out an RFP for investments to at least 3 reasonably competitive providers, asking for recommendations on how it should invest bond proceeds for a particular period of time. The broker could respond to that RFP by providing advice on which investments are good candidates for the issuer. A form of RFP document that would satisfy this exemption, along with model language for the other exemptions in the Rule, is available in the GFOA MA Rule Alert, which is linked to in the reference section of this document. A definition of the term Municipal Advisor can also be found in the Alert.

There is also an exemption if the issuer has an independent registered municipal advisor (IRMA)
that will provide it with advice on investments. It requires a written representation on the part of the issuer and a corresponding disclosure on the part of the broker to both the issuer and the municipal advisor. A form of an issuer IRMA representation and a form of broker required disclosure is also available in the GFOA MA Rule Alert. Note: A government may not use an SEC-registered investment adviser as its IRMA, because SEC-registered investment advisers are exempt from the definition of “municipal advisor.” Additional resources to help governments become familiar with the Rule are included in the References section of this Best Practice.

There is also an exemption if the issuer has an independent registered municipal advisor (IRMA) that will provide it with advice on investments. It requires a written representation on the part of the issuer and a corresponding disclosure on the part of the broker to both the issuer and the municipal advisor. A form of an issuer IRMA representation and a form of broker required disclosure is also available in the GFOA MA Rule Alert. Note: A government may not use an SEC-registered investment adviser as its IRMA, because SEC-registered investment advisers are exempt from the definition of “municipal advisor.” Additional resources to help governments become familiar with the Rule are included in the References section of this Best Practice.

**RECOMMENDATION:**

The Government Finance Officers Association (GFOA) recommends that state and local governments develop an understanding of the risks inherent in investing bond proceeds and incorporate steps in their investment strategy for each fund to minimize these risks. Three types of risk are: (1) credit risk (safety), the risk of investing in instruments that may degrade in credit quality or default; (2) market risk (liquidity), the risk of selling an investment prior to maturity at less than book value; and (3) opportunity risk (yield/return), the risk of investing long term and having interest rates rise or investing short term, having interest rates fall and needing to reinvest the bond proceeds.

Issuers should consider actions to mitigate these risks. These actions include establishing guidelines for permitted investments to reduce credit risk, developing good cash flow estimates and periodically updating those estimates to reduce market risk, and integrating knowledge of prevailing and expected future market conditions with cash flow requirements to reduce opportunity risk. As with investment decisions made with other public funds, the balance generally is weighted heavily towards the preservation of capital (avoiding risk), maintaining liquidity second, and yield last.

Provided that the maximum allowable arbitrage yield can be earned, state and local government series securities (SLGS) generally are the recommended investment option rather than utilizing open market securities for escrows accounts for refunding bonds. The benefits of SLGS include better matching of debt service payment dates on the refunded bonds and fewer arbitrage rebate issues for borrowers. One cautionary point, however, is that issuers need to be aware of times when the federal government stops selling SLGS and discuss with counsel and/or their municipal advisor or investment adviser an alternative investment strategy for the escrow account.

GFOA also recommends that governments develop specific policies and procedures for the investment of bond proceeds to ensure that legal and regulatory requirements are met, fair market value bids are received, and issuer objectives for various uses of proceeds are attained. Governments should also have in place policies and procedures for when they will engage the use of an investment adviser or municipal advisor. Governments that may not have dedicated staff to closely monitor markets and their investments are strongly encouraged to use a municipal advisor or investment adviser.

Investment of bond proceeds should include an evaluation of investment alternatives including: (1) individual securities or portfolio of securities; (2) investment agreements; and (3) mutual or pooled investment funds, including money market funds. The following actions are recommended as part of the evaluation of investment alternatives:
1. A government should have an investment policy which is disclosed and summarized in the Official Statement and which includes the investment of bond proceeds or describes other documents that outline the parameters for investment of bond proceeds. A government should comply with its investment policy or document and explain the reasons(s) for any deviation from the policy.

2. The government should coordinate its debt management and investment of bond proceeds activities, especially if different offices and staff are involved in each task. Governments should be aware that different types of bonds proceeds may have varied investment goals and procedures.

3. The government should understand its interactions with brokers-dealers regarding the investment of bond proceeds and escrows may change as a result of the new MA Rule described above. Many broker-dealers will likely be unwilling to provide advice, which would subject them to a federal fiduciary duty. Some broker-dealers may clarify that they will not provide advice absent an exemption from the MA Rule (as described above), but will instead only show the government their inventory, quote prices and respond to requests for offers. Some broker-dealers may refuse to accept accounts with bond proceeds or escrows.

4. If investments are longer than one year, mark to market accounting requirements should be in place, which can be verified by external auditors.

5. The duties of the individual designated by the government to be responsible for the investment of bond proceeds (internal or external personnel, which could be the investment officer) should be specified and include the management and ongoing monitoring of the following:

   - Work with the municipal advisor or investment adviser, bond counsel, and other consultants, to determine how bond proceeds will be invested given expectations for the drawdown of proceeds, federal tax law requirements, or other concerns;
   - Make certain that the drawdown of proceeds is planned and recorded and that the investment duration is shorter than the expected drawdown schedule. Since the draw schedule may change over time, it should be periodically revisited;
   - Ensuring that fees paid to brokers are reasonable and are within internal policy and federal guidelines;
   - Regular and ongoing monitoring of investment and custody of bond proceeds;
   - Reinvestment of bond proceeds when necessary;
   - Governments should ensure that they review their investment policy to ensure compliance when the investment of bond proceeds may span several years;
   - Understanding federal tax law, particularly as it pertains to arbitrage restrictions;
   - Providing periodic reporting of investment results; and
   - Maintaining adequate records to comply with arbitrage reporting and rebate requirements.

6. The identified personnel, working with the investment officer, debt manager or where applicable, outside professionals, must ensure that investment decisions conform to all legal, statutory, and regulatory requirements, all requirements established by the trust indenture/bond resolution or fiscal agent agreement, and all requirements that might be imposed by rating agencies and/or credit enhancement providers, including:

   - Establishment of funds and accounts;
   - Designation of eligible investment instruments;
   - Credit risk should be very low
   - Final maturity dates should be the focus rather than call dates or expected maturity dates
   - Purchase of investments at fair market price;
   - Permitted yields, such as those to comply with federal arbitrage requirements (outside professionals should be hired to ensure accurate arbitrage reporting and compliance); and

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7. An issuer should require that municipal advisors and investment advisers report any finder's fees or fee-sharing arrangements. The issuer should evaluate any other potential conflicts of interest. As a general matter, there should be no fee sharing or finder's fee arrangement. If, in fact, these arrangements occur, issuers should require that municipal and investment adviser report this information to them in advance of any such arrangement.

8. An issuer should seek competitive bids and, where required, a minimum of three bids. Additionally, an issuer should require that all fees associated with investments be fully disclosed to ensure that investments are being purchased at a fair market price. Issuers should document that they are getting a fair market price on the investments from those bidding on the investment of the proceeds. In many cases, the IRS requires three bids from parties not related to the transaction. Furthermore, to allow for brokers-dealers that do not have a fiduciary duty to the issuer to place a bid, the SEC requires that the issuer that wants to create the RFP exemption from the definition of “municipal advisor” have widely disseminated its call for bids to at least three parties. Records should be maintained to document that investments were purchased at a fair market price. The issuer also should ensure that the bids are date stamped and arrive at the same time. It is important to note that the IRS has implemented enforcement action over the years regarding professionals that have misled or manipulated the bidding process, noting that issuers should be extra cautious and implement appropriate policies to help ensure that the bidding process is conducted properly and fairly.

The specifications of the request for proposals for purposes of obtaining competitive bids are described in more detail in the GFOA MA Alert referred to below. GFOA recommends obtaining a minimum of three competitive bids.

9. Extreme care and due diligence should be taken to guarantee that the interests of the issuer are represented if outside professionals are used to solicit and evaluate bids. This generally is best accomplished through the use of competitive requests for proposal processes to select the necessary outside financial professionals.

References:

- GFOA MA Alert, May 2014
- Federal Register / Vol. 78, No. 218, Registration of Municipal Advisors by the Securities Exchange Commission
- IRS Forum, Arbitrage and Rebate Compliance, May, 2012
- GFOA Best Practice, Analyzing and Issuing Refunding Bonds, 2010
- GFOA Best Practice, Creating an Investment Policy, 2010
- GFOA Best Practice, Selecting and Managing Municipal Advisors, 2014
Use of Debt-Related Derivatives Products

Advisory:

GFOA Advisories identify specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is not to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

BACKGROUND:

A derivative - or swap - is a financial instrument created from or whose value depends upon (is derived from) the value of one or more separate assets or indices of asset values. As used in public finance, derivatives may take the form of interest rate swaps, futures and options contracts, options on swaps and other hedging mechanisms such as rate locks. Derivative products have been used in the debt, risk and asset management programs of state and local governments and other debt issuing authorities. Although it is appropriate to retain a derivatives advisor to assist in a transaction, issuers are advised that they should have a level of in house expertise necessary to understand the core aspects and risks of a derivatives transaction. Simply stated if you do not feel you understand and can explain the transaction, it is probably not appropriate for your use.

When used properly derivative products can be effective interest rate management tools, which can provide a governmental entity financial flexibility, opportunities for interest rate savings, alter the pattern of debt service payments, create variable rate exposure, or change variable rate payments to fixed rate and otherwise limit or hedge variable rate payments. However, as observed during and after the financial crisis of 2008 and 2009 ("the Financial Crisis"), there are significant risks involved with such transactions, especially when other related markets - such as the variable rate market - trigger events in swap contracts. Some governments have experienced collateral calls, and involuntary and voluntary termination of their swaps, which, for some, came at a substantial cost. As a result, governments have significantly curtailed engaging in these types of transactions since the Financial Crisis.

To alert governments to the risks associated with derivative products, GFOA maintains an Advisory (Use of Derivatives and Structured Investments by State and Local Governments for Non-Pension Fund Investment Portfolios - 2010) which specifically advises state and local government finance officers to exercise extreme caution in the use of derivatives and structured finance products. Governmental entities must learn about and understand the potential risks and rewards of derivative and structured products, before deciding if they should be used. Governments must understand fully the characteristics of these instruments and have the ability (internal staff and external advisors) to determine the fair market price and be aware of the market, legal, accounting, credit and disclosure risks involved. It is also recommended that issuers read and understand the most current rating
agency guidance regarding the effect of derivatives on ratings, prior to execution of a derivatives contract.

Following the Financial Crises, Congress and regulators took steps to regulate the derivatives market, both in the public finance and corporate sectors. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and subsequent Commodity Futures Trading Commission (CFTC) rulemaking have established Business Conduct Rules for dealers. The regulations provide for safe harbors which include issuer representations and the need for a governmental entity to have a Qualified Independent Representative (QIR) – a professional that is independent from the swap dealer (the QIR has not been associated with a swap dealer within the past year and has not been recommended by the swap dealer).

Additionally, Dodd-Frank contains other regulations that issuers should be familiar with if considering swaps (see reference section). Before a dealer will engage in any discussions or executions of derivative transactions with a municipal counterparty (or any issuer defined as a Special entity under the CFTC rules), the swap dealers are requiring issuers to adhere to the August 2012 and March 2013 Protocols, which effectively amend any existing ISDA Agreements to allow them to fulfill their obligations under the regulations. These protocols mandate the use of the new CFTC Interim Compliant Identifier (CICI) legal entity identifier system for each Issuer Counterparty. The August 2012 Protocol addresses the swap dealers' Business Conduct Rules and suitability issues and requires issuers to select a QIR, make certain representations and maintain internal policies and procedures including swap policies and policies regarding the selection of the QIR.

The March 2013 Protocol covers swap clearing requirements and provides for an "End-User Exception" that allows issuers an exception to the clearing requirements if the issuer meets certain criteria. Swap dealers will require adherence to March 2013 Protocol before transacting any derivative. Instead of adhering to the Protocols, Issuers may choose to execute Bi-Lateral Agreements with each swap counterparty. The Bi-lateral Agreements incorporate essentially the same representations under the Protocols. Adhering to Protocols typically is more efficient for issuers with multiple swap counterparties as it allows issuers to provide information, make elections and representations one time.

RECOMMENDATION:

The Government Finance Officers Association (GFOA) advises that state and local governments exercise caution in the use of derivative instruments. Unless your government has the appropriate expertise to understand and resources to monitor the transactions, prepare financial reports, and audit footnotes for swap transactions on an ongoing basis, as well as manage the variable rate instruments and liquidity facilities associated with the instrument, it should not enter into swaps. Issuers must understand fully the characteristics of derivative instruments, have the ability together with its QIR Advisor to determine a fair market price and be aware of the legal, accounting, credit, and disclosure issues involved. These instruments should not be used for speculation, but only to manage risks associated with an issuer's assets or liabilities and only in conformity with financial policies that reflect the risk tolerances and management capabilities of the issuer. These products should only be used when the issuer has developed:

1. A comprehensive derivatives policy that includes:
   1. Evidence of clear legal authorization to enter into swap contracts and guidelines for how derivative products fit within the overall debt management program.
   2. Documentation of the expected impact of the derivative on the issuer's underlying bond ratings. Credit rating agencies evaluate the risks of a derivative and its impact on the issuer's rating. An issuer should understand the impact if any, prior to entering into a transaction. A financial advisor or QIR should assist the issuer in evaluating the likely rating considerations.
3. Policies and procedures in place for the hiring of a QIR.

4. Determining the scope of work for the QIR. In addition to transaction assistance, an issuer should have the QIR assist with securing the CICI number for the transaction, ensuring that the transaction qualifies as an end user exemption, and adherence to other CFTC rules.

5. Procurement of a written recommendation from the QIR that the transaction should be undertaken.

6. A list of the types of derivative products that may be used or are prohibited.

7. A requirement that the issuer work with the QIR to document the incremental value of the swap transaction versus the cash market, including a valuation of call option considerations. Call option considerations should include valuing the swap if non-callable versus a comparable non-callable bond; and valuing the cost of imbedding a call option in the swap to provide some potential protection for the issuer to manage the termination costs.

8. Prohibition or restrictions into taking upfront payments or premiums, and on selling options.

9. The conditions under which these types of products can be utilized (i.e. bidding procedures, minimum benefit thresholds, valuation of no call or call options\(^2\), policy on collateralization, and terms of master agreements).

10. The maximum allowable notional amount of derivatives contracts, or a means of determining such amount, e.g., by reference to floating rate assets.

11. Guidelines for selecting counterparties of high credit quality and addressing the risks.

12. Prior to the execution of a transaction, a requirement that the issuer document that the transaction contemplated fits the requirements of the derivatives policy.

13. A written fairness opinion from the QIR that the transaction was priced at market with a fair pricing.

2. **A sufficient understanding of the products.** The GFOA encourages all financial officers to learn about the risks and potential benefits of using derivatives. A decision whether or not to use derivatives must be made on an informed basis. Training is essential both in evaluating the use of derivatives and in managing their use.

3. **The internal staffing and expertise to manage, monitor, and evaluate these products properly** (either on their own or in combination with a QIR). Tax counsel may also need to be consulted. Issuers must have in place:

   1. Methods for measuring, evaluating, monitoring and managing risks associated with derivative products, including:

      1. **Basis risk** - the mismatch between variable rate debt service and the variable rate index used to determine swap payments. Basis risk can also occur when a divergence arises between the index associated with the bonds, and that of the derivative. This divergence could be caused by a number of factors including but not limited to, changes in credit spreads/trading values, tax law changes, absolute levels of interest rate and supply and demand. This risk can be managed through the a matching of the bond index with that of the derivative index, creation of an interest rate reserve fund, or conservative budgeting strategies.

      2. **Interest rate risk** - how the movement of interest rates over time affects the market value of the instrument. Interest rate risk can arise as a) cashflow risk – which is the risk that any market factors (including interest rates or ratios) may increase cashflow from expectations, and b) Mark-to-Market risk – also affected by market factors depending on the trade (interest rates, ratios, yield curve, etc.).

      3. **Collateral Posting risk** – the risk that market movements or an issuer downgrade will cause the market value of the swap to be negative enough that the issuer has to post collateral under a Credit Support Annex (CSA). Issuers
should be mindful of the different rating standards applied to corporate and municipal credits when evaluating collateralization thresholds and understand that this is a negotiable requirement. Termination and collateral requirements should reflect relative comparable credit strengths of the parties determined on a corporate equivalent or global rating basis.

4. Counterparty risk - the risk that the counterparty fails to make required payments, experiences rating downgrades, or files for bankruptcy protection. This is particularly important if an issuer has more than one swap with a counterparty and the documents contain cross-default provisions. This can be addressed through the establishment of ratings thresholds, guidelines for exposure levels and, particularly, collateralization requirements.

5. Termination risk - the need to terminate the transaction in a market that dictates a termination payment by one of the counterparties. Market practice allows governmental issuers to limit the instances in which this can occur. This risk can also be mitigated through the identification of revenue sources for and budgeting of potential termination payments, structuring the swap so that refunding bond proceeds can be used for termination payments and subordinating the lien status of potential payments. Issuers are cautioned to understand the potential for termination costs to change over time in different interest rate environments and should document the sensitivity to these factors. Issuers are cautioned to ensure that counterparties do not impose excessive or unnecessary fees at termination in excess of amounts allowed for in the swap documents, and are urged to consult with their financial advisors about negotiating the terms of a termination payment.

6. Market-access risk - the risk that the markets may be closed or that an issuer may not be able to enter the credit markets due to its own credit quality deteriorating. For example, to complete a derivative’s objective, a new money bond issuance or a refunding may be planned in the future. If at that time the markets are not functioning or an issuer is unable to enter the credit markets, expected cost savings may not be realized while the issuer will continue to be subject to its obligations required by the derivative contract.

7. Amortization risk - the mismatch of the maturity of the swap and the maturity of the underlying bonds or a mismatch in the amortization of the swap and bonds. This should be eliminated by making the maturity and amortization of the swap match those of the bonds.

8. Rollover risk - the underlying variable rate bond related to the swap will typically have a liquidity feature or put feature that will require periodic remarketing, rollover or renewal. This requires transactions fees and the risk that a change in the issuer’s credit, or a change in market conditions may economically disadvantage the issuer.

9. Credit risk - the occurrence of an event modifying the credit rating of the issuer or its counterparty. This should be addressed through minimizing cross defaults and the favorable negotiation of credit event triggers in the underlying documentation.

2. Methods for selecting and procuring derivative products, including when competitive bids and negotiated transactions are warranted, and knowledge of pricing conventions and documentation standards.

3. Guidelines governing the proper disclosure of material information relating to executed derivative products to the issuer’s governing body, in financial statements, to the rating agencies, to investors in connection with bond offerings, and through secondary market disclosure. Internal disclosure should include information about legal authority, risks, guidelines and market value. Official Statement and secondary market disclosure should comport with current market practice.
Use of Debt-Related Derivatives Products

4. Procedures and personnel responsible for internally managing and monitoring the issuer's (i) obligations (also known as operational risk), such as monitoring rates, calculating and making payments, managing collateral, and budgeting and accounting for derivatives appropriately and (ii) exposure, such as counterparty credit, collateral posting levels, variable rate exposure levels and basis risk. Pursuant to applicable accounting requirements, these procedures must include the development of a methodology for providing periodic termination value analyses.

4. Documentation Standards. The new regulatory framework dictates that all derivative transactions be documented using standardized forms, as standardized terms make it easier for market participants to analyze transactions, which minimizes costs. Documentation in the municipal swap market is accomplished through the negotiation and execution of the forms of documents published by the International Swaps and Derivatives Association, Inc. (ISDA). ISDA has updated these forms to conform to the new CFTC regulations. The GFOA also advises that many provisions in such forms are subject to negotiation and therefore recommends that finance officers have a QIR to advise on negotiations and amend ISDA documents as changing market conditions warrant. Specifically, the provision of collateral by one or both parties to a swap under certain circumstances is determined at the time the swap is executed. The form of that potential collateral may also be decided at the point of execution or may be postponed until such collateral is required. Collateral is identified in a Credit Support Annex ("CSA"), and while it will add legal costs to the original transaction and has the potential of never being used, the GFOA recommends it be completed simultaneous with the execution of the swap to avoid having to negotiate collateral arrangements under distressed circumstances.

5. Ongoing Monitoring. Once an issuer has adopted a derivatives policy and executed a derivatives transaction, the issuer should monitor and, to the extent possible, take action to limit its exposure to the risks described above. Because opportunities in the derivatives market change frequently, the GFOA encourages finance officers to keep abreast of such market conditions.

Notes:

1 Commodity Exchange Act definition of a swap - "any agreement...that provides on an executory basis for the exchange...of one or more payments based on the value or level of one or more...rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind...and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred."

2 The cost of many of the problems experienced by municipalities with swaps could have been reduced had the municipalities been able to terminate swaps at lower costs. One way to reduce the cost of termination is to imbed an issuer call option in the swap. Historically bonds have call options as a matter of course and historically most municipalities have not had call options imbedded in their swaps. It is important to evaluate the portion of the value in the swap that is being derived from the elimination of the call option versus the value being derived from other components of the swap transaction. When undertaking a swap, municipalities should evaluate the incremental value and or cost of imbedding a call option in the swap. Depending on market conditions, call options in swaps may increase costs which should be evaluated versus the risk reduction obtained.

3 Terminating Swaps and Re-indexing – There may be opportunities to restructure or re-index a swap to obtain savings or a reduction in the size of the swap. When evaluating these types of transactions, Issuers should be aware that there are potential tax consequences to the modification...
of an existing swap. The issuer should get advice from a qualified bond counsel regarding any potential adverse tax consequences of a partial termination or re-indexing for example.


References:

- SIFMA/GFOA March 2013 Webinar: Municipal Swaps - Understanding the New World of Regulation
- GFOA Best Practice: Debt Management Policy, 2012
- GFOA Advisory: Use of Derivatives and Structured Investments by State and Local Governments for Non-Pension Fund Investment Portfolios, 2010
- GFOA Public Policy Statement: Regulation of Derivative Products, 1994
- Swaps in the Aftermath of the Banking Debacle, Peter Schapiro, Government Finance Review, 2/2013
- CiCi identifier page -www.cicutility.org
- GFOA Publication: Elected Official's Guide to Debt Issuance, Patricia Tigue and J.B. Kurish, 2005
- Understanding Municipal Derivatives, David Taub, Government Finance Review, 2005
- GFOA Derivatives Checklist, 2010
- GASB – Derivative Instruments: A Plain-Language Summary of GASB Statement No. 53
- Moody's U.S. Public Finance – Potential Risks of Variable Rate Debt and Interest Rate Swaps for U.S. State and Local Governments are Heightened by Economic and Financial Crisis, October 2009.
Use of Derivatives and Structured Investments by State and Local Governments for Non-Pension Fund Investment Portfolios

Advisory:

GFOA Advisories identify specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is not to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

BACKGROUND:

A derivative product is a financial instrument created from, or the value of which depends on (is derived from), the value of one or more underlying assets or indices of asset values. Derivatives may include forwards, futures, options, swaps (currency and interest rate), caps, floors, collars and rate locks.

Structured investments are financial instruments that are created (structured) through pooling or redistributing assets, tranching liabilities (backed by pools of assets) and/or separating the credit risk of the collateral assets from the originating entity. Examples of such instruments commonly used by governmental entities may include asset backed securities, mortgage backed securities, various collateralized obligations and credit derivatives among others.

RECOMMENDATION:

GFOA advises state and local government finance officers to exercise extreme caution in the use of derivatives and structured finance products. Governmental entities must learn about and understand the potential risks and rewards of derivative and structured products, before deciding if they should be used. Governments must understand fully the characteristics of these instruments and have the ability (internal staff and expertise) to determine the fair market price and be aware of the legal, accounting, credit and disclosure risks involved.

Governments should consider the following factors in determining whether to use derivatives and structured investment products:

1. Legality. Governmental entities should understand that state and local laws may not specifically address use of these products. Factors to consider include:
the constitutional and statutory authority of the governmental entity to execute derivative contracts or to buy structured finance products,

- the potential for violating constitutional or statutory provisions limiting the governmental entity's authority to incur debt resulting from the transaction, and

- the application of the governmental entity's procurement statutes specifically to derivative transactions.

2. Appropriateness. Governmental entities must observe the objectives of principal preservation, liquidity, and return within legally allowable investments. Judicious asset and liability management policies help achieve these objectives while managing risk. Characteristics of some derivatives and structured investment products that may preclude their use and make them inappropriate include high price volatility, illiquid markets, valuation difficulties, insufficient market history, high degree of leverage, keen monitoring and modeling system requirements, and the need for a high degree of sophistication to manage risk. Governmental entities should be aware of all the risks associated with the use of derivatives and structured investment products, including credit, counterparty, market, prepayment, liquidity, settlement, custodial and operating risk.

Regarding the difficulty in valuing derivatives and structured investment products, governmental entities should understand that there may be little or no pricing information or standardization for some derivatives and structured investment products. Competitive price comparisons are recommended before entering into a transaction. Even in cases of competitive pricing, because valuations of such products are based on highly sensitive models and not on actual markets, changes in the underlying assumptions may severely impact asset values.

In addition to determining legality and appropriateness, governmental entities should analyze the materiality of a transaction to determine if it might affect a bond or other credit-related rating of such entity. Rating agencies should be notified if required.

3. Procedures and Internal Controls. Governmental entities should establish internal controls for use of derivatives and structured investment products to ensure that risks involved with these are adequately managed. Such procedures should include:

- Creating an oversight board and establishing upfront criteria for use of derivatives and/or structured securities;
- Comprehensive derivatives and structured securities policy (evidencing legal authority, listing authorized and prohibited types of derivatives and structured investments, identifying guidelines for counterparty selection, limiting maximum permissible amounts and specifying means of determining such maximums);
- Review with ratings agency(ies) impact of derivatives use on governmental entity;
- Written statement of purpose and objectives for derivative use,
- Written procedures for monitoring of derivative instruments and structured investment products, including how often they will be priced and what pricing services will be used:
- Periodic training for managers and access to technical resources to oversee derivative and structured investments:
- Sufficiently detailed recordkeeping to allow governing bodies, auditors, and examiners to determine if the program is functioning in accordance with established objectives. Managers should report regularly on the use of derivatives to their governing body and appropriate disclosure should be made in official statements and other disclosure documents:
- Reporting on derivative use in accordance with generally accepted accounting principles. Because of the complexity of these instruments, governments should consult with public accountants at an early point to determine if specialized reporting may be required:

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• Required documentation of stress testing and scenario analysis of derivatives and structured investment products. Every possible effort should be made to determine worst case scenarios when using derivatives or structured products, as well as likelihood or probability of these outcomes and the government’s ability to weather them; and
• Procedures for evaluation and review on a periodic basis.

4. Role of External Parties. Governmental entities should know if their broker-dealers are merely acting as an intermediaries or are taking a proprietary positions in derivatives or structured investment product transactions. Possible conflicts of interest should be taken into consideration before entering into a transaction.

Governmental entities should exercise caution in the selection of broker-dealers or investment advisers. They should confirm that these vendors are knowledgeable about, understand and provide disclosure regarding the use of derivatives and structured investment products, including benefits and risks.

Governmental entities are responsible for ensuring appropriate safeguards are in place when derivative or structured investment product transactions are conducted by a third party acting on behalf of the governmental entities.

The GFOA reiterates the need for governments to exercise extreme caution when considering derivative products for their investment portfolio. It is important to emphasize that these instruments should not be used for speculation.

Governmental entities must learn about and understand the risks and rewards of derivative and structured investment products in order to properly evaluate and manage. Governmental entities should consider the use of derivatives and structured investment products only when they have attained a sufficient understanding of the products and the expertise to manage them. Certain derivative products and structured investment products may not be appropriate for all governmental entities.

Ultimately, it is the responsibility of each governmental entity to determine what constitutes a derivative and/or a structured investment, and what is allowable by statute and policy.

References:

• GFOA Best Practice: Use of Debt-Related Derivatives and Development of Derivatives Policy, 2010, GFOA’s Committee on Governmental Debt Management.
• GFOA Derivatives Checklist, 2010, GFOA’s Committee on Governmental Debt Management.
GFOA Alert: MCDC Initiative Settlement Terms for Issuers

Wednesday, June 8, 2016

The information contained in this document was developed to educate members about the SEC MCDC Initiative and should not be construed as legal advice.

As the SEC moves forward to address cases where issuers self-reported under the Municipalities Continuing Disclosure Cooperation (MCDC) initiative, issuers can expect to receive settlement offers containing standard provisions to which they must consent. The SEC is requesting an extraordinarily short turn-around for the settlement (5-10 days) but have indicated they will extend the settlement offer if the issuer requests. To assist in a quick but thorough review, GFOA recommends state and local governments participating in the MCDC initiative become familiar with the standard terms that are expected to be in the offered settlements. This alert addresses expected settlements for issuers that self-reported under the MCDC initiative and is not intended to be legal advice. Issuers should seek legal advice prior to finalizing or signing the proposed SEC settlement agreement and fully understand the consequences of the proposed settlement.

As noted in the appendix to GFOA’s first alert about the MCDC initiative, the following are standardized undertakings that are expected to be required of any issuer under a settlement agreement:

- Establish appropriate policies and procedures and training regarding continuing disclosure obligations within 180 days.
- Comply with the existing continuing disclosure undertakings, including updating past delinquent filings within 180 days.
- Cooperate with any subsequent investigation by the SEC regarding the false statement(s), including the roles of individuals and/or other parties involved.
- Disclose in a clear and conspicuous fashion the settlement terms in any final official statement for an offering by the issuer within five years.
- Provide the commission staff with a compliance certification regarding the applicable undertakings by the issuer on the one year anniversary of the date of the settlement.

In addition, the settlement agreement is expected to include the following terms:

- Admitting the jurisdiction of the SEC and consent to the institution of cease and desist proceedings.
- Consenting to the settlement order.
- Agreeing to cease and desist from committing any further violations of the Securities Act.
- Waiving various legal and administrative procedures.
- Agreeing not to deny the findings in the settlement order (but maintaining the ability to “neither admit nor deny”).
- Agreeing not to seek attorney’s fees or other fees, expenses or costs.

The proposed settlement agreements will describe the circumstances surrounding the issuers’ failure to comply with its continuing disclosure agreement(s) and the SEC’s legal analysis of the securities law violation(s). Issuers should be prepared to consult counsel and carefully review and verify all facts being alleged as the basis of the securities law violation. In most cases, the discovery done during self-examination and self-reporting will provide the information needed to verify the accuracy of the factual statements.

Participating issuers should also remember that the MCDC settlements apply only to the issuer and not to the issuer’s staff or elected officials and will not release them from personal liability for federal securities law violations. Depending on the facts and circumstances, individuals involved in the alleged securities law violations may want to engage their own legal counsel to protect them individually.

Lastly, the settlement terms for all issuers, including those issuers that self-reported under MCDC out of an abundance of caution, call for a statement by the SEC that the issuer’s conduct was negligent, which constitutes a type of securities fraud. Issuers should consult counsel regarding how to best respond to the SEC’s proposed settlement offer.

Resources

GFOA MCDC Alert
GFOA Alert: Bank Loan Disclosure

Thursday, May 12, 2016

Over the past five years, the municipal securities market has witnessed a dramatic increase in the use of bank loans by municipal issuers as a tool to finance capital improvements as well as refund outstanding debt. Bank loans, which may be structured with fixed or variable interest rates and with defined maturities or flexible payment provisions, may offer a number of potential advantages over a public offering of municipal securities. The increasing use of bank loans has recently begun to attract the attention of regulators, such as the Municipal Securities Rulemaking Board (MSRB) and Securities and Exchange Commission (SEC), as well as the credit rating agencies, which are growing increasingly concerned about bank loan disclosure practices among municipal issuers.

Typically, the process for executing a bank loan is more streamlined than a traditional bond issue that is publicly marketed, with fewer costs of issuance and ongoing compliance requirements. In particular, banks often do not require an offering document or credit ratings. Additionally, bank loans are often structured in a more flexible manner than a traditional municipal bond issue, to conform to a specific project schedule or particular cash flow considerations. However, because bank loans are not typically executed in an environment that is as transparent as the municipal securities market, an issuer may have limited ability to assess information about whether the proposed interest rate, fees, and terms of a particular loan are consistent with bank loan market practices.

For these reasons, GFOA urges state and local governments that are considering bank loans to:

- Provide voluntary public disclosure of the bank loan;
- Develop specific policies and procedures that address the applicable legal and financial requirements of using bank loans for their jurisdiction; and
- Seek guidance from outside professionals including municipal advisors and bond counsel in reviewing the legal and financial terms of the bank loan.

Bank Loan Disclosure Considerations

In order to enhance market transparency and public communication to its citizens and other stakeholders who are interested in understanding a government’s total debt profile, GFOA recommends that governments should voluntarily disclose information about bank loans. Disclosure of a bank loan would be relevant to bondholders if the bank loan is secured by any or all of the same revenues as the outstanding bonds, and is large enough to be material to the creditworthiness of the government. Additionally, if a government executes numerous bank loans, entities investing in the government’s bonds may need to know about the combination of those loans in the aggregate. Lastly, certain terms and conditions of the bank loan (e.g., liquidity covenants, events of default, and acceleration provisions) may be important information for credit analysts and bond holders. While disclosure of bank loans is not currently required under MSRB or SEC rules, issuers are advised that increased regulatory scrutiny may result in mandatory disclosure of bank loans in the future, subject to similar standards of materiality and timeliness as apply to municipal securities.

Voluntary disclosure of bank loans may be accomplished in a variety of ways, either by posting the loan agreement itself or a summary of material terms on the MSRB’s Electronic Municipal Market Access (EMMA), incorporating bank loan information in the government’s comprehensive annual financial report, or releasing a summary of the material terms of the bank loan on the government’s website. When using EMMA to disclose bank loan information, governments should be aware that the bank loan will not have a CUSIP reference number, and the information will need to be uploaded as "other Information" connected with a bond issue already established in EMMA. The government, in consultation with its municipal advisor, disclosure counsel, and bond counsel, should determine both the extent of information it provides and the manner in which it is disseminated.

GFOA also encourages governments to keep abreast of the current regulatory environment surrounding bank loan disclosure. For example, the MSRB recently requested public comment on a regulatory approach that would require municipal advisors to disclose information about the bank loans and direct purchases of their government clients on EMMA. GFOA will submit comments to the MSRB on this proposal and invites GFOA members to do the same. GFOA has significant concerns with this proposal, including the fact that municipal advisors are the only party in a municipal debt transaction that have a fiduciary responsibility to issuers, as outlined in the SEC’s 2013 MA Rule. The MSRB’s proposed approach to pass along responsibility of issuer disclosure of bank loans and private placements breaches that
fiduciary duty, making municipal advisors also beholden to the investor community. Such a requirement would change the nature of issuers' relationships with municipal advisors in a way that is beneficial to neither issuers nor municipal advisors.

Comment letters are due May 27, 2016, and can be transmitted to the MSRB through this link. GFOA members can access full text of the short regulatory proposal here.

Resources

- GFOA Best Practice – Understanding Bank Loans (2013)
- Standard & Poor's Rating Services – Not All Loans are Equal: Some Terms and Conditions That Make Disclosure Critical in Evaluating Credit Risk (2014)
The December 1, 2014 deadline for issuers to self-report under the MCDC initiative is quickly approaching. In July and August 2014, GFOA issued MCDC alerts that explained the initiative and highlighted key considerations for issuers in deciding whether to self-report any failure to make required continuing disclosure or material event filings. Below are the links to the two previous MCDC alerts:

GFOA Alert: The SEC MCDC Initiative and Issuers

GFOA Alert: Deadline Extended for SEC MCDC Initiative

In addition, guidance was provided on the common deficiencies in underwriter findings, warning issuers to scrutinize the information provided by underwriters as many findings were erroneous and preparing issuers to evaluate the materiality of any misstatement regarding its continuing disclosure compliance. At this point, underwriters have provided their reports to the SEC and hopefully communicated with issuers on transactions included in their report.

If an issuer learns that an underwriter reported its transaction to the SEC, it should conduct a self-examination to either verify or disprove the accuracy of the underwriter’s report. If upon completion of the self-investigation it is determined that the underwriter’s report is accurate, the issuer should consult with legal counsel to determine materiality of the failure and misstatement in the offering document. Issuers should also correct any material failures by filing the information required with the Municipal Securities Rulemaking Board’s EMMA system. Lastly, issuers should consider whether to self-report under the MCDC Initiative by December 1, 2014. Issuers should carefully consider the legal and practical consequences of self-reporting under the MCDC Initiative and thoughtfully and thoroughly consider all facts and consequences of self-reporting. If the failure is determined to be immaterial with the assistance of legal counsel, issuers are advised to document the circumstances and the reasoning for not self-reporting under MCDC. This may include obtaining a memorandum from counsel outlining the decision not to participate in the MCDC Initiative. Finally, an issuer should augment its disclosure policies and procedures to ensure a failure does not occur in the future and statements in the offering document accurately reflect compliance with disclosure undertakings.

Through the self-examination process, an issuer may determine an underwriter reported a transaction in error to the SEC. If this occurs, the issuer should provide documentation to the underwriter and request the underwriter amend its report. Confirmation and documentation that the amendment was requested and made by the underwriter should be retained for the issuer’s file.
On August 24, 2016, the SEC Office of Municipal Securities announced enforcement actions against 71 municipal issuers for violations in municipal bond offerings from 2011 to 2014, as part of the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative. The issuers settled without admitting or denying the findings and agreed to cease and desist from future violations. The SEC has not indicated if or when it will take similar actions with other issuers.

Close review of the Cease and Desist Orders reveals that nearly all of the enforcement actions related to late filings of financial information on EMMA. Some issuers failed to note the late filing in the official statements of subsequent bond issues. The named issuers missed filing deadlines by a little as 36 days to as much as several years. There were few examples of failures to report other material events.

This GFOA Continuing Disclosure Alert reminds issuers of the importance of making timely filings of financial information in accordance with each issuer’s continuing disclosure agreement. GFOA’s best practices including Understanding Your Continuing Disclosure Responsibilities and Using the Comprehensive Annual Financial Report to Meet SEC Requirements for Periodic Disclosure have long provided guidance on how to meet disclosure commitments. Recent alerts have assisted issuers in understanding recent SEC enforcement actions throughout the MCDC process.

The best practices and alerts highlight essential practices that are worth emphasizing:

1. Understand and discuss your organization’s policies and procedures on disclosure
2. Know who is filing what, when and where
3. Be aware of what is posted on EMMA
4. Be aware of what your organization has promised to do in the continuing disclosure agreement
   Recognize that each official statement must include a statement about whether the issuer failed to materially comply with previous commitments within the past five years

GFOA recommends that all issuers carefully review and confirm statements regarding past compliance in the preparation of offering documents. Additionally, GFOA urges issuers to seek legal counsel if missed deadlines or filing failures are discovered.
GFOA Alert: The SEC MCDC Initiative and Issuers

Monday, July 7, 2014

The information contained in this document was developed to educate members about the SEC MCDC Initiative and should not be construed as legal advice.

On March 10, 2014, the Securities and Exchange Commission’s Enforcement Division (the SEC) announced the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative to provide issuers and underwriters the opportunity to self-report instances of material misstatements in bond offering documents regarding the issuer’s prior compliance with its continuing disclosure obligations. The deadline for self-reporting under the MCDC initiative is December 1, 2014. (See SEC Press Release) SEC is not defining the term material and has indicated that a determination of the materiality of submissions under the initiative will be made on a case by case basis depending on the overall facts and circumstances of a situation.

While SEC is encouraging issuers and underwriters to participate by offering predetermined and more lenient settlement terms, the GFOA is urging members to exercise caution and familiarize themselves with the details of the initiative before consenting to engage in this program. For example, though the terms of the initiative preclude SEC from imposing monetary fines on participating issuers, the SEC reserves the right to pursue separate enforcement actions against individuals within a government who it deems to be culpable of the misstatements. Additional information on individual liability and standardized settlement terms under the initiative are listed in Appendix A at the end of this document.

By way of background, SEC Rule 15c2-12 (the Rule) prohibits an underwriter from purchasing or selling municipal securities unless an issuer has committed to annually provide financial information and operating data specified in a written Continuing Disclosure Agreement (CDA). Additionally, the Rule requires underwriters to obtain and review a “final official statement” that discloses whenever the issuer has failed to file information required by the CDA during the previous five years. While the Rule only applies to underwriters and SEC is prohibited from directly regulating issuers under the 1975 Tower Amendment to the Securities Exchange Act of 1934 (Exchange Act), SEC has demonstrated through recent enforcement actions that making false statements in official statements about compliance with continuing disclosure obligations will be construed as securities law violations under Section 17(a) of the Securities Act of 1933 and/or Section 10(b) of the Exchange Act. Due to the typical five-year statute of limitations for securities law violations, the MCDC initiative covers bond transactions dating back to September 2009. However, since final official statements must disclose compliance failures for the five years prior, the scope of the initiative actually looks back to 2004.

In response to the MCDC Initiative the underwriter community is actively conducting internal compliance investigations by reviewing the official statements for all bonds underwritten over the last five years and associated continuing disclosure filing data, to confirm whether the official statements for this period accurately described the issuer’s prior compliance with continuing disclosure undertakings. The MCDC Initiative incentivizes underwriters to participate by placing a cap of $500,000 on all instances of material misstatements contained in an underwriters MCDC report. As a result many underwriters have indicated their intent to participate in the initiative, and are now compiling a list of bond issues that contain a misstatement regarding continuing disclosure compliance so that they can limit their financial and legal exposure to potential SEC enforcement actions. The lists being compiled by underwriters will identify issuers that the underwriters believe have not made all of their continuing disclosure filings required by the CDA, but indicated they have done so in official statements.

In most cases these lists will be compiled using continuing disclosure filings since 2009 made through the MSRB’s Electronic Municipal Market Access (EMMA) platform. However, some underwriters are attempting to verify filings prior to 2009 when the dysfunctional Nationally Recognized Municipal Securities Information Repository (NRMSIR) system was in use. This is likely to lead to many erroneous findings of failures to file because of the known deficiencies of the NRMSIR system and difficulties in locating filings. Although underwriters are being encouraged to contact issuers with the results of their review to discuss any potential misstatements, they are not required to do so and may not have time to contact all issuers because of the unreasonably short deadline for the MCDC Initiative (September 10, 2014). These factors could result in underwriters participating in the initiative and falsely reporting that statements made by issuers pertaining to their prior continuing disclosure compliance are material misstatements when in fact they are not. For these reasons issuers should consider contacting all underwriters who have been senior or co-managers on their bond deals.
over the past five years and asking these underwriters for at least a month of notice in advance of September 10 of any planned participation in the MCDC initiative related to these bonds.

Further, if issuer is unsure of prior compliance or has reason to believe that it has failed to file information required by its CDA and inaccurately described this failure in its official statement over the last five years, they should consult with their legal counsel to ensure prior compliance. Issuers can evaluate the MCDC Initiative in light of their own circumstances and review their compliance with the CDA by using the guidance outlined below.

**Guidance on Self-Examination in Response to MCDC Initiative:**

An issuer should disregard the MCDC Initiative entirely if:

- Has not issued bonds within the last five years.
- Has issued bonds in the last five years but has:
  - personal knowledge and supporting documentation that continuing disclosure filings required by the CDA have been made;
  - policies and procedures in place to ensure compliance; or
  - an outside vendor or counsel under contract engaged to assist with continuing disclosure filings that can confirm continuing disclosure compliance for the five-year period in question.

If an issuer has publicly offered bonds since September 10, 2009 and is unsure whether it has complied with continuing disclosure undertakings, it should:

- Review the description of past compliance in any official statements for bonds issued during the past five years. (The section is typically titled “Continuing Disclosure” in the official statement).
- If the description in the official statement says the issuer is in compliance with its continuing disclosure requirements, consider the best way to verify the statement including:
  - review of internal files that document continuing disclosure filings made on EMMA;
  - if internal files not maintained, review EMMA to verify continuing disclosure filings made;
  - contact the senior managing underwriter for the bond issue to determine if they have files documenting compliance with the CDA or are conducting a review of their prior bond deals to identify possible non-compliance; or
  - contact appropriate transaction participants that would be most knowledgeable about this matter, e.g., underwriters counsel, disclosure counsel, financial advisor or bond counsel.
- If the information in the official statement describes any instances of prior non-compliance (including instances that may be immaterial), the issuer can probably conclude that it has not misstated compliance and no further investigation is necessary.

If an issuer discovers through a self-examination or through a discussion with counsel or an underwriter that the final official statement potentially contains inaccurate statements relative to past compliance with continuing disclosure obligations, the issuer should:

- Contact the bond or disclosure counsel to assess the materiality of the misstatement and assess/discuss the advantages/disadvantages of self-reporting under the MCDC Initiative if the misstatement is determined to be material.
- Correct any prior non-compliance, if possible.
- Adopt or enhance policies and procedures to ensure compliance with continuing disclosure obligations going forward and add a process for the thorough review of all issuer statements in the final official statement regarding compliance with the CDA.
- Adopt policies and procedures that require all filings on EMMA to be documented and maintained.

**Take the MCDC Initiative Seriously but Exercise Caution**

The legal consequences of participating in the MCDC Initiative are significant and should be thoroughly evaluated with the assistance of counsel. Issuers should also consider the following information if contacted by an underwriter or asked to participate in the MCDC Initiative:

- Consult with legal counsel and exercise caution when determining if self-reporting under the MCDC Initiative is beneficial.
- Participating in the MCDC Initiative will need to be approved by the governing board of the issuer because of its legal significance.
- Self-reporting under the MCDC Initiative does not limit the personal liability of municipal officials and may expose an issuer or official to further SEC investigation and enforcement.
- Self-reporting under the MCDC Initiative requires an issuer to sign and submit a questionnaire. By signing the questionnaire, the issuer:
  - Agrees to cooperate with the SEC and testify in the event of an SEC investigation; and
  - Consents in advance to all settlement terms (which will likely require approval of the governing body of the issuer prior to submission).
- Financial penalties for underwriting firms participating in the MCDC are capped at $500,000. As a result, underwriters have an incentive to over-report transactions without regard to materiality of any misstatements.
- If contacted by an underwriter, request the underwriter’s list of findings so that the issuer can either verify that they are accurate or show that they are erroneous. Additionally, the facts can be evaluated to determine whether any inaccuracies are considered “material”.

GFOA Advocacy on the Initiative

In an effort to streamline the requirements of the MCDC Initiative, make any review of CDA compliance process more manageable, and avoid unnecessary costs to issuers and underwriters, GFOA and several other industry groups including the National Association of Bond Lawyers (NABL) and Securities Industry and Financial Markets Association (SIFMA) met with the SEC Enforcement Division staff on June 18, 2014 and requested, among other things, the following:

- An extension of the deadline for participation in the MCDC Initiative to ensure that issuers and underwriters have sufficient time to work together to self-report true instances of non compliance and allow time for issuers to meaningfully evaluate the merits of participating in the MCDC Initiative.
- A narrowing of the scope of the review to only consider annual filings made to the MSRB's EMMA platform after July 1, 2009.
- A clarification from SEC as to what will not be considered material under the initiative.

The initial feedback from the SEC indicated an unwillingness to streamline the MCDC Initiative to improve the efficiency and effectiveness and reduce the uncertainties and burdens being imposed on issuers. GFOA will continue to press for common-sense changes to modify the MCDC Initiative and focus on constructive ways to improve continuing disclosure compliance.

Other Resources

- SEC MCDC Initiative
- GFOA Best Practice: Understanding Your Continuing Disclosure Responsibilities (2010)

APPENDIX A

Standardized Settlement Terms and Individual Liability

SEC's Enforcement Division has established standardized settlement terms for participating issuers and underwriters under MCDC, which are covered on pages 4-5 of the MCDC summary released by SEC on March 10, 2014, and are reiterated below.

For Issuers

- establish appropriate policies and procedures and training regarding continuing disclosure obligations within 180 days of the institution of the proceedings;
- comply with existing continuing disclosure undertakings, including updating past delinquent filings within 180 days of the institution of the proceedings;
- cooperate with any subsequent investigation by the Division regarding the false statement(s), including the roles of individuals and/or other parties involved;
- disclose in a clear and conspicuous fashion the settlement terms in any final official statement for an offering by the issuer within five years of the date of institution of the proceedings; and
- provide the Commission staff with a compliance certification regarding the applicable undertakings by the issuer on the one year anniversary of the date of institution of the proceedings.

For eligible issuers, the Division will recommend that the Commission accept a settlement in which there is no payment of any civil penalty by the issuer.

For Underwriters

- retain an independent consultant, not unacceptable to the Commission staff, to conduct a compliance review and, within 180 days of the institution of proceedings, provide recommendations to the underwriter regarding the underwriter's municipal underwriting due diligence process and procedures;
- within 90 days of the independent consultant's recommendations, take reasonable steps to enact such recommendations; provided that the underwriter make seek approval from the Commission staff to not adopt recommendations that the underwriter can demonstrate to be unduly burdensome;
- cooperate with any subsequent investigation by the Division regarding the false statement(s), including the roles of individuals and/or other parties involved; and
- provide the Commission staff with a compliance certifications regarding the applicable undertakings by the underwriter on the one year anniversary of the date of institution of the proceedings.

For eligible underwriters, the Division will recommend that the Commission accept a settlement in which the underwriter consents to an order requiring payment of a civil penalty as described below:

- For offerings of $30 million or less, the underwriter will be required to pay a civil penalty of $20,000 per offering containing a materially false statement;
- For offerings of more than $30 million, the underwriter will be required to pay a civil penalty of $60,000 per offering containing a materially false statement;
However, no underwriter will be required to pay more than $500,000 total in civil penalties under the MCDC Initiative.

Individual Liability

As mentioned earlier in this document, though the terms of the initiative preclude SEC from imposing monetary fines on participating issuers, the SEC reserves the right to pursue separate enforcements against individuals within an issuing entity who it deems to be culpable of material misstatements reported under MCDC.
GFOA Alert: The SEC MCDC Initiative and Issuer Settlements

Wednesday, February 10, 2016

Following three rounds of settlements with underwriters and broker dealers under the Securities and Exchange Commission’s (SEC) 2014 *Municipalities Continuing Disclosure Cooperation (MCDC) Initiative*, the SEC’s Enforcement Division has begun reaching out to government debt issuers who participated in the program. As issuers receive calls and settlement proposals from the SEC in the coming weeks, the GFOA wants to alert members who participated in the initiative that they may have very little time to agree to settlement terms once those terms are offered by the SEC’s Enforcement Division.

In the three rounds of SEC settlements with underwriters that were announced in 2015 and 2016, *underwriters were given as little as one week to agree to the settlement findings*. The SEC’s Office of Municipal Securities has assured GFOA that issuers will be given greater flexibility in approving proposed settlements and that additional time will be provided, if requested. However, the GFOA is urging members who participated in the initiative, as well as members who many not have participated but were reported by their underwriter, to:

- Be prepared for tight settlement turnaround times. Issuers who need more time to review the proposed settlement should request additional time from the SEC Enforcement Division staff who is managing the settlement process.
- Consult with your legal counsel and have them review the proposed settlement and settlement findings and provide advice on how best to respond to the SEC’s Enforcement Division. Obtain advice regarding appropriate disclosures regarding the disposition of the settlement.
- Initiate conversations with elected officials and any other governing board members to brief them on the situation and be aware of timeframes for internal approval processes to prepare decision-makers for the settlement process.

**Background on the MCDC Initiative**

In 2014 the SEC’s Enforcement Division announced the MCDC initiative to provide issuers and underwriters the opportunity to self-report instances of material misstatements in bond offering documents regarding the issuer’s prior compliance with its continuing disclosure obligations. As issuers interested in participating prepared to file by the December 1, 2014 deadline, the GFOA urged members to exercise caution and familiarize themselves with the details of the initiative before consenting to engage in this program.

For example, though the terms of the initiative preclude SEC from imposing monetary fines on participating issuers, the SEC reserves the right to pursue separate enforcements against individuals within a government who it deems to be culpable of the misstatements. Additional terms agreed to by issuers participating in the initiative include the commitment to:

- Establish appropriate policies and procedures and training regarding continuing disclosure obligations within 180 days of the institution of the proceedings;
- Comply with existing continuing disclosure undertakings, including updating past delinquent filings within 180 days of the institution of the proceedings;
- Disclose in a clear and conspicuous fashion the settlement terms in any final official statement for an offering by the issuer within five years of the date of institution of the proceedings; and
- Provide the Commission staff with a compliance certification regarding the applicable undertakings by the issuer on the one year anniversary of the date of institution of the proceedings.

In the three rounds of settlements with underwriters and broker dealers 72 firms paid just over $18 million for failing to identify misstatements and omissions before offering and selling bonds as required by SEC Rule 15c2-12. Violations identified in the settlements included failure to file material event notices and late filings (some as little as 14 days). The SEC Enforcement Division has not offered information on how many issuer settlements it is pursuing, how many rounds of issuer settlements will occur, the terms of any proposed settlements, and over what period of time these settlements will be announced.

Resources

- GFOA MCDC Alert

http://gfoa.org/gfoa-alert-sec-mCDC-initiative-and-issuer-settlements
Debt 101 (Volume 1) - Issuing a Bond

Introduction: Getting Ready to Issue a Bond

Governmental entities have been using debt (most often in the form of “municipal bonds”) for over 200 years to fund public infrastructure such as government buildings, water distribution systems, schools, police stations and many other projects that require significant capital investment. When a government issues debt, it receives an infusion of cash to build a project; in return the government repays the bond purchasers over time, plus interest. By using debt, the government can complete a capital project with a repayment schedule that spreads the cost of that project over its useful life, and the bond purchaser receives a reasonably reliable source of investment income.

Before issuing debt, there are many factors that a government official should consider. Appropriate planning and understanding helps to provide the most favorable results to the issuer and also helps avoid unnecessary risks and negative consequences. Debt issuance requires working with a number of partners, each of whom has a specific role. The debt issuance will result in a financing agreement that is legally binding, and it is critically important that government officials understand the basic terms of the agreement and what the agreement commits them to do.

This document provides a high-level outline of the debt issuing process and important considerations, and is intended to be a resource for the first-time or infrequent bond issuer. A companion document entitled Debt 101, Volume II discusses issuer expectations after bond issuance is completed. Both documents refer to more detailed Best Practices, Advisories and other resources. The GFOA strongly advises that Issuers wishing to proceed with a debt financing review these resources as well.

The Financing Team

A successful financing requires assembling a team of capable professionals to assist the issuer, each with a different specialization and focus on the financing. It is important to understand the different roles of the participants involved.

- **Bond Counsel**

  Bond Counsel works directly for the Issuer. Bond Counsel is an attorney (or team of attorneys), typically with specialized experience in municipal financings, that generally issues two legal opinions in the offering:

  1. An opinion as to whether the financing is a valid legal, binding obligation of the Issuer, and,
  2. An opinion of the nature of the taxability of the interest the investor earns on the financing.

  These two opinions are relied upon by investors when considering whether they will purchase the bonds. In order to make these opinions, Bond Counsel must work closely with the Issuer to understand the nature and structure of the issue.

  Bond Counsel should also be knowledgeable in local, State and federal laws and regulations related to municipal financings and any special requirements for public agencies.

  The Bond Counsel will often also serve as a disclosure counselor for the issue. This attorney assists with the preparation of the official statement and the continuing disclosure agreement, and will help facilitate preparation of the final (closing) documentation.

- **Municipal Advisor/Financial Advisor**

  A financial advisor (or “Municipal Advisor” or “MA”) is a professional consultant that works directly for the Issuer. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, a Municipal Advisor working for a municipality must be registered with the Securities and Exchange Commission (SEC) and must give fiduciary care in advising the Issuer by putting the Issuer's interests above their own financial interests in a transaction.

  The role of the MA varies upon the level of sophistication of the Issuer, but often the MA works as an extension of the Issuer's staff with a specialty focus on the proposed financing. The MA has an independent view of the financing market, and works closely with Bond Counsel and the Issuer to assist in structuring and marketing the financing in the most economical way. The MA will also assist in determining if the method of sale should be through a competitive or negotiated sale. They will further assist by managing the sale and assisting the Issuer through the closing process.

- **Underwriter/Investment Banker**

  An Underwriter or Investment Banker is the key conduit between the Issuer and ultimate investor. In a financing, they are ultimately working for the investors. The Underwriter, via the bond sale, agrees to buy the bonds and resell them to investors. Their role varies by the type of sale the Issuer chooses (“competitive” versus “negotiated”) as described under “Issuance Process” below.

- **Other Participants**
Paying Agent/Trustee. A paying agent or trustee may be used to take debt service payments from the Issuer and distribute to the investors that actually own the bonds. A paying agent may also be used to hold a reserve or other funds as determined in the issuing documents.

Rating Agency. A rating agency can be obtained in order to help the investor determine the level of repayment risk before purchasing a bond. The higher the rating, in the opinion of the rating agency, the less risk of default; and, ultimately the lower the interest rate.

Bond Insurance Provider or Other Credit Enhancer. The financing may also include a credit enhancer to entice the investor to offer a lower rate. The enhancer can be an insurance company, bank or other government authority.

Legal Considerations

In order to issue debt, Issuers must comply with local, State and federal laws, and enter into a number of legal agreements with various parties. Local and State laws will vary, and it is critical that Issuers consult with specialized legal counsel (Bond Counsel) to determine if they are authorized to issue debt, what actions are required to authorize issuance, and any constraints placed on debt issuance. For example, State law may place legal limits on the amount of debt to be secured by a government’s general revenues.

The use of the financed facility will impact the project’s eligibility for federal tax exemption, and the associated reduced borrowing cost to the Issuer. Legal counsel should advise the Issuer on tax implications related to private use and tax exempt status affecting the debt obligation. These requirements could have significant impact on interest rates, repayment and continuing disclosure for the debt instrument selected.

Additionally, an Issuer’s legal counsel (and/or Municipal Advisor) should consider outstanding debt agreements or other legal agreements that may include financial covenants or restrictions. An Issuer’s debt policy may also provide guidance or limits related to legal considerations.

Structuring Considerations

Users looking to utilize debt financing should review and update annual capital improvement plans to identify projects that can be funded with annual operating funds, in addition to those that might be candidates for debt financing. Projects should be thoroughly reviewed as to scope, feasibility, cost, useful life of the financed asset, and capacity to repay debt. All of these factors will help determine whether long-term financing is an appropriate tool – and if so, what revenues are appropriate to pledge for repayment and what the term of repayment should be.

Sufficient revenues should be available to meet ongoing debt payments and jurisdiction needs to understand what type of revenues are pledged to support (or "secure") the debt. Potential revenues may include a full or limited taxing power of the jurisdiction, utility revenues, other specific revenue streams, or collateral such as an asset that is being acquired with the debt proceeds.

Various types of debt are typically available to Issuers. Financing tools may include municipal bonds (both taxable and tax-exempt), direct loans from financial institutions, and other less common alternatives. Each option has its own benefits and risks, and the Issuer should utilize a Municipal Advisor to assist with determining which selection best suits a specific circumstance.

Further information on legal considerations and use of Bond Counsel are available in the following resources:

- GFOA Best Practice: Selecting Bond Counsel
- Debt Issuance Checklist: Considerations When Issuing Bonds

Issuance Process: How do Bonds Get Sold?

Most local governments do not have the in-house expertise or resources to find investors for their proposed bond offerings, and will require the services of a specialized municipal securities dealer, underwriter or a syndicate of underwriters to sell the bonds for them.

The decision of how to market municipal bonds should be based on the characteristics of the Issuer, the bond issue, and the financial market. Governmental entities usually issue bonds through competitive bid or a negotiated sale. The primary goal of an Issuer undertaking a bond issue should be the proper administration of the bond issue at the least possible issuance cost and interest rate. Both methods are used frequently in bringing municipal bonds to market.

The overriding concern of many Issuers is the minimization of interest rates and issuance costs; however, there currently are varying opinions regarding which type of sale results in the best outcome. Competitive bidding is most appropriate when the Issuer is well known, high demand for the bonds is predicted, and the market is stable. A negotiated sale can more appropriate when the Issuer is less known, the market instrument is complex and less well understood by investors, and/or the market is less stable.

Competitive Bid Process
In a competitive bid sale, the Issuer conducts all of the tasks necessary to offer bonds for sale including structuring the maturity schedule, preparing the official statement, verifying legal documents, obtaining a bond rating, securing credit enhancement, if advantageous, and timing the sale. These tasks are normally done with the assistance of outside consultants, including a financial advisor and bond counsel. Once the issue is structured, the public sale begins with the publication of an official notice of sale that describes the size, maturities, purpose, and structure of the proposed issue, along with instructions for submitting bids. Underwriters submit sealed bids to the Issuer on the day and time designated in the official notice of sale. The bonds are awarded to the underwriter that has submitted the best price (the lowest true interest cost bid). Once the bid is awarded, pricing and major structural aspects of the bonds are locked in regardless of the success or failure of the underwriter to sell the bonds to investors.

Negotiated Sale Process

In a negotiated sale, the bond issue is not structured before an underwriter is chosen. If the Issuer has not retained a Municipal Advisor, the underwriter may assist the Issuer in determining what is to be financed, the method of financing and the financing structure. The underwriter is chosen based on expertise, financial resources, compatibility, and experience. After the underwriter is selected, the Issuer and the underwriter will begin the process of structuring the bond issue and completing the other origination tasks. The underwriter starts the marketing process and develops an interest rate to be negotiated with the Issuer. It is highly recommended that Issuers using a negotiated sale employ a Municipal Advisor not associated with the underwriting firm to represent the Issuer's interests in the process.

Bond Rating

Municipal bond credit ratings measure the Issuer's risk of paying all interest and principal back to investors. A bond rating system helps investors distinguish a company's credit risk. Municipal Issuers rely on specialized rating agencies to determine the overall risk of the issue and assign a "grade" to the bond. The three major rating agencies are Moody's Investor Services, Standard and Poor's, and Fitch Ratings. Ratings have a significant effect on both the ability of the Issuer to raise funds and the price the Issuer will be required to pay.

Credit Rating Agencies

Debt issued by governmental entities is rated to reflect the degree of risk and probability of repayment of all interest and principal to the investor. Investors use the bond ratings to determine the level of repayment risk associated with the specific issue and determine a minimum rate of return for the risk involved. If the bonds have high ratings, they are assumed to have low risk and the investor will therefore require a lower yield. Just the opposite will occur for a lower rated (riskier) bond. There are four major investment grade ratings assigned to bonds by the rating agencies - Highest (AAA/Asa), High (AA/Aa), Above Average (A), and Medium (BBB/ Ba). All long-term bonds rated below the fourth category are judged to be below investment grade (speculative grade) and are often referred to as "junk" bonds.

Below are five Best Practices related to the sale of bonds. These resources should be read and considered in conjunction with each other because of the interaction of the processes to which they apply.

Best Practice: Selecting and Managing the Method of Sale of Bonds

1. Selecting and Managing the Municipal Advisors
2. GFOA Best Practice: Selecting Bond Counsel
3. Selecting Underwriters for Negotiated Bond Sales
4. Pricing Bonds in a Negotiated Sale

Issuer Responsibilities During and Following the Bond Sale

The Issuer is more than just a participant in the sale of the bonds. The agency is the owner of the transaction and the obligor of the debt until "maturity" when the debt is fully repaid - perhaps a period of 20 to 30 years. This means staff must take more than a casual interest in the transaction. While the Issuer will hire various finance professionals to assist in the structuring of the transaction and the preparation of various legal documents and financial analysis, staff must also have a firm understanding of the commitments made on behalf of their organization. When the transaction closes, the financing team will move on and the public agency will be left with a number of ongoing commitments. If staff cannot explain the structure and obligations of the transaction to their governing board, the deal most likely should not be done.

The Issuer's typical duties at and after the time of sale include the approval of a pricing scale (if the bonds are to be sold on a negotiated basis). While it may only be a few basis points, the decision to accept or reject a proposed pricing scale could mean the difference of hundreds of thousands of dollars in interest expense over the life of the bonds. Once the sale is completed and bids accepted, the designated staff will sign a bond purchase agreement. Following this, the lawyers will finalize the remaining legal documents which will be signed a day or two before the actual closing of the transaction.

Once the deal closes, staff will need to book the transaction in the general ledger/balance sheet. Depending upon the structure, consulting with external auditors may be advised. In addition, setting up a tickler file with key dates of when bond payments are due and when continuing disclosure information needs to be filed is extremely useful. During the period when there are unspent bond proceeds or reserve funds, staff will want to determine how these funds should be invested. This may be with the help of a third party, the purchase of a guaranteed investment contract, providing specific investment instructions to the Trustee, or in some instances, managing the funds directly in-house. Federal tax laws, in most instances, will require Issuers to rebate any net positive arbitrage earned on the investments of the bond proceeds. As such, staff will need to track interest earnings, offset by the true interest costs, in order do the calculations. Finally, the organization needs to keep detailed records as to how the bond proceeds were spent. First of all, when the original bond documents were signed, staff acknowledged that there was a reasonable expectation that the bond proceeds will be spent within a three year period. If this does not happen, the issuing agency will be required to yield the investments of any remaining unspent bond proceeds. In addition, it is important to be able to report the use of bond proceeds to the governing board of the general public, should the transaction ever be audited by the IRS.

Alternative Financing Products

In addition to traditional municipal bonds, a number of alternatives are available to Issuers. These financing tools carry special considerations, as described briefly below. These financing tools may be more or less appropriate for less frequent Issuers and - as with municipal bonds - a Municipal Advisor and Bond Counsel should be consulted before proceeding.
Commercial Paper is a fixed-income instrument that matures in 270 days or less. This short-term instrument can be a viable alternative for to the more traditional long term debt and may be an appropriate source of funding for the design and construction phase of a project or projects with the long term debt being issued once there is more certainty as to the completion of the project. While perhaps supported by one or more dedicated revenue streams, commercial paper is an unsecured form of a promissory note that pays a fixed rate of interest. The commercial paper may be rolled into a new commercial paper at maturity and is typically backed by a letter of latter issued by a bank. As with any other type of bond or debt instrument, the issuing entity offers the paper assuming that it will be in a position to pay both interest and principal by maturity. One significant aspect of commercial paper is that it is negotiable, which means that it can be freely transferred (traded) from one party to another.

Bank Loans can take on many forms and can typically be structured to provide the issuer with flexibility regarding duration and repayment. A bank loan may carry a fixed or variable interest rate, in which interest may be paid in equal payments over a fixed period of time, or may be interest only with a balloon payment at maturity. In addition, bank loans can be structured as a revolving line of credit. This means the borrower can draw on the funds up to the loan amount, pay some or all of the loan back, and then redraw funds all during the term of the loan. Typically bank loans are for a shorter duration than traditional bond sales and are usually in the five to ten year duration, though some banks may be willing to go as long as 20 years. The legal work involved in preparing loan documents is more straightforward and thus less expensive than a traditional bond deal. While bank loans should be disclosed as part of a debt portfolio, they have no disclosure or continuing disclosure requirements.

Inter-fund Borrowing can be complex, and the ability to do so may be restricted by an Issuer's local Charter, governing board policies, and State laws. The duration of inter-fund borrowing may also be limited in duration. If permitted, this may be a quick, flexible and inexpensive way to do some short-term borrowing for necessary projects or equipment. Typically, the internal borrowing rate would be tied to the investment rate of return pooled portfolio in order to ensure that one fund is not subsidizing another fund.

Ongoing Requirements after the Bond Sale

Continuing Disclosure

Governmental entities issuing bonds generally have an obligation to meet specific continuing disclosure standards set forth in continuing disclosure agreements (CDAs, also called continuing disclosure certificates or undertakings). Issuers enter into CDAs at the time of bond issuance to enable their underwriters to comply with Securities and Exchange Commission (SEC) Rule 15c2-12. This rule, which is under the Securities Exchange Act of 1934, sets forth certain obligations of (i) underwriters to receive, review and disseminate official statements prepared by Issuers of most primary offerings of municipal securities, (ii) underwriters to obtain CDAs from Issuers and other obligated persons to provide material event disclosures and annual financial information on a continuing basis, and (iii) broker-dealers to have access to such continuing disclosure in order to make recommendations of municipal securities in the secondary market.

Once bonds have been issued, the Issuer commits (via the CDA) to provide certain annual financial information and material event notices to the public. In accordance with SEC Rule 15c2-12, those filings must be made electronically at the Electronic Municipal Market Access (EMMA) portal (www.emma.msrb.org). It is also important to provide this information to Bond Counsel and financial advisor which insure the annual CDA requirements set forth with in your CDA are being met.

Bonds and the SEC's Municipalities Continuing Disclosure Cooperation (MCDC) initiatives in 2014, along with other recent regulatory actions, have highlighted the importance of maintaining a reliable system to adequately manage continuing disclosure.

Issuers may choose to provide periodic voluntary financial information to investors in addition to fulfilling the specific SEC Rule 15c2-12 responsibilities undertaken in their CDA. It is important to note that issuers should disseminate any financial information to the market as a whole and not give any one investor certain information that is not readily available to all investors. Issuers should also be aware that any information determined to be "communicating to the market" can be subject to regulatory scrutiny.

In addition to filing information via EMMA, a government may choose to post its annual financial information and other financial reports and information on the investor section of its web site.

Tax Compliance

To assist the issuer with Tax Compliance, the National Association of Bond Lawyers (NABL) and the Government Finance Officers Association (GFOA) have jointly developed a checklist to assist Bond Counsel in discussing with Issuers and conduit borrowers. As applicable, post issuance compliance matters.

The checklist is divided into three parts: tax, securities and State law matters. The checklist can serve as a framework for discussion at an appropriate time during the transaction or as a written document prepared by Bond Counsel and furnished to the Issuer or conduit borrower after completion of the financing.

Bond Counsel may need to explain various items on the checklist to provide the Issuer with a more complete understanding of the noted concept. The checklist can be amended or supplemented as needed to address the particular financing issue. Issuers and conduit borrowers are encouraged to contact Bond Counsel at any time they may have questions or concerns pertaining to tax, securities or State law issues.

It is important to remember the goal of establishing and following written procedures is to identify and resolve noncompliance, on a timely basis, to preserve the preferential status of tax-advantaged bonds.

For additional information on post-issuance compliance you can refer to the following references:

- GFOA Best Practice: Debt Management Policy
- Post Issuance Compliance Checklist
- Debt Issuance Checklist: Considerations When Issuing Bonds
- Debt 101, Volume II

Glossary / Other References

Debt 101 (Volume 2) - Responsibilities After Bond Issuance

Introduction: What to Do After a Bond Has Been Issued

Bonds issued by State and local governments are generally subject to ongoing monitoring and reporting with respect to federal disclosure requirements, as well as compliance with federal tax requirements.

Issuers of municipal bonds need to comply with the requirements of Securities and Exchange Commission (SEC) Rule 15c2-12 with respect to continuing disclosure. Such activities include annual reporting as described in the continuing disclosure undertaking prepared at the time of issue, as well as disclosure of certain material events as outlined in the rule.

Tax-advantaged bonds (tax-exempt, tax credit and direct pay) are bonds that receive preferential tax treatment. These bonds are subject to applicable federal tax requirements both at the time of issuance and for as long as the bonds remain outstanding. Failure to comply with these requirements can jeopardize the preferential tax status of those bonds.

Ensuring that these federal tax requirements are met normally will occur at the time of closing on the bonds. There are other requirements, however, that require ongoing monitoring after the bonds are issued. Such post issuance activities will generally fall into two categories: (1) qualified use of bond proceeds and bond-financed property; and (2) arbitrage yield restriction and rebate.

This document will highlight key topic areas that Issuers need to be familiar with. A companion document entitled Debt 101, Volume I discusses steps prior to bond issuance and the bond issuance process itself.

Continuing Disclosure

Governments that issue bonds generally have an obligation to meet specific continuing disclosure requirements that are identified specifically in a continuing disclosure agreement (CDAs, also called continuing disclosure certificates or undertakings). These are entered into at the time of bond issuance pursuant to SEC Rule 15c2-12 (Rule). Obligations that have a maturity of 270 days or less are exempt from these requirements, while other short-term issues with a maturity of 18 months or less are subject to lesser requirements.

When bonds are issued, the Issuer covenants via the CDA to provide certain annual financial information as identified in the CDA, and to notify the public of certain material events as described in the Rule. Such information is required to be submitted electronically either by the Issuer or by their agent via the Municipal Securities Rulemaking Board’s (MSRB) Electronic Municipal Market Access (EMMA) portal. In addition to filing through EMMA, an Issuer may also choose to post its annual financial information or other reports on its web site.

Typically, a series of bonds will require its own CDA. While a separate CDA will generally be required with the issuance of each series of bonds, the information that is required to be disclosed is generally quite similar for each issue. In the offering document for those bonds, Issuers will be required to state whether or not they are in compliance with all previous continuing disclosure obligations.

Issuers may choose to provide information beyond that required by the Rule and identified in its CDA on a voluntary basis. Such information may also be posted on EMMA. Issuers should be aware that they should disseminate such information to the market as a whole and not provide any one individual or group with any information that is not readily available to the public as a whole. Issuers should also develop a continuing disclosure policy or procedure as further described below.

Issuers should review the following GFOA best practices for further information on meeting their continuing disclosure responsibilities:

- GFOA Best Practice: Understanding Your Continuing Disclosure Responsibilities
- GFOA Best Practice: Using Technology for Disclosure

Tax Compliance

When tax-advantaged bonds are issued, an Issuer needs to ensure they have the appropriate procedures in place to comply with all the federal tax rules applicable to those bonds from the date of issuance through their final maturity.

Federal tax rules applicable to tax-advantaged bonds generally include the following major areas:

Expenditure of Proceeds: At the time of sale, the Issuer must expect to expend bond proceeds promptly, and, in some cases, by time-specific deadlines set forth in the Internal Revenue Code and Treasury Regulations. Furthermore, bond proceeds may only be spent for purposes permitted based upon the type of bonds issued.

Use of Financed Assets: Internal Revenue Code and Treasury Regulations limit how an Issuer may use assets financed with the proceeds of tax-advantaged bonds. For example, for governmental purpose bonds, there are detailed rules that limit both direct and indirect use of bond-financed assets by private entities.
Investment of Proceeds: Tax rules generally require that, except during certain temporary periods, the proceeds of tax-advantaged bonds may not be invested at a yield materially higher than the yield on the bonds. Any permitted investment income above the yield on the bonds is rebated to the federal government.

Recordkeeping: The issuer needs to retain sufficient records to support the continuing tax-advantaged status of its bonds, and to prove compliance with the rules for expenditure of proceeds, use of the financed assets, and investment of proceeds.

The GFOA has issued an Alert on the MA Rule and Issuers, and this Alert details the multiple exemptions permitted. It is recommended that issuers become familiar with the MA Rule and its definitions, requirements and exemptions. A link to the Alert is provided below.

As with the investment of other governmental funds, there are risks inherent in investing bond proceeds. These include credit risk (safety), the risk of investing in instruments that may degrade in credit quality or default; market risk (liquidity), the risk of selling an investment prior to maturity at less than book value; and opportunity risk (yield/return), the risk of investing long term and having interest rates rise, or investing short term and having interest rates fall while needing to reinvest the bond proceeds.

Issuers should be acquainted with federal tax law as it applies to arbitrage restrictions, and maintain adequate records to comply with arbitrage reporting and rebate requirements. Arbitrage is the ability to obtain tax-exempt bond proceeds and invest the funds in higher yielding taxable securities, resulting in a profit. In short, arbitrage occurs when interest earned on invested proceeds exceeds the interest rate of the interest repayment, or debt service, of the proceeds. Investments should be considered in light of the yields permitted to comply with federal arbitrage requirements. Procedures should be established to monitor any arbitrage rebate liabilities and reserve liabilities for future remittance to the IRS.
Alert on the MA Rule and Issuers
GFOA Best Practice: Creating an Investment Policy
GFOA Best Practice: Investment of Bond Proceeds

Payment of Debt Service

Issuers of government debt have a fiduciary responsibility to manage their funds in a manner that assures timely and accurate payment of debt service principal and interest. Failure to make a debt service payment generally results in a default, a requirement to post a Material Events Notice on the MSRB EMMA system, and can have major negative consequences. If a debt service payment is missed, Issuers should take immediate action to remedy the situation.

It is recommended that Issuers review GFOA's Best Practice Settlement Procedures for Debt Service Payments. Major recommendations of this Best Practice include:

- Establishing procedures and appropriate contractual terms for making debt service payments
- Use of electronic funds transfers to ensure timely payments and to ensure full utilization of funds until the due date.

In addition to the recommendations from the Best Practice, Issuers should consider the following items when designing procedures and policies for making debt service payments:

- Issuers should have a debt service schedule for each bond issue containing all principal and interest payment dates and amounts
- Issuers should be aware of any "flow of funds" requirements contained in a bond indenture. Some bond issues may require monthly or other periodic transfers of funds before actual payment dates (i.e. 1/12 of principal payment each month)
- Issuers with variable rate debt should understand and monitor changing debt service requirements

Refunding Analysis

It is common that – prior to maturity of the debt – an Issuer will have the opportunity to refinance the remaining debt at lower interest rates (called a "refunding"). Municipal debt is typically issued with a call or redemption feature. The call feature must be specific and include what bonds can be called, at what time, and for what price, giving flexibility to the Issuer. The date is usually approximately 10 years after the original issue date, but can vary based upon the specific terms agreed to at the original point of debt issuance and the length of the bonds. Refunding debt at or after the call date is called a "current refunding." Debt can also be refunded prior to the call date via an "advance refunding", though there are typically additional cost requirements and tax compliance issues associated with an advance refunding prior to the call date.

Refunding of debt requires essentially the same process and effort as a "new money" issue, and often there is only one opportunity to refund debt for significant interest savings. Therefore, an Issuer should have a policy or guidelines that set a minimum savings baseline under which a refunding would be pursued. For example, many Issuers require a minimum of 3% or 5% savings (and/or a minimum dollar amount of savings) in order for a refunding to proceed. Setting an appropriate savings minimum avoids inefficient use of time exploring inefficient refundings, and can prevent refunding too early and missing greater savings by waiting until a later date.

Typically, the final maturity in a refunding remains unchanged, and the other terms of the refunding often closely match the original debt issue. The proceeds of the refunding are generally placed into an escrow until the call date (or next payment date) occurs, at which point the original bonds are paid off from money in the escrow. It is important that an Issuer work with service providers to create an escrow that earns as much as possible (i.e. an efficient escrow) without exceeding maximums allowed under federal regulations.

GFOA Best Practice: Analyzing and Issuing Refunding Bonds

Other Requirements

Issuers should be aware that in addition to continuing disclosure and tax compliance requirements, there are often other legal documents, laws and regulations, policies, contractual requirements, and/or relationships that must be monitored. Some of the most common of these are included in this section.

Bond Indentures/Bond Ordinance/Bond Resolution. Many bond issues have an ordinance and/or resolution that authorize and set many of the terms of the bond issue. Also, some bonds may have a bond indenture, which is a legal contract between the Issuer and bondholders. These documents can contain a variety of requirements that may include:

1. Notice requirements
2. Reporting requirements
3. Coverage ratios or revenue covenants
4. Additional bonds tests
5. Permitted investments
6. Debt service payment requirements
7. Debt service reserve fund requirements
8. Bond insurance or surety bond requirements
9. Required accounts/segregation of funds
10. Requirements related to a trustee or paying agent
11. Restrictions on the use of bond proceeds
12. Redemption provisions

State/Local Law Requirements: Issuers should work with Bond Counsel and/or legal counsel to determine if there are any ongoing requirements related to State or local law that must be monitored. These may include items such as notice requirements, public protest procedures, legal debt limits, or limitations on revenue used to pay debt service.

Policy Requirements: Issuers may have debt or other financial policies that must be monitored to ensure compliance. Common policy items that relate to debt issuance are debt limits, use of debt, debt ratios, and investment policies.
Rating Agencies. Issuers should be familiar with the GFOA best practice Using Credit Rating Agencies. Issuers (often with assistance from their Municipal Advisor) are responsible for managing the relationship with rating agencies after issuance. This can involve keeping the rating agencies informed of material events and responding to ongoing requests for information.

Investor Relations. Issuers should be familiar with the GFOA best practice Maintaining an Investor Relations Program. An effective investor relations program that responds to the informational needs of investors may lead to lower future borrowing costs for Issuers.

Financing Team Relationships. Issuers should manage the ongoing relationships with the various members of the financing team, which may include a Municipal Advisor, Bond Counsel, disclosure counsel, trustee banks, and/or paying agents. Issuers should continuously evaluate services provided, ensure compliance with contracts, and periodically conduct selection processes as needed.

GFOA Best Practice: Analyzing and Issuing Refunding Bonds
GFOA Best Practice: Using Credit Rating Agencies
GFOA Best Practice: Maintaining an Investor Relations Program

Download PDF
The Implications of the SEC Rule and MSRB Rule G-42 on Hiring and Using Municipal Advisors and Underwriters

The information contained in this document was developed to educate members about the SEC MCDC Initiative and should not be construed as legal advice.

The Securities and Exchange Commission's municipal advisor rule took effect on July 1, 2014. The Rule defines the term "municipal advisor" (MA), and creates the broad framework for the regulations that the MSRB is charged with developing regarding the duties and responsibilities of MAs. The MA Rule itself stems from the new regulatory framework over municipal advisors created by the Dodd-Frank Act to protect issuers from unfair and deceptive practices by outside professionals and clearly states that municipal advisors have a federal fiduciary duty to their issuer clients, must meet professional qualification standards and may serve no other role than to advise their clients in a transaction.

While the MA Rule and subsequent MSRB rulemaking do not regulate issuers directly, there are numerous indirect implications, especially related to MSRB Rule G-42, Duties of municipal advisors, that goes into effect June 23, 2016. These include: formal standards that must be met by the MA, and between MAs and their clients, including written documentation of municipal advisory engagements; disclosures to client of MA conflicts of interest; and the recommendations that MAs provide issuers must meet a suitability standard, which may in turn result in additional discussions between MAs and their clients.

If an issuer is engaged with a MA on June 23, 2016 (and thereafter), regardless of the timing of the project, the MA must adhere to new rulemaking. The MA will send issuers disclosure of conflicts of interest, at the very least.

MAs' Fiduciary Duty to Issuers

The Dodd-Frank Act imposes a fiduciary duty on those professionals that advise governments when they sell bonds or other forms of municipal securities.
enter into a financial product. MSRB Rule G-42 further details the meaning of fiduciary duty and places a standard of both duty of care and duty of loyalty on MAs to their municipal entity clients (MAs advising obligated persons only have a duty of care standard). The duty of care includes the MA having the knowledge and expertise needed to provide particular advice to a client; inquiring with the client about information that is relevant to making a recommendation of a financing or any advice for a certain course of action; and having a basis for which to provide the advice to the client. The duty of loyalty, applicable to municipal entities, requires that the MA deal honestly and with the utmost good faith to the entity; puts the client's interests ahead of all other interests, including the MA's own; and not engage with a client if the MA cannot manage or mitigate their conflicts of interest in a manner that allows them to work in the best interests of the client.

Only the municipal advisor has these fiduciary duties to their clients. While MAs and other parties have acted in the spirit of many of these concepts over the years, SEC and MSRB rulemaking makes clear the responsibilities MAs have to their clients, which are non-negotiable.

**MA Contract with Issuer Client**

Issuers will be seeing more formal contracts from municipal advisors, as MSRB Rule G-42 requires documentation of the municipal advisor relationship with issuers. This must be done in writing, dated and delivered to the client upon or promptly after the relationship is established. Information in the documentation includes - scope of services to be performed; disclosures of conflicts of interest and any detailed legal disciplinary event; limitations to the scope of engagement; and events that would trigger the termination of the relationship.

Rule G-42 does not technically require that the issuer sign or acknowledge this written documentation; however, issuers should expect that they may be asked to sign a contract with their MAs.

**MA Disclosures to Issuers**

The MA is required to disclose, in writing, all material conflicts of interest and the manner in which the MA plans to manage or mitigate these conflicts. This includes, fee-splitting arrangements and payments to third parties; and any conflict that would impair the MA's ability to provide advice under the Rule's standard of conduct. If an MA has no conflicts of interest, it must state that in writing to the client.

The MA must also provide information on any legal and disciplinary events that are material to the client's review of the municipal advisor. The MA must give the client the information or link to the information in the SEC's EDGAR system related to these events. The issuer does not have to acknowledge receipt of this information.

**MA Recommendations to Client**

The MA must have a reasonable basis for making a recommendation to a client. This includes:

- Making a determination that the recommendation is suitable for a particular government by knowing the client's facts and circumstances, abiding by the client's rules, and understanding the authority of each person acting on the client's behalf.
- Knowing the client's experience with municipal securities and financial products, and the client's understanding of the type and complexity of the instruments being discussed and recommended.
- Being aware of the client's tax status, risk tolerance, and liquidity needs.
- Evaluating the risks, benefits, structure, and characteristics of the securities or financial product.
- Tell the client whether or not the advisor investigated or considered other reasonably feasible alternatives.

The MA may also be asked, upon request from the issuer, to review a recommendation from another party and determine if the recommendation is suitable for the client.

Finally, the MA may share with the client documentation of the tasks it performed to determine its recommendation. The issuer does NOT need to acknowledge receipt of this information.

**Prohibitions on Principal Transactions**

The SEC and MSRB have developed rules that prohibit municipal advisors from engaging in certain activities with municipal entities when the transaction relates directly to the same municipal securities or financial product from which the MA provides advice. This includes, sale or purchase of any security; a derivative contract; guaranteed investment contract (GIC); bank loans over $1,000,000 when it is "economically equivalent to a security; and other similar financial products. The rulemaking does not prohibit a MA serving as MA on one transaction from serving in a different capacity on a separate transaction (e.g., underwriter).

**The MA Rule and Underwriters**

The role of the underwriter is to sell bonds for the issuer. They do not have a fiduciary duty to the issuer. However, many investment banking firms have previously provided other services to their clients, including financing recommendations and advice on bond sales. The MA Rule and subsequent MSRB rulemaking states that only professionals with a fiduciary duty to the state or local government may provide advice, unless an exemption is in place. While investment banks may continue to respond to RFPs, talk in general terms with issuers about general market information, and pitch products within certain limits, specific advice from investment bankers is prohibited unless certain exemptions apply.

Under these conditions, and those met through an exemption, the underwriter may speak freely with the issuer, without
The MA being present. Additionally, if an underwriter provides an idea or recommendation, it is up to the issuer to determine whether or not it is serious enough to be evaluated by the MA.

Below is a discussion of the exemptions along with model language that issuers may wish to use themselves, or may be sent to them from underwriters or other professionals.

**Independent Registered Municipal Advisor Exemption**

An issuer may obtain advice from an underwriter when the issuer has retained an independent registered municipal advisor. The independent registered municipal advisor must not have been associated with the underwriter within the past two years. The issuer must represent in writing to the underwriter that it has retained and will rely on a municipal advisor for advice (preferably through the use of a contract with the MA). The underwriter must have a reasonable basis for relying on the issuer's representation. The municipal advisor may be hired for a specific deal for which the underwriter may be providing advice, or if a government hires a municipal advisor on a retainer basis, an underwriter may approach the issuer on any type of financing, as long as the issuer states in writing that it will rely on advice of its municipal advisor. Upon request, the issuer may send the representation to the underwriter directly, or post it on its web site. GFOA recommends posting this language on the government's website for efficient distribution and access by underwriters. It is important to note that the issuer remains in control of the scope of work it wishes to receive from its municipal advisor. GFOA discourages an underwriter from speaking with or sending materials directly to the issuer's municipal advisor unless specifically authorized by the issuer. Additionally, for those entities that use multiple municipal advisors, suggested language is noted below for those circumstances.

**Independent Municipal Advisor Exemption Language**

DATE

(State or local government) has retained an independent registered municipal advisor. [State or local government] is represented by and will rely on its municipal advisor [Include name of firm here] (If desired, include name of advisor at the firm here) to provide advice on proposals from financial services firms concerning the issuance of municipal securities and municipal financial products (including investments of bond proceeds and escrow investments, if applicable). This certificate may be relied upon until [insert date]. Proposals may be addressed to [State or local government] at [address] if the proposal received will be seriously considered by [State of local government] the entity will share the document with its municipal advisor. Please note that aside from regularly mandated correspondence between an underwriter and municipal advisor, the underwriter should not speak directly with or send documents directly to the municipal advisor unless specifically directed to by the issuer.

Draft language for 2nd sentence to be used by larger entities - The [State or local government] uses several municipal advisors in its debt management program. To know which firm is being used for a particular credit, please contact the issuer at [phone number or email] (or see below for the appropriate listing). [If posted on the issuer's website, add the following language at the beginning: By publicly posting the following written disclosure, [State or local government] intends that market participants receive and use it for purposes of the independent registered municipal advisor exemption to the SEC Municipal Advisor Rule.]

**Issuer Uses RFP/RFQ Process/RFQ Exemption**

Underwriters responding to an RFP may include recommendations without violating the MA Rule. For this exemption to apply, the RFP may not be outstanding for more than six months and the issuer must widely distribute the RFP to at least three reasonably competitive firms or post it on their web site. GFOA recommends that the RFP be posted on a government's web site to ensure wide distribution. If an issuer uses a pool of underwriters from which it chooses underwriters for a particular transaction, the issuer may have to issue a mini-RFP to receive advice from members of its underwriting pool. Issuers may be asked to provide - or may provide on their own - a disclaimer that they their RFP process is in line with the MA Rule, as noted here.

**Issuer Uses RFP/RFQ Process/RFQ Exemption Language**

(State or local government) is aware of the "Municipal Advisor Rule" of the Securities and Exchange Commission (effective July 1, 2014) and the RFP/RFQ exemption from the definition of "municipal advisor" for a person providing "advice." In response to an RFP/RFQ, [State or local government] hereby notifies [all] [certain designated] investment banking firms that it wishes them to provide advice and recommendations on [insert description of particular objectives concerning the issuance of municipal securities and/or municipal financial products (as such terms are defined in the municipal advisor rule)]. [State or local government] intends for such advice and recommendations to qualify for the RFP/RFQ exemption. The advice and recommendations may be made orally or in writing. [State or local government] reserves the right to accept or reject any proposals submitted to it and to conduct a formal procurement process, in each case if deemed by [State or local government] to be in its best interests and to comply with applicable laws or procurement policies. This RFP/RFQ is open from [insert date] to [insert date no later than six months after the first date or, in the case of mini RFPs, a date that is no later than 3 months after the first date). [State or local government] understands that by responding to this RFP/RFQ, respondents are not municipal advisors to [State or local government]. [If not posting publicly, add the following language: This RFP/RFQ is being sent to [a least three investment banking firms] [the entire pool of firms].]
Underwriter is Selected for a Transaction/Letter of Intent

Upon selection of an underwriter for a specific transaction (GFOA recommends selecting underwriters through a competitive RFP process), GFOA recommends issuing a “letter of intent”, which will allow the underwriter to more freely discuss the transaction as its being developed. Model language for this exemption is suggested as followed:

Underwriter is Selected for a Transaction/Letter of Intent Language

[State or local government] is aware of the municipal advisor rule of the Securities and Exchange Commission (effective July 1, 2014) and the underwriter exclusion from the definition of “municipal advisor” for a firm serving as an underwriter for a particular issuance of municipal securities.

[State or local government] hereby designates [Underwriter] as an underwriter for [brief description of the Bonds] (the “Bonds”) that [State or local government/Conduit Issuer/Obligated Person] currently anticipates issuing. [State or local government] expects that [Underwriter] will provide advice to [State or local government] on the structure, timing, terms, and other matters concerning the Bonds. It is [State or local government’s] intent that [Underwriter] serve as an underwriter for the Bonds, subject to satisfying applicable procurement laws or policies, formal approval by [governing body/issuer], finalizing the structure of the Bonds and executing a bond purchase agreement. While [State or local government] presently engages [Underwriter] as the underwriter for the Bonds, this engagement letter is preliminary, nonbinding and may be terminated at any time by [State or local government] without penalty or liability for any costs incurred by the underwriter, or [Underwriter]. Furthermore, this engagement letter does not restrict [State or local government] from entering into the proposed municipal securities transaction with any other underwriters or selecting an underwriting syndicate that does not include [Underwriter].

[Underwriter]

[State or local government] duly authorized official responsible for public finance

Issuer Concerns with a Municipal Advisor

If an issuer believes that a MA is not acting in their best interest, is violating federal law and rulemaking, or other professionals are acting in a manner that is not compliant with the SEC MA Rule and MSRB Rulemaking, the issuer should submit those concerns to the SEC - https://www.sec.gov/complaint.shtml.

Resources

- SEC Municipal Advisor Rule
- SEC MA Rule Frequently Asked Questions 5/19/14
- MSRB Rule G-42
- MSRB Resources for Issuers
- GFOA Issue Brief: SEC Municipal Advisor Rule
- GFOA Best Practice, Selecting and Managing Municipal Advisors (2014)
- GFOA Best Practice, Selecting and Managing Underwriters for Negotiated Bond Sales (2014)
- GFOA Best Practice, Selecting and Managing the Method of Sale of Bonds (2014)
- GFOA Best Practice, Investment of Bond Proceeds (2013)
10 Things You Should Know About Public Pension Disclosure Changes

State and local government retirement systems have significant oversight and disclosure requirements, some of which are being considerably modified. Several new and separate public pension calculations are being published – each derived in different manners and for distinct purposes – and could easily be misunderstood and create confusion. Below are ten key takeaways regarding existing disclosures, notable changes, and their effects.

1. State and local governments provide significant oversight for their retirement systems and require open reporting and processes. These systems are established under state statutes, local ordinances, or both; subject to fiduciary, investment and administrative laws, as well as to open records and sunshine statutes; overseen by elected governmental bodies, state and local regulators, elected office holders, the public, and independent boards of trustees.

2. The Governmental Accounting Standards Board (GASB) is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments. GASB standards must be followed to receive a clean audit. GASB was established by state and local government organizations in conjunction with the Financial Accounting Foundation, in recognition of the fact that governments are fundamentally different from for-profit business enterprises, including their unique time horizons, oversight, revenue streams, constitutional or contractual protections, stakeholders and accountability for resources.

3. GASB has recently completed a multi-year process of reviewing and revising its accounting standards on public pension reporting. GASB Statement 68, which will be implemented into state and local government financial statements this year, includes many changes. Notably, state and local governments will now be required to report their net pension liability on their balance sheets.

4. The new GASB requirements do not affect actuarial funded ratios or pension contribution requirements; they only change where and how pension costs are accounted for in financial statements to provide additional and more prominent information.

5. The placement of net pension liabilities on an employer's balance sheet could create the erroneous impression that this is an obligation that is due immediately. This is not the case. Pensions are funded and paid out over very long periods – contributions are made over employees' careers and distributions are provided in monthly installments in their retirement.
6. A new term, pension expense, refers to the change in the net pension liability from one year to the next, and should not be confused with what governments actually budget and expend on pension contributions. The new GASB net pension liability figure will be volatile, because it is based, in part, on the market value of pension assets, which fluctuate with investment markets. Under GASB 68, pension expense is a measure of this volatility, not an employer's pension contribution.

7. Information about annual pension contributions has not gone away. Actuarially determined pension contributions, as well as the assumptions that underlie them, are required to be included in financial notes, along with a government's 10-year pension contribution history. The financial condition of the retirement system, including funded status and necessary contributions, must be certified by qualified actuaries that adhere to Actuarial Standards of Practice maintained by the Actuarial Standards Board, which identifies what U.S. actuaries should consider, document, and disclose.

8. Adjusted pension data being published by some credit rating agencies does not change a government's pension liabilities, it is merely part of their credit analytics. Some credit ratings agencies are now modifying pension data using their own methodologies to standardize results and they are publishing this adjusted data. Credit ratings agencies have long been factoring pension liabilities into their credit ratings and bond ratings for only a small number of governments are expected to change due to pension obligations.

9. State and local policymakers are urged to review the effectiveness of existing funding policies and practices. National organizations representing the nation's governors, state legislatures, state and local officials, and public finance professionals have released Pension Funding: A Guide for Elected Officials, which recommends the calculation and payment of actuarially determined pension contributions within accepted guidelines so that pension promises can be paid, employer costs can be managed, and the pension funding policy is clear to all stakeholders.

10. Since the Great Recession, all 50 states and numerous localities have been taking steps to strengthen their pension funding; none has requested nor required federal intervention. Federal legislation has been proposed to eliminate the tax-exempt status of municipal bonds if state and local governments do not comply with federally-imposed, conflicting and costly pension reporting mandates. It is inappropriate for the federal government to propose unfunded mandates and penalties in an area that is the fiscal responsibility of sovereign States and localities.
MCDC Resource Center

What is MCDC?

On March 10, 2014, the SEC’s Enforcement Division announced the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative. According to the SEC, the purpose of MCDC is to provide issuers and underwriters the opportunity to self-report instances of material misstatements in bond offering documents regarding the issuer’s prior compliance with its continuing disclosure obligations.

The SEC’s Enforcement Division has established standardized settlement terms for participating issuers under MCDC, which are described below. For issuers found to be in violation, the settlement to be recommended by the Division must include undertakings by the issuers.

Specifically, as part of the settlement, the issuer must undertake to:

- establish appropriate policies and procedures and training regarding continuing disclosure obligations within 180 days of the institution of the proceedings;
- comply with existing continuing disclosure undertakings, including updating past delinquent filings within 180 days of the institution of the proceedings;
- cooperate with any subsequent investigation by the Division regarding the false statement(s), including the roles of individuals and/or other parties involved;
- disclose in a clear and conspicuous fashion the settlement terms in any final official statement for an offering by the issuer within five years of the date of institution of the proceedings; and
- provide the Commission staff with a compliance certification regarding the applicable undertakings by the issuer on the one year anniversary of the date of institution of the proceedings.

Though the terms of the initiative preclude SEC from imposing monetary fines on participating issuers, the SEC reserves the right to pursue separate civil enforcement against individuals within a government who it deems to be culpable of the misstatements.

MCDC Enforcement

On August 24, 2016, the SEC Office of Municipal Securities announced enforcement actions against 71 municipal issuers for violations in municipal bond offerings from 2011 to 2014, as part of the MCDC Initiative. During this heightened state of attentiveness regarding issuers continuing disclosure responsibilities, GFOA is acutely aware that issuers require information. In addition to the member Alerts, the GFOA Debt Committee continues to update best practices to enhance members’ familiarity with and knowledge of continuing disclosure responsibilities. In addition, the Federal Liaison Center is committed to providing the issuer community quick, quality information reported from the SEC as we continue to progress through the MCDC Initiative.

GFOA Resources

GFOA’s best practices have long provided guidance on how to meet disclosure commitments. Many GFOA best practices either focus on or contribute to members understanding about continuing disclosure documents. Recent alerts have also assisted issuers in understanding recent SEC enforcement actions throughout the MCDC process. GFOA issued a series of alerts on the MCDC initiative that remind issuers of the importance of making timely filings of financial information in accordance with each issuer’s continuing disclosure agreement. A portion of these types of best practices and alerts are described below. It is important to note that information contained in disclosure alerts and best practices are developed to educate members about the SEC MCDC Initiative and should not be construed as legal advice. GFOA urges issuers to seek legal counsel if missed deadlines or filing failures are discovered.

- GFOA Alert: The SEC MCDC Initiative and Issuers
- GFOA Alert: MCDC Initiative Settlement Terms for Issuers
- GFOA Alert: Recent SEC Enforcement Actions
- Small Government/New Issuer-Debt Issuance Checklist: Considerations When Issuing Bonds - GFOA provides new and infrequent issuers key considerations for issuing debt, including links to other useful and related GFOA debt management resources.

GFOA Best Practices

GFOA Best Practice: Understanding Your Continuing Disclosure Responsibilities - This best practice offers issuers guidance on important components to include in their continuing disclosure policies and emphasizes the need for governments to adopt procedures to ensure that continuing disclosure responsibilities are met.

GFOA Best Practice: Disclosures of Pension Funding Obligations In Official Statements - Recognizing the increased scrutiny in recent years on the state of government pension liabilities, GFOA offers guidance about the information that issuers should consider including in their official statements about their pension obligation obligations.

GFOA Best Practice: Maintaining an Investor Relations Program - GFOA best practice provides guidance to issuers on key components to include in an investor relations program.

GFOA Best Practice: Using Technology for Disclosure - As the use of technology for communication with the municipal market has increased, GFOA developed this best practice to provide recommendations to issuers about how to use issuer websites and the MSRB’s Electronic Municipal Market Access (EMMA) platform to...
GFOA Best Practice: Debt Management Policy - GFOA recommends that state and local governments adopt comprehensive written debt management policies, and this best practice introduces finance officers to the core elements that comprise a working debt management policy, including disclosure practices.

Additional GFOA Resources

Publications  Training