UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9629 / August 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16009

In the Matter of **THE STATE OF KANSAS,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), against the State of Kansas ("Respondent" or the "State").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

1. From August 2009 through July 2010, the Kansas Development Finance Authority ("KDFA") raised $273 million through eight series of bonds on behalf of the State and its agencies without disclosing in the bond offering documents (the "Official Statements") the existence of the significant unfunded liability in the State's pension system, known as the Kansas Public Employees Retirement System ("KPERS"), or the effect of such unfunded liability on the risk of non-appropriation of debt service payments by the State Legislature. At the time, according to one study, KPERS was the second-most underfunded statewide public pension system in the nation.[2] The failure to disclose this material information in the Official Statements resulted from insufficient procedures and poor communications between KDFA and the Kansas Department of Administration ("KDA"), which provided information to KDFA for inclusion in the Official Statements, including preparing the State's financial statements that were included as part of the Official Statements.

Respondent

2. Kansas possesses all powers, functions, rights, privileges and immunities authorized by the United States Constitution, the Kansas Constitution and the State's laws, including the power to issue debt.

a. KDFA is an independent instrumentality of the State created in 1987 by the State Legislature for the primary purposes of enhancing the ability of the State to finance capital improvements and improving access to long-term financing for State agencies, political subdivisions, and public and private organizations and businesses. As a conduit issuer, KDFA offers municipal securities on behalf of underlying borrowers, including the State.

b. KDA, a component of the State, provides essentially all financial and administrative services for the State. KDA's Division of Budget was responsible for overseeing the incurrence of debt, including the review of certain disclosure documents drafted by KDFA, while KDA's Division of Accounts and Reports ("Division of Accounts") was responsible for preparing the Comprehensive Annual Financial Reports, or CAFRs, for the State.

KPERS Was Significantly Underfunded

3. KPERS, an independent instrumentality of the State, is a multi-employer pension system administering various defined benefit pension plans covering substantially all governmental employers and public employees in the State. The State is the largest of the approximately 1,400 employers that participate in KPERS, and directly or indirectly contributes approximately 70% of all employer contributions to KPERS, although more than half of KPERS's 155,000 active members are employed by local school districts. KPERS annually prepares and publicly releases an actuarial valuation as of the end of each calendar year and a Comprehensive Annual Financial Report for each 12-month period ended June 30 ("KPERS CAFR").

[2] Only Illinois had a lower funded ratio for its state pension fund system than Kansas. See "*The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform*," Pew Center on the States (February 2010).

4. For years, KPERS was significantly underfunded. Specifically, the State's statutory maximum annual contribution rates were insufficient to cover both (a) the cost of pension benefits earned by public employees by virtue of their service in the current year, known as the normal cost, and (b) a payment to amortize the accumulated amount of pension liabilities that have been deemed earned, but are not funded, known as the unfunded actuarial accrued liability, or UAAL. At the end of the 2008 calendar year, KPERS had a total retirement system UAAL of $8.3 billion and a 59% funded ratio.[3] This liability was substantial - by comparison, in 2008, the State's tax-supported debt was $3.1 billion.

5. The State was not the only obligor of the total retirement system UAAL. Other obligors included, but were not limited to, local school districts and local governments. The State Group of KPERS (State employees) had a 72% funded ratio and represented $1.0 billion of the $8.3 billion total retirement system UAAL at the end of 2008. The School Group of KPERS (local school district employees) had a 52% funded ratio and represented $5.2 billion of the $8.3 billion total retirement system UAAL at the end of 2008. Although technically an obligation of the local school districts, historically the State appropriated from its general fund an amount sufficient to cover the entire cost of those school districts' contributions to KPERS's School Group. By the end of 2009, KPERS had a total retirement system funded ratio of 64% and UAAL of $7.7 billion, which included a State Group funded ratio of 78%, representing a $0.8 billion UAAL, and a School Group funded ratio of 56%, representing a $5.0 billion UAAL.

The State's Debt is Subject to a Risk of Non-Appropriation

6. The Kansas Constitution substantially limits the State's ability to directly issue general obligation debt, and consequently the State borrows money through the issuance of revenue obligations subject to annual appropriation, including certain bonds issued by KDFA. Moreover, unlike many states that provide significant legal protections regarding the repayment of their debt, in Kansas the Legislature must annually appropriate money to pay the principal and interest on the debt issued by the KDFA on its behalf.[4] Because of this requirement for annual appropriation, bond holders are at risk that the Legislature may choose, for any reason, to not appropriate funds for debt service over other competing budget demands, such as state services, school funding, or pension obligations. The major credit rating agencies routinely reduce the credit rating assigned to these bonds by one level in order to reflect the risk of non-appropriation.

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[3] The funded ratio, which is one measure of the financial health of a pension plan, is the actuarial value of assets expressed as a percentage of the actuarial accrued liability. A 100% funded ratio means that that the existing assets cover the present value of the future benefits to be paid by the system.

[4] The annual debt service on the State's bond debt payable from appropriations from the State General Fund is less than two percent of the State General Fund budget.

The CAFRs Did Not Disclose KPERS's Underfunded Status

7. The State, by and through the KDA's Division of Accounts, issues CAFRs purportedly in accordance with standards promulgated by the Governmental Accounting Standards Board ("GASB"). Beginning with the 2004 CAFR, on the advice of outside accountants, the State changed the way the pension liabilities of KPERS were reported. The outside accountants concluded that GASB did not require a detailed disclosure of KPERS in the State's CAFR as long as KPERS made such disclosure in its own CAFR, which it did.

8. As a result of this change, for the 2004 through 2009 fiscal years, the State's CAFRs did not provide any information regarding KPERS's UAAL or funded ratio. Instead, the CAFR simply provided certain information regarding KPERS and the State's expenditures to fund employer contributions to KPERS, and listed the mailing address and telephone number for KPERS (but not an internet website, email address, or contact person), should someone want additional information. As a result, the State's CAFRs from 2004 through 2009 made no reference to the State's substantially underfunded pension plan.

The Failure to Disclose KPERS's Underfunding

9. From 2004 on, the underfunding of KPERS was repeatedly discussed in various local newspapers, and by credit rating agencies. In several reports issued by Moody's during this time period, the rating agency noted that the State faced budgetary pressures by virtue of KPERS's underfunded status, including both statutorily scheduled increases in pension fund contributions and the debt service payable on the State's pension obligation bonds, and that the State's debt ratings could go up if there was strong improvement in pension funding.

10. Kansas's practice of not disclosing the underfunded status of KPERS became increasingly inconsistent with the practice of most states issuing municipal securities, which generally provided disclosure in their CAFRs or the body of their Official Statements regarding the financial health of their pension funds. By 2008, with the exception of Kansas, the overwhelming majority of the Official Statements for state-level bond issuances at a minimum disclosed the UAAL or funded ratios of the associated state-level pension plans, particularly if those plans were significantly underfunded.

KDFA and KDA's Disclosure Practices and Procedures

11. KDFA took the lead in preparing the three Official Statements for the eight series of bonds issued on behalf of the State from August 2009 through July 2010, including the retention of disclosure counsel. Each of the Official Statements made repeated boldface disclosures regarding the possibility of non-appropriation. The Official Statements also contained sections reporting on appropriations and budget processes for the State, and on current State budget issues such as revenue estimates, general fund receipts and pending school finance litigation, as well as long-term economic, income, and demographic trends. Each Official Statement included as an appendix the most recent State CAFR and identified the amount of other State indebtedness payable from appropriations from the State General Fund, but none of

the relevant Official Statements (or appendices thereto) specifically mentioned the underfunded status of KPERS.

12. In the course of preparing each Official Statement, KDFA routinely asked KDA, and in particular KDA's Division of Budget, to advise it of, among other things, material adverse changes in the State's overall financial condition, or of any liabilities not reflected in the most recent CAFR that had a material adverse effect on the State's financial condition. Moreover, at each closing, KDA executed a certificate to the effect that the information in the Official Statement set forth under certain captions and in specific appendices, which corresponded to information regarding the State, was true in all material respects, and insofar as such matters were concerned, did not omit to state a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which the statements were made, not misleading. At each closing, KDFA also executed a certificate stating that, in the Official Statement, the KDFA had not made an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

13. These queries and certifications did not trigger the inclusion of any additional information regarding KPERS's unfunded liability to any of the August 2009 to July 2010 Official Statements. Furthermore, although KDFA, KDA, and other members of the working group had an informal process for the development and review of official statements, neither KDFA nor KDA had any formal written policies or procedures for addressing trends or risk factors that might be material to bondholders. KDFA operated with the understanding that KDA was responsible for providing the information and disclosures in the Official Statements relating to financial issues impacting the State. Conversely, KDA understood that KDFA was responsible for such disclosure. This lack of clear communication, together with the absence of effective written policies or procedures in either organization, meant that neither KDA nor KDFA identified the absence of the KPERS unfunded liability, or discussed the need to add such disclosure to the Official Statements.

KPERS's 2008 Investment Losses Highlighted the Materiality of its Underfunded Status

14. By the summer of 2009, the impact of KPERS's 2008 investment losses was becoming clear. A draft actuarial report provided to the KPERS Board in mid-July 2009 spelled out that KPERS's UAAL had jumped from $5.6 billion in 2007 to $8.3 billion in 2008, a 49% increase, and its aggregate funded ratio dropped from 71% to 59%.

15. The State was contemporaneously preparing for a large multipurpose $127 million bond offering through KDFA. A portion of this offering, approximately $40 million, was sold primarily to out of state investors. At meetings or on telephone conferences with S&P and Moody's regarding the credit rating of this bond offering at the end of July, the Secretary of Administration raised as a topic the financial health of KPERS, and in particular the possible need for legislative action to increase the statutory annual contribution rate so as to provide for additional State funding to KPERS. KDFA emailed the draft actuarial report to the relevant

rating agency analysts the following week. KPERS's underfunded status was explicitly referenced in each firm's credit rating report.

Omitted Language Made the Official Statements Materially Misleading

16. These credit rating agency discussions led to further discussions by the working group to consider possible changes to the draft August 2009 Preliminary Official Statement. Proposed language was circulated to the working group setting forth a warning that future State expenditures could be affected by various unpredictable circumstances or events beyond the control of the State, including the need for additional state funding of KPERS and/or gains or losses on KPERS's investments.

17. Notwithstanding the renewed focus on the financial health of KPERS, no one at KDA or KDFA raised a concern that the proposed language was inadequate or that additional disclosure regarding KPERS should be added to the Official Statements. Rather, KDFA's proposed language was adopted following review, but without comment, and incorporated into both the Preliminary and final Official Statement for the August 2009 offering. At the closing, KDFA and KDA signed without objection the certifications regarding the accuracy and completeness of the Official Statement as more fully described in paragraph 12.

18. The added language was materially misleading in that it omitted any information regarding KPERS's financial health, or the associated risks created by the State's underfunding of its pension obligations. As the actuarial report detailed, and the Secretary of Administration highlighted, KPERS's financial difficulties were the result of years of statutory maximum contribution rates insufficient to cover both KPERS's normal costs and UAAL. The need for increased funding for KPERS was both reasonably predictable and within the control of the State. The three Official Statements for the eight series of bonds offered by KDFA in August 2009 through 2010 omitted this language rendering them materially misleading.

19. Respondent should have known the Official Statements were deficient, and that the absence of any disclosure concerning KPERS's finances and underfunding within the Official Statements rendered the disclosure materially misleading.

Prompt Remedial Measures

20. Respondent adopted new disclosure policies and procedures prior to the November 2011 offering of bonds payable from appropriations from the State's general fund. Among other things, these new procedures designated responsible parties in critical State agencies, mandated closer communication and cooperation among those agencies, established a State Disclosure Committee, and required annual training of key personnel. Moreover, the State's fiscal year 2010 CAFR resumed including information regarding KPERS contributions and a schedule of funding progress. Additionally, Official Statements for the State's most recent revenue bond offerings included a separate appendix discussing KPERS and, among other things, its underfunded status.

Legal Discussion

21. Issuers of municipal securities must ensure that financial information contained in their disclosure documents is not materially misleading. Proper disclosure allows investors to understand and evaluate the financial health of the municipality in which they invest.

22. The antifraud provisions of Section 17(a) of the Securities Act prohibit fraudulent or deceptive practices in the offer or sale of securities by the issuers of municipal securities. Section 17(a)(2) of the Securities Act prohibits obtaining money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Section 17(a)(3) of the Securities Act prohibits engaging in any transaction, practice, or course of business which operates, or would operate as a fraud or deceit upon the purchaser. A misstatement or omission is material if there is a substantial likelihood that a reasonable investor would have viewed the information as "having significantly altered the 'total mix' of information available." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). To the extent the omitted information relates to contingent future events, materiality depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of circumstances." Basic, Inc. v. Levinson, 485 U.S. 224, 238 (1988). Cautionary words about future risk cannot insulate one from liability for the failure to disclose actual material facts regarding that risk. Dolphin and Bradbury v. SEC, 512 F.3d 634, 640 (DC Cir. 2008). Negligence is sufficient to prove violations of Section 17(a)(2) or (3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 696-97 (1980).

Violations

23. As a result of the conduct described above, Respondent violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

24. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by the State, as described in Paragraph 20, and KDFA's and KDA's substantial cooperation afforded the Commission staff during the investigation.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that**:**

Pursuant to Section 8A of the Securities Act, the State shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

By the Commission.

Jill M. Peterson
Assistant Secretary