

*National Federation of Municipal Analysts*

*White Paper on*

*Best Municipal Bond Issuance and Disclosure Practices*

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**EXECUTIVE SUMMARY**

Every year, several hundred billion dollars of municipal bonds are issued and purchased by both institutional and retail investors. Because municipal bond issuers are largely exempt from Securities and Exchange Commission (SEC) regulation, there is comparatively little comprehensive or uniform federal regulatory guidance regarding bond issuance practices to which municipal issuers may refer. Consequently, the variation in new issuance practices of municipal issuers, underwriters,<sup>1</sup> and financial advisors is considerable.

The National Federation of Municipal Analysts (NFMA) is particularly concerned that all municipal bond investors have current, complete, and reliable information; sufficient time to review that information; and, as desired, access to issuers, so that they can make informed investment decisions.<sup>2</sup> Consequently, this NFMA White Paper (the White Paper) recommends improving the offering and disclosure practices of municipal issuers and underwriters, and seeks to communicate to those issuers and underwriters the expectations of municipal investors and credit analysts.

This White Paper outlines best offering practices and procedures for municipal issuers and underwriters regarding the preparation and content of preliminary offering documents. It also makes suggestions about how issuers and underwriters can best interact with investors and credit analysts during the pre-pricing and offering periods.

The NFMA hopes that recommendations in this White Paper will serve as a benchmark for improved issuance and disclosure practices and procedures by municipal issuers and underwriters. It also aims to promote increased dialogue with industry groups, regulators, and other interested parties. The NFMA believes that issuers will ultimately benefit from these improved practices by broadening the investor base for their bonds, and may enjoy reduced borrowing costs.

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<sup>1</sup> As used in this White Paper, the term *underwriters* includes placement agents. The Securities Act of 1933 defines the term *underwriter* as “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security . . . .”

<sup>2</sup> As used in this White Paper, the term *issuers* refers primarily to obligors. The NFMA recognizes that conduit issuers, as opposed to obligors, generally are not considered by the market to have substantive disclosure responsibilities.

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## **PART ONE: OVERVIEW AND COMMENT ON RECOMMENDED NEW ISSUE PRACTICES**

### **I. Goals of this White Paper**

The National Federation of Municipal Analysts (NFMA) is publishing this White Paper to address four main concerns:

- First, over the past few years, the number, complexity, and variety of municipal bond issues has increased. This change in has occurred at a time when the percentage of issues covered by bond insurance has dropped from approximately 50% to less than 10%, thereby increasing the need for and importance of credit analysis.
- Second, a wide variety of idiosyncratic offering practices by municipal issuers and underwriters is available.
- Third, new issue municipal practices are not as heavily regulated as corporate issues for a number of reasons, including: (a) legal rulings and historic traditions that underlie the US federal system of government and that in turn limit SEC and Municipal Securities Rulemaking Board (MSRB) authority over municipal issuers, and (b) the multitude and diversity of different municipal issuers and offerings.
- Fourth, the NFMA is of the opinion that there is insufficient market guidance regarding events that occur during the pre-pricing period and in the preparation of the Preliminary Offering Statement (POS). Given the NFMA's goal of improving the fairness of the municipal marketplace for all types of investors, we believe that new issue marketing practices and POS disclosure should go beyond what is minimally required by law or current industry practice.

As part of the preparation of this White Paper, the NFMA conducted a survey of its members and received more than 100 responses, the results of which have been incorporated into this document. The overwhelming majority of respondents support the recommendations made herein.

The format of this White Paper is intended to mirror the typical investment decision process. It starts with a discussion of the pre-pricing period, including the Internet roadshow. Next it goes through the POS, from cover page to the appendix. A more detailed section on defining general obligation (GO) bonds is next, followed by a discussion of private placements. Finally, we provide some examples of what we view as deficient practices or offering documents.

## II. **Pre-Pricing Practices**

Large, frequent issuers or complex transactions can attract a larger investor base with presentations that walk through key information of interest to investors. The NFMA believes these practices can be improved as follows:

### **A. Internet-Based Roadshows**

Internet-based roadshows can be very helpful to investors and analysts; they are a useful complement or substitute for “in-person” roadshows. These Internet roadshows provide a high-level overview of the bond issue and allow prospective investors to hear directly from management. The NFMA believes that Internet roadshows can be improved by implementing the following practices:

1. *Live Q&A*: A “live” question-and-answer session following the prepared presentation is very valuable when a physical investor meeting is not an option, particularly with more complex transactions, but many Internet roadshows do not include this feature. The Q&A session should also be included in the recorded material for replay.
2. *Security Discussion*: The NFMA recommends including discussions of the bond security provisions during the roadshow, whether it is in-person, Internet, or phone-based.
3. *Portability*: The post-roadshow availability of roadshow material such as PowerPoint presentations is highly inconsistent across venues and periods. In some cases, the material is available only during the time of the in-person roadshow or is available online only during the pre-pricing period. In other instances, the same PowerPoint presentations are posted on an issuer’s website. Provided that the material in the Internet roadshow is derived from and comparable to the material in the offering documents, there appears to be no compelling reason to make Internet roadshows unavailable. If roadshow information includes material information that is not contained in the POS, the POS should be supplemented with that information. The NFMA recommends that municipal underwriters follow the corporate practice of making these roadshow materials available to investors after bonds are issued, provided appropriate action is taken to ensure that the material remains current.

### **B. POS Release Considerations**

Not having enough time to review a transaction presents particular problems for municipal analysts because they and/or their firms typically have a fiduciary duty that requires a sufficient

review of the terms of each transaction. Analysts with a Chartered Financial Analyst (CFA) designation are also required to have a “reasonable basis” for making investment recommendations. Within the limited time frames available, investors and credit analysts can often be reviewing multiple offerings simultaneously.

Based on the NFMA member survey, there should be at least three full business days between release of the POS and the pricing date for high-grade, lower-risk transactions such as GO bonds and essential service revenue bonds rated single-A or better. For higher risk transactions, which include hospitals and project finance bonds, there should be at least ten business days between release of the POS and bond pricing. For especially voluminous offering documents and complex transactions, we suggest that municipal issuers follow the corporate practice of *non-deal roadshows*,<sup>3</sup> or the municipal high yield sector practice of information sessions well in advance of the formal offering period.

### **C. Site Visit Timing**

If a site visit is offered by the issuer or underwriter, it should take place after the release of the POS in order to allow investors sufficient time to understand the transaction and to formulate relevant questions.

### **D. Availability of Purchaser’s Counsel**

The NFMA recommends providing purchaser’s counsel, with fees and expenses included in the uses of funds, for more complex, lower rated, and/or speculative grade transactions such as those involving project finance risk, public-private partnerships, multiple operating and financing agreements, or technologically complex or lengthy construction programs.

## **III. POS Contents**

The POS is a time-of-sale document on which investors rely to make their investment decisions. Investors should be informed in a POS of all material information prior to completion of pricing. In all circumstances, the POS should clearly and concisely describe, both on the cover and in its introductory section, the nature of the pledged revenues without referring the reader to obscure terms as defined in bond indentures, loan agreements, or POS appendices. In addition, all material credit considerations should be explained completely and accurately, in plain English, in a single section that appears within the first few pages of a POS.

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<sup>3</sup> In a *non-deal roadshow*, issuers can hold discussions with current and potential investors, although no securities are offered for sale.

### **A. Issue Name**

Bond-pricing services often use the name of a bond issue to make particular sector-pricing attributions. The name of the issue also affects how the bonds are classified and traded by retail and institutional brokers. For these reasons, the NFMA recommends that the name of the bond issue reflect the revenue stream that secures the bonds rather than the purposes for which bond proceeds will be spent. Problems with misuse of the term *General Obligation* are discussed in Section IV, entitled “Defining *General Obligation* in the POS.” Part Two provides several examples of bond issue titles where the pledged security was materially different than the title of the bonds, potentially misleading investors and analysts—for example, “Water” bonds that were in fact secured by sales taxes on cigarettes.

### **B. Public Ratings Placement**

The public rating(s), including outlook modifiers, should appear on the cover page of the POS. The NFMA is aware of no justifiable reason to include them only in the body of the document, where they are much more difficult to find.

### **C. Plain English Summary Section**

An introductory summary in plain English on the cover page or in the introductory section of the POS would be very useful to all investors and credit analysts. Plain English ensures the orderly and clear presentation of complex information that uses words economically, is well-organized and easy to read, avoids the extensive and redundant use of technical and “defined” terms, and avoids lengthy sentences.<sup>4</sup> This is particularly important in the case of more complex transactions. The summary should include a description of all transaction parties, payment sources, key documents, sources and uses of proceeds, any collateral, flow-of-fund priorities, any unusual redemption or call options, and rate-setting provisions.

### **D. Variable Rate/Reset Periods**

For municipal financings that have variable rates, multi-term maturities, and other variable pricing elements, the NFMA recommends that the POS disclosure include a plain English description of how the rates and terms are set along with a table that identifies the applicable rate setting, rate periods, redemption, and maturity modes.

### **E. Debt Service Schedule**

Although a final debt service schedule for a new issue is not known at the time a POS is distributed, it is still a good practice to include an estimated debt service schedule with an

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<sup>4</sup> See the SEC’s *A Plain English Handbook: How to Create Clear SEC Disclosure Documents*, August 1998, available at <http://www.sec.gov/pdf/handbook.pdf>.

assumed coupon, with separate columns for outstanding and new debt as well as interest rate assumptions on any variable rate debt.

## **F. Financial Covenant Identification and Calculation**

For bond issues that include financial covenants (e.g., debt service coverage, liquidity, and leverage), a table that illustrates these ratios—both historical and projected—should appear early in the body of the POS.

## **G. Security Section**

The security section of the POS is complex and crucial to a clear presentation. The NFMA elaborates five areas that can be improved.

1. *Clearly Identify the Sources of Revenue that Will Pay Debt Service on the Bonds.* Greater clarity in the description of the revenues legally pledged to pay debt service is crucial to a good, transparent, and clear presentation. This is especially important in cases where the intended source of debt service payment differs from what is legally pledged. The confusion that can occur in the market can be seen when a POS indicates that the securities are secured by the “Trust Estate” or by “Revenues,” and the investor or analyst must study a POS, including its appendices, in order to ascertain the meanings of these phrases. The NFMA recommends that the cover page of the POS state in plain English that the securities are “generally secured by xyz revenues as further described herein,” and that the introductory summary section include a plain English description of the security and sources of payment for the bonds.

For an elaboration of the term *General Obligation*, please see Section IV.

2. *Clearly Describe Key Legal Provisions in the Security Section.* Legal provisions—such as Rate Covenants, Additional Bonds Tests, and Debt Service Reserve Fund requirements—should be stated clearly and in such a way that they will not be subject to misinterpretation in the future. The Debt Service Reserve Fund requirement and funding sources—for example, cash, letter of credit, or surety, and including substitution provisions and replenishment requirements—should also be clearly stated in the security section of the POS. The use of language such as “the debt service reserve fund is equal to the debt service reserve requirement” should be eliminated because it is confusing and subject to multiple interpretations. Such language should be replaced by direct, clear statements such as “the debt service reserve fund requirement is the lesser of \$X, 10% of par, or MADS,” or whatever is actually the case.
3. *Provide a Table Detailing the Issuer’s Debt Obligations.* It is often difficult to determine an issuer’s other outstanding debt that shares the same revenue stream or fund for repayment. To clarify the issuer’s other obligations, a table should be provided. For

example, if an issuer is issuing lease bonds that are intended to be repaid from its general fund, the table should show all other debt and guarantees secured by the same fund or revenue stream (e.g., GO debt, “double-barreled” debt, other lease obligations, guarantees, and the like). The table should show, by revenue stream, the associated amount of debt, including the par amount and dated date, the rate, and the amortization profile, along with subtotals for each column.

4. *Provide Flow of Funds Diagrams.* The NFMA recommends that the POS contain a flow of funds/waterfall diagram, both pre- and post-default.
5. *Explicitly Note Bankruptcy Eligibility, Receivership, and Authorization Procedures.* Because of increased fiscal stresses on municipal issuers and obligors, the eligibility of an issuer or obligor to seek bankruptcy protection under Chapter 9 or Chapter 11 of the bankruptcy code, or to be subject to receivership proceedings under state law, has become an important disclosure item for analysts. Because laws vary from state to state regarding the eligibility and authorization procedures for municipal borrowers to enter these types of proceedings, the NFMA recommends that a brief section on bankruptcy/receivership eligibility, authorization procedures, and conditions for or limitations on eligibility, if any, be included in the “risks” section of the POS. If state law is unclear or nonexistent regarding these issues, that should be noted as well.

## **H. Bank Loans and Similar Private Financings**

Municipal issuers are increasingly using banks or other private lenders as a source of funding for capital projects, cash-flow needs, and other purposes. Those financings may or may not include publicly offered securities. When privately placed bank financings are not part of a publicly placed municipal securities offering, public information regarding those private financings may not be available. The NFMA recommends that material terms and covenants of these transactions be disclosed in an issuer’s POS when the issuer publicly offers securities that will be paid from the same GO pledge or revenue stream as other privately placed bank financings. The debt service schedule for these securities should be incorporated into the debt service schedule and coverage ratios for the publicly offered municipal securities referenced above. The NFMA notes that the credit effects of these financings—for example, terminations, accelerations, covenants, and interest rate changes—can have substantial effects on an issuer’s creditworthiness.<sup>5</sup>

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<sup>5</sup> See MSRB Notice 2012-18 (April 3, 2012), “Notice Concerning Voluntary Disclosure of Bank Loans to EMMA,” available at <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-18.aspx>.

## **I. Swaps and Derivatives**

Offering documents should provide a full description of all the issuer's swaps and derivatives, including the dates, terms and conditions, collateral posting requirements and triggers, term-out provisions, mark-to-market values, counterparty identifications, and ratings.

## **J. Specific Investment Risks**

Every municipal bond entails some amount of credit risk, so a Risk Factors or Investment Considerations section should be included in every POS to highlight those risks specific to the particular bond. Too many POSs focus on lengthy generic discussions of investment risks rather than more specific and/or likely investment risks particular to the project, issuer, or bond financing. The NFMA recommends that transaction-specific risks be placed in the beginning of this section and that more generic investment risk disclosure be placed later in some order of priority.

## **K. Refunding Bonds and the Status of Refunded Bonds/Legal Defeasance Rights**

In the case of a new bond issue that also advance refunds some of the issuer's outstanding bonds, bondholders frequently have difficulty in determining whether the bonds to be refunded are legally or economically defeased.<sup>6</sup> Consequently, the NFMA recommends that the POS expressly state if the refunded bonds are being legally defeased pursuant to their indenture, or if they are only economically defeased.

## **L. Full Disclosure of Basis for Bond Counsel and Other Legal Opinions/Reliance**

If bond counsel is relying on an opinion of special tax counsel or on the opinion of another law firm when it renders its own opinion, that reliance should be disclosed in the body of the POS and the supporting legal opinions should be attached.

Under many state laws, if counsel has not addressed its opinion letter to the bond trustee, the trustee may have limited ability to assert claims if the legal opinion is incorrect. Consequently, without the proper "reliance letters," the bond trustee and investors may have limited or no standing to make any claims against law firms giving these supporting legal opinions to bond counsel if those opinions prove to be problematic.

In addition, POS disclosure of the identity of these supporting law firms will allow investors to assess how much legal complexity/uncertainty may be involved in the transaction. Finally, POS disclosure of the supporting legal opinions should require the consent of the law firm giving the opinion, provide a basis for a reliance claim by investors, and allow investors to determine whether the supporting legal opinion has any qualifications or improper assumptions.

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<sup>6</sup> Economic defeasance absent legal defeasance could lead to a situation where an issuer would in the future be required to pay debt service on both the "new" bonds and on the refunded bonds. This could occur if securities held in escrow are insufficient for some reason to pay debt service on the refunded bonds.

## **M. Documents Referenced in POS/Other Supporting Document Issues; Prioritizing of Documents**

1. *Material Documents.* When the POS refers to “material supporting documents,” the NFMA recommends that the material provisions of those documents be summarized in plain English in the body of the POS even if those documents are also summarized in appendices to the POS. In addition, the POS should contain a URL for each supporting document. This would overcome the difficulties often faced in reading legal documents that have been crammed four to a page in the POS.
2. *Financial Statements.* If the fiscal year-end of the audited financial statements presented in the POS has occurred more than six months prior to the offering, the POS should contain a disclosure section that identifies the auditors working on the issuer’s financial statements for the current fiscal year, provides the date of probable release for the current year’s financial statements, notes whether the issuer has made significant changes in its accounting treatment subsequent to the audited financial statements presented in the POS, and notes any and all material subsequent events that have occurred since the end of the most recently concluded and audited fiscal year. The issuer should disclose any failure to obtain the consent of the auditors for the inclusion of their audit report in the POS, since that failure may limit investors’ ability to rely on the audit report. Any unaudited information, if available, should be included in the POS. To help bridge the time gap for financial reporting, a link to an issuer’s website or websites covering interim financial information—such as budgetary updates and revisions to economic forecasts and cash flows—should be included.

## **N. Underwriter as Initial Purchaser Consents**

If, by purchasing a new issue of bonds, the buyer is effectively consenting to changes in the security provisions of the bond documents and thereby changing the security for all outstanding parity bonds, this should be clearly stated in the Summary and the Risks/Investment Considerations sections of the POS. In addition, a table comparing the security provisions before and after such consents should be provided. If the issuer does not yet have a sufficient majority or supermajority to effect such changes but is in the process of accumulating such rights, it is important to state this circumstance, along with a tabulation of how many consents have been accumulated relative to how many are needed.

## **O. Updating the Initial POS before Pricing**

In today’s municipal market, transactions often are brought to market quickly and the POS is often released before full due diligence on all potentially relevant matters has been completed. In

addition, institutional investor calls, site visits, and Internet roadshows may also give rise to new POS items that need to be disclosed and addressed. To make sure all investors have access to all material information relevant to their investment decision, issuers and underwriters need to promptly update (or “sticker”) the POS before undertaking to “price” the transaction. SEC Rule 15c2-12 (b)(i) permits only a few items to remain subject to finalization in a POS during the pricing process. However, many POSs continue to have additional items not permitted under 15c2-12 during the pricing process, a situation that can impair investors’ and analysts’ full understanding of the transaction. Unfortunately, SEC Rule 15c2-12(b)(i) does not apply to all municipal offerings (e.g., transactions with minimum \$100,000 denominations), which has allowed this practice of “incomplete” POSs to continue. The NFMA recommends that underwriters of all transactions, regardless of size or minimum denomination, re-circulate, in a timely manner, supplements to the POS or the amended POS with the changes highlighted. The NFMA urges issuers and underwriters to address updates to POS disclosure before pricing quickly with a formal POS supplement or “sticker.” This way a “deemed final” POS is available to all investors during the pricing process, so they will not have to wait until the final Official Statement (OS) is compiled and filed on the MSRB’s Electronic Municipal Market Access system (EMMA).

#### **P. Selective Disclosure of Information to Rating Agencies**

For publicly rated municipal offerings, issuers may be selectively providing material information to the rating agencies but not to investors by way of the POS. The NFMA believes that such selective disclosure of material information is not warranted. All material information should be included in the POS. The NFMA also notes that supplemental nonmaterial information provided to the rating agencies can be posted to EMMA as pre-sale information and recommends that practice.

#### **Q. Third-Party/Expert Work Products**

The NFMA reiterates its concerns regarding the disclosure of all third-party financial and other projections, appraisals, feasibility studies, forecasts, compilations, and engineering and environmental reports (Expert Work Products), as well as issuer and underwriter projections. The POS should disclose the existence of all Expert Work Products known to the issuer or underwriter.

#### **R. Continuing Disclosure Resources: Key Contact Information and Internet Site Links**

The NFMA recommends that the OS section regarding Continuing Disclosure be expanded to include the name and contact information of the person(s) designated by the municipal issuer to answer questions from analysts and investors on fiscal and disclosure matters after pricing the securities, regardless of whether the transaction is deemed exempt from SEC Rule 15c2-12 reporting requirements.

In addition, the NFMA recommends that issuers and obligors add to their Continuing Disclosure section (or their continuing disclosure agreement) website links to issuers' posted public information that may contain important post-issuance information (e.g., annual budgets, capital improvements plans, interim financial reports, loan and asset pool reports, etc.). Such website links will allow investors and analysts to quickly and effectively access public information needed to support an informed credit opinion. Ideally, this information should be consolidated into an easily identifiable investor relations section of the issuer's website. Where information is posted by different branches of government, links to each of the various websites should be included.

#### **IV. Defining *General Obligation* in the POS**

The terms *general obligation* and *full faith and credit* are used to describe many bond issues. Because the definition of these terms can vary from state to state, merely stating that the bond is a "general obligation bond" or that it is backed by an issuer's "full faith and credit" may be incomplete or even unintentionally misleading. For example, securities labeled "GO Bonds" may be secured by a wide array of tax and revenue sources, but they may be subject to limitations and restrictions often not clearly described in a POS.

Consequently, the NFMA believes that the terms *general obligation* and *full faith and credit* should be more fully described in the introductory section of a POS.

In order to allow an analyst or investor to ascertain the relative strength of GO and full-faith-and-credit pledges, the NFMA recommends that the security section of the POS include a discussion of the following:

- What specific taxes, revenues, or funds are dedicated to pay the debt service?
- Under state law, what is the legal authority governing the use of property taxes earmarked for the payment of debt service? Is it constitutional or statutory? Are there provisions giving budgetary priority to the allocation of taxes to debt service?
- Is new or additional voter or other approval needed to generate the requisite taxes, revenues, or funds? If so, what is the plan for obtaining such approval?
- Does the issuer have autonomous authorization to raise tax rates or revenues for repayment of the bonds?
- Is the raising of taxes and generating of revenues subject to any existing state or local debt or tax limits?
- Are the taxes, revenues, or funds needed to pay debt service required to be placed in a separate fund or account? If so, when does this take place?
- Are there material legal or practical limitations or restrictions on increasing taxes or revenues?
- Are intercept mechanisms of pledged revenues used?

- What are the steps necessary to increase taxes or revenues?
- Is the issuer able to use, borrow, or otherwise access or interrupt the flow of pledged taxes, revenues, or funds before application to debt service?
- Is a tax or revenue pledge enforceable by the bond trustee and/or bondholders by mandamus action or by another state law remedy?
- Do state courts in the issuer’s jurisdiction have a history of being reluctant to approve or mandate tax or revenue increases in trustee/investor actions?
- Is there a history of issuer reluctance to approve or mandate tax or revenue increases?
- Is any tax or revenue pledge secured by a statutory lien or by other security mechanisms?
- Is the issuer permitted to file for bankruptcy? If the ability to file for bankruptcy is restricted by certain conditions, those conditions should be described. If the issuer is permitted to file, what is the expected effect on its general obligations?
- Is there pending or threatened litigation challenging a tax?
- What would be the practical financial impact on the issuer if such litigation were successful?

In addition, specifically with reference to full-faith-and-credit (FFC) bonds, the NFMA recommends that the POS address the following:

- Is an FFC bond payable from all taxes, revenues, and fund balances of the issuer?
- Is only the general fund of the issuer available to pay FFC bonds?
- Are FFC bonds payable only from unrestricted general fund balances, or can they be paid from some other combination of revenues and funds?
- Is there any form of pledge of these revenues or funds for FFC bonds?
- Is there any budgeting priority or earmarking of these funds/balances to pay debt service on FFC bonds?

## **V. Limited Offerings and Private Placements**

Municipal bonds that are offered to sophisticated investors only are frequently referred to as *limited offerings* and *private placements*. These bonds generally involve riskier sectors of the municipal market. Payment of debt service on these types of bond issues frequently depends upon the performance of private obligors and/or newly created entities with limited or no operating history. These securities may also depend for payment upon revenues from start-up projects that do not necessarily provide essential services to the sponsoring governmental entity. Commonly, many of these risk factors may be present with these types of bonds. Sale and/or trading of these securities in the secondary market may also be limited or prohibited.

### **A. Disclosure and Due Diligence Issues**

Regardless of whether a municipal bond offering is a public offering or a limited offering, the NFMA takes the position that investors are entitled to rely on the material accuracy, timeliness, and completeness of information that is provided to them by issuers or underwriters.

However, issuers and/or underwriters of limited offerings and private placements have used disclaimers of responsibility or “investor letters” that require investors to certify that they are not relying on the issuer or underwriter for any disclosure or due diligence matters on the project, the obligor, and so on.<sup>7</sup> These letters may also require investors to certify that they have had the opportunity to review the preliminary offering documents and any other relevant documents, and have also had the opportunity to ask questions before purchasing—essentially these letters constitute a form of due diligence disclaimer. The NFMA believes that these disclaimers and investor letters are not appropriate, that issuers must still disclose all material information relevant to the offering, that the POS must disclose all material information in the underwriter’s possession, and that underwriters must still conduct due diligence in order to form a reasonable basis for belief in the representations made in the offering documentation. These disclaimers do not absolve the issuer, or their underwriters, of their obligations under the anti-fraud provisions contained in Rule 10b-5 under Section (10)b of the Securities and Exchange Act of 1934, as amended, or Section 17(a) of the securities Act of 1933.

### **B. Continuing Disclosure Issues**

For limited offerings exempt from SEC Rule 15c2-12, continuing disclosure agreements are not required. Nevertheless, the NFMA recommends that issuers agree to disclose to investors annual and interim financial statements, operating information, the occurrence of material events, and so on, just as they would with an offering subject to the Rule. In order to improve secondary market liquidity, as well as to provide equal access to updated information for all investors, this information should be posted to the MSRB’s EMMA system.

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<sup>7</sup> As the NFMA uses the term *underwriters* in this discussion, we include placement agents. The NFMA recognizes that pure conduit issuers, as opposed to obligors, generally are not considered in the market to have substantive disclosure responsibilities.

## **PART TWO: EXAMPLES OF DEFICIENT OFFERING DOCUMENTS**

### **I. Examples of Problematic Bond Titles**

The following examples of municipal bond titles have significant potential to mislead investors and to confuse other market participants about the actual security for the bond issues. The NFMA recognizes that issuers may have had reasons for the use of the titles, but given the repetition of the titles by market information services and others, we believe strongly that the actual security needs to be reflected in the title in a clear and appropriate manner. Because these examples are intended only as a sample of such practices, we describe these bond issues without specifically identifying the issuer.

#### **ABC County, General Obligation Capital Improvement Warrants**

Issue: Use of the term *General Obligation* is a problem here. It is not until page 10 that it is disclosed that certain revenues “available to the county for payment of debt service” include “ad valorem taxes, sales, business license and occupational taxes and other general fund revenues available.” But the next sentence says “None of such revenues are...pledged for payment of debt service on the ... Warrants...” On pages 22–23 it is disclosed that only the state legislature can approve ad valorem property tax increases, which then must be approved by local voters.

Recommendation: Clearly state the limitation of the tax pledge on the cover of the POS and early in the body of the POS.

#### **State DEF, State Loan and Investment Board, Tax-Exempt Capital Facilities Refunding Revenue Bonds**

Issue: The title provides no clear indication of security provisions. These originally appear as if they might be state obligations, but later it is disclosed that they are secured by oil severance monies. There is no description of the security for the bonds until page 14, and even then it is very vague. On page 13, the POS describes the particular authorizing legislation in very legalistic language.

Recommendation: It would be helpful to say, on the cover page, something to the effect of “The Bonds are secured by a repatriation of certain federal oil and gas severance taxes, as described herein.”

## **GHI State Water Commission, Water Development Trust Fund, Water Development and Management Program Refunding Bonds**

Issue: The word *water* is used three times in the large bold-faced title of the POS, but no water revenues are pledged as security for the bonds. The cover page gives no indication of the security for the bonds. The security section on page 2 indicates that the bonds instead are secured by tobacco settlement monies and monies in the “Resources Trust Fund.” The Definition of Resources Trust Fund (page 4) indicates the fund is funded by a state oil extraction tax.

Recommendation: The security pledged for the bonds should be reflected in the title of the transaction, on the cover of the POS, and early in the body of the POS.

## **II. Examples of Other Deficient Practices**

### **JKL County Limited Obligation School Warrants**

Issue: The POS does not describe the actual sales tax base (i.e., what can be taxed: does this include or exclude food, clothing, medicine?) or the combined tax rate with other jurisdictions.

Recommendation: Clearly describe the tax base and any material exclusions to that base. Also describe the overlapping (e.g., state and city) sales tax rates and total effective tax rate.

### **MNO Urban Renewal Authority, Senior Tax Increment Revenue Bonds**

Issue: Offering documents for this tax allocation bond omit key information such as the trend in assessed value (AV), delinquencies, and so on. The main table showing property tax and sales tax revenues does not show their derivation.

Recommendation: Provide all of this information in table format.

### **(1) PQR Finance Authority Tax-Exempt Private Activity Bonds**

This was a low rated (NR/BBB/BBB), highly complex public-private partnership transportation transaction with multiple parties and operative agreements. The POS is 418

pages long. The POS was released on a Tuesday afternoon, the roadshow took place the following Friday, and pricing the following Tuesday.

**and (2) STU Finance Authority Transportation Bonds**

This also was a low rated (Baa3/BBB-/NR), highly complex public-private partnership transportation transaction with multiple parties and operative agreements. The POS is 918 pages long. The POS was released the Friday before Labor Day. The roadshow took place a week after Labor Day and pricing was the following day.

Issues: Insufficient time was available to review either transaction. The PQR bonds had only six business days available for review. The STU issue provided only five business days between the POS release and the roadshow, and only half a day between the roadshow and the pricing date, allowing little time for follow-up. In neither case was purchaser's counsel provided. These types of issues often take months, if not years, to bring to market. A lengthy consultation period has likely occurred between the issuer and the rating agencies. The practice of not providing the investor sufficient time to fully diligence the details of such an issue is not beneficial to the marketplace or the municipal bond industry as a whole.

Recommendation: In both cases, provide investors with sufficient time to review the transaction based on its complexity and risk level. See Section II B "POS Release Considerations" above.

### **PART THREE: NFMA COMMENTS AND PAPERS INCORPORATED BY REFERENCE**

- Recommended Best Practices in Disclosure for Variable Rate and Short-Term Securities, August 2012
- White Paper on Expert Work Products, June 2011
- White Paper on Federal Securities Law Relating to Municipal Securities, March 2008
- White Paper on Project Finance Risk Assessment and Disclosure, August 2006
- Recommended Best Practices in Disclosure for Hospital Debt Transactions, September 2012
- Recommended Term Sheet and Legal Provisions for Hospital Debt Transactions, December 2005
- NFMA Comment on Draft Amendment to Limit Dealer Consents to Changes in Authorizing Documents for Municipal Securities, MSRB Rule G-11 Comment, dated July 30, 2012

## **PART FOUR: THE NFMA MEMBER SURVEY ON NEW ISSUE PRACTICES**

From April through June, 2013, NFMA members were invited to participate in a survey on new issue practices. Of the approximately 1,300 NFMA members, 113 completed the survey.

### **Summary of survey results**

- 54% characterized primary market disclosure as inconsistent, with 42% saying it was generally adequate.
- For high-grade bonds, 46% of recipients said five business days comprise a reasonable review period, and 43% thought three business days were sufficient.
- For lower grade bonds, 41% said ten business days were needed for review and 40% said five days were needed.
- For higher grade bonds, 28% thought a “comprehensive risks” section was essential and 61% thought it was desirable; for lower grade bonds these figures were 87% and 13%, respectively.
- For both low- and high-grade bonds, 97% and 68% of respondents, respectively, preferred the opportunity for a “live” question-and-answer session or the opportunity for a one-on-one with the issuer/underwriter over the exclusive use of pre-recorded material.
- A plain English summary of the transaction was considered either essential or desirable by 84% of analysts (for high-grade bonds) and 93% (for low-grade bonds).
- 29% thought it was essential that the pledged security be reflected in the title, and 40% thought it essential for it to be somewhere on the cover page of the POS; 56% and 49% thought it “desirable” to indicate the pledged security on the title and cover page, respectively, of the POS.
- 77% of respondents said they were “sometimes” or “frequently” aware that other parties had access to material information not disclosed in offering documents.
- 71% thought disclosure of bank loans, swaps, large capital leases, and derivative exposure was materially deficient in POSs.
- 87% thought prohibitions on keeping or printing Internet roadshow materials were not acceptable.
- Regarding private placements, a majority thought it was not appropriate that the placement agent undertake less due diligence than with public offerings, and a majority thought that requiring “investor letters” was inappropriate.

## Appendix I: Summary of Recommendations

<b>Item/Section</b>	<b>Recommendation</b>
Roadshow	"Live" Q&A is preferable to prerecorded roadshow without Q&A. Security discussion should be permitted. Presentation material should be portable.
Time between POS Release and Pricing	For high grade, allow three or more business days.  For low grade, allow ten or more business days. For high risk, have non-deal roadshow or information sessions well in advance of offering period.
Site Visit Timing	Site visit should occur after the release of POS.
Purchaser's Counsel	This should be provided for certain complex, lower rated, speculative transactions.
Issue Name	The name should reflect the security pledged.
Ratings	Place the ratings on cover page of POS, along with ratings outlook modifiers.
Summary Section	Provide a plain English summary section for all but the simplest transactions. The summary should include a description of all transaction parties, payment sources, key documents, sources and uses of proceeds, any collateral, flow-of fund priorities, any unusual redemption or call options, and rate-setting provisions
Debt Service Schedule	Include a table with the estimated schedule, with separate columns for new and outstanding debt.
Financial Covenants	Include a table illustrating ratios, historical and projected, early in body of POS.
Security Provisions	Identify the pledged security, preferably on the cover page of the POS and also in the summary.
Security Section	Include a full definition of financial covenants, additional bonds tests, and reserve requirements without having to reference definitions in appendices.  Debt service reserve requirement should be defined in the Security Section, along with funding sources—e.g., cash, letter of credit or surety—including substitution provisions and replenishment requirements.  Provide a table detailing issuer's debt obligations that are pledged from or intended to be paid from the same revenue stream.

	<p>Provide a flow-of-funds diagram, both pre- and post-default. Summarize bankruptcy eligibility, receivership, and authorization procedures.</p>
Bank Loans and Other Private Financing Sources	<p>Provide details including covenants, accelerations, and rate change provisions.</p>
Swaps and Derivatives	<p>Provide a table showing all swaps and derivatives with their terms: the dates, terms and conditions, collateral posting requirements and triggers, term-out provisions, mark-to-market values, counterparty identifications, and ratings triggers.</p>
Risk Section	<p>Provide risk descriptions for all transactions, starting with issuer-specific risks and then going on to broader, generic risks.</p>
Refunding Status	<p>Expressly state if the refunded bonds are being legally defeased pursuant to their indenture or only economically defeased.</p>
Bond Counsel and Other Legal Opinions	<p>Reliance should be disclosed in the body of the POS, and the supporting legal opinions should be attached.</p>
Documents Referred to in the POS	<p>Material provisions of those documents should be summarized in plain English in the body of the POS even if those documents are also summarized in appendices to the POS; and URLs for the supporting legal documents should also be provided.</p>
Financial Statements	<p>If the fiscal year end of statements has occurred more than six months prior to the offering, provide interim financials, details on the status, and probable release date of the new financial statements.</p>
Underwriter-Led Consents	<p>If the bond purchaser is effectively consenting to changes in bond documents, clearly state this in the Summary and Risks sections. If an underwriter is accumulating consent rights, provide details. Provide a table with security provisions before and after the consents.</p>
Selective Disclosure Considerations	<p>Any material information provided to rating agencies should also be provided to potential investors as part of the POS.</p>
Expert Work Products	<p>Disclose all third-party financial and other projections, feasibility studies, forecasts, and so on, including any such products obtained by the issuer or underwriter within the past two years.</p>
Contact Information	<p>Include name, position, and contact information for key bondholder relations official. Also provide a website link to the issuer's posted public information.</p>