SEC Charges Kansas for Understating Municipal Bond Exposure to Unfunded Pension Liability

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Washington D.C., Aug. 11, 2014 — The Securities and Exchange Commission today announced securities fraud charges against the state of Kansas stemming from a nationwide review of bond offering documents to determine whether municipalities were properly disclosing material pension liabilities and other risks to investors. According to the SEC's cease-and-desist order instituted against Kansas, the state's offering documents failed to disclose that the state's pension system was significantly underfunded, and the unfunded pension liability created a repayment risk for investors in those bonds.

Shortly after its nationwide review of municipal bond disclosures began, the SEC brought its first-ever enforcement action against a state when it sanctioned New Jersey for failing to disclose to investors that it was underfunding the state's two largest pension plans. Around the same time, the SEC began questioning the disclosures surrounding eight bond offerings through which Kansas raised $273 million in 2009 and 2010. As the SEC began its inquiry, Kansas began adopting new policies and procedures to improve disclosures about its pension liabilities. Kansas has now fully implemented those remedial actions, and has agreed to settle the SEC's charges for its prior incomplete disclosures.

The SEC also charged Illinois last year for its misleading pension disclosures, and the state similarly implemented a number of remedial actions.

"We're pleased that our actions have resulted in improved disclosure of pension liabilities in states that were not making investors aware of a significant repayment risk," said Andrew Ceresney, director of the SEC Enforcement Division. "Investors must be given adequate information to evaluate the impact of pension fund liability on a state's overall financial condition."

According to the SEC's order against Kansas, the series of bond offerings were issued through the Kansas Development Finance Authority (KDFA) on behalf of the state and its agencies. According to one study at the time, the Kansas Public Employees Retirement System (KPERS) was the second-most underfunded statewide public pension system in the nation. In the offering documents for the bonds, however, Kansas did not disclose the existence of the significant unfunded liability in KPERS. Nor did the documents describe the effect of such an unfunded liability on the risk of non-appropriation of debt service payments by the Kansas state legislature. The SEC's investigation found that the failure to disclose this material information resulted from insufficient procedures and poor communications between the KDFA and the Kansas Department of Administration, which provided the KDFA with the information to include in the offering materials.

"Kansas failed to adequately disclose its multi-billion-dollar pension liability in bond offering documents, leaving investors with an incomplete picture of the state's finances and its ability to repay the bonds amid competing strains on the state budget," said LeeAnn Ghazil Gaunt, chief of the SEC Enforcement Division's Municipal Securities and Public Pensions Unit. "In determining the settlement, the Commission considered Kansas's significant remedial actions to mitigate these issues as well as the cooperation of state officials with SEC staff during the investigation."

According to the SEC's order, Kansas has since adopted new policies and procedures to help ensure that appropriate disclosures about pension liabilities are being made in its offering documents. Kansas designated responsible parties in state agencies critical to the disclosure process, mandated closer communication and cooperation among those agencies, established a disclosure committee, and now requires annual training of key personnel. Without admitting or denying the findings, Kansas consented to the SEC's order to 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 of 1933.

The SEC's investigation was conducted by Robert Hannan and Eric Werner in the Fort Worth Regional Office with assistance from members of the Municipal Securities and Public Pensions Unit including Joseph Chimienti, Creighton Papier, Jonathan Wilcox, and Mark Zehner (deputy chief).

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- SEC order