



State Disclosure Review Highlights

Recent SEC enforcement actions have demonstrated that some local governments have had difficulty filing required financial disclosure documents on a timely basis and disclosing that fact when they next issued bonds.¹ State governments are in a unique position to help ensure that local governments meet their disclosure obligations going forward.

SIFMA has conducted a thorough, 50-state² review of laws and regulations that govern local government disclosure, issuance and audit practices. SIFMA undertook the review to determine the extent to which states oversee the continuing disclosure activity of local governments. Continuing disclosure involves the public dissemination of annual financial statements and certain event notices that are material to investors who own or may consider buying bonds issued by governments, authorities, agencies, districts and other public sector issuers. Disclosure requirements in federal securities laws are designed to help ensure that investors have ready access to material information on which to base investment decisions. Disclosure is especially relevant in the municipal securities market, where over 40 percent of bonds are held directly by households.

In its review SIFMA looked at questions like whether states require localities to submit and make public official statements (OSs), audited annual financial statements and other information relevant to investors. Highlights of our findings are below.

Key findings

Only one state, Louisiana, has a law in place designed to help ensure that local governments meet their legal disclosure obligations. In 2014 Louisiana enacted Act 463, a state law which both: (1) requires local governments to maintain records of Continuing Disclosure Agreement (CDA) requirements and compliance actions; and (2) requires financial auditors to examine governments' CDA records and check that local governments have made required financial filings.

Some states have policies in place that require the filing of OSs with state repositories and impose other disclosure requirements on local governments related to bond issuance. These states include: Arizona, California, Colorado, Florida, Illinois, Indiana, Kentucky, Louisiana, Michigan, Missouri, New York, North Carolina, Oklahoma, Oregon, Tennessee, Washington and West Virginia. Four states and one territory have laws in place requiring the filing of financial audit information and make those filings publicly

¹ See U.S. Securities and Exchange Commission Statements on the Municipalities Continuing Disclosure Cooperation Initiative. For example, see, U.S. Securities and Exchange Commission, "SEC Completes Muni-Underwriter Enforcement Sweep," February 2, 2016, at: www.sec.gov/news/pressrelease/2016-18.html.

² The review includes all 50 states as well as the District of Columbia and Guam, Puerto Rico and the U.S. Virgin Islands.

available: California, Missouri, New Jersey, Texas and the U.S. Virgin Islands. These policies are a positive step towards improving market transparency.

While these initiatives help improve the availability of financial information, they generally are targeted at citizens and taxpayers, not investors. Also, they do not help ensure that local governments are in compliance with their continuing disclosure obligations under federal securities rules.

Conclusions

States have a unique opportunity to be proactive in helping to ensure that local governments that issue bonds in the public market make complete and timely disclosure of financial information and comply with all federal and contractual requirements. We encourage states to build on existing financial disclosure regimes with the goal of ensuring that investors have access to the financial information they need and that local governments are in compliance with their obligations. SIFMA believes states can do this by adopting laws to ensure that local government issuers, at a minimum, meet all federal and contractual requirements. These laws could include:

- Requiring auditors to check for compliance with continuing disclosure requirements in the context of annual or periodic financial audits; and
- Requiring local governments to adopt internal policies and procedures related to compliance with all disclosure requirements.

In addition, some states have processes in place that could be leveraged to help ensure disclosure compliance. In North Carolina, for example, all local government bond issues are generally required to be approved by the Local Government Commission. A state with such a process already in place could include compliance with outstanding CDAs as a condition of approving future bond issuance.

Background

The disclosure regulatory regime in the municipal market is different from other sectors of the U.S. capital markets. The U.S. Securities and Exchange Commission (SEC) has relatively little direct authority over the disclosure practices of state and local governments that issue securities in the public markets. Instead, SEC Rule 15c2-12 imposes certain requirements on municipal securities underwriters with indirect, implied requirements for state and local issuers. For example Rule 15c2-12 requires underwriters, before they offer securities to investors, to obtain from the issuer and review Official Statements, offering documents that describe the instruments being offered and contain information material to the securities. In addition, underwriters must obtain from issuers a contractual agreement—a “Continuing Disclosure Agreement”—to file certain financial information to the Municipal Securities Rulemaking Board’s information repository on a continuing basis as long as bonds are outstanding. However, unlike in the corporate securities markets, the SEC does not have the authority to directly impose disclosure requirements on municipal bond issuers.

Some investors have argued that disclosure practices in the municipal market are not always as robust as they could be, and publicly available financial information is sometimes delayed or unavailable. When

an issuer fails to make required financial disclosure filings, the SEC does not have the authority to sanction issuers directly. The only recourse is for investors to sue a delinquent issuer for performance, a time-consuming, expensive and unattractive option. States, however, generally have the authority to enact laws and regulations governing local government financial practices, including disclosure. SIFMA undertook this review of state policies to determine which states currently exercise authority over local government disclosure practices and to identify best practices among the states.

June 15, 2016