

*National Federation of Municipal Analysts*  
*White Paper on Best Municipal Bond Issuance Practices*



**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, there is considerable variation in new issuance practices of municipal issuers, underwriters,<sup>1</sup> and financial advisors.

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 access to issuers, so that market participants 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 parties the expectations of municipal investors and credit analysts.

This White Paper outlines best offering practices and procedures for issuers and underwriters regarding 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 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. We also seek 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 that they may as a result 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.

***Please note that this White Paper does not constitute legal advice to any participant in the municipal bond market, including, among others, bond issuers, obligors, broker-dealers, and/or law firms. The White Paper represents NFMA's recommended primary market disclosure, based on our experience as municipal credit analysts and market participants, of information that is important when we assess the credit features and security provisions of a tax-exempt bond issue.***

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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 have increased. This change has occurred at a time when the percentage of issues covered by bond insurance has dropped from approximately 50% to less than 10%, increasing the need for and importance of fundamental credit analysis.
- Second, a wide variety of idiosyncratic offering practices is used by municipal issuers and underwriters.
- Third, new issue municipal practices are not subject to the same regulatory requirements 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 municipal issuers and offerings.
- Fourth, the NFMA is of the opinion that there is insufficient market guidance regarding events that occur during pre-pricing periods for municipal bond issues and in preparation of preliminary offering statements (POSs) for those issues. Given that one of NFMA's goals is to improve 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, 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 illustrate the process by which credit analysts and investors typically make investment decisions. The White Paper begins with a discussion of the pre-pricing period, including any internet-based presentation. Next it examines the standard format of a POS from its cover page to its appendix. A more detailed section regarding the definition of 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 describe key information of interest to investors. The NFMA believes these practices can be improved as follows:

### **A. Internet-Based Presentations**

These presentations can be very helpful to investors and analysts; they are a useful complement and/or substitute for in-person presentations. Internet presentations, or "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 roadshow presentation is very valuable, especially for more complex transactions. However, 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.
3. *Portability*: The post-roadshow availability of material used during the presentation, such as PowerPoint presentations, is highly inconsistent among issuers. In some cases, the material is available only during the time of the in-person roadshow or is online, but only during the pre-pricing period. In other instances, the same PowerPoint presentations are posted on an issuer's website. Provided that material in the internet roadshow is derived from and comparable to material in the offering documents, there appears to be no compelling reason to make any roadshow information 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 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**

Having insufficient time to review a transaction presents particular problems to municipal analysts for a number of reasons, including the following:

- The innate complexity of some bond offerings requires a substantial amount of time on the analyst's part in order to fully assess the risks of a transaction. Many of these offerings are frequently accompanied by a POS of several hundred pages and supporting bond documents that comprise, in addition to the POS, hundreds of pages;
- Analysts and/or their firms typically have a fiduciary duty that requires a sufficient review of a transaction; and
- Analysts with a Chartered Financial Analyst (CFA) designation have additional duties that require them to have a “reasonable basis” for making investment recommendations.

Based on the NFMA member survey, there should be at least three full business days between release of a 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 a POS and bond pricing.

For bond issues that have voluminous offering documents and complex structures, we suggest that municipal issuers follow the corporate practice of *non-deal roadshows*.<sup>3</sup> Another option is that used for the municipal high yield sector, where information sessions are held 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 a few days after release of the POS, in order to allow investors sufficient time to understand the transaction and formulate relevant questions.

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

For bond issues/projects that involve project finance risk, public-private partnerships, multiple operating and financing agreements, technological complexity, or lengthy construction programs, the NFMA recommends that the issuer provide purchaser's counsel. Counsel fees are typically paid from bond proceeds.

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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.

### **III. POS Contents**

The POS is a time-of-sale document on which investors rely to make investment decisions. Investors should be informed in a POS of all material information that exists prior to completion of pricing. The POS should clearly and concisely describe, both on the cover and in the introductory section, the nature of the pledged revenues without need for the reader to refer 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.

#### **A. Issue Name**

Bond-pricing services often use the name of a bond issue as their basis for making particular sector-pricing decisions. 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 reflects the revenue stream that secures the bonds rather than the purposes for which bond proceeds will be used.

Part Two of this White Paper provides several examples of bond issue names where the pledged security was materially different than the name of the bonds, potentially misleading investors and analysts. For example, “water” bonds were issued that were in fact secured by sales taxes on cigarettes.

A related problem that has recently received particular attention is the exact meaning of the term *General Obligation*. We discuss this controversy in Section IV, “Defining *General Obligation* in the POS.”

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

Public rating(s), including any 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 useful to all investors and credit analysts. As we use the term, “Plain English” entails orderly and clear presentation of complex information that uses words economically, is well-organized and easy to read, avoids extensive and/or redundant use of technical and “defined” terms, and avoids lengthy sentences.<sup>4</sup> A Plain English approach is particularly

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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>.

important in the case of more complex transactions. We also recommend that a summary include a description of all transaction parties, bond payment sources, key documents and the general purpose of those documents, estimated 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 include a Plain English description of how rates and terms are set along with a table that identifies the applicable rate setting, rate periods, redemption, and maturity modes.

#### **E. Debt Service Profile**

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 at an assumed interest rate, with separate columns for outstanding and new debt as well as interest rate assumptions on any variable rate debt. It is also important for an issuer to include any anomalies in its debt service schedule such as bullet maturities within bond issues, maturities of notes payable from the revenue stream, and similar items.

#### **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 crucial to a clear presentation of bond security. The NFMA is of the opinion that the following areas 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 presentation of bond security. This is especially important in cases where the intended source of debt service payment differs from what is legally pledged. Confusion also occurs when a POS indicates that bonds are secured by the “Trust Estate” or by “Revenues,” and the investor or analyst must study the POS, including its appendices, in order to understand the meanings of these terms. 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. *Identify Collateral.* If bondholders will have a security interest in collateral, include language describing the collateral, e.g. whether there are senior, parity, or subordinate liens on it.
3. *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 future misinterpretation. The debt service reserve fund requirement and funding sources—for example, cash, letter of credit, or surety, including substitution provisions and replenishment requirements—should be defined and described 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, as it is confusing and subject to multiple interpretations. We recommend such language be replaced by direct, clear statements such as “the debt service reserve fund requirement is the lesser of \$X, 10% of par, or MADS,” along with an indication of which of these three amounts is expected to occur at closing.
4. *Provide a Table Detailing the Issuer’s Debt Obligations.* It is often difficult to determine an issuer’s other debt that shares the same revenue stream or fund(s) for repayment. A table should be provided that clarifies the issuer’s other obligations. 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 and/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 par amount and dated date, the rate, and the amortization profile, along with subtotals for each column.
5. *Provide Flow of Funds Diagrams.* The NFMA recommends that the POS contain a flow of funds/waterfall diagram, both pre- and post-default.
6. *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, 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.

7. Provide information on any state law under which officials can appoint an emergency manager or similar oversight body.

## **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. Because of this, 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 privately placed bank financings.

Important credit information regarding these privately-placed bond issues, e.g. debt service schedules and coverage ratios, for these securities should be incorporated into relevant sections of a POS for subsequent publicly-offered municipal securities. 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>

## **I. Swaps and Derivatives**

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

## **J. Specific Investment Risks**

Every municipal bond issue 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 issue. The NFMA recommends that transaction-specific risks be placed in the beginning of this section, followed by any generic risk discussion.

## **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 only 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 will be only economically defeased.

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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>.

<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.

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

If bond counsel is relying on an opinion of special tax counsel and/or other 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. Without this information, the bond trustee and investors may have limited or no standing to make any claims against the law firms that give these supporting legal opinions in the event the opinions prove to be problematic.

In addition, disclosure of the identity of these supporting law firms will allow investors to assess how much legal complexity or uncertainty may be involved in a transaction. Finally, 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.

Finally, one additional concern regarding legal opinions is that 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. NFMA recommends that bond counsel's legal opinion should always include the trustee, if any, as an addressee.

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

1. *Material Documents.* When a 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 discussed in greater detail in appendices to the POS. In addition, the POS should contain an internet link for each supporting document. This would help ensure readability of documents that due to formatting needs are rendered illegible in a POS. Finally, we recommend that all bond documents be made available on EMMA.
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 a) identifies any expected change in auditing firm, b) provides the expected release date of those statements, and c) notes any material subsequent events that have occurred since the end of the most recently 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. Unaudited information - interim or for a full fiscal year - should be included in the POS. To help cover the time gap between release of the most recently-audited financials and the new bond offering, any link to an issuer’s website(s) that have 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 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 security provisions before and after such consents should be provided. If the issuer does not yet have a sufficient majority to effect such changes but is in the process of accumulating such a majority, it is important to state this circumstance along with a tabulation of how many consents have been accumulated and how many are still needed.

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

In the municipal market, transactions often are brought to market quickly and the POS may be released before due diligence on all potentially relevant matters has been completed. In addition, institutional investor calls, site visits, and internet roadshows may also prompt new POS items that need to be disclosed and addressed. To make sure all investors have access to material information, issuers and underwriters need to promptly update, or “sticker”, the POS before pricing the transaction. SEC Rule 15c2-12 permits only a few items in a POS to remain subject to finalization. However, many POSs continue to omit additional items not permitted under 15c2-12 during the pricing process, a situation that can impair investors’ and analysts’ full understanding of a transaction. Unfortunately, 15c2-12 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, recirculate in a timely manner supplements to a POS or amended POS with the changes highlighted. This process, which will result in a “deemed final” POS, will eliminate the need for investors to wait until the final OS is filed with EMMA.

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

For rated municipal offerings, issuers may be providing material information to the rating agencies but not to prospective investors. The NFMA believes that such selective disclosure of material information is not warranted. All material information should be included in a 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 disclosure of all third-party financial and other projections, appraisals, feasibility studies, forecasts, compilations, and engineering and environmental reports (i.e. "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.<sup>7</sup>

### **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 issuer or obligor 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 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 improvement plans, interim financial reports, collections of taxes that may be dedicated to payment of debt service, loan and asset pool reports, etc.). 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.

### **S. Executive Compensation**

If the bonds are to be repaid by a nongovernmental entity not subject to SEC disclosure regulations, e.g. a college or hospital that is also a 501(c) (3) corporation, information regarding executive compensation should be provided in the POS. This information should include details on cash, deferred and other compensation for the top five executives over the past three years, and a brief discussion of compensation policy

## **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 frequently varies among states, saying 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 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.

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<sup>7</sup> Please refer to NFMA's *White Paper on Expert Work Products*, <http://www.nfma.org/disclosure-guidelines>.

Consequently, the NFMA recommends that the terms *general obligation* and *full faith and credit* should be more fully described in the introductory section of a POS. Information provided should include specific authorizing language for the bonds as cited in the state constitution, state legislation, issuer ordinance, or other legal authority.

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 debt service?
- In a given state, what is the legal authority governing the use of property taxes earmarked for the payment of debt service? Is it constitutional or statutory? Do these provisions give budgetary priority to allocation of taxes for payment of debt service?
- Does the issuer have autonomous authorization to raise tax rates or revenues for repayment of the bonds?
- 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?
- Is there an intercept mechanism for pledged revenues that will be used immediately after issuance or upon the occurrence of certain adverse credit conditions?
- What remedies do bondholders have to require an issuer to levy and collect taxes or other revenues if there is a debt service default?
- Do state courts in the issuer's jurisdiction have a history of being reluctant to approve or mandate tax or revenue increases for payment of debt service?
- Is there pending or threatened litigation challenging the intended source of debt service payment?

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 pledge of 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/or *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. Frequently, many of these risk factors may be present. Sale and/or trading of these securities in the secondary market is usually limited to certain classes of investors or prohibited.

### A. Disclosure and Due Diligence Issues

Regardless of whether a municipal bond issue 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, also known as “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, or other parties to the transaction.<sup>8</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 inappropriate in that as a matter of industry practice - regardless of whether there is a legal obligation on the part of issuers and their representatives to do so - these parties should disclose all material information relevant to the offering, and underwriters should conduct due diligence in order to provide a reasonable basis for belief in the representations made in offering documents.<sup>9</sup>

Investors expect placement agents to conduct due diligence in accordance with general market practices. This is the case unless all of the following conditions exist:

- The placement agent(s) function solely in an introductory role between obligors and investors,
- The agents do not participate in the preparation or delivery of offering documents,
- The agents do not place their names on the offering documents, and

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<sup>8</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.

<sup>9</sup> 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.

- The agents explicitly inform investors that they are not verifying information provided by the obligor or otherwise in the offering documents.

When no due diligence or when limited due diligence is conducted by a placement agent that party should disclose that situation clearly and conspicuously in the opening pages of the placement memorandum. This information should include the nature of the limitations on due diligence and any information about waivers of due diligence requested of the obligor.

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

For limited offerings exempt from 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, and material events, 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 also be posted to EMMA.

## **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 actual security for a bond issue. The NFMA recognizes that issuers may have had legitimate reasons for the use of the titles, but given their use by market information services and others, we believe strongly that the actual security for the bonds needs to be clearly reflected in the title. Because these examples are intended only as a sample of such practices, we describe them without identifying the issuer.

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

Issue: Use of the term *General Obligation* is somewhat misleading. It is not until page 10 of the POS that investors learn 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, e.g. in the "Introduction" to the POS.

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

Issue: The title provides no clear indication of security for the bonds. An investor could get the impression that these are the state's obligations, but later it is disclosed that bonds are secured by oil severance taxes. There is no description of the security for the bonds until page 14, and even then the language is very vague. On page 13, the POS describes the authorizing legislation, but only in a very legalistic manner.

Recommendation: It would be helpful to include on the cover page language such as “The Bonds are secured by certain federal oil and gas severance taxes, as described herein.” Including this information in the title of the bonds, e.g., "State Loan and Investment Board, Tax-Exempt Capital Facilities Oil and Gas Severance Tax Refunding Revenue Bonds", would also clarify which revenues actually secure the bonds.

## **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 security for the bonds. The security section on page 2 indicates that the bonds are secured by tobacco settlement monies and monies in the “Resources Trust Fund.” The definition of Resources Trust Fund (page 4) indicates that it 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**

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

Issue: For these bonds, payable from sales tax receipts, the POS does not describe the actual sales tax base (i.e., what can be taxed and whether the tax base includes, for example, food, clothing, or medicine). The combined tax rate, including rates applied by overlapping jurisdictions, is also not included.

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.

### **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, delinquencies, and so on. A table that shows property tax and sales tax revenues does not indicate the source of this information.

Recommendation: Provide all of this information in table format.

### **Finance Authority Tax-Exempt Private Activity Bonds**

Issue: This was a low rated (NR/BBB/BBB), highly complex bond issue for transportation purposes. It was financed via a public-private partnership and had multiple parties and operating agreements. The 418-page POS was released on a Tuesday afternoon, the roadshow took place the following Friday, and pricing occurred the following Tuesday.

### **Finance Authority Transportation Bonds**

The structure of this bond issue was very similar to that of the "Finance Authority" noted immediately above. Ratings were (Baa3/BBB-/NR. The 918-page POS was released the Friday before Labor Day, with a roadshow occurring a week after Labor Day and pricing the next day.

Insufficient time was available to review either of these "Finance Authority" transactions, and in neither case was purchaser's counsel provided. Given that these types of issues frequently take years to develop and bring to market, there appears to be no reason for the financing team to not give investors sufficient time to perform due diligence on this type of bond issue.

Recommendation: 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 Hospital Debt Transactions*, September 2012
- *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 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*, July 2012

*Recommended Best Practices* and *White Paper* publications can be found here:

<http://www.nfma.org/disclosure-guidelines>.

The *NFMA Comment* can be found here: <http://www.nfma.org/position-statements>.

## **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 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 meetings with the issuer or underwriter, as opposed to use of pre-recorded material only.
- 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% of respondents 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

Item/Section	Recommendation
Roadshow	"Live" Q&A is preferable to prerecorded roadshow without Q&A.
	Security discussion should be included.
	Presentation material should be portable.
Time between POS Release and Pricing	For high grade, three or more business days.
	For high risk/ low grade, ten or more business days.
	For high risk/low grade, provide non-deal roadshow or information sessions well in advance of offering period.
Site Visit Timing	Site visit should occur no sooner than a few days after release of the POS.
Purchaser's Counsel	Should be provided for certain complex, lower rated, and/or speculative transactions.
Issue Name	Should indicate the security pledged.
Ratings	Place on cover page of POS, along with 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, collateral, flow-of-fund priorities, any unusual redemption or call options, and rate-setting provisions.
Debt Service Schedule	Should be included, with separate columns for the current offering, and outstanding debt payable from the same revenue stream.
Financial Covenants	Provide 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 and clear definition of financial covenants, additional bonds tests, and reserve requirements.
	Debt service reserve requirement should be defined, along with its funding source (e.g., cash, letter of credit or surety), substitution provisions, and replenishment requirements.
	Provide a table detailing the issuer's obligations that are covered by a pledge from or intended to be paid from the same revenue stream.
	Provide a flow-of-funds diagram, both pre- and post-default.
	Summarize bankruptcy eligibility, receivership, and authorization procedures.
Bank Loans and Other Private Financing Sources	Provide details including covenants, accelerations, and rate change provisions.
Swaps and Derivatives	Provide a table showing all swaps and derivatives and including execution dates, terms and conditions, collateral posting requirements and triggers, term-out provisions, mark-to-market values, counterparty identifications, and ratings triggers.
Risk Section	Provide descriptions of risks for all transactions whether these are issuer-specific or broader, generic risks.
Refunding Status	Expressly state if the refunded bonds are being legally defeased pursuant to their indenture or only economically defeased.
Bond Counsel and Other Legal Opinions	Extent of investor reliability on the opinion should be disclosed in the body of the POS and any supporting legal opinions should be attached.
Documents Referred to in the POS	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 POS appendices. Internet links for these supporting documents should also be provided.
Financial Statements	If an issuer's fiscal year ended six or more months prior to the current offering and no audited financial statements have yet been provided, interim financial statements should be included. Information regarding the probable release date of the new financial statements should also be provided.
Underwriter-Led Consents	If the initial bond purchaser (e.g. the underwriter) is consenting to changes in bond documents, clearly state this in the Summary and Risks sections.
	Provide a table with security provisions as they exist or will exist both before and after any necessary consents. If an underwriter is accumulating consent rights, provide details.

Selective Disclosure Considerations	Any material information provided to rating agencies should also be provided to prospective investors.
Expert Work Products	Disclose all third-party financial and other projections, feasibility studies, forecasts, and other expert work products known to the issuer and/or underwriter.
Contact Information	Include name, position, and contact information for key bondholder relations official. Also provide an internet link for the issuer's posted public information.