CONSIDERATIONS IN PREPARING DISCLOSURE IN OFFICIAL STATEMENTS REGARDING AN ISSUER'S PENSION FUNDING OBLIGATIONS

(PUBLIC DEFINED BENEFIT PENSION PLANS)

National Association
of Bond Lawyers

May 15, 2012

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INTRODUCTION

This document ("Considerations") provides guidance regarding the application of the federal securities laws to the preparation of official statement disclosure addressing the pension funding obligations of state and local governments to their public defined benefit pension plans. As discussed under "UNDERSTANDING PUBLIC PENSION PLANS" herein, there are different types of public pension plans, such as defined contribution plans and hybrid plans which combine aspects of different plans that are beyond the scope of this project.

Preliminary and final Official Statements (collectively, "OSs") are disclosures made by the issuer when offering bonds to the market, and as such the issuer is primarily responsible for the content of such documents.[1] An element of a cause of action against issuers, by either the Securities and Exchange Commission (the "SEC") or a private plaintiff, is either an "untrue statement of a *material* fact" or an omission "to state a *material* fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[2] Materiality for federal securities law purposes means whether there is a substantial likelihood that a reasonable investor would consider the facts at issue to be important to an investment decision.

Issuers, with the assistance of counsel, financial advisors and other professionals make numerous judgments as to what information constitutes material information each time an OS is prepared. With materiality as the guiding principle, the extent of the disclosure about the issuer's pension funding obligations in an OS will vary considerably from issuer to issuer and from type of credit to type of credit, based in principal part on the issues addressed in this document. The Pension Disclosure Task Force respectfully recommends that issuers, their counsel and other members of the financing team give due attention to these Considerations in making the determinations as to what disclosure and reasonable investigation is appropriate in a particular instance. We hope these Considerations are useful for such purpose.

The Pension Disclosure Task Force included members of NABL, and representatives of issuers, underwriters, analysts, institutional investors, accountants, actuaries, and other interested parties. The particular groups that comprised the Task Force are listed in Appendix A.

Considerations is not intended to create legal standards or describe existing legal standards in any detail, nor establish a template for all issuers regarding disclosure concerning their pension plans. The Task Force participants recognized the importance of the guidance these Considerations provide and in that spirit a consensus was achieved. However, any particular part of this document does not necessarily reflect the individual views of one or more participating organizations or individual participants. In addition, such organizations (other than NABL) have not formally approved this document. The reservations of certain organizations are set forth in footnotes, to which we direct the reader's attention.

TELLING THE CREDIT STORY

As a practical matter, when issuers offer and sell bonds, the federal securities laws require issuers to act with reasonable care and prudence to simply and plainly tell the whole credit story related to their bonds. This means giving investors the information that they consider to be important in making an informed investment decision. With respect to disclosure concerning an issuer's pension funding obligations and the pension plan or plans in which it participates, investors are interested in knowing whether the future pension obligations and the issuer's ability to pay such obligations will (i) have a materially negative adverse impact on the issuer's ability to (a) pay principal and interest on the bonds when due, or (b) substantially maintain current debt service coverage levels; (ii) cause an adverse change in the public rating or outlook of the bond issue; (iii) reduce the issuer's ability to refinance and/or refund the bonds in

1 SEC Rel. No. 34-26985 (June 28, 1989), at fn. 84: "[I]ssuers are primarily responsible for the content of their disclosure documents, and may be held liable under the federal securities laws for misleading disclosure."

2 17 CFR § 240.10b-5.

the future; or (iv) limit the issuer's ability to issue new debt at market rates for capital improvements and other important projects. The overall point of the disclosure of pension funding obligations is to indicate whether the state or local government will likely struggle in meeting such obligations without making difficult financial decisions. One of those decisions may be related to the payment of debt service on bonds. Thus, in circumstances where there is expected to be financial strain caused by an issuer's pension funding obligations, being clear and plain about this point to investors is very important. Pension funding obligation disclosure is not "one size fits all" and the story of one issuer will be different from other issuers.

Issuers need to carefully consider the likely impact that pension funding obligations will have on the issuer's overall financial condition. For some issuers, the current and projected annual contributions may either constitute only a small portion of their annual budgets or, if larger, may be readily manageable. Similarly, for enterprise fund financings (*e.g.*, water systems, wastewater systems, electric systems), the proportionate share of the issuer's aggregate pension liability borne by a particular fund may represent a relatively small portion of an enterprise fund's annual operating expenses, and therefore not be material.

With respect to the numerous issuers that do not sponsor their own pension plan, but rather provide pensions to their employees through participation in either multiple-employer agent defined benefit pension plans or cost-sharing multiple-employer defined benefit pension plans, much of the information considered in this document may simply not be available to such issuers. Ultimately, the federal securities laws require the issuer to exercise reasonable care and prudence in the preparation of its offering documents and so, in this context, the issuer will only be responsible to disclose information it has obtained or with the exercise of reasonable prudence could obtain. In addition, in this context, the issuer should caution the investor that it has obtained the information from the pension plan administrator or sponsor and that it disclaims any responsibility for such information (provided that the issuer has reviewed such information with care and has no reason to believe that the information is not accurate, or that future required contributions will be materially different from what is disclosed).

An issuer has a legal obligation, when accessing the capital markets, to not omit to state any material fact necessary to make the statements made not misleading. As the municipal market has learned from recent SEC enforcement actions relating to disclosures regarding the obligations of state and local governments to their pension plans, governmental pension plans may have problems that may not be apparent to investors and analysts from either the basic information about a pension plan or system or even from the actuarial valuation. Based on factors that are known today, such as past and current (and expected) funding practices, smoothing methodologies, plan benefit changes, investment losses or other factors, the issuer (acting with reasonable care and prudence) should disclose and explain potentially materially adverse changes to the credit story. For some issuers, the annual pension contribution rate is established by the state legislature and is less than an actuarially determined annual contribution rate. In those instances, the issuer may not project a materially increasing rate of pension contributions (simply because the statutory rate is not expected to increase), but does expect a future trajectory of increased underfunding that at some point would deplete the assets of the pension plan or system without a major change in the funding policy. Investors also care about such longer-term considerations because at some point in the future the issuer will likely be required to increase its pension contributions to maintain pension plan or system integrity. Further, the extent to which existing or future legal, political or economic factors will likely materially constrain an issuer's ability to meet its overall general operating costs (and thereby materially affect an issuer's ability to meet its pension funding obligations) should also be disclosed and discussed. Beyond an issuer's legal disclosure obligations, market participants and investors will want various disclosures to assess the existing and future creditworthiness and rating stability of issuers after taking into consideration pension funding credit implications.

Finally, if an issuer is aware that future annual pension contributions are expected to materially increase (or become a materially larger part of its annual expenses), reasonable care and prudence would entail engaging an actuary (which could be the actuary of the pension plan or system itself) experienced with governmental pensions to help explain the way that the issuer's pension plan funding obligations could affect the overall credit worthiness related to the bonds, including the preparation of projections. Whether there is a potential material adverse financial trend or other pension contribution credit implication that needs to be disclosed in any particular instance will depend upon the facts and circumstances. [3]

GENERAL BACKGROUND

This guidance is based principally on a review of the following:

- GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, which establishes financial reporting standards for such ***pension plans*** [4]

- GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, which establishes standards for pension information in the financial reports of ***state and local government employers*** [5]

- GASB Statement No. 50, *Pension Disclosures*, which amended in part GASB Statements Nos. 25 and 27 [6]

- *In re* City of San Diego, California, SEC Rel. Nos. 33-8751, 34-54745 (Nov. 14, 2006) (the "San Diego Order")

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3 The NFMA has suggested the following guidelines as to what could result in a determination to prepare five-year projections of pension contributions:

1. When one of the following conditions is present:

    a. Pension contributions by the issuer from the relevant fund (e.g., the general fund) are a significant percentage of the issuer's discretionary expenditures from that fund; or

    b. The issuer is aware of information indicating that there is a possibility that pension contributions by the issuer from the relevant fund may become a significant percentage of the issuer's discretionary expenditures from that fund;

and in addition,

2. One of the following applies:

    a. The funded ratio of the issuer's pension plan is below 80%; or

    b. The issuer is aware of information indicating that there is a significant possibility that the funded ratio of the issuer's pension plan may fall below 80%; or

    c. In the past three years, the issuer's pension plan has experienced a significant increase in unfunded liabilities or significant reduction in pension assets; or there has been a decline in the issuer's contributions to the pension fund either in dollar amount or as a percentage of expenditures from the relevant fund.

4 GASB approved an Exposure Draft on June 27, 2011, which would amend GASB Statement No. 25. The comment period closed October 14, 2011. (the "GASB No. 25 ED")

5 GASB approved an Exposure Draft on June 27, 2011, which would amend GASB Statement No. 27. The comment period closed October 14, 2011 (the "GASB No. 27 ED").

6 GASB Statement No. 50 aligned financial reporting for pensions with those for OPEB. The statement required defined benefit pension plans and sole and agent employers to present additional information related to disclosures in the notes to financial statements and required supplementary information.

- *In re* State of New Jersey, SEC Rel. No. 33-9135 (Aug. 18, 2010) (the "NJ Order")
- Rule 10b-5 promulgated under the Securities Exchange Act of 1934, as amended
- Section 17 of the Securities Act of 1933, as amended

Based on a review of such materials, we have provided an overview of the issues and the information to be considered when preparing disclosure regarding an issuer's pension funding obligations related to public defined benefit pension plans in which it participates. We have also set forth in Appendix B those definitions that are key to an understanding of governmental pension funding obligation disclosure. Appendix C is an overview of (i) the proposed changes being considered by GASB for pension accounting and financial reporting, (ii) GASB's preliminary views on the key issues related to reporting financial projections, and (iii) the accompanying narrative that will assist users in assessing a government's or governmental entity's economic condition.

UNDERSTANDING PUBLIC PENSION PLANS

Although Considerations is about the pension funding obligations of state and local governments and the pension plans in which they participate, an understanding of such obligations requires understanding how pension plans themselves operate. Although there are different types of public pension plans, the most common are Defined Contribution Plans and Defined Benefit Plans. Defined Contribution Plans, which are plans with terms that determine how contributions are to be made versus how benefits are to be paid, are beyond the scope of this project. Defined Benefit Plans can include single-employer plans (i.e., municipal pensions for general employees, public safety, and fire), agent multiple-employer plans (aggregation of multiple employers with shared administration but no cost or risk sharing; individual valuations are done for each employer)[7] and cost-sharing multiple-employer plans (all risks and costs, including benefit costs, are shared by participating employers). In addition, there are a number of hybrid plans which combine aspects of different plans together with both defined benefit and defined contribution plans.

With respect to financial reporting concerning Defined Benefit Plans, there are two principal types of information: (a) the current financial information about the plan's assets and financial activities, and (b) the actuarially determined liabilities of the employers that provide benefits through the plan, including information about the funded status of the benefits provided through the plan, the history of its funded status and the progress being made in accumulating assets to pay benefits when due. The current financial information appears in the financial statements of the plan and the notes related thereto. The actuarially determined information, which is prepared based on a long-term, ongoing plan perspective that is used to determine the funded status or funding progress of the plan, is prepared using certain methodologies that include various economic and demographic assumptions. While actuarially determined information currently appears in the required supplementary information ("RSI"), which follows the notes to the financial statements, the actuarially determined measures and information about the methods and assumptions used in determining the actuarial information are also required to be included in the notes to the financial statements.

GASB 25 requires inclusion of a minimum of six years of actuarial information, which is presented in two schedules that are to be included in the RSI. The two schedules that provide this information are (i) the Schedule of Funding Progress, which contains a comparison of the actuarial value of the plan assets to the actuarially determined liability for benefits to be paid through the plan and the relationship of the two over time, and (ii) the Schedule of Employer Contributions, which supplies information about the annual required contribution of the employer ("ARC") and the percentage of the ARC that was recognized by the plan as contributed.

7 Disclosures related to an issuer's participation in an agent multiple-employer plan should provide information about the issuer's individual plan, not the agent plan as a whole.

Under GASB 25, as amended, the actuarial information about the plan's most recently calculated funded status should be presented in the notes to the financial statements with disclosures as to the actuarial methods and significant assumptions used for this reporting. The assumptions upon which information is determined can and do change over time. Actuarial reports (valuations) are required to be done, at a minimum, every two years; however, it is not uncommon for plans to be valued each year (pursuant to state or local law or pension board policy). The goal of the actuarial report or valuation is for the actuary to project, using various economic and demographic assumptions, the future benefit payments that the pension plan will pay over the lives of the covered retirees and other beneficiaries and to determine whether the pension plan has accumulated a sufficient amount of assets such that, together with future annual payments and assumed earnings on those assets, there will be funds sufficient to pay that future stream of benefit payments. The actuarial report is prepared based on the prior period's information and assumptions as to future events. This report is intended to provide for the determination of appropriate contribution levels (employer and/or employee) for the following year or years, resulting in a potential lag of at least a year in the valuation information regarding the pension plan. For other plans, employer contribution rates are set by statute, local ordinances or court orders. When this rate is set (fixed), the variable becomes the amortization period required to amortize the unfunded actuarial accrued liability ("UAAL"). The length of the amortization period is important, and differs greatly between pension systems. In instances in which the issuer is likely to face materially increasing pension contributions, the investor or analyst should be able to know and understand the specific amortization periods and policies that are being used by the pension plan in which the issuer participates, and this information should be made available, preferably by reference in the issuer's disclosure document, the issuer's budget or issuer's financial statements or the pension fund's financial statements. In general practice, amortization periods of 10 to 30 years may be applied, and there may be different amortization periods assigned to different components of the pension valuation (e.g., UAAL, experience gains and losses, assumption changes). Recognition of the time lag with respect to these actuarial reports underscores why mere reliance on the information in the notes to the financial statements may not be sufficient to provide a complete understanding of both the current financial status of the plan (assets) and the actuarial determined liabilities, which together represent the funded status of the plan. This time lag will necessitate making inquiries regarding changes to plan benefits and actuarial assumptions that may have occurred subsequent to the date of the last actuarial report.

WHAT DOCUMENTS WOULD BE HELPFUL TO GATHER THE NEEDED INFORMATION

Before starting to prepare or assist in the preparation of pension disclosure, it would be helpful to obtain and review copies of the following documents, if available:

- Issuer's Financial Statements
- Issuer's Budget
- Pension Plan Actuarial Reports (periodically available)
- Pension Plan's Financial Statements (or the financial statements of the pension system that includes the plan)
- The most recent market and actuarial value of assets of the Pension Plan
- Most recent state and local statutory changes, session laws, regulations and any actuarial or fiscal impact statements prepared or requested by the plan or issuer related thereto
- Pension Plan Investment Policy
- Asset Allocation Plan (which may be part of the Pension Plan Investment Policy)

- Asset Liability Modeling Studies[8] (periodically available)
- Experience Studies requested by the pension board of trustees (periodically available)
- Any studies/projections regarding future trends of annual required contributions commissioned by the issuer, plan sponsor or the plan itself
- Multi-year budget projections prepared by the issuer that include forecasts regarding pension costs

Certain critical information is required currently by the GASB's financial reporting standards to be set forth in the notes to the issuer's financial statements (audited), while other information (*e.g.*, the funded status and funding progress for the more recent actuarial valuation and the two preceding valuations), when required to be presented, would be set forth as RSI (limited audit procedures).[9] If the reports and studies mentioned above are available on the issuer's website or the website of the pension plan or the system that includes the plan, the location should be provided or how and from whom such information may be obtained should be disclosed.

Pension plans may be amended during the course of the year and such amendments may have a financial impact on the plan, and therefore the issuer preparing the OS. Once the issuer and its financing team has gathered the key documents containing the plan information to be disclosed, it is important to make inquiries as to changes in assumptions, funding policies, funding method, contribution levels or plan benefits that would impact the presentation of the historical information. The drafter should be aware that certain reports listed above are normally prepared at regular intervals and may not be updated in the interim unless significant changes in the benefits provided by the plan occur. For instance, actuarial impact statements are typically prepared when a change in benefits is being considered.

KEY DEFINITIONS

Certain key definitions and concepts used in pension plan reporting are set forth in Appendix B. It is critical to understand the definitions when reviewing or preparing pension disclosure. The use of various terms and phrases may vary in actual reports and financial statements from the terminology contained in Appendix B.

DRAFTING DISCLOSURE LANGUAGE

As mentioned in the introductory statement, materiality is the guiding principle in the type and level of all disclosures included in the issuer's disclosure document, including regarding an issuer's pension funding obligations. The determination of materiality of pension funding obligations is no different than the determination related to any other disclosure issue facing the issuer. For certain issuers, the current and projected annual required contributions may either constitute only a small portion of their annual budgets or, if larger, may be readily manageable (as viewed objectively by a reasonable investor). Similarly, for enterprise fund financings (*e.g.*, water systems, wastewater systems, electric systems), the proportionate share of the issuer's aggregate pension liability borne by a particular fund may represent a relatively small portion of an enterprise fund's annual operating expenses and any projected increases in contributions relatively manageable. In these instances, the disclosure of the enterprise fund's obligations to the pension plan may not be material to investors.

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8 An Asset Liability Modeling Study is a statistical modeling that looks at alternative asset allocations and determines the expected long term return rate and risk associated with the investment of pension plan assets.

9 Under the current GASB standards, funded status is required in the notes to the financial statements for single and agent employers. Although limited audit procedures are applied to RSI, the information contained in the multi-year schedules of funding progress for single and agent employers is subject to audit procedures as part of the note disclosures in either the current period or in past periods.

Federal securities laws do not impose an obligation to disclose *all information* that an investor (or analyst) may want to evaluate the credit story of the bonds or the creditworthiness of the issuer. Rather, the obligation is (1) to disclose *material* facts, and further, (2) such material *facts* must be "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[10] The outcome of the analysis, as determined by the issuer in consultation with its financing team (underwriter, financial advisor, underwriter's counsel, disclosure counsel, etc.) will determine the degree to which more detailed information should be considered and disclosed. For some issuers with well funded plans and where the budgeting for pension obligations is not significant to the overall budget or not subject to significant annual variation, minimum disclosures may suffice. Where concerns arise about the funding and budgeting aspects of an issuer meeting its pension obligations or concerns with the funding and policies of a pension plan, and therefore material to an investor, further disclosure may be warranted. Appendix D provides for examples of additional information that may be required in order to fully explain to investors how the issuer's pension funding obligations factor into the whole credit story of the bonds.

Set forth below are certain key questions that are important to an analysis of what disclosure about an issuer's pension funding obligations may be required in a particular instance. Once the various documents listed above[11] have been gathered and reviewed and such key questions have been considered and discussed, the appropriate disclosure can be drafted. Appendix D sets forth suggested formats for such disclosure.

A. Budgeting for Pension Obligations

- Does the issuer maintain a public defined benefit pension plan, either for retired employees or current employees?
- How much is the current annual required contribution to such plan?
- Is the issuer expecting to make such annual required contribution in full? If not, what is the shortfall? If not, why is the issuer unable to make the full contribution?
- Does the issuer prepare, as part of the budgetary process, forecasts or projections of pension contribution payments?
- Was an actuary engaged to prepare such forecasts?
- If there are no forecasts or projections, on what basis does the issuer estimate its current pension contributions and how reliable is this source? Are there indications that the issuer's annual pension contributions (either in absolute numbers or as a relative percentage of the respective fund) may increase in the future?
- Even if not prepared by an actuary or included as part of the budgetary process, does the issuer have forecasts or projections that have been commissioned by the issuer, plan sponsor or the plan itself that should be brought to the attention of the financing team?
- Are there statutory provisions that determine the amount of the annual pension contributions?
- How do the budgeted amounts of pension contributions compare to ARC? To payments actually made in prior years? Consider including a chart showing comparisons of ARC to budgeted contributions and to actual contributions for last ten years.
- Does the issuer have a pension funding policy? What are the significant provisions of any such policy? What are any recent amendments to such policy?

10 SEC Rule 10b-5(b).

11 See "WHAT DOCUMENTS WOULD BE HELPFUL TO GATHER THE NEEDED INFORMATION."

B. Pension Contribution Obligations

- Is funding for pension contributions coming from the same source as funding or security for debt payments? Is it from a dedicated revenue stream, reserve funds, debt issuance or from the issuer's general ability to raise revenue from year to year? What other revenues, reserve funds, and/or other sources (e.g., bond proceeds) have been used or are planned to be used to make annual pension contribution payments?

- If an enterprise fund, with respect to the portion of the annual pension payment for which the fund is responsible, what percentage does such payment represent of annual operating expenses?

- If not an enterprise fund, what percentage does the annual pension payment represent of total issuer expenditures?

- What percent of covered payroll does the ARC and the actual pension contribution payment represent? Has this amount been increasing in the last several years? If so, by what percentage?

- Are there statutory provisions that govern the priorities of pension contributions?

- See Appendix D for recommended tables for the presentation of information to be provided.

C. Information About The Pension Plan

- What is the current funded ratio for such plan?

- What has been the historical (prior 10 years) funded ratio?

- What are the current and historical funded ratios on both market value and actuarial value bases for assets?

- What are the current demographic and economic assumptions?

- What was the date of the most recent experience study regarding such assumptions?

- What is the liabilities discount rate (to determine present value of future liabilities)?

- What is the investment return assumption (to determine the future value of present assets)?

- Historically (last 10 years), how has the assumed investment rate compared to the actual investment rate?

- A sensitivity analysis that shows the effect on the current year's ARC and any projected ARCs if the investment rate of return were 1.00% lower than the assumed investment rate of return.

- What are the classes of investments in plan's policy (e.g., pie chart)?

- Provide a link to plan's statutes and policies regarding how changes are made to plan benefits, contributions, etc.

- Describe material trends about the plan; impact on operations, capital funding, etc. of issuer sponsoring the plan.

See Appendix D for recommended tables for the presentation of information that the issuer has determined needs to be provided.

Appendix A

Participating Organizations

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA)
BOND DEALERS OF AMERICA (BDA)
GOVERNMENT FINANCE OFFICERS ASSOCIATION (GFOA)
INVESTMENT COMPANY INSTITUTE (ICI)
NATIONAL ASSOCIATION OF BOND LAWYERS (NABL)
NATIONAL ASSOCIATION OF PUBLIC PENSION ATTORNEYS (NAPPA)
NATIONAL ASSOCIATION OF STATE AUDITORS, COMPTROLLERS AND TREASURERS (NASACT)
NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS (NASRA)
NATIONAL ASSOCIATION OF STATE TREASURERS (NAST)
NATIONAL COUNCIL ON TEACHER RETIREMENT (NCTR)
NATIONAL FEDERATION OF MUNICIPAL ANALYSTS (NFMA)
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (SIFMA)

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Appendix B

Key Definitions

- **Actuarial Accrued Liability (or AAL):** that portion, as determined by a particular Actuarial Cost Method, of the actuarial present value of pension plan benefits and expenses that is not provided for by future Normal Costs.

- **Actuarial Cost Method:** a method used to develop the actuarial present value of benefits and the allocations of such costs to certain periods of time in order to develop the AAL. Two common Actuarial Cost Methods are projected unit credit, or PUC, and entry age normal, or EAN. The PUC method tends to push more costs into the later part of a member's service. The EAN method develops a level contribution as a percent of pay (Normal Cost) which, if contributed and invested throughout the member's career, is expected to generate sufficient funds to equal the actuarial value of the future benefits by the time the member retires. In order to keep the costs level, EAN allocates a large Normal Cost for the earlier years and a relatively smaller Normal Cost to the later years compared to the PUC method.

- **Actuarial Value of Assets (or AVA):** the value of cash, investments, and other property belonging to a pension plan, as used by the actuary for the purpose of an actuarial valuation. An Actuarial Value (in contrast to a current market value) attempts to smooth annual investment return performance over multiple years to reduce annual return volatility.

- **Amortization Period:** the period over which the UAAL is amortized, which can be either a "fixed" (or "closed") period or a "rolling" (or "open") period. During a fixed period, the UAAL is amortized over a declining number of years; for example, 30 years the first year, 29 years the second year, etc. During a rolling period, the UAAL is amortized over an unchanging number of years; for example, 15 years the first year, 15 years the second year, etc.

- **Annual Pension Cost (or APC):** the aggregate in a particular year of (i) the ARC, (ii) one year's interest on the NPO, and (iii) an adjustment to the ARC to offset, approximately, the amount included in item (i) for amortization of past contribution deficiencies.

- **Annual Required Contribution of the Employer (or ARC):** the aggregate in a particular year as calculated by the actuary comprised of (i) the Normal Cost and (ii) payments made to amortize the UAAL in accordance with the adopted actuarial method of the pension plan or system.

- **Assumptions:** an actuarial report will utilize demographic and economic assumptions as to the occurrence of future events affecting pension costs, such as investment rate, inflation rate, interest credited to member contributions, salary increase rate, annual cost-of-living adjustment, rates of separation from active membership, post-retirement mortality, active member mortality, and rates of retirement.

- **Funded Ratio:** the ratio of (A) the AVA or market value of assets to (B) AAL. Such valuation can be on an actuarial or a market value basis. If a plan has a funded ratio of less than 100%, then the plan has a UAAL.

- **GASB:** Governmental Accounting Standards Board of the Financial Accounting Foundation.

- **Market Value of Assets:** as of the valuation date, the value of assets as if they were liquidated on that date.

- **Net Pension Obligation (or NPO):** the cumulative difference between the APC and the actual employer contribution (*e.g.*, does not include contributions by the employees) in a particular year.

- **Normal Cost:** the present value of the benefits that the pension system projects to become payable in the future that are attributable to a valuation year of service.

- **Smoothing Method:** a method used in determining AVA that is intended to reduce the impact of market volatility on the assets of a pension plan. Under a Smoothing Method, the annual investment return performance is "smoothed" over multiple years to reduce annual contribution volatility. For example, by use of a "five-year smoothing" methodology, a percentage difference between the net market value and the net book value for each of the most recent five years is calculated. The resulting percentages are averaged for the five-year period and applied to the valuation's year's market value of assets to arrive at the actuarial value of assets, with the result that only 20% of investment gains or losses in a particular year are taken into account in the annual actuarial valuation.

- **Unfunded Actuarial Accrued Liability (or UAAL):** the difference between (A) the AVA or market value of assets and (B) the AAL. Such valuation can be on an actuarial or a market value basis.

Appendix C

Overview of GASB Proposals

GASB's Proposed Changes to Pension Accounting and Financial Reporting

On June 27, 2011, the Governmental Accounting Standards Board ("GASB") approved two proposals to effect significant changes to the manner in which pensions are accounted for and reported. The proposed changes are made in the following two Exposure Drafts (EDs):

- The GASB No. 27 ED draft proposes to establish new accounting and financial reporting requirements for state and local government employers whose employees are provided with pensions through a defined benefit pension plan that is administered as a trust that meets certain criteria. Those proposals would amend GASB Statement No. 27

- The GASB No. 25 ED relating to financial reporting by the pension plans that administer pensions provided to the employees of a governments that would be under the proposed requirements of the GASB No. 27 ED. Those proposals would amend GASB Statement No. 25.

Although the Exposure Drafts concern reporting for different entities, both Exposure Drafts reflect the same approach to certain measurement requirements related to the pension liabilities of employer(s). As such, this Appendix will explain the underlying approaches proposed in the Exposure Drafts and note the applicability of certain statements to the government that provides the pension or to the pension plan itself where necessary.

It should be noted that the Exposure Drafts would apply solely to the accounting and financial reporting for pensions and would not apply to the manner in which governments fund their pension plans.

This Appendix is intended as a summary of the key provisions of the Exposure Drafts and does not purport to be a comprehensive analysis of all provisions of the Exposure Drafts.

THE NET PENSION LIABILITY

The Exposure Drafts would require that a government employer recognize a liability for its net pension obligation in its financial statements. This reflects the view that pensions are a component of compensation in return for work such that the costs and obligations associated with pensions should be recognized as they are earned by employees, not when the employer government makes contributions to the pension plan or when benefit payments are made to the employees.

The Exposure Drafts would require that an employer government recognize a measure of its liability—termed the Net Pension Liability—in its financial statements. The Net Pension Liability of the employer government equals the overall obligation of such government for its pensions—the Total Pension Liability—less the amount of resources accumulated in the pension plan that are available to make future payments when they come due. In addition, employers would recognize a separate pension liability for legally required contributions that are due but have not yet been made.

MEASURING A GOVERNMENT'S TOTAL PENSION LIABILITY

The process for calculating the Total Pension Liability (the actuarial valuation) would consist of three steps (which, in general terms, would not differ from the process used under current GASB standards to calculate the measure of an employer actuarial accrued liability): (1) projecting benefit payments, (2) discounting the projected benefit payments to their actuarial present value, and (3) attributing the present value of projected benefit payments to past and future years during which the employees have worked or are expected to work. Within these broad steps, the Exposure Drafts propose changes that would limit the number of options available with respect to certain aspects of the measurement, more specifically, the method of attributing the actuarial present value to periods of employee service, the timing of expense recognition and discount factors to be used in the present value calculations, among others.

Projecting Benefit Payments. The Exposure Drafts would retain the current practice of incorporating expectations about (1) future employment-related events (including salary increases and years of continuing employment until retirement) and (2) automatic postemployment benefit changes such as automatic cost of living adjustments ("COLAs") into projections of benefit payments. The Exposure Drafts would, however, also require pension-related measures to include the expected effects of future COLAs that are made at the discretion of the government ("*ad hoc* COLAs") if those types of changes effectively have become automatic. For example, if a government's past practice and future expectations of granting them indicate that condition has been met.

Discounting Projected Benefit Payments. The Exposure Drafts would change the discount rate used to determine the present value of projected benefit payments in certain situations. At present, GASB standards require governments to apply a discount rate equal to the expected future rate of return on the investments of the pension plan over the long term (the "Long-Term Expected Rate of Return"). The Exposure Drafts retain use of the Long-Term Expected Rate of Return to the extent that the future benefit payments are projected to be payable from a projected plan net position. However, to the extent that the future benefit payments are not projected to be payable from a projected plan net position, the discount rate would be required to incorporate a rate equal to a high quality tax-exempt municipal bond index rate. The Exposure Drafts would consider "high quality" to mean rated AA or higher (or equivalent rating).

Attributing the Actuarial Present Value to Specific Periods. Present GASB rules allow governments to choose among six methods for attributing the actuarial present value of projected benefit payments to specific years for accounting and financial reporting purposes. The manner in which such attribution is made can have a significant impact on pension expense (by altering the amount of benefits that are considered related to services in each period) and on Total Pension Liability (by determining the portion of benefits assigned to past periods). The Exposure Drafts would require all governments to attribute the actuarial present value of projected benefit payments using the "entry age normal" (commonly known as "EAN") method applied as a level percentage of payroll. To determine the amount attributed to each period, this method calculates the actuarial present value of projected benefit payments when employees first begin to earn benefits and attributes that present value to employees' expected periods of employment until retirement.

IMMEDIATE EXPENSE RECOGNITION

The amount reported by government employers in the financial statements as pension expense would be immediate for:

- Pension benefits earned during the reporting period (service cost);
- Interest on the total pension liability during the reporting period;
- The effect on the total pension liability of changes in benefit terms during the period;
- The effect on the total pension liability of two events—differences between expected and actual changes in economic and demographic factors and changes in such actuarial assumptions—related to inactive/former employees during the period; and
- Projected earnings on plan investments.

DEFERRED EXPENSE RECOGNITION

Changes in the Net Pension Liability resulting from the following events would be recognized as a deferred outflow of resources or deferred inflow of resources in the period in which the event occurs, with pension expense for the effects of these events recognized over a period equal to the weighted average remaining service periods of active employees:

- Differences between expected and actual changes in economic and demographic factors that affect measurement of the Total Pension Liability
- Changes in assumptions about economic and demographic factors

Differences between actual and projected earnings on plan investments also would be recognized as a deferred outflow of resources or deferred inflow of resources and would be recognized as pension expense over a five-year, closed period.

CHANGES WITH RESPECT TO COST-SHARING MULTIPLE-EMPLOYER PENSION PLANS

A government employer participating in a cost-sharing pension plan would be required to report a net pension liability based on its proportionate share of the collective net pension liability of all of the employers that participate in the plan. An individual government's proportion would be based on the government's long-term expected contributions to the plan as compared to those of all employers participating in the plan.

DISCLOSURES FOR GOVERNMENTS PARTICIPATING IN PENSION PLANS

Note Disclosures. All governments participating in a defined benefit pension plan would include the following information in their Note Disclosures:

- Descriptions of the plan, the benefits provided, and the authority establishing the plan and requiring contributions to it;
- Number of retirees and beneficiaries currently receiving benefits, inactive employees entitled to benefits but not yet receiving them, and active employees covered by the plan;
- The policy for determining the government's annual contributions to the plan;
- Significant assumptions employed in the measurement of the Net Pension Liability;
    - With regard to the discount rate:
        - Assumptions about contributions and other projected cash flows;
        - The rate(s) selected and the basis for selecting the long-term expected rate of return on plan investments and the municipal bond index rate (if applicable);
        - The projection periods to which each rate was applied;
        - A sensitivity analysis that shows the effect on the net pension liability of a 1 percentage point increase and a 1 percentage point decrease in the discount rate;
- Descriptions of benefit changes and changes of assumptions;
- Net Pension Liability, deferred outflows of resources and inflows of resources, and pension expense (if not separately displayed in financial statements)

Governments participating in single-employer or agent multiple-employer pension plans would also disclose:

- The beginning and ending balances in Total Pension Liability, the plan's net position, the Net Pension Liability and the effect on those amounts of items such as service cost, benefit changes, changes of assumptions, contributions, net investment income, and benefits paid, all for the current year;
- Components of the current-period pension expense, such as service costs, benefit changes, investment earnings, and the portions of beginning and deferred outflows and inflows that were incorporated into pension expense;

- Reconciliation of the beginning and ending balances of deferred outflows of resources and deferred inflows of resources, including the effects of (1) changes of assumptions, (2) differences between assumptions (demographic and economic) and actual experience, and (3) differences between projected and actual investment earnings, and the portions of the beginning balances that were incorporated into the current period's pension expense.

RSI Schedules. With respect to single-employer or agent multiple-employer pension plans, the following RSI Schedules would be required for each of the past 10 years:

1. Total Pension Liability beginning and ending balances, the plan's net position, the Net Pension Liability, and the effects on those amounts of items such as service costs, benefit changes, changes of assumptions, contributions, net investment income, and benefits paid;

2. A schedule showing: (1) Total Pension Liability, (2) the plan's net position, (3) the Net Pension Liability, (4) the ratio of plan net position to Total Pension Liability, (5) covered-employee payroll, and (6) ratio of Net Pension Liability to covered-employee payroll; and

3. Only if the government has an actuarially calculated annual pension contribution, a schedule showing (1) the actuarially calculated employer contribution; (2) the amount of employer contribution made; (3) the difference between the contribution made and the actuarially calculated contribution; (4) covered-employee payroll; and (5) ratio of the contribution made to covered-employee payroll.

Governments participating in a cost-sharing multiple-employer plan would present these three schedules, as applicable, for all participants in the plan as a whole. In addition, such a government would present schedules 2 and 3, if applicable, for its proportionate share of the aggregate amounts.

All governments also would be required to provide notes to the RSI Schedules concerning the significant assumptions underlying the actuarially calculated contributions (if applicable and not disclosed elsewhere) and factors that significantly affect the trends in the schedules (*e.g*., changes in benefits).

GASB's Preliminary Views on Economic Condition Reporting: Financial Projections

- On November 29, 2011, GASB approved a Preliminary Views, Economic Condition Reporting: Financial Projections (the "Preliminary Views") that presents the Board's current views on what it believes are the most fundamental issues associated with the reporting of financial projections and related narrative discussions that will assist users of state and local governmental financial reports in assessing a governmental entity's economic condition. The preliminary view is that five components of information (which would be reported as RSI) are necessary to assist users in making this assessment, one of which is projections of total financial obligations and major individual financial obligations, including bonds, pensions, other post employment benefits, and long term contracts, with explanations of the known causes of fluctuations in financial obligations. These financial projections and explanations are intended to assist users in assessing the governmental entity's ability to meet financial obligations as they come due and interperiod equity. "Interperiod equity" refers to the degree to which a government raises sufficient resources in each reporting period to cover that reporting period's costs, versus shifting costs into future years, consuming resources accumulated in past years, or accumulating resources in the current year.

Annual financial projections would be made for a minimum of five individual years beyond the reporting period and would be (1) based on current policy, (2) informed by historical information, and (3) adjusted for known events and conditions that affect the projection period. Assumptions underlying the financial projections would be selected by the governmental entity utilizing a set of guiding principles proposed by the GASB. Disclosures of the underlying assumptions used in the projections would be required.

Appendix D

Pension Disclosure - Issues to Consider in Drafting Disclosure

Official Statement disclosure is about the credit quality of the bonds being offered. Disclosure about an issuer's pension obligations that is included in the OS should reflect the degree to which such obligations could affect the issuer's ability to make bond payments to investors, or place pressures on the basic functions of government that would affect the creditworthiness of the bonds. This may depend, to varying degrees, on matters such as size of those obligations relative to the issuer's overall budget, the funding status of the pension plan, and identifiable trends and problems that are material to an investor. It will also depend on the degree to which the pension obligation payments and debt service payments are payable from the same source of revenue. The goal of this disclosure, as with all disclosure in an OS, is the appropriate level of information for the issuer's specific situation. Neither too much information nor too little information is helpful to the investor.

Considerations should not be viewed as a template or a checklist for what must be included in an OS. The guidance provided by Considerations should be seen as the beginning of a conversation among the issuer, counsel and other finance professionals in helping to determine what degree of pension disclosure is appropriate in a particular instance. While governments need to include certain basic information about their pension obligations and their pension plan in their OS, in many cases the additional pension disclosure, as described in the Drafting Disclosure Language section and Appendix D, may not be material and thus would not need to be included. Accordingly, it would be a misunderstanding of the purpose of Considerations to conclude it represents a checklist of all topics that must be addressed in the disclosure of an issuer's pension obligations and pension plans in all OSs. Instead, it is a guide to assist issuers in making decisions about materiality that the financial status of their pension plans have to the credit quality of the bonds they are offering and, by so doing, determine what information about their pension obligations and pension plan needs to be included in an OS.

When determining what information about its pension funding obligations may be material, issuers should consider the following categories of information, which will have varying import from issuer to issuer and from type of credit to type of credit. To the extent that an issuer's historical and anticipated pension funding obligations imposes a major fiscal stress on its budget and financial condition, the more likely that more or all of this information is important to investors. To the extent that an issuer's pension funding obligations do not impose a fiscal stress on its budget or financial condition, much of the following information may not be material or even helpful to investors. Issuers and their financing team will need to determine if current circumstances warrant addressing pension funding credit implications in more detail. If an issuer's situation warrants such information to be disclosed, Appendix D will assist the issuer in discharging its disclosure obligations to investors and the market.

The same pension funding information does not need to be presented multiple times, so if certain pension funding information is located in a report or document that can be cross-referenced or incorporated by reference, such information would not need to be repeated in the general discussion of the issuer's pension plan in the OS. The issuer and its financing team will need to determine for each OS the most effective and efficient manner to present the information. Some of the information about the status of pension funding that the issuer may wish to include in the OS may not have been prepared by the issuer itself. In those cases where the information comes from a pension plan, pension system or actuarial report not completed by the issuer, it is important for the issuer to note in the disclosures that the information comes from a third party source. In so doing, the issuer should also state if it has reviewed such information and whether it has any reason to believe that the information is not accurate.

A. General Overview of Pension Plan or System in Which the Issuer Participates

- A plain language summary of the pension plan or plans that the issuer sponsors and for which it provides funding or the pension plan in which the issuer participates. Such summary is typically provided in the notes to the financial statements of the issuer, the plan or the system and the actuarial valuation report.

- For each pension plan that the issuer sponsors and for which it provides funding or in which the issuer participates, consider providing:

  ► A general plan description, which includes (i) the legal authorization and applicable language (if any) from the state constitution or statutes governing benefit protection and funding obligation,

  > This discussion should include a description of the legal status or priority of payments or obligation to fund contributions vis-à-vis other obligations of the issuer such as debt service payments.

  (ii) the type of pension plan and the significance of that form of plan (*e.g.*, defined-benefit, defined-contribution, single-employer, multiple-employer agent, or cost-sharing multiple-employer), (iii) the number of active members, retired members and beneficiaries and deferred members,

  > The issuer may consider providing some of this information in tabular format. For example, a table setting forth the total number of members, the number of active members, retired members and beneficiaries and deferred members, and the percentage of member contributions for the pension plan could provide a visual enhancement of the disclosure in the narrative overview of the pension system.

  (iv) whether members contribute to the pension plan and the contribution level as a percent of payroll, (v) whether there are, and an explanation of the structure of, any tiers by members are classified, (vi) the pension plan's fiscal year, (vii) whether there is any regulation, investment policy or legislation as to how the assets of the pension plan may be invested, (viii) whether there is any recent or pending legislation that is likely to have an impact on the pension plan and the disclosures provided in the official statement and (ix) include any legislative committee or governing body that has commenced a study or published a report regarding the issuer's pension funding requirements, or the pension plan itself. For cost sharing plans, it should be noted that actuarial information is provided for the plan in total.

  ► A general description of how each plan is governed, which includes (i) a description of the governing board of the pension plan, (ii) how members are elected, appointed and removed, (iii) terms of office, and (iv) the relationship of the issuer to the plan (*e.g.*, is the issuer the plan sponsor or solely a plan participant).

  ► A statement of whether the issuer or the state, if the issuer participates in a state-sponsored cost-sharing plan, participates in the Old Age Disability Security Income component of the Federal Social Security System. Currently Alaska, Colorado, Louisiana, Massachusetts, Maine, Nevada and Ohio do not participate in the Federal Social Security System. Statewide teacher plans that do not participate include California, Texas, Illinois, Missouri, Kentucky and Connecticut. 50% of the teachers in Rhode Island do not participate and 37% of those in Georgia do not participate. Many local governments may also have employees outside of the Federal Social Security System, particularly public safety personnel.

  > Contribution levels by issuers that do not participate in the Federal Social Security System may be higher than those that do participate and contribute to the system. This distinction needs to be explained to investors so they take this disparity into account when comparing and evaluating contribution levels across different defined benefit pension plans.

- ► A relatively brief, plain language analysis at the lead-in to the pension disclosure section, comparable in form and substance to what is typically included in a management discussion and analysis section, can quickly apprise the reader as to whether the issuer is meeting its financial commitments or may "have difficulty funding its future annual pension contributions unless it obtained new revenues, reduced pension benefits, or reduced [issuer] services." San Diego Order.

  This analysis should include a description of the current funding policy of the issuer for each pension plan sponsored by the issuer or in which the issuer participates and a description of the issuer's discipline in meeting such policy. If the issuer is aware of a material adverse trend related to the annual required contributions, the issuer should explain the relevant factors, whether underfunding, smoothing of investment gains and losses, amortization methods, plan changes, or other factors, that are likely to materially impact an issuer's annual required contributions in the future.

- Regarding the status and policies of the pension plan itself, consider including cautionary language that provides (i) the information included in the pension disclosure section relies on information produced by the pension plan and their independent accountants and actuaries, (ii) actuarial assessments are "forward-looking" information that reflect the judgment of the fiduciaries of the pension plans, and (iii) actuarial assessments are based upon a variety of assumptions, one or more of which may prove to be inaccurate or be changed in the future, and will change with the future experience of the pension plans. If any third party pension information is included in the OS pension disclosure (and regardless of any cautionary language), the assumptions on which such pension information was generated should be included so that investors may undertake their own evaluation of the appropriateness of such assumptions.

B. Summary of Pension Contribution Funding Policy of the Issuer

- Current level of employer contributions of each pension plan that the issuer sponsors and provides funding or in which the issuer participates in a plain language summary. Pension contribution as a percentage of covered payroll can be one element of this disclosure.

- Hypertext links to or a description of current funding policies and practices (e.g., funding is provided through a legislative or governmental appropriation process or required contributions from participating employers, employees or other contributing entities) and any adopted changes to be implemented in the future.

> See the NJ Order at Paragraph 11, wherein the SEC found that the State bond offering documents did not adequately disclose that the amount actually contributed to the pension plans was subject to the Governor's budget request and annual appropriations by the State legislature. This type of disclosure can be important in instances in which the State Legislature establishes contribution rates. That is because the statutory contribution rates may not bear any connection to the funding status of the pension plan or the amount that an actuary would recommend be contributed to a pension plan.

- If any determinations have been made or legislation exists regarding priorities of funding of the ARC, current payroll, current pension payments, contractual obligations, contribution/funding policy, etc., consider providing a discussion of such analyses, if material. Factors regarding materiality in this context would include who was party to the determinations, whether they have been formally adopted or accepted, and the likelihood of being implemented.

- Consider providing actual cash inflows, including investment earnings, and cash outflows for the pension plan for the last five years.

> Cash inflows and outflows can be essential to know because they can be the best indication of the actual health of a pension plan.

- It is typical for issuers to prepare forecasts or projections of future obligations and liabilities as part of the normal budgetary process. If such forward-looking budget analysis is being prepared, it is likely to include projected pension contributions. It is important to determine how such information was prepared - for example, was it prepared by the issuer's financial staff or with the assistance of the pension plan's actuary. On occasion the issuer may engage, at its expense, the plan actuary to provide projections regarding future contributions. (Actuarially determined information at the participant level is currently not available from the system or plan for participants in a cost-sharing plan.). When disclosing this information, it will be important to include a description of the assumptions used, the process undertaken and the persons involved in the preparation of this information. There was an acknowledgement by members of the Task Force that the reliability of some forecasts or projections might vary due to the number of assumptions involved or the methods used in determining this information. However, the fact that an issuer has undertaken to study or evaluate this future obligation would provide a level of assurance that some attempt was being made to comprehend, monitor and manage the scope of this obligation on future budgets.

> The ultimate objective of pension funding obligation disclosure is to tell investors what are the obligations and expenditures that may compete for the issuer's revenues when the principal and interest on the bonds are due.

- Any pension funding and pension expense projections commissioned or prepared by the issuer, the plan sponsor or the plan should be disclosed and included in the offering documents, with appropriate disclaimers regarding the reasonable of the underlying assumptions, the purpose for the projections, and any limits on their usefulness to investors and reliability.[12]

C. General Funding Practices of Pension Plan or System

- Source of Information. For those issuers that participate in a plan that is not part of their own government, references to or securing information from the pension plan may be in order. In those cases, it is important for the issuer to cite the fact that this information comes from a source not within the issuer's control.

- General. Consider including: (i) an explanation of the legal requirements regarding commission of actuarial valuations, experience studies, any other evaluations of the pension plan that the issuer sponsors and for which it provides funding or in which the issuer participates, (ii) a discussion of the pension plan's historical practices of commissioning valuations/studies in relation to legal requirements, and (iii) indicate the identity of the pension plan's actuary, as well as method and frequency of appointment. Consideration should be given to any terminations of prior actuaries or other advisors or consultants for reasons other than normal course of business rotations and disclosure of the causes for any such termination.

- Actuarial Cost Method. An overview of the actuarial cost method employed to calculate the employer's ARC.

- Asset Smoothing Method. Include a description of any Smoothing Method employed in calculating the AVA and the relative relationship to the fair value of assets.

- Describe the current funded status of the pension plan and highlight the (i) AVA, (ii) AAL, (iii) Funded Ratio, and (iv) UAAL.

- Amortization of UAAL. Describe any amortization of the UAAL, including (i) the length of the amortization period, or if components of the UAAL are amortized over different periods, the equivalent single amortization period, (ii) whether such period or periods is/are open or closed, and (iii) whether the employer has changed the

12 On November 29, 2011 GASB approved a Preliminary Views, Economic Condition reporting: Financial Projections that presents GASB's preliminary views on what it believes are the key issues related to reporting financial projections to assist users of financial reports with assessing a government's economic condition. See Appendix C herein for additional information.

amortization period or periods from time to time, and if so, why.

> The amortization of UAAL is important because it may indicate whether the amortization of the UAAL is not being effectively amortized or whether the method and the period of amortization is such that the UAAL is expected to be amortized so quickly that the issuer's contributions may increase in the near term.

- Actuarial Assumptions. Describe the actuarial assumptions (economic and demographic) employed by the actuaries and the methodology for reviewing/updating such assumptions and the process of determining the actuarial assumptions to be used. In addition, consider any recent recommendations from the plan's actuaries for changing such assumptions and the fiscal impact of implementing such changes, to the extent that such fiscal impact may be material. Describe the results of any experience studies conducted by the plan's actuary and what recommendations have resulted from such analysis. Describe the results of any actuarial impact statements conducted by actuaries regarding plan amendments that have been approved by the legislative or governmental body.

> Actuarial assumptions are important because they provide the basis on which the actuary projects the future stream of benefit payments and by which the actuary calculates the unfunded actuarial liability of the pension plan.

D. Pension Plan Investment Policy and Practices

- Include a summary of or reference to an investment policy that has been adopted by the governing body of the pension plan or system for plan assets including a brief description any asset allocation policy. Specify if the policy is available online or from whom a copy may be obtained.

- Consider providing the current market value of the plan assets, with the appropriate notation that this number existed at a specific day and time, which will be different than the day and time it is being reviewed by an investor or analyst. [13]

E. Litigation, Investigations and Labor Relations

- Describe all (i) material litigation brought in connection with the pension plan or system or involving members of the governing body, (ii) investigations of the pension plan or system or members of the governing body by any governmental authority, (iii) audits of the pension plan and/or its administrators arising from any perceived inadequacy in accounting practices, policies or rules applicable to such pension plan, and (iii) investigations of the issuer's prior disclosures regarding the pension plan.

- Describe the current status of provisions in existing labor contracts between the issuer and its unions that may have a material impact on future funding of the issuer's pension obligations.

F. Transfers of Investment Earnings

Determine if a plan has an "excess earnings" policy (*i.e.*, earnings generated as the product of an investment rate of return that exceeds the assumed investment return) that are used for any purpose other than being retained as a plan asset and explain such policy, if any. Note the permitted and planned uses of such excess earnings and the impact of such use on the historical and projected fiscal health of the pension plan.

> Some pension plans pay benefits if the plan has "excess earnings." Under actuarial theory, there are no excess earnings because the assumed rate of return presupposes volatility from year to year and thus better-than-expected results in one year are expected to be offset by lower-than-expected results in future years.

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13 See NJ Order at Paragraph 43 wherein the SEC found that the failure of the State's bond offering documents to provide asset and funded ratio information on both an actuarial and a market value basis was a material omission in that instance because of the significant disparity between the values. As of the financial statement date, information about the market value of plan assets would be available from the plan financial statements under the current GASB standards, and under ED proposals it would be available as of the employer fiscal year end and the plan fiscal year end in their respective financial statements.

G. Pension Plan Reserves

Determine if the pension plan has a policy that establishes and maintains or earmarks "liabilities" or "assets" that are not reflected in ARC. If so, define how these reserves are determined and the permitted and planned uses for such reserves.

H. Pension Obligation Bonds

If pension obligation bonds have been issued, or are authorized to be issued in order to help meet the need of the issuer's pension obligations, describe the aggregate principal amount of all outstanding pension obligation bonds, including any specific covenant or bond provision that may affect pension funding, a description of each issuance of outstanding pension obligation bonds and any plans for future issuances of pension obligation bonds. This information may already be included in the debt section of the issuer's OS or the issuer's financial statements which may be cross referenced.

I. Other Relevant Reports

Any reports, studies or analyses related to the funding of the pension plan that may have been commissioned by the issuer, plan sponsor or the plan itself should be taken into consideration and disclosed, if material.

> See San Diego Order at Section 5 wherein the SEC found that the City officials knew or were reckless in not knowing that the City's disclosures were false and misleading by failing to disclose the results of the Mayor's Blue Ribbon Committee Report that put the City officials on notice of the growing pension liabilities and the NJ Order at Paragraphs 23 and 24 related to the State's failure to disclose the existence of or findings from the Benefit Review Task Force Report commissioned by the State's Acting Governor.

Tabular Information

- The chart formats set forth below are a useful means of disclosing much of the pension plan information described herein and/or deemed material and meaningful by investors in assessing pension contribution credit implications. For historical information consider including a ten year history of the information presented. For projections consider presenting such information in a table containing three to five years of information.

- Historical Funded Status. For ease of presentation, consider setting forth the historical funded status of the plan for which the issuer sponsors or in which the issuer participates based on actuarial value and market value in separate ten-year tables.

> The presentation of historical funded status can be used to identify whether there is an historical trend of deteriorating funded status and a historical trend of increasing pension contributions.

► Ten-Year Table - Actuarial Value.

HISTORICAL FUNDING PROGRESS
ACTUARIAL VALUE

Valuation Date	Actuarial Value of Assets	AAL	UAAL	Funded Ratio	Member Payroll	UAAL to Payroll Ratio

Source: (include source).

► Ten-Year Table - Market Value. Consider providing another table that indicates the same information based on the market value of assets. This table would only be necessary if the plan does not use the market value of assets as the actuarial value of assets. The UAAL (market value), funded ratio, and ratio of UAAL (market value) to member payroll would then be recalculated.

Usually, the difference between the market value of assets and actuarial value of assets is the amount of investment losses or gains that the actuarial smoothing method of the pension plan has "smoothed" and thus has not been fully reflected in the actuarial value of the assets. In instances in which an issuer's pension obligations indicate a material financial concern to a fund that supports debt service on the bonds, it is important to tell investors what the difference between the actuarial value and the market value of assets is because it can indicate future increases in pension contributions by the issuer.

- Explanation of Table Data. Following the inclusion of the above tables, consider providing a discussion covering the following:

(i) sources of contributions by the employer;

(ii) the method for expanding pool of beneficiaries and increasing benefits, including whether the governing body has expanded benefits within the last five years and the impact of such benefit increases upon the funded status of the plan for which the issuer sponsors or in which the isuer participates (Funded Ratio, UAAL) and the issuer's budget;

(iii) any revaluations of the plan or system within the past five years, the impetus for such revaluations and the impact of such revaluation on the ARC, the employer's actual contributions, the UAAL and the Funded Ratio; and

(iv) if a UAAL is present or expected (based on actuarial analysis), plans for reducing/avoiding such UAAL noting whether such plans are firm or flexible and expected or likely to change, and the anticipated source of funds to reduce/avoid such UAAL.

► Comparative Ratios - Ten Years. The information in the following table is a convenient presentation of the comparison of the actuarial value of assets to the market values, the ratio of the AVA to market value, and the funded ratio based on AVA compared to funded ratio based on market value of assets.

Fiscal Year	Actuarial Value of Assets	Market Value of Assets	% of AVA to market value	Funded Ratio (actuarial value)	Funded Ratio (market value)

Source: (include source).

► Ten Year Table Annual Employer Contribution Status. The following table indicates, on a Fiscal Year basis, the ARC, the actual contribution and any amount unfunded.

As discussed above, the most important information in the historical contribution table is whether there is a trend of increasing contributions and also if there has been any pattern of the issuer to not fund its contributions completely.

ANNUAL EMPLOYER CONTRIBUTION STATUS

Fiscal Year	ARC /Contractually Required Contribution	Actual Employer Contribution	Amount Unfunded	% of Total Govt. Expenditures	% of Total Gen. Fund Expenditures

Source: (include source).

- Explanation of Table Data. Following the inclusion of the above tables, consider providing disclosures covering the following:

(i) contingent or deferred contributions and the manner of reflecting such contributions in historical and prospective calculations of the ARC, AAL, UAAL and Funded Ratio;

(ii) a discussion of any deviation from actuarially-recommended actions such as a difference in funding between the ARC and the actual contribution made; and

(iii) how/when employer's contributions may/have deviate(d) from the ARC and whether contributions are subject to appropriation or otherwise subject to underfunding.

- Funding Source. The percentage of total governmental expenditures or percentage of total general fund expenditures is important if the source of security or repayment of the debt obligation is the general fund.

- Prospective Funded Status. The prospective funded status of each pension plan of the issuer based on projections by an actuary in a three to five-year table.

> If an issuer's future contributions are expected to increase to levels that will likely create fiscal strain, an issuer should consider whether projections should be included in order to present such information to the investor.

► Multi-Year Table - Prospective Funded Status.

PROSPECTIVE FUNDED STATUS OF THE PENSION SYSTEM

Fiscal Year	Actuarially Determined Contribution	AVA	AAL	UAAL	Funded Ratio	% of Total Govt. Expenditures	% of Total Gen. Fund Expenditures

Source: (include source).

- Summary of the Funded Status of the Pension System. Following the inclusion of the above table include a discussion of the following funding analysis:

(i) the impact of the ARC and actual contributions on the employer's budget;

(ii) whether there have been any reports or evaluations commissioned by the issuer, plan sponsor or the plan itself on the funding of the pension system;

> This discussion would also review any material internal or third party reports or evaluations commissioned by the issuer, plan sponsor or plan, and any recommendations regarding and/or evaluations of current assumptions employed by the pension actuary.

(iii) consider providing a description of what steps/plans the issuer has, if any, to address future funding obligations;

(iv) a discussion of any sensitivity analyses of the fiscal impact of changes in actuarial assumptions; and

(v) if pension obligation bonds have been issued consider adding a column and disclosing the annual debt service for such obligations.

- Investment Policy. Expand the discussion of the pension plan's investment policy to include a comparison of Actuarial Assumed Rate of Return to Historical Investment Return for the prior year, the prior three years, the prior five years, and the prior ten years.

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