VII. The Municipal Securities Market: How Increasing the Unfunded Ratios of Public Pension Plans Can Be a Good Thing

A. Introduction

Since establishing its Municipal Securities and Public Pension Unit in 2010, the U.S. Securities and Exchange Commission ("SEC") has increased its enforcement efforts against municipal securities issuers.[1] The SEC brought its first action against a state on August 18, 2010, when it charged New Jersey for failing to disclose its unfunded pension liabilities.[2] Later that year, the SEC settled with two officials involved in an earlier case brought against San Diego "for underreporting [its] pension liabilit[ies]."[3] Most recently, on July 24, 2012, the SEC warned Miami of a possible enforcement

---

[1] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence (Jan. 13, 2010), *available at* http://www.sec.gov/news/press/2010/2010-5.htm (announcing establishment of five specialized units in priority areas of securities law); E-Alert, Covington & Burling LLP, SEC Steps up Enforcement Efforts in the Municipal Bond Market (Aug. 1, 2012), http://www.cov.com/files/Publication/36b897f4-a5d8-4feb-aa50-15ca482b3ccb/Presentation/PublicationAttachment/f2805e9c-576f-426a-bb7b-217741d5395a/SEC_Steps_Up_Enforcement_Effort_in_Municipal_Bond_Market.pdf [hereinafter Covington & Burling LLP] (predicting increased enforcement actions against municipal securities issuers).

[2] *See In re* State of New Jersey, Exchange Act Release No. 9135, 2010 WL 3260860 (Aug. 18, 2010) [hereinafter Exchange Act Release No. 9135] (bringing action against New Jersey for violations of sections 17(a)(2) and 17(a)(3) of Securities Act of 1933); William Selway & Dunstan McNichol, *SEC's New Jersey Fraud Case Seen as Harbinger in Muni Crackdown*, BLOOMBERG NEWS (Aug. 19, 2010, 3:20 PM), http://www.bloomberg.com/news/2010-08-19/sec-muni-bond-dragnet-may-ensnare-a-dozen-issuers-after-new-jersey-settles.html (questioning whether case against New Jersey "presage[s] a wave of lawsuits" against municipal securities issuers).

[3] *See* Alison Frankel, *SEC Set to Bring Civil Charges Against Miami in Muni Bond Probe*, REUTERS (July 24, 2012), http:// newsandinsight.thomsonreuters.com/Legal/News/2012/07_-_July/SEC_set_to_bring_civil_charges_against_Miami_in_muni_bond_probe/ (indicating that settlement with San Diego officials evidences SEC's focus on municipal securities market).

action for allegedly misrepresenting its financial status to investors.[4] The SEC's recent increase in enforcement activity against state and local governments is illustrative of disclosure challenges concerning public pension liabilities.

Currently, investors in municipal securities struggle to understand issuers' pension liabilities and evaluate risk.[5] The SEC specifically claims that "the lack of uniformly applied generally accepted accounting standards in the municipal market raises significant issues for investors and the market."[6] One effort to improve disclosure of financial information comes from the Governmental Accounting Standards Board ("GASB").[7] GASB recently approved two new standards that "increase the transparency, consistency, and comparability of pension information across governments."[8] However, the new standards magnify weaknesses in government budgets because they require most governments to report a greater amount of liabilities up-front.[9]

This article discusses how GASB's new standards seek to improve substantive disclosure in the municipal securities market. Part B introduces the current regulatory scheme, Part C explains the impact of GASB's new standards, and Part D assesses their

---

[4] *See id.* (observing that SEC sent a Wells Notice to lawyers for Miami). It is currently unclear whether the SEC's allegations against Miami relate specifically to the failure to disclose pension liabilities. *See id.* (reporting that "SEC staff intends to recommend civil charges of securities fraud and other disclosure violations against the city").

[5] *See* Wesley Smyth, *Special Comment: GASB's Proposed Accounting Changes Would Improve Transparency and Comparability for Public-Sector Pension Plans*, MOODY'S INVESTORS SERVICE, Oct. 11, 2011, at 2, *available at* http://www.nasra.org/resources/Moodys.pdf.

[6] U.S. SEC. & EXCH. COMM'N, DISCLOSURE AND ACCOUNTING PRACTICES IN THE MUNICIPAL SECURITIES MARKET 6 (2007) [hereinafter SEC, DISCLOSURE AND ACCOUNTING PRACTICES].

[7] *See* GOVERNMENTAL ACCOUNTING STANDARDS BD., NEW GASB PENSION STATEMENTS TO BRING ABOUT MAJOR IMPROVEMENTS IN FINANCIAL REPORTING (2012) [hereinafter GASB].

[8] *Id.*

[9] *See id*. *See generally* Alicia H. Munnell et al., *How Would GASB Proposals Affect State and Local Pension Reporting?*, (Ctr. for Ret. Research at Bos. Coll., Working Paper No. 2012-17, 2012), *available at* http://leg.mt.gov/content/Publications/fiscal/Pensions/Boston-College-Proposals.pdf (assessing financial disposition of public pension plans under GASB's proposed standards).

effectiveness. The article concludes that while establishing more effective substantive disclosure requirements will lead to an expansion of the SEC's regulatory authority, GASB's new standards will encourage much needed pension funding reforms.

B. The Municipal Securities Market: How Issuers Escape Strict Regulation of Substantive Disclosure Practices

Accurate reporting of a state or local government's pension liabilities is necessary to maintain the stability of and confidence in the municipal securities market.[10] The municipal securities market includes debt instruments issued by states and their political subdivisions.[11] As such, municipal securities help fund essential public services and infrastructure projects.[12] Investors in municipal securities hold about $3.7 trillion in securities.[13] Pension liabilities can affect an issuer's ability to pay these investors.[14] Analysts estimate that, nationwide, public pension fund shortfalls range between $757 billion and $7 trillion.[15] Yet investors cannot

---

[10] *See* U.S. SEC. & EXCH. COMM'N, REPORT ON THE MUNICIPAL SECURITIES MARKET 84 (July 31, 2012) [hereinafter SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET].

[11] *See* Securities Exchange Act of 1934 § 3(a)(29), 15 U.S.C. § 78c(a)(29) (2006) ("The term 'municipal securities' means securities which are direct obligations of . . . a state or any political subdivision thereof . . . or any municipal corporate instrumentality . . . .").

[12] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at i.

[13] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-698, MUNICIPAL SECURITIES: OPTIONS FOR IMPROVING CONTINUING DISCLOSURE 1 (July 2012). Individual investors hold 50% of outstanding municipal securities, and 25% are held through investment funds. *See id.*

[14] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 23 ("[M]unicipal bonds can and do default, and these defaults can negatively impact investors in ways other than non-payment, including delayed payments and pricing disruptions.").

[15] *Compare* Martin Z. Braun, *U.S. Public Pensions Earn 1.15% for Worst Showing Since 2009*, BLOOMBERG NEWS (Aug. 6, 2012, 1:49 PM), http://www.bloomberg.com/news/2012-08-06/u-s-public-pensions-earn-1-15-for-worst-showing-since-2009.html, *with* Richard Ravitch, Former Lieutenant Governor of N.Y., Address at The Wharton School of the University of Pennsylvania (Feb. 15, 2012) (audio recording on file with

determine an issuer's financial health, and, in turn, make prudent investments in public service and infrastructure projects, without a clear representation of such financial obligations.[16] Accordingly, accurate reporting of pension liabilities and shortfalls, which widen budget deficits, is essential to the evaluation of risk in municipal securities investing.

Despite the importance of clear financial information, the SEC does not strictly regulate issuers' substantive disclosure practices.[17] Under section 3(a)(2) of the Securities Act of 1933 ("'33 Act"), municipal securities are exempt from registration provisions of the securities laws.[18] Historically, the SEC has avoided strict regulation of the municipal securities market because of (1) the "lack of proven abuses" in issuing municipal securities; (2) investors' "perceived sophistication"; (3) "the desire to avoid the costs of regulation"; (4) the low default rate relative to corporate securities; and (5) uncertainty over the constitutional basis of federal regulation of state and local governments.[19] However, in light of the financial crisis of 2008, the reduction in property tax revenues, and an anticipated increase in municipal defaults, the SEC is urging Congress to enhance federal regulation of the municipal securities market.[20]

---

author) (estimating nationwide shortfalls at $7 trillion if pension liabilities are discounted at the riskless rate).

16 *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 436-38 (6th ed. 2009); Smyth, *supra* note 5, at 2.

17 *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 28 ("In the absence of a statutory scheme for municipal securities registration and reporting, the [SEC's] investor protection efforts in the municipal securities market have been accomplished primarily through regulation of broker-dealers and municipal securities dealers.").

18 *See* Securities Act of 1933 § 3(a)(2), 15 U.S.C. § 77c(a)(2) (2006).

19 *See* COX ET AL., *supra* note 16, at 429, 435.

20 *See* Mary Williams Walsh, *S.E.C. Suggests Reforms of Municipal Bond Market*, N.Y. TIMES, July 31, 2012, at B1, *available at* http://www.nytimes.com/2012/08/01/business/sec-urges-reforms-of-municipal-bond-market.html?pagewanted=all&_r=0; Ravitch, *supra* note 15 (asserting that decrease in value of housing market consequently reduced tax revenues); Nin-Hai Tseng, *Reading the Tea Leaves on Buffett's Muni Trades*, FORTUNE (Aug. 22, 2012, 12:36 PM), http:// finance. fortune.cnn.com/2012/08/22/warren-buffett-muni-bonds/ (quoting Warren Buffet comparing guaranteeing of municipal securities defaults to insuring of natural catastrophes). S*ee generally* SEC, REPORT ON THE MUNICIPAL

1. Current Regulations

Standards in disclosure practices in the municipal securities market have evolved from section 17(a) of the '33 Act, section 10(b) of the Securities Exchange Act of 1934 ("'34 Act"), Securities Exchange Act Rule 15c2-12, the Municipal Securities Rulemaking Board ("MSRB"), and voluntary guidelines established by various industry groups like GASB.[21] Sections 17(a) and 10(b), known as the antifraud provisions, prohibit any person from making material misstatements or omissions in connection with municipal securities.[22] However, section 15B of the '34 Act, known as the Tower Amendment, prohibits the SEC and the MSRB from requiring municipal securities issuers to directly furnish information to either entity.[23] Therefore, the SEC effectively lacks the authority to detail the form and content of municipal issuers' disclosure documents notwithstanding its authority under the antifraud provisions.[24]

Most of the SEC's regulatory authority instead stems from its oversight of underwriters as opposed to issuers.[25] For example, under Rule 15c2-12, a broker-dealer must obtain and review an "official statement," and, upon request, provide a copy of that statement to potential investors.[26] However, neither Rule 15c2-12 nor

---

SECURITIES MARKET, *supra* note 10 (calling for legislative action to increase federal oversight of the municipal securities market).

[21] *See generally* Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (2006); Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b); Securities Act Amendments of 1975, Pub. L. No. 94-29, §78 et seq., 89 Stat. 131 (1975); 17 C.F.R. § 240.15c2-12(b)(1), (b)(2) (2012); GOVERNMENTAL ACCOUNTING STANDARDS (2012).

[22] *See* § 17(a); § 10(b); COX ET AL., *supra* note 16, at 429.

[23] *See* Securities Exchange Act of 1934 § 15B(d)(1), 15 U.S.C. § 78o-4(c)(9)(B)(d)(1) ("Neither the [SEC] nor the [MSRB] is authorized under this title, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the [SEC] or the [MSRB] prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities."); SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 27.

[24] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 28.

[25] *See id.*

[26] *See* 17 C.F.R. § 240.15c2-12(b)(1), (b)(2). The official statement is similar to a corporate prospectus. *See* COX ET AL., *supra* 16 note, at 439.

any of the regulatory provisions mandate the content or preparation of the official statement.[27] Rule 15c2-12 thus expands the SEC's regulatory authority over underwriters, not issuers.

The MSRB also lacks the authority to directly impact the disclosure practices of issuers. Under Rule G-17, the MSRB requires the disclosure of all material information concerning a transaction when such information is reasonably accessible to the dealer.[28] Thus, the MSRB similarly regulates dealers, not issuers.

In 2008, the SEC amended Rule 15c2-12 and thereby established the Electronic Municipal Market Access ("EMMA"), which is the municipal securities market counterpart to the Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") database for corporate securities.[29] EMMA helps to provide transparency by centralizing the information that issuers disclose, but the content of disclosure documents remains discretionary.

While it appears that municipal securities issuers generally escape regulation by the SEC—insofar as they do not violate the antifraud provisions—and the MSRB, several industry organizations influence issuers' disclosure practices.[30] For example, the Government Finance Officers Association provides the guidelines for preparing the official statement.[31] Additionally, GASB establishes generally accepted accounting principles ("GAAP") that many state and local governments adopt.[32]

---

[27] *See* COX ET AL., *supra* note 16, at 444.

[28] *See* MUN. SEC. RULEMAKING BD., Rule G-17 (2012), *available at* http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx.

[29] *See* COX ET AL., *supra* 16 note, at 445. Corporate securities are nonexempt securities and include all financial instruments issued by any corporation that carry interest coupons or are registered as such. *See* United States v. Leslie Salt Co., 350 U.S. 383, 391 (1956) ("[A]ll instruments, however termed, issued by any corporation with interest coupons or in registered form [are] generally known as securities . . . .").

[30] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 56 (recognizing that various industry groups provide voluntary guidelines affecting disclosure practices, e.g., GASB, Government Finance Officers Association (GFOA), and Association of School Business Officials International).

[31] *See* COX ET AL., *supra* note 16, at 439.

[32] *See* SEC, DISCLOSURE AND ACCOUNTING PRACTICES, *supra* note 6, at 7.

C. GASB: Making Public Pension Funding Information Clear and Comparable

1. What is GASB?

Even though GASB is responsible for establishing GAAP for the public sector, the municipal securities market lacks uniformly applied accounting standards.[33] GASB was established in 1984 as an independent organization.[34] It operates as a component of the Financial Accounting Foundation, the non-profit organization that oversees the Financial Accounting Standards Board ("FASB"), the organization that establishes GAAP for the private sector.[35] GASB does not have enforcement authority and its standards are not federal laws or regulations, but many state laws require "adhere[nce] to GASB's standards."[36] Additionally, financial consultants and auditors that issue opinions on municipalities' financial statements reinforce adherence to GASB's standards.[37]

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") required the establishment of permanent funding for GASB.[38] As a result, the Financial Industry Regulatory Authority ("FINRA"), the self-regulatory organization that oversees securities, proposed a rule to collect fees from its

---

[33] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 71.

[34] *See* SEC, DISCLOSURE AND ACCOUNTING PRACTICES, *supra* note 6, at 7 n.28.

[35] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 71 n.426.

[36] *See id.* at 71-72 (reporting that, as of 2010, thirty-eight states require compliance with GAAP as established by GASB). *But see id.* at 72 n.428 (offering New Jersey as an example of a government that does not comply with GASB's standards).

[37] *See, e.g.*, James C. Lanzarotta, *GASB or FASB? Making the Right Decision for Your Organziation*, GOV'T FIN. Q. (Moss-Adams LLP), Spring 2012, at 1, *available at* http://www.mossadams.com/mossadams/media/Documents/Publications/Nfp/NFP_Govt-Finance-Quarterly_Spring2012.pdf (advising organizations on "which financial reporting framework is the correct one to follow").

[38] *See* Securities Act of 1933 § 19(g)(1)(A), 15 U.S.C.A. § 77s(g)(1)(A) (West 2012) (providing that the SEC may establish a reasonable support fee to "adequately fund the annual budget of [GASB]").

member firms to fund GASB's annual budget. [39] On February 23, 2012, the SEC approved the proposed rule.[40] However, neither the SEC nor FINRA has authority under the Dodd-Frank Act to affect GAAP as established by GASB.[41]

2. GASB's New Standards

GASB, on June 25, 2012, approved Statements No. 67 and 68, which seek to increase transparency in the municipal securities market.[42] These new standards change the way that local governments calculate and report pension liabilities on financial statements.[43] Under the new standards, funded ratios, on average, will dramatically decrease from about 76% to 57%.[44] The funded ratio indicates the amount of liabilities that the plan is able to cover.[45] This means that unless contributions increase, most pension plans will eventually become exhausted.[46] Additionally, governments "will report[] the net pension liability . . . on the face of the financial statements."[47] Many state and local governments' pension funds will

---

[39] *See* GASB Accounting Support Fee, FINRA Notice 12-15, 2012 WL 896157 at *1 (Mar. 14, 2012) ("For 2012, FINRA will assess and collect a total of $8,451,300 for the GASB Accounting Support Fee by collecting $2,112,825 from its member firms each calendar quarter.").

[40] *See id.*

[41] *See id.* at *2 n.2 (recognizing that support fee shall not be construed to permit SEC or FINRA to oversee or affect GASB's agenda including establishment of GAAP).

[42] *See* GASB, *supra* note 7. Statements No. 67 and 68 will take effect for fiscal years beginning after June 15, 2013 and June 15, 2014 respectively. *See id.* at 8.

[43] *See id.* at 2.

[44] *See* Theo Francis, *Why Public Pensions are About to Look Less Healthy*, PLANET MONEY BLOG (July 23, 2012, 3:40 PM), http://www.npr.org/blogs/money/2012/07/23/156323322/why-public-pensions-are-about-to-look-less-healthy. See Munnell et al., *supra* note 9, at 11–14 app. B, for change in funded ratios of 126 public pension plans analyzed under GASB's new standards.

[45] *See* Munnell et al., *supra* note 9, at 2 (defining funded ratio as amount of plan assets divided by plan liabilities).

[46] *See* Francis, *supra* note 44 ("Under the old rules, plans reported having, on average, 76% of the assets they would need to pay promised benefits to every retiree and employee from now until the last one dies. The new rules would slash that figure . . . to an estimated fifty-seven percent.")

[47] *See* GASB, *supra* note 7.

thus appear "weaker" under the new standards, but this is an accurate reflection of those governments' financial positions.[48] These two major changes are further explained below to illustrate the substantive improvements to disclosure practices.

a. The Discount Rate

GASB's new discount rate reflects a more realistic expectation of future returns on plan assets.[49] The discount rate is the number by which pension liabilities, i.e., promised pension payments, are reduced in order to express those liabilities in today's dollars.[50] Under the old accounting methods, pension liabilities were discounted by the long-term yield of the assets held in the fund, which historically has been about 8%.[51] Many economists, however, argue that the discount rate should reflect the characteristics of the liabilities, not the assets.[52] Under this approach, an appropriate discount rate would equal the riskless rate, the rate generally associated with United States Treasury securities: about 5%.[53] GASB's new standards blend these rates depending on the funded status of the particular fund.[54] This means that the 8% discount rate

---

48 *See id.*

49 *See* GOVERNMENTAL ACCOUNTING STANDARDS BOARD, No. 327-B, GOVERNMENTAL ACCOUNTING STANDARDS, at 18-22 (June 2012); GOVERNMENTAL ACCOUNTING STANDARDS BOARD, No. 327-C, GOVERNMENTAL ACCOUNTING STANDARDS, at 20-32 (June 2012) [hereinafter GASB, No. 327-C].

50 *See Planet Money: Handling Other People's Money*, NATIONAL PUBLIC RADIO (July 24, 2012), *available at* http://www.npr.org/templates/archives/archive.php?thingId=127413729&date=09-23-2012&p=16 [hereinafter *Planet Money*], for a plain language explanation of the discount rate.

51 *See id.* (stating that pension plans calculate an 8% rate of return under old standards).

52 *See* Jeffrey R. Brown & David W. Wilcox, *Discounting State and Local Pension Liabilities*, AM. ECON. REV., May 2009, at 542 (concluding that discount rate should reflect riskiness of liabilities, not assets); *see also* Ravitch, *supra* note 15 (denouncing 8% discount rate as "not applicable" given current market conditions).

53 *See Planet Money*, *supra* note 50 (reporting that the current riskless rate equals about 5%).

54 *See* GASB, No. 327-C, *supra* note 49, at 20–32; Munnell et al., *supra* note 9, at 1 ("[L]iabilities [will] be discounted by a blended rate that reflects the expected return for the portion of liabilities that are projected to be

will apply to the amount of pension liabilities that are currently covered by the assets in the fund, but insofar as the pension liabilities are unfunded, the 5% discount rate will apply.[55] As a result, the funded ratios of most public pension funds will decrease—from, on average, about 76% to 57%—revealing that those funds are substantially underfunded.[56] In other words, the new blended rate prevents local governments from making their pension liabilities look smaller than they are.

b. Recognition of Liabilities on the Balance Sheet

The new standards also require state and local governments to report a net pension liability on their balance sheets.[57] Under the old standards, governments reported a liability only if the amount needed to cover the normal cost and amortize unfunded liabilities exceeded the amount contributed to the fund in a given year.[58] A net pension liability calculates the total pension liability less the plan assets.[59] Under the new standards, governments will report the net pension liability "on the face of the financial statements" placing pension liabilities on "an equal footing with other long-term obligations."[60] The result is an immediate recognition of the amount of a government's unfunded pension liabilities, instead of just the difference between the contributions that were needed and the amount actually contributed in a particular year.

D. The Effectiveness of GASB's New Standards

GASB's new standards more clearly indicate pension liabilities and shortfalls, but these standards are not enough to establish truly "transparen[t], consisten[t], and comparabl[e]"

---

covered by plan assets and the return on high-grade municipal bonds for the portion that are to be covered by other resources.").

[55] *See id.*

[56] *See Planet Money, supra* note 50.

[57] *See* GASB, No. 327-C, *supra* note 49, at 18–22.

[58] *See* Smyth, *supra* note 5, at 3 ("Neither the total obligation for pensions nor the unfunded portion is reported as a liability in a government's financial statement under GASB's [old] standards.").

[59] *See* GASB, *supra* note 7.

[60] *Id.*

financial statements across state and local governments.[61] The new standards require that funds, *inter alia*, report a net liability "on the face of financial statements" and discount liabilities by the riskless rate to create a more accurate representation of a local government's financial position.[62] These new accounting practices thus improve issuers' disclosure of public pension funding information, a "top concern" of the SEC as evidenced by the recent enforcement activity of its pension fund task force.[63] However, GASB's new standards do not have the force of law.[64] Contrast this with the corporate securities market wherein the SEC compels corporate securities issuers to conform to GAAP as established by FASB.[65] Therefore, both the SEC's and GASB's lack of authority to enforce accounting standards across local governments underscores the need for further reforms to establish substantive disclosure practices in the municipal securities market that are consistent and transparent.

The SEC, on July 31, 2012, issued a report on the municipal securities market wherein it recommended, *inter alia*, legislative action to establish a national standard-setting body for public sector financial statements.[66] The SEC noted that issuers' "deficient financial statements" have been the cause of many of its enforcement actions for material misrepresentations, including its actions against New Jersey, San Diego, and Miami discussed *supra*.[67] It further concluded that many market participants agreed that GASB's standards "promote[] consistency and comparability of financial information" across governments.[68] As such, the SEC recommended that Congress create a mechanism by which the SEC can establish (1) "the form and content [of municipal securities issuers'] financial statements"; and (2) oversight of a GAAP "standard setter" such as GASB.[69] Establishing uniformly applied accounting standards across local governments and gaining federal oversight of issuers'

---

[61] *Id*.
[62] *See id.*
[63] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 84; Walsh, *supra* note 20.
[64] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 71.
[65] *See id.* at 71 n.425.
[66] *See id.* at 136.
[67] *See id.* at 70.
[68] *Id.* at 137.
[69] *See id.* at 136.

substantive disclosure practices thus requires an expansion of regulatory authority in the public sector.

GASB's new standards are further limited because they only relate to accounting and financial reporting issues.[70] With several states, under the new standards, having less than 30% of the assets needed to cover their pension liabilities, the dearth of adequately funded pension plans is arguably a bigger problem than disclosure challenges in the municipal securities market.[71] Yet the new standards do not change how plans are funded.[72] Reforms to pension funding practices are therefore needed to increase cash flows, offset unfunded liabilities, and decrease budget deficits.[73] Such improvements would help to ensure that issuers are financially healthy enough to pay both investors and future retirees.[74]

E. Conclusion

The SEC has increased its efforts to regulate the municipal securities market. [75] An area of concern in the market is the disclosure of substantive financial information, specifically about pension funds.[76] GASB's new standards help improve the transparency of financial statements by requiring state and local governments to more accurately report pension funding information.[77] But because GASB lacks enforcement authority, the SEC has suggested reforms that will either give it oversight of a "standard setter" such as GASB or allow it to establish uniformly

[70] *See* Mark J. Magyar, *Will New Accounting Rules Force NJ to Put Billions More Into Pension Payments?*, NJ SPOTLIGHT (June 14, 2012), http://www.njspotlight.com/stories/12/0614/0121/ (observing that pension contributions do not have to comply with GASB's standards).

[71] *See* Munnell et al., *supra* note 9, at 11 app. B; Ravitch, *supra* note 15 (comparing current pension funding practices to "kicking the can down the road").

[72] *See* GASB, *supra* note 7.

[73] *See* Ravitch, *supra* note 15 (suggesting that higher tax rates are needed to cover pension shortfalls).

[74] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 84.

[75] *See* Covington & Burling LLP, *supra* note 1; Selway & McNichol, *supra* note 2.

[76] *See* Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 1.

[77] *See* GASB, *supra* note 7.

applied accounting standards itself.[78] For now, state and local governments that adopt GASB's new standards will likely improve the content of their financial disclosure statements and thereby reduce their exposure to liability under the securities laws, even if it means significantly decreasing their funded ratios. However, the new standards cannot solve the underlying problem—that state and local governments' promised benefits are outdistancing the growth of their revenues.[79] Further, obfuscating pension liabilities does not lead to a balanced budget when measured in actual dollars and cents. Therefore, even if GASB's new standards do not uniformly establish the content of disclosure statements, perhaps they will help to accelerate pension *funding* reforms as the unsustainability of pension obligations becomes more apparent to many issuers.[80]

Jillian Zvolensky[81]

---

[78] *See* SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET, *supra* note 10, at 136.

[79] *See* Ravitch, *supra* note 15 (highlighting the unsustainability of current pension liabilities).

[80] *See* Lisa Lambert & Nanette Byrnes, *New Rules May Make Public Pensions Appear Weaker*, REUTERS (June 25 2012, 6:29 PM), http://www.reuters.com/article/2012/06/25/us-usa-pensions-standards-idUSBRE85O01Z20120625 (recognizing that GASB's new standards "may immediately raise the level of attention to seriously do something" about pension deficits).

[81] Student, Boston University School of Law (J.D. 2014).