

UPDATE

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Part V: “Key Measurements Related to Pension and Employee Benefit Liabilities and the Importance of the Government Accounting Standards Board”

“Securities Disclosure: What Lessons Can We Learn from the Securities and Exchange Commission’s Proceedings versus the City of San Diego, California?”

BY MARK H. VACHA, ESQ.

This installment is Part V in a seven-part series about the Securities and Exchange Commission’s (the “Commission”) proceedings versus the City of San Diego, California (the “City”) as set forth in the November 14, 2006 Release No. 8751 (the “Release”). The Release relates to the settlement between the Commission and the City pursuant to which the City consented to the entry of a cease-and-desist order relating to the City’s offer and sale of over \$260 million in municipal bonds in 2002 and 2003. For more factual background on these proceedings and an overview, please see Part I of this series which is available on the Dilworth Paxson LLP website at www.dilworthlaw.com. This article addresses potential insights from the Release regarding measurements related to pension and employee benefit liabilities. Although the Release dealt with a general purpose governmental issuer, the points made by the Commission can also be instructive for the board of a conduit borrower in a transaction such as a tax-exempt qualified 501(c)(3) bond financing (e.g. the board of directors or trustees of a university or a hospital).

Important Factors Related to Pension and Employee Benefit Liabilities

The Commission cited three concepts that were particularly important in the disclosure of the City’s pension obligations and the funding of those

obligations: (1) the retirement plan’s funded ratio (i.e. the ratio of the retirement system’s assets to its liabilities); (2) the City’s unfunded liability to the retirement system (i.e. the dollar shortfall between the retirement system’s assets and liabilities); and (3) the City’s net pension obligation which is also called the “NPO” (i.e. the cumulative difference between what the City actually contributed to the retirement system and the amount that the City would have contributed had it conformed to a funding method recognized by the Government Accounting Standards Board (“GASB”).

Departures by the City from GASB were noted by the Commission and a principle that may be inferred from the Release is that pension funding practices that do not conform to GASB (or such other applicable accounting standards) should be disclosed. The Commission particularly cited certain actions by the City such as its use of reserved surplus earnings to pay certain benefits and to pay an increased portion of the employee’s retirement system contribution. The report discussed an agreement between the City and the CERS which was termed “Manager’s Proposal 2” which the Commission stated “allowed the City more time to under-fund” the CERS. Pursuant to Manager’s Proposal 2, once the CERS’s funded ratio fell below 82.3%, the City would have five years to increase its contributions to CERS to reach a GASB-recognized funding rate.

A LOOK AHEAD... The remaining two installments in this series are:

Part VI: “The Importance of Projections in Matters Related to Pension and Employee Benefit Liabilities”

Part VII: “Remedial Efforts and Undertakings as a Source of Best Practices” (with conclusion).



Mr. Vacha is a member of Dilworth Paxson’s Corporate Department and its Public Finance and Securities Groups. He has advised issuers, national, and regional investment banking firms in municipal capital markets transactions. He has handled securitization/ structured finance, initial public debt offerings, tax credit financings, bond pools, and tax district financings as well as traditional municipal bond transactions in the general governmental and 501(c)(3) contexts.

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