National Federation of Municipal Analysts
Recommended Best Practices in Disclosure for Hospital Transactions

DRAFT – To be finalized after receipt of comments from industry participants
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Background:

The National Federation of Municipal Analysts ("NFMA") has undertaken a leadership role concerning the need to improve municipal bond market disclosure. The NFMA worked with several other organizations including the SEC and the MSRB culminating in the 1994 Amendments to SEC Rule 15C2-12 (the "Amendments"). As stated in the Spring 1998 NFMA Position Paper on the 1994 Amendments to Rule 15C2-12: "The Securities and Exchange Commission (the "SEC") stated that the Amendments were "designed to enhance the quality, timing and dissemination of [secondary market] disclosure in the municipal securities market."'

While there is overwhelming consensus that the Amendments have been a positive development in the municipal market, implementation of the Amendments has resulted in several issues that are of concern for the municipal bond community. These issues have been discussed in the aforementioned NFMA Position Paper and will be restated here:

- The promulgation of minimum standards has led, in many instances, to a decrease in access to secondary market disclosure.
- The goal of bringing the quantity and quality of secondary market disclosure to the level of primary market disclosure has led some issuers to lower the level of primary disclosure.
- The goal of increased dissemination is being thwarted by cost and access issues.
- The absence of a filing deadline and penalties has worked against the goal of improving the timeliness of secondary market information.
- The Amendments have resulted in two classes of securities in terms of disclosure requirements: pre- and post-amendment.

In order to build upon the positive achievements of the Amendments and address the technical sector-specific issues, the NFMA has established sector-specific subcommittees to work with other industry stakeholders to achieve consensus in establishing improved disclosure practices. This NFMA effort began with a housing subcommittee that has been active for several years. This subcommittee has issued a second draft of its disclosure recommendations based on feedback from other industry participants (particularly the relevant issuers's group, the National Council of State Housing Agencies). Similar efforts have begun in the areas of land-based municipal bonds and the education sector.

Hospital credits are as volatile as corporate credits. The NFMA is not suggesting that issuers should incur the time and expense required to produce an extensive 10Q or 10K type of disclosure document. However, this volatile sector requires disclosure at least as timely as general corporate issuers. Timeliness of information is a particular concern for hospital bond analysts. The dynamic nature of the industry is resulting in high volatility in the financial and operating position of hospitals. The intent of the guidelines was to establish minimum standards where none existed. It was expected that the market would continue with the more timely disclosure standards that existed in sectors such as hospital bonds where voluntary, quarterly disclosure was the norm.

While the SEC has not directly called for more frequent disclosure, it has established standards for the brokerage community that cannot be met without more frequent disclosure. The rationale here is that brokers are required to assess the suitability of an investment prior to a sale (whether a primary or secondary sale). In volatile sectors such as the hospital industry, it is impossible for this standard to be met without more frequent and complete disclosure.

The NFMA Hospital Bond Disclosure Subcommittee has attempted to anticipate potential concerns that may be raised by interested parties. Access to information and the potential burden placed on the borrower are issues that we have considered in making these recommended changes to Rule 15C2-12. We have addressed the burden issue by limiting our requested financial and operating information to data that is monitored on a monthly basis by hospital providers. While we acknowledge that the management discussion portion of the recommended changes may require some additional time and effort by the borrower, the marginal information provided is extremely important to the market and may eliminate some of the potential problems that currently occur when bonds are trading.

A common concern mentioned by hospital CFOs relates to access issues, especially when bonds are for sale in the secondary market. The typical question raised is as follows: How does a CFO respond to numerous phone calls requesting financials and a discussion thereof because his bonds are out for the bid? One answer is that readily available quarterly financials should relieve some of the pressure. Adequate information in the form of management discussion and the other items that we are requesting should come close to completely closing the information gap. Finally, periodic investor relations calls or the opportunity for regularized access to hospital personnel can eliminate the need for "emergency" response calls to the market. For example, quarterly conference calls with investors and market participants can be utilized to reduce or eliminate the need for ad hoc investor calls. Mechanisms can be developed, with the participation of all interested parties, with a view towards providing equal access to bondholders without unduly burdening management.

4. Management discussion and analysis, on a quarterly basis, of financial information to include, in addition to other items:

   - Disclosure on the operating income (i.e., operating revenues which exclude non-operating revenues/expenses, investment income, extraordinary gains/losses, contributions to affiliates, minus operating expenses), with a detailed breakdown of the operating loss, if any. It should be noted if the loss in question is a non-recurring or recurring item, with comments as to any write-down of assets and with a description of all remedial initiatives undertaken.

   - Trends in financial performance for the Obligated Person and the entire System, with a discussion on recent material changes, that may have occurred during the period. Such discussion may cover more than two years of operations.

   - Specific mention of access to lines of credit with a description of the name of the line of credit provider, any collateral, repayment terms and specific mention of status of lines of credit.

   - Any significant changes to the current year's budget and changes in long and short- term debt since the end of the most recent audited financial period with comments as to the type of debt.

   - Trends in the operating expense per adjusted discharge.

5. Material Events, i.e., any event that in the opinion of management materially impacts the organization, including but not limited to:

   - Principal and interest payment delinquencies
   - Non-payment related defaults. For example, rate-covenant default and use of debt service reserve fund.
   - Material non-default related events including violation of any covenant mandating the engagement of a management consultant and any required remedial efforts/provisions (e.g., funding of the debt service reserve fund) and Consultant reports prepared as a result of such events.
   - Unscheduled draws on debt service reserve funds or surety bonds or letters of credit.
   - Unscheduled draws on other credit enhancement.

- If managed care contracts in the aggregate contribute more than 25% to net revenues, then the following additional information should be provided. Description of the top 5 managed care contracts, name of contract provider, number of enrollees, whether the contract is capitated or discount from charges and a discussion of profitability of these contracts and % of revenues contributed by each of these contracts.

- FTE's per adjusted discharge and total FTE's.

- If commercial payors in the aggregate contribute more than 25% to net revenues, then the following additional information should be provided. Description of the names of such commercial payors, nature of reimbursement, a discussion of profitability of these contracts and % of revenues contributed by each of these payors.

7. Description and Discussion on Changes to Regulatory Environment that Impact the Obligated Person and/or System:
   - Federal, e.g., changes to disproportionate share reimbursement or sole community provider status.
   - State or local e.g., changes to district funding or imposition of local provider taxes.
   - Other major laws/regulations enacted or proposed.

8. Management, Medical Staff and Board:
   - Changes in top management of Obligated Person with a brief background on new employees.
   - Composition and size of medical staff and changes in top ten admitters with a description of departures of medical staff members who contributed in excess of 5% of net revenues. (This information to be made available on an annual basis within 60 days after the end of Fiscal Year). In the case of a multi-hospital system, such information shall be submitted for those hospitals that contribute more than 15% of the System's revenues.
   - Material changes in Board membership and governance.
   - Union activity.

9. Legal Documents:
   - If there is a DSRF Put Agreement or an Investment Contract, a description of such Agreement/Contract with mention of the security offered to the Put/Contract Provider and terms of repayment.

The federal securities laws were not designed to prohibit a free flow of information between issuers and investors. In fact, they may create an affirmative obligation on the part of the issuer to be responsive to investor inquiries.

Rule 10b-5, as promulgated by the SEC, provides the basic framework regarding disclosures to investors and potential investors in securities. Generally, there is no affirmative duty under Rule 10b-5 to provide information to the market. However, if an issuer provides information either voluntarily or pursuant to some regulatory requirements (such as the requirements of the Amendments), then Rule 10b-5 states that such provided information must be full, accurate and complete. To the extent that investors have follow-up inquiries to the information which has been provided pursuant to he Amendments, the issuer may have a duty to respond to such inquires in order to make the information previously provided complete and accurate. As discussed below, this may be especially true since the annual information is often fairly out-dated by the time it is finally released.