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SB 179 (Procurement)
SEC's Municipal Advisor Rules and
Proposed MSRB Rule G-42

Jon Bronson Zions Bank Public Finance March 28, 2014



The Regulators Have Been Busy

- The Securities and Exchange Commission
- ■The Municipal Securities Rulemaking Board
- □The Dodd-Frank Act
- □The GFOA









SEC's Municipal Advisor Rules

- The Dodd Frank Act of 2010 authorized the SEC and the MSRB to adopt rules governing Municipal Advisors.
- On September 18, 2013, the SEC approved its final Municipal Advisor Registration Rules.
- The rules were scheduled to be effective on January 13, 2014, but the SEC stayed the effective date until July 1, 2014.
- The new rules define who is, and who is not, a Municipal Advisor.



According to the SEC, A Municipal Advisor is:

Any person who provides "advice" to a municipal entity regarding a municipal financial product or an issuance of municipal securities – or- a person that undertakes a solicitation to do so.

"Advice" means, a recommendation that is specific or tailored to a particular client with respect to the structure, timing, terms, or similar matters related to a municipal debt issue.

Your Underwriter:

- Is <u>prohibited</u> from serving as your Municipal Advisor while also serving as your Underwriter on the same issue. (This is illegal under MSRB Rule G-23.)
- Is <u>prohibited</u> from providing you with "advice" unless certain exemptions apply.
- Is *prohibited* from being your underwriter if he/she does give you "advice" outside of the exemptions.

The Exemptions

- An Underwriter may give you (as an issuer) advice if you tell him/her, *in writing*, that you have retained a Municipal Advisor and that you are relying on that Municipal Advisor to assist you. (You will see these requests.)
- An Underwriter may give you advice in response to a legitimate RFP solicitation for underwriting services.
- An Underwriter may give you <u>certain</u> advice after he/she is hired as your underwriter, but that advice must be limited to "traditional underwriting activities".

The Exemptions

- "Traditional underwriting activities" do not include:
 - which method of bond sale you should use;
 - preparing and/or evaluating <u>any</u> RFPs (BC, UW, MA, Trustee)
 - how you should invest your bond proceeds;
 - other investment strategies;
 - if and how to use swaps;
 - how your escrow funds should be structured and invested;
 - advice regarding your debt or financial policies or procedures;
 - how the current transaction may be coordinated with your other debt issues;
 - Mode changes for variable rate debt.



For this kind of advice, you will need a

Municipal Advisor aka Financial Advisor

GFOA Recommended Practices

"A municipal advisor represents the issuer in the sale of bonds, and unlike other professionals involved in a bond sale, has an explicit fiduciary duty to the issuer per the Dodd-Frank Wall Street Reform and Consumer Protection Act."

GFOA Debt Committee "Best Practices" Document Dated 2014 "Selecting and Managing the Engagement of Municipal Advisors"





GFOA Recommended Practices

"The appropriate duties, roles and responsibilities of municipal advisors and underwriters are often not well understood. Municipal advisors are the only parties with a federal fiduciary duty to state and local government issuers."

GFOA Debt Committee "Best Practices" Document Dated 2014 "Selecting and Managing the Method of Sale of State and Local Government Bonds"



Municipal Bond Teeter Totter

Price



Interest Rate



SEC Rule - Municipal Advisors:

- Must register with the SEC and the Municipal Securities Rulemaking Board.
- Are subject to substantially the same SEC disciplinary rules as underwriters.
- Will be subject to a set of rules to be adopted by the MSRB that will impose a comprehensive regulatory regime, including:
 - Fees
 - Testing
 - Training
 - Supervision
 - Record keeping
 - Prohibited conduct
 - Compliance exams
 - Comprehensive code of conduct



SEC Rule - Municipal Advisors:

- Activity-based Exemptions
 - Officers and Employees of School Districts
 - Underwriters
 - Banks
 - Registered Swap Advisors
 - Registered Investment Advisors
 - Accountants (audit and attest services only)
 - Engineers (with limitations)
 - Attorneys



According to the SEC, Advice:

- Is a recommendation that is particularized to the specific needs, objectives, or circumstances of a District with respect to a "covered transaction", including structure, timing, terms and similar matters.
- The more *individually tailored* the communication to a District about a security or group of securities, the greater the likelihood that the communication may be viewed as a recommendation that constitutes advice.

RFP Exemption

MODEL LANGUAGE FOR RFPS

■ The District desires advice and recommendations regarding [description of the issuance of bonds].

The District intends that such advice and/or recommendations may be made orally or in writing, to qualify for the RFP exemption.

This RFP/RFQ is open from ______ to [insert date that is no later than 6 months after the first date].

The District understands that by responding to this RFP/RFQ, respondents are not acting as municipal advisors.

(If the RFP is not posted publicly, include the following: This RFP/RFQ is being sent to at least 3 firms.)



IRMA Exemption

IRMA EXEMPTION

- The municipal advisor rules exempt **all** advice and recommendations given by **any person** to a school district that is represented by an independent registered municipal advisor ("IRMA").
- This exemption is subject to the following conditions:
 - □ The District's Financial Advisor must provide advice with respect to same aspects of a municipal financial product or municipal securities issuance about which the underwriter wants to speak.
 - The District's Financial Advisor cannot have had association with the person relying on exemption for the past 2 years.
 - The District must represent in writing that it is represented by and will rely on the advice of its Financial Advisor.



IRMA EXEMPTION

- Underwriters relying on the FA exemption must:
 - □ Disclose in writing to the District that it is not acting as an municipal advisor with respect to the transaction.
 - □ Disclose in writing to the District that it is not subject to the fiduciary duty standard imposed on municipal advisors.
 - Provide a copy of such disclosures to the FA.
- Once the FA exemption has been established, it is not necessary to include the FA in discussions and meetings with its client.



SAMPLE DISTRICT LETTER

"Pursuant to the SEC's Municipal Advisor Rule, we hereby represent to you that we are represented by, and will rely on the advice of _[insert name of FA firm]_on all matters relating to issuances of municipal securities and municipal financial products."

"We have been advised by _[insert name of FA firm]_that it has registered as a municipal advisor with the SEC and the Municipal Securities Rulemaking Board; and that the following individuals, each of whom has been employed by the Advisor for at least two years prior to the date of this letter, will be responsible for representing and advising us with respect to [all matters relating to issuances of municipal securities and municipal financial products]: [names of FA employees]."

SAMPLE DISTRICT LETTER

- This statement may be posted to the District's website, with reliance text.
- Scope of the financial advisor's engagement determines the scope of the exemption:
 - Only a single bond issue?
 - Investments and derivatives?

UNDERWRITER LETTER

- Any person relying on the IRMA exemption must send a disclosure statement to the issuer or borrower and its FA stating:
 - We are not a municipal advisor to you, and
 - We are not subject to the fiduciary duty imposed on municipal advisors.
- Additional disclosures:
 - We are acting as a principal and our interests differ materially from yours.
 - You should consult your own legal, financial and other advisors to the extent you deem appropriate.



Underwriter Exemption

UNDERWRITER EXEMPTION

- Requires an engagement to underwrite a specific issuance of municipal securities. Inclusion in a pre-approved underwriting pool is not sufficient.
- Oral or written acknowledgement of engagement from an the issuer/obligated person is permitted.
- Preliminary, non-binding engagements permitted so long as issuer/obligated person reasonably expects to formally engage the broker-dealer as underwriter.
- Multiple engagements are permitted, no need to specify status as senior or co-manager.
- The underwriter exemption is limited in duration:
 - Exemption begins once underwriter is "engaged as underwriter" and terminates at the "end of the underwriting period" under Rule 15c2-12 (the closing date in most cases).



SAMPLE UNDERWRITER ENGAGEMENT LETTER

"This letter confirms our engagement to serve as an underwriter for the Bonds. Delivered with this letter are the disclosures required by MSRB Rule G-17 regarding our role, duties and interests as an underwriter of the Bonds.

Your execution of this letter will confirm that [you reasonably expect that] we will serve as an underwriter of the Bonds, and will enable us to provide advice with respect to the structure, timing, terms, and other similar matters concerning the Bonds pursuant to the underwriter exclusion under the SEC's municipal advisor registration rules."

Proposed Rule G-42



PROPOSED RULE G-42

- The MSRB published the first of several MA rules on January 9, 2014, Proposed Rule G-42 on the duties of municipal advisors.
- This is a rigorous *code of conduct rule* that includes:
 - Duty of care
 - Duty of loyalty
 - Disclosure obligations, esp. conflicts of interest
 - Suitability of recommendations
 - Know thy client
 - Prohibitions on principal transactions with clients and other activities
 - Disclosure obligations to investors



THE FIDUCIARY DUTY

- Proposed Rule G-42 defines the fiduciary duty imposed by the Dodd-Frank Act as including a duty of care and a duty of loyalty.
- The proposed duty of care requires that a municipal advisor:
 - exercise due care in performing municipal advisory activities,
 - possess the degree of knowledge and expertise needed to provide the client with informed advice, and
 - make a *reasonable inquiry* as to the facts that are relevant to a client's determination to proceed with a course of action or that form the basis for any advice provided to the client.

THE FIDUCIARY DUTY

- The proposed duty of care also requires that a municipal advisor:
 - undertake a *reasonable investigation* to determine that any recommendation is not based on materially inaccurate or incomplete information,
 - undertake a thorough review of the official statement unless otherwise directed by the client and documented in writing, and
 - have a reasonable basis for any advice provided, any representations made in certificates it signs that will be relied upon by the client, other parties or investors, and any information provided to the client or other parties when participating in the preparation of an official statement.

STANDARDS OF CONDUCT

Documentation of Municipal Advisory Relationship

- □ A municipal advisor must document a municipal advisory relationship in writing prior to, upon or promptly after the beginning of the relationship.
- Such writing must include matters relating to compensation, the scope and limitations of engagement, conflicts and terms for termination and the municipal advisor's responsibilities with regard to the official statement.

STANDARDS OF CONDUCT

- **Specified Prohibitions.** Municipal advisors are prohibited from certain actions, including:
 - Receiving excessive compensation.
 - Delivering invoices that do not accurately reflect activities performed or personnel that performed services.
 - Making materially false or misleading representations in RFPs or RFQs or in oral presentations.
 - □ Fee-splitting arrangements with underwriters.
 - Any undisclosed fee-splitting arrangements with the client's investment or service providers.
 - Pay to play.

