

The New Municipal Advisor Rule

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Issuers Lack Info On MA Rule

BY KYLE GLAZIER

WASHINGTON — Many smaller issuers are uninformed about what the impending municipal advisor regulatory regime will mean for them, leaving it to broker-dealers to provide them with information, market participants said.

The Securities and Exchange Commission's MA registration rule takes full effect July 1. The Municipal Securities Rulemaking Board is also of creating rules for MAs, including standards for conduct, professional qualifications, supervision and fees.

The rules are required by the Dodd-Frank Act, which mandated that MAs register with the SEC, become subject to federal regulatory oversight, and be bound by a fiduciary duty to put their issuer clients' best interests first.

Though issuers are not covered by them, the regulations will affect how they interact with the dealers, who have driven conversations about the impacts.

"Although the municipal advisor rule directly applies to those firms that meet the regulatory definition of advisor, the rule has significant implications for is-

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Small Issuers Lack Education on MA Rules, So Dealers Jump In to Help

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suers as well, and all market participants should make an effort to stay abreast of regulatory changes," said Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at the Securities Industry and Financial Markets Association.

SIFMA recently released model documents showing an underwriter how it can use any of three major exemptions to provide advice to an issuer without being considered an MA. The three are: becoming engaged as an underwriter, responding to an issuer's request for proposals, or confirming that the issuer has its own MA not associated with the underwriter. "SIFMA and our members have been working with issuers to understand the breadth of the rule," Norwood said.

Ben Watkins, Florida's bond finance director and head of the debt committee at the Government Finance Officers Association, said the level of knowledge about the rule among some issuers is very low.

"There's a huge contingent in the market that doesn't have a clue," he said.

Watkins strongly disagrees with the way the SEC wrote the rule, and said it could have been a much more streamlined piece of regulation. Watkins said SEC mini chief John Cross, head of the SEC's Office of Municipal Securities, is "hamstringing" in terms of what he's able to do in terms of making the rule simpler for market participants, and that the SEC's "frequently asked questions" guidance earlier this year was only marginally helpful. "They're not actively engaged in educating," Watkins said of the SEC. "In terms of outreach, there basically hasn't been any."

Cross said the mission of educating issuers is an important one for his office.

"It is very important to increase the

awareness of municipalities about how the final municipal advisor registration rules will affect their interactions with regulated municipal advisors," he said. "A core purpose of this regime is to enhance protections to municipalities through a fiduciary duty on municipal advisors to look out for the best interests of their municipal entity clients. I will speaking to the [Government Finance Officers Association's] upcoming annual conference in May about the topic and also looking for other opportunities to provide outreach to municipalities about these important new final municipal advisor rules."

Laura Lockwood-McCall, director of the debt management division in the Oregon State Treasury, said that the MSRB's chief education officer Ritta McLaughlin recently spoke to a conference of Oregon issuers about the rule, but many small issuers still lack knowledge and will likely learn more from dealers.

"This new requirement will impact a lot of smaller issuers, particularly school districts in our state, in that they may not currently have a financial advisor on contract," Lockwood-McCall said. "I'm not sure they will realize there's a problem with the new rule, however, as they are infrequent issuers to begin with. The underwriting community will in some ways be the educator, as I can envision them asking issuers if they have an [financial advisor], and then pointing out that they need to have one on board in order for them to work with the district on a transaction."

Mark Kim, chief financial officer at the District of Columbia Water and Sewer Authority, said he and other issuers got hit with a flurry of communications from investment bankers earlier this year. Because the SEC has made clear that a firm cannot be an MA on, and underwrite the bonds for, the same transaction, Kim said, deal-



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ers have been eager to be the ones letting issuers know about the available exemptions and how to utilize them.

"The banks certainly gave their own interested spin on the MA regs," Kim said.

DC Water retains its own MA, which it pays hourly whenever the authority wants it to look over a proposal from a dealer firm, Kim said. He said he receives pitches from would-be underwriters on a nearly daily basis. Kim said he likes being able to be his own idea gatekeeper and being able to receive ideas from dealer firms without restriction thanks to the exemption available from the independent MA. Although the bankers and advisor firms have been the leading sources of information for issuers in Kim's view, the MSRB has also attempted some interaction and the SFC has made staff available at some issuer

community events. "I think the MSRB is trying very hard to get out in front of this," Kim said. "I think the SEC has been trying to be accommodative."

Glen Pederson, director of finance for Benson, Minn., said his MA began filling him in a few years ago but he doubts most cities with only a few thousand in population are as well-informed.

"It happens to live in a smaller city and the experience there was much different," he said. "They actually use or used a firm that would help them issue the bonds and then would also consider purchasing them. This was happening as recently as last year. I encouraged them to seek a different firm to act strictly as a financial advisor and they are in the process of taking proposals. So my take would be the cities of my size, 3,500 and up, are probably aware. But those smaller units are probably at the mercy of the [dealer] firm they are working with."

The MSRB is likely to take the educational lead among regulators, some said. Since Dodd-Frank, the self-regulator is tasked with protecting issuers and has a majority-public board.

"The MSRB views education as a central component of a comprehensive regulatory framework for municipal advisors," said MSRB executive director Lynnette Kelly. "We are reaching out not only to the municipal advisory community, but also to issuers that engage the services of municipal advisors. As part of our expanded outreach campaign to state and local governments, the MSRB is speaking to issuer audiences around the country about the regulatory framework for municipal advisors. The MSRB also conducts free public webinars to educate all interested stakeholders about our draft rules to establish standards of conduct and professional qualifications for municipal advisors." □

What are we talking about?

What is the background?

Does this affect me?

Am I regulated?

When does it take effect? (extended to July 1, 2014)

Background:

- Regulations in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, passed after the Great Recession, established that anyone providing financial advice to issuers of bonds would be regulated.
- Responsibility was left to the Securities and Exchange Commission to define what a municipal advisor is and is not.

What or who is a municipal advisor?

- A firm and its associated persons that provides “advice,” with or without compensation, to “municipal entities” and “obligated person” on the issuance of “municipal securities” or “municipal financial products.”

What is advice?

- A recommendation that is particularized to the specific needs, objectives or circumstances of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including information on structure, timing, terms and other similar matters concerning such products or issues.
- Advice on the “issuance of municipal securities” includes advice during the entire lifespan of the transaction – from the earliest pre-planning stages through maturity or earlier redemption.

What is not advice?

- Factual information
- General information
- Widely available information

What are the implications of being a Municipal Advisor?

- Required to register with the MSRB
 - Issuers can verify a municipal advisor's registration on the MSRB's website
- Statutory Fiduciary Duty: includes a duty of loyalty and duty of care
 - Requires a municipal advisor to act with utmost good faith and in the best interests of the client
 - Disclose conflicts of interest
 - Document the relationship with the client in writing
 - Make suitable recommendations
- Subject to the MSRB rules:
 - Restrictions on ability to switch from Municipal Advisor to Underwriter:
 - Recordkeeping requirements
 - Employee supervision standards, marketing limitations
 - Subject to annual onsite examination by FINRA
 - Minimum Professional Qualifications
 - Limits on Political Donations
 - Minimum Qualifications

How will this impact South Carolina issuers?

- Many issuers had grown accustomed to relying on their existing financing team members (primarily bond counsel and underwriter) to provide financial advice.
- After July 1st, those professionals will be limited in the amount and type of financial advice they may provide, unless they meet one of the exceptions/exemptions.
- Once the rule goes into effect, the types of conversations issuers can have with underwriters and other professionals may be more limited in nature than what has traditionally occurred.

What is the National GFOA's position?

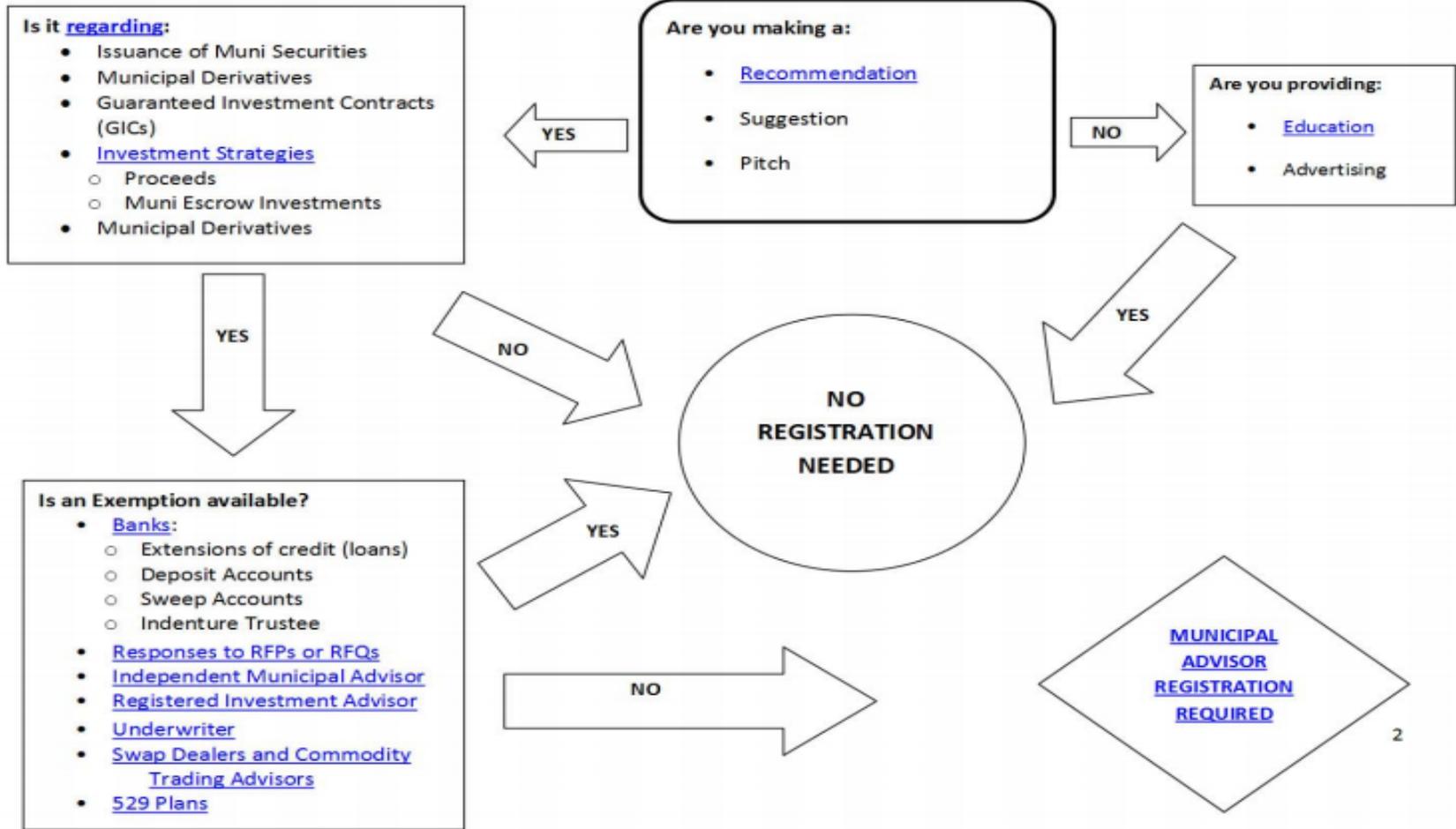
- The Government Finance Officers Association (GFOA) recommends that issuers hire a municipal advisor prior to the undertaking of a debt financing unless the issuer has sufficient in-house expertise and access to current bond market information.

Exceptions to the Requirement to Register as a Municipal Advisors

- State and Local Government employees and officials – “acting in an official capacity”
- Certain professionals:
 - Attorneys (traditional legal advice);
 - Engineers (traditional engineering advice);
 - Accountants (traditional audit work);
 - Registered investment advisors (federally registered);
 - Remarketing agents (standard remarketing)
- Swap dealers
- Banks (limited)

Exemptions Available:

- Underwriter Exemption: applies when dealer has been engaged to underwriter an issue of securities and applies through the end of the underwriting period
- RFP Exemption: applies to responses to issuer RFPs and RFQs.
- Independent Municipal Advisor Exemption: municipal entities that are represented by independent municipal advisors may receive advice from underwriters and others on the issuance of securities or financial products as long as the independent advisor is providing advice about the solicitation and the municipal entity is relying on its own advisor.
- *If there is no exemption, then the underwriter or other professionals may not provide “advice” to the municipal entity.*



Other Sources of Information

- Section 975 of Dodd-Frank (the SEC Rule):
<http://www.sec.gov/rules/final/2013/34-70462.pdf>
- FAQs: <http://www.sec.gov/info/municipal/mun-advisors-faqs.pdf>
- GFOA Issue Brief: SEC Municipal Advisor Rule (Jan. 2014)
- BP: Selecting and Managing the Engagement of Municipal Advisors (2014)
- BP: Selecting and Managing the Engagement of Underwriters for Negotiated Bond Sales (2014)
- BP: Selecting and Managing the Sale of State and Local Government Bonds (2014)

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