CPIM

CENTER FOR PUBLIC INVESTMENT MANAGEMENT

A PROGRAM BROUGHT TO YOU BY:

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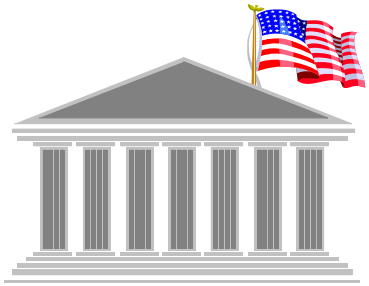
FINANCE 235

Municipal Finance Advisors: MSRB Draft Rule 42

2014 CPIM Academy

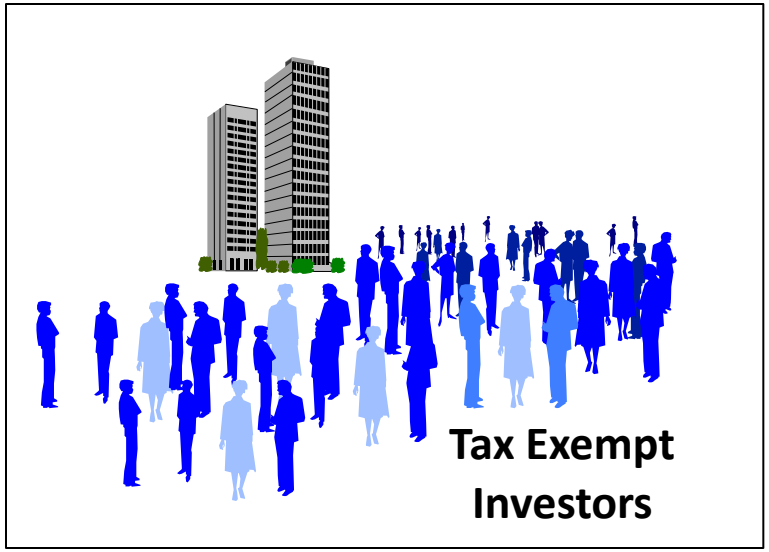
Roles of Transaction Participants



Issuer

Bonds

$$$$$



Potential Conflict of Interest

Municipal Advisor

Underwriter

Fiduciary Duty

Municipal Advisor Rule – G-42

- Why you should care?
  - Your relationship with your banker/underwriter will be impacted.
    - Following the events in Jefferson County and elsewhere (as specifically mentioned by the SEC when adopting the rule) the Municipal Advisor (MA) Rule was implemented to make clear to issuers that an underwriter does not have a duty to look out for the issuer's best interest.
  - You will be required to act affirmatively, so as to ensure that you are aware that an underwriter does not have a requirement to look out for your best interests.
- While there is no requirement that issuers engage a municipal advisor, GFOA recommends that issuers utilize municipal advisors who have a fiduciary duty to the issuer.

Municipal Advisor Rule – G-42

- Creation of the Rule
- Scope of the Rule
- Key Definitions
- Exceptions to the Rule
- Scenarios
- Questions & Answers

Creation of the Rule

Draft Rule G-42: MSRB & SEC

- Expansion of MSRB's jurisdiction under Dodd-Frank
- Rule Drafting Process
  - Expected Effective Date: July 1, 2014
- Regulated Entities
- SEC and FINRA as Regulators

Scope of the Rule

Draft Rule G-42: Scope

- Establishing Standards of Conduct
- Disclosure of Conflicts of Interest
- Documentation of Relationship
- Recommendations
- Principal Transactions
- Prohibitions on Compensation, Fees and Retention of Business

Draft Rule G-42: Intent

- Define Persons that Constitute Municipal Advisors
- Establish a Registration Regime
- Provide Recordkeeping Requirements
- Provide Enforcement & Examination of the Rule

Key Definitions

Key Definition: Municipal Advisor

- ***Municipal Advisor***: "a person (who is not a municipal entity or an employee of a municipal entity) that:
  1. Provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or
  2. Undertakes a solicitation of a municipal entity." (SEC Final Rule 15Ba1-1)

Key Definition: Municipal Advisor

Municipal Advisor Includes:

Key Definition: Municipal Advisor

- Municipal Advisor Excludes:
  - A broker-dealer serving as an underwriter
  - A registered investment adviser
  - A registered commodity trading advisor
  - Attorneys
  - Engineers
  - Public Officials and Employees of Municipal Entities and Obligated Persons acting in Official Capacity

Image courtesy of renjith krishnan/FreeDigitalPhotos.net

Key Definition: Advice

- "… ***advice*** includes, without limitation, a 'recommendation' that is particularized to the specific needs, objectives or circumstances of a municipal entity or obligated person with respect to the structure, timing, terms and other similar matters concerning such financial products or issues, based on all the facts and circumstances." (SEC Adopting Release)

Key Definition: Advice

Exclusion of 'General Information'

- General information that does not include a 'recommendation' – information of a factual nature without subjective assumptions, opinions or views, and information not particularized to a specific municipal entity.

Examples:

- Professional qualifications and experience
- Market statistics regarding issuance activity or current interest rates
- Information regarding an institution's currently available investments
- Factual information regarding types of debt financing structures
- Factual/educational information about various government financing programs and incentives

Examples of Advice

1. *Whether to authorize sale*
2. *Method of sale (competitive vs. negotiated)*
3. *Structuring components (final maturity, call features, premium vs. discount bonds)*
4. *Bond election campaign assistance (including interest rate to be used for ballot millage calculation)*
5. *Whether to refund bonds*
6. *Selection of rating agency and overall rating strategy including actions taken between financings*
7. *Financial analysis and strategic service advice not specific to transaction*
8. *Preparation of financial feasibility analysis related to a new project*
9. *Budget planning and analysis/budget implications related to debt issuance*
10. *Advice on overall financial controls not related to transaction*
11. *Advice for RFP's for underwriter or other professionals for a project financing including their compensation*
12. *Advice on municipal derivatives*

Exemptions: Attorneys

- Analysis, discussion, negotiation, and advice regarding *legal* ramifications of structure, timing, terms and other provisions.
- Official statements, other disclosure documents, closing certificates, legislation, opinions, advice and documentation relating to post-issuance compliance.
- Interpretation of legal document provisions before and after a formal attorney-client relationship exists with respect to a particular issuance.
- When non-client acts upon advice given to client.
- Responses to RFPs and RFQs.

Exemptions: Attorneys

- What falls outside of attorney exemption:
  - Activities of a primarily financial nature
  - Presenting oneself as a financial advisor/expert
  - Advice regarding financial feasibility of a project or financing
  - Estimating/comparing the relative cost to maturity of an issue depending on various interest rate assumptions
  - Recommending a particular structure as being financially advantageous
  - Advice regarding financial aspects of competitive sale v. negotiated
  - Other advice not legal in nature

More Key Definitions

- Solicitation
- Municipal Entity
- Obligated Person
- Municipal Financial Products
- Issuance of Municipal Securities

Exceptions & Exemptions to the Rule

Exemptions

- RFP and RFQ
- Independent Registered Municipal Advisor (IRMA)
- Registered Investment Adviser
- Underwriter Exclusion

Exemption: RFP & RFQ

Requirements

- Municipal Entity or MA conducts
- Particular objective identified (structuring for a particular program or project)
- Specified period of time (up to 6 months)
- Competitive (website, or 3 market participants)

Mini RFP Requirements

- Municipal Entity or MA conducts
- One or more particular questions
- Specified period of time (up to 3 months)
- Sent to entire pool of pre-screened participants (or at least 3)

Exemptions: IRMA

- IRMA must be a registered MA and has not been associated with person (market participant) seeking to use exemption within last 2 years.
- Person (market participant) using exemption must have written representation from municipal entity that the entity is represented by, and intends to rely on the advice of, the IRMA.
- Person (market participant) must provide written disclosures to municipal entity and copy the IRMA, stating that person (market participant) is not a registered MA and has no fiduciary duty.
- IRMA exemption can be used if MA is program specific or general.
- IRMA exemption can be represented on a issue by issue basis, a program basis, or on a one time basis (i.e. posted to website).

Exemptions: Registered Investment Adviser

- "Investment advice" permitted.
- "Investment advice" does not include:
  - Whether or how to issue municipal securities, and advice concerning structure, timing and terms of the issuance and similar matters.
  - Advice concerning the issuance of municipal derivatives.

Exemptions: Underwriter Exclusion

- If an underwriter does not comply with the new regulations it could be considered the municipal advisor, which would exclude it from underwriting the bonds.
- Engagement can be represented through a letter, including the following:
  - Executed/approved by authorized official
  - Clear reference to underwriting services
  - Clear reference to role of broker-dealer in the transaction
  - Relates to a particular issue (not general)
  - G-17 acknowledgment (insufficiency of G-23)
- Underwriter may be formally engaged directly without an RFP process or the presence of an MA

Exemptions: Underwriter Exclusion

- Engagement letter can be general if limited or conditional, if it contains:
  - A statement that engagement is preliminary and issuer reasonably expects to engage the broker-dealer as the underwriter for a particular issue.
  - A statement specifying engagement is subject to conditions, such as a formal approval of a governing body.
  - Statement that engagement is non-binding and can be terminated by either party.
  - Terms limiting the liability of parties.
  - May be furnished to multiple underwriters if municipal entity expects to engage each on the identified issue.

Scenarios

Applying the Rule: Scenarios

- Scenario 1: Municipal entity has a relationship with a local banker and no MA.
- Scenario 2: Various bankers visit wanting to present refunding scenarios.
- Scenario 3: IRMA chosen, banker advice used, municipal entity and MA relationship undocumented.
- Scenario 4: Municipal entity's banker also advises on the investment of bond proceeds.

Questions?

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