

2104 NSCP NATIONAL CONFERENCE

SESSION 10D – MUNICIPAL ADVISOR RULES

9:30 a.m. – 10:30 a.m., Wednesday, October 22, 2014
Gaylord National Harbor

*** NOTE: This Workshop is CLOSED to Regulators and Members of the Press**

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DODD-FRANK AMENDS '34 ACT § 15B

Registration and Oversight of Muni Advisors

- **Who's Covered:** Anyone who solicits or provides advice to or for a municipality or *obligated person* regarding *municipal financial products* or securities (including structure, timing, or terms).
- **Expressly includes:** FAs, GIC brokers, third-party marketers, placement agents, solicitors, finders and swap advisors
- **Who's Not:** otherwise regulated BDs or MSDs acting as underwriter, or RIAs, commodity trading advisers advising on swaps or lawyers or engineers as such.
- **Who's an *Obligated Person*?** Anyone obligated by contract or arrangement to support the payment of any part of the obligations on the municipal securities in an offering.
- **What's a *Municipal Financial Product*?** Beyond municipal securities, the Act now covers municipal financial products, which includes municipal derivatives, GICs and investment strategies.

DODD-FRANK AMENDS '34 ACT § 15B

- **Registration and Regulation will include:**

- registration
- oversight, e.g. examinations, record-keeping, testing, CE and fees
- rule-making
- compulsory arbitration (but not as to the public)

- **Fiduciary Standard:**

"A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the Board."

- **Antifraud Provisions:** mirroring long-standing securities anti-fraud rules proscribing "any fraudulent, deceptive, or manipulative act or practice." **Note:** MSRB Rules implementing the fiduciary standard will be much broader than mere anti-fraud rules.

DODD-FRANK AMENDS '34 ACT § 15B

MSRB:

- **Expanded Composition with "slots":** 15 total
 - 8 independent (with at least: 1 investor; 1 municipality; 1 public)
 - 7 industry (with at least: 1 bank; 1 non-bank; 1 advisor)
- **Expanded Jurisdiction**
 - to protect municipalities and *obligated persons* over advisors
 - over municipal financial products and investment strategies, not just securities

GAO Studies on:

- Municipal Disclosures, and whether to repeal the Tower Amendment
- Municipal Markets
- GASB's role and importance

SEC:

- Formalizes and elevates Office of Municipal Securities (previously part of Div. Trading & Markets) so reports to Chairman
- Requires coordination among SEC, FINRA and MSRB

GASB Funding: SEC can require FINRA members to pay annual fee to fund GASB

SEC'S MA RULE 15BA1-1, SEC REL. No. 34-70462

Registration: Form MA & MA-I with DRPs, through EDGAR

MA or Not?

1. *Advice* (facts & circumstances; recommendation; call to action - same as FINRA suitability standards)

- excludes general widely-disseminated factual, non-particularized, or general educational material (like FINRA Rule)

- excludes uncompensated statement of qualifications responding to RFP

2. *Issuance municipal securities* (conception to grave) or

Investment proceeds (same as IRS standard) *of municipal securities*, including investment strategies for proceeds or escrow funds, or municipal financial products (e.g. muni derivatives)

Solicitation of municipality or obligated person (OBO others, not self or affiliates; for compensation direct or indirect)

SEC'S MA RULE 15BA1-1, SEC REL. NO. 34-70462

3. **Status-Based Exemptions.** The Rules do not apply to:
 - a. Municipal entities or obligated persons, their employees and board members (when acting within course and scope)
 - b. General RFP responses “to get hired”
 - c. "IRMA" Advice to client having an independent registered MA (two-year affiliation conflict look-back), with written bilateral non-reliance disclosures and client’s affirmative representation *is relying* on independent MA (like FINRA institutional-client safe harbor)

4. **Activities-Based Exclusions.**
 - a. Banks acting as such re: municipal clients
 - b. Underwriters only to extent of traditional underwriting activities integral to *the particular* underwriting from engagement to “end of underwriting” (MSRB Glossary).
 - c. Swap dealers acting as such
 - d. RIA acting only as RIA (not MA)
 - e. CPA as audit or attest (but not tax or arbitrage)
 - f. Attorney acting as attorney (but not financial specialist)
 - g. Engineer acting as engineer

MSRB RULES

- **Registration:** Form A-12
- **Qualifications:** MA Representative exam in the works for 2015; 1-year grace period
- **Revised Draft Rule G-42: Duties of Non-Solicitor MA's**
 - **Duties:** Fiduciary to ME; Care to OP
 - **Disclosures:**
 - Compensation-related conflicts from contingent size or closing
 - Conflicts from other engagements or relationships
 - Form MA information, including DRP
 - Termination or withdrawal provisions
 - **Do's:**
 - Suitability obligations for recommendations and 3rd-party review
 - Safe-harbor for inadvertent advice
 - **Don'ts:**
 - No MA / underwriter fee-splitting on same deal
 - No Principal Transactions with ME directly related to advised transaction or product
- **Supervision:** Proposed Rule G-44 (like FINRA)

REGULATORY EXPECTATIONS

- **New Focus with Congressional Mandate = Zeal**
- **Gun-jumping zeal in Rulemaking**
- **OCIE exam initiative: 2-year, 3-phase**
 - Engagement
 - Examination
 - Informing Policy
- **Enforcement's Engaged: MCDC**
 - Section 17(a)(2)
 - Update all disclosures
 - Remediate compliance and WSPs (underwriters = independent consultant)
 - Disclose for 5 years
 - Cooperate
 - Tiered fines for underwriters: \$100k, \$250k, \$500k

POLICIES & PROCEDURES YOU SHOULD HAVE

- **Supervision & Compliance:**
 - MSRB G-44 is like FINRA 3130
 - WSPs
 - MA Principals Supervising
 - Compliance Processes
 - Annual review & certification
 - Designated CC O
 - Books & Records
 - Rule G-37: Pay to Play Prohibition
 - 2-year look back
 - Contributions to elected official of the issuer / ME; office can affect hiring
 - Firm, MAP, or controlled PAC
 - *De minimus* exception max \$250
 - No bundling, soliciting; bond ballot campaigns
 - BUT: USDC DDC Litigation over SEC IA version of rule.

KEY DOCUMENTS & SAFEGUARDS

1. **Engagement Letters** (Rev. Draft Rule G-42) must include:

- A writing (may be a contract, letter, exchange of emails or other);
- The scope of the representation and any limitations
- The form and basis of compensation (direct and indirect);
- Disclosures of:
 - All material conflicts (or certification no known material conflicts);
 - Affiliates providing things related to the MA activities;
 - Payments made to obtain the business;
 - Payments received to make recommendations;
 - Fee-splitting arrangements;
 - Material conflicts arising from comp contingent on size or closing;
 - DRP Disclosures material to MA & integrity of personnel, with link and the date of the last material change.
- Duration and termination (or withdrawal) of the relationship.

2. **IRMA Letters**

3. **RFP Response Language**

4. **Consent Certificates Regarding Bond Proceeds**

5. **Preliminary Underwriter Letter of Intent** (consider Rule G-17 disclosures)

THE UNDERWRITER EXCLUSION: WHAT'S "ADVICE"?

“Advice” is “construed broadly” on a “facts and circumstances” basis and rests upon a particularized recommendation – a call to action (or to refrain) – distinguished from general and broadly-applicable factual information.

The **General Information Exclusion** encompasses

- (a) professional qualification and prior experience;
- (b) general market and financial information;
- (c) a financial-institution’s currently available investments (terms, maturities, etc) or price quotes for products specified by the ME or OP;
- (d) factual descriptions of various debt-financing structures
- (e) factual / educational information re gov’t financing and incentives
- (f) Even some particularized information, such as current prices and yields for an ME’s outstanding bonds.

Some disclosures can help, for example: (a) No recommendation; (b) Not acting as an advisor or fiduciary; (c) Acting for your own interest; and (d) Discuss with your own advisors.

The Underwriter Exclusion: What's "Advice"?

The **business-promotion exclusion** also could cover non-recommendatory materials including:

- (a) indications of hypothetical new-issue pricing using factors particular to the prospective issuer;
- (b) market information about an issuer's outstanding securities;
- (c) information regarding ranges of hypothetical rates or debt-service requirements for new-money debt of varying maturities;
- (d) public information regarding Treasuries or SLG's for refunding; and
- (e) calculations of potential refunding arbitrage.

This exclusion would be strengthened by disclaimers that the broker-dealer is seeking to act in its own interests as an arms-length underwriter and not as a municipal advisor, and the information is provided only for discussion.

WHAT IS “UNDERWRITING ACTIVITY”?

- From “quarterbacking the deal” to narrow service-provider view

FINE NINE:

- (1) Advice re structure, timing, terms of particular issuance (but not investment strategies or derivatives);

and advice or assistance with...

- (2) Rating strategies preparation and presentations;
- (3) Investor Relations road-shows and assistance for this issue;
- (4) Retail order periods and institutional marketing of negotiated deals;
- (5) OS preparation;
- (6) Closing details and negotiations (e.g. documents, certificates, opinions);
- (7) CUSIP, registration and DTC issues;
- (8) Post-sale reports;
- (9) Structuring refunding escrow cash flow requirements (but not investment of proceeds)

WHAT IS NOT “UNDERWRITING ACTIVITY”?

DIRTY DOZEN: Advice on...

- (1) Investment strategies;
- (2) Municipal derivatives (including valuation);
- (3) Method of sale (whether competitive or negotiated);
- (4) Whether to approve or authorize an issuance;
- (5) Bond election campaigns;
- (6) Non-issue-specific analysis or strategic advice on financing options, debt capacity, portfolio impact, variable assumption scenarios, etc.
- (7) Assisting issuers with conducting competitive sales;
- (8) Financial feasibility analyses of new projects;
- (9) Budget planning and analysis re debt issuance;
- (10) Overall rating strategies beyond a given issuance;
- (11) Overall financial controls beyond a given issuance;
- (12) Forming, issuing and evaluating RFP/RFQs.

But even these would not require MA registration if otherwise: (a) inapplicable to municipal financial product or issuance of municipal securities; (b) within RFP/RFQ exclusion; (c) within IRMA exemption.

UNDERWRITER EXCLUSION HYPOS

- Underwriter for an issue but not a period of time
- Other deals or tranches unless advice also relates to your deal or tranche
- Timing of a related sale if documented how it affects your deal
- Deal Summaries?
- Other Post-closing services?
- Assisting RFP for sub-professionals?

- - alternatively, IRMA or RFP or other exemption

THE IRMA EXEMPTION

The Rule exempts from registration those who provide municipal advice to an ME or OP which is relying upon its own, Independent Registered Municipal Advisor (“IRMA”). See Rule 15Ba1-1(d)(3)(vi)

(a) The IRMA and the party claiming the exemption are advising on the “*same aspects*” of the municipal financial product or issuance of municipal securities;”

(b) The IRMA is registered and has not been associated (at the entity and at the individual levels) with the party claiming the exemption within the past two years;

(c) The ME or OP provides a written representation that it is relying on its own MA and the circumstances render reliance upon it reasonable; and,

(d) The party claiming the exemption provides written “I’m not your MA, not fiduciary, and have these conflicts” disclosures to the ME or OP *and* to its IRMA.

INADVERTENT-ADVICE SAFE-HARBOR?

MSRB Revised Draft Rule G-42 (“Duties of Non-Solicitor Municipal Advisors”) proposed a safe-harbor for inadvertent provision of municipal advice under circumstances where the parties do not intend a municipal advisory relationship.

Safe-harbor from conflict-disclosure and engagement-letter under Rule G-42(b)-(c), upon delivery of prompt written, dated, disclaimer that

- (a) the advice was inadvertent and has stopped;
- (b) the ME or OP should know that required conflicts and other disclosures have not been made;
- (c) the advisor has taken good-faith steps to identify the inadvertent advice;
- (d) asking the ME or OP to acknowledge receipt; and
- (e) the inadvertent advisor also must conduct a compliance review reasonably designed to prevent a recurrence.

- Conflicts with SEC Rule?
- Purports to supersede SEC Rule?

QUESTIONS?

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