

MUNI ADVISOR RULE OVERVIEW

- ❑ The Dodd-Frank Act charged the Municipal Securities Rulemaking Board (“MSRB”) with developing a regulatory framework for municipal advisors to help safeguard the interests of state and local governments. The MSRB will propose rules, that will be adopted by the SEC. The rules will cover registration, professional qualifications, fiduciary duty, conflicts of interest, and standards of conduct, among other topics.
- ❑ Under MSRB Rule G-23, broker/dealers can not act as an underwriter of municipal securities for which it has served as a municipal advisor. A municipal advisor has an explicit fiduciary duty to the issuer; an underwriter does not. However, under MSRB Rule G-17, and underwriter must adhere to standards of “fair dealing” with all persons.
- ❑ Upon implementation of the municipal advisor rule, underwriters became prohibited from activities deemed “advice” under the rule. If they engage in such activities, they would be prohibited from serving as an underwriter. These activities include specific recommendations on financing structures and ideas, but do not include general market conditions, the firm’s qualifications and capabilities, and case studies of other financings in the market.



DEFINITION OF A MUNICIPAL ADVISOR (MA)

Rule uses term Municipal Advisor (MA) to refer to Financial Advisors (FA), which is the common term in Texas

Dodd-Frank act defines an MA (municipal advisor) as:

- a person (who is not a municipal entity or an employee of a municipal entity) that provides advice to a municipal entity 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... or a person that “undertakes solicitation of a municipal entity.”



DEFINITION OF A MUNICIPAL ADVISOR

Dodd-Frank specifically excludes:

- ▶ Broker dealers serving as underwriters
- ▶ Registered investment advisors
- ▶ Commodity trading advisors who advise on swaps
- ▶ Attorneys offering legal advice or “providing services that are of a traditional legal nature”
- ▶ Engineers providing engineering services



TYPES OF FINANCIAL ADVISORS

- Broker-dealer advisors
 - ▶ Advisors employed by a registered broker-dealer firm who also underwrite bonds
 - ▶ MSRB Rule G-23 restricts underwriting and advising on same transaction
- Independent financial advisors
 - ▶ Advisors who only provide advisory services; do not underwrite bonds
- Swap advisors
 - ▶ Regulated by Commodity Futures Trading Commission “CFTC”
- Other – bond attorneys, architects/engineers



DEFINITION OF FIDUCIARY DUTY

- ▶ MSRB proposed: “In the conduct of its municipal advisory activities on behalf of municipal entity clients, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and care.”
 - Loyalty includes disclosure of conflicts of interest, including payments to third parties, form of compensation, and anything that might impair the advisor’s ability to act in the best interest of its client.
 - Duty of care would bar advisors from engagements where they lack sufficient expertise.



CURRENT ADVISOR REGULATIONS

- ▶ Fiduciary Duty
- ▶ Registration
 - SEC registration required as of October 1, 2010
 - MSRB registration required as of December 31, 2010
 - MSRB Fee of \$100 for initial registration and \$500 annually
- ▶ State Rules
 - Some states impose additional regulation on advisors
 - Texas, for example, requires financial advisors to register with state and adhere to same MSRB professional standards (“pay to play”, gifts, record keeping, etc.) as broker dealers



ADVISOR REGISTRATION

- ▶ MSRB is referring non-registered advisors to SEC for possible enforcement
- ▶ Current SEC Registrations:
<https://tts.sec.gov/MATR/index.html>
- ▶ Current MSRB Registrations:
www.msrb.org/msrb1/pqweb/MARegistrants.asp
- ▶ Market penalties for non-registration still unclear



PROPOSED GIFT BAN RULE

- ▶ MSRB has asked for comment on extending Rule G-20 (already applicable to underwriters) to MA's
- ▶ Would prohibit gifts in excess of \$100 per person per year to a client
- ▶ Excludes "normal business dealings"
- ▶ Would ban reimbursement for MA's for entertainment expenses from bond proceeds



PROPOSED PAY TO PLAY RULE

- ▶ MSRB proposed ban on pay to play activities for MA's
- ▶ Would prohibit political donations of cash or in kind donations to elected officials who could influence giving business to that MA or his/her firm
- ▶ Limits donations to \$250 per candidate per election cycle only if the MA can vote for that candidate
- ▶ Violation triggers two year ban from working with that candidate's issuing authority



OTHER ANTICIPATED RULES

- ▶ Fair dealing – would limit excessive compensation and disclosure of conflicts
- ▶ Supervisory rules
- ▶ Professional testing and continuing education
 - MSRB in beginning stages of developing testing



MUNICIPAL ADVISOR RULE

Took affect July 1, 2014

- Government employees and elected officials working in official capacity exempted from municipal advisor definition
- Outside parties (including underwriters) excluded from providing financial “advice” to issuers without being defined as a municipal advisor – and barred from serving as underwriter
- Certain exemptions can be met



WHAT IS “ADVICE”?

- Advice includes a recommendation that is individualized to a municipal entity with respect to municipal securities
- Includes structure, timing, and terms of a bond issuance
- Doesn't include: non-particularized information, information that is widely disseminated for use by public or clients or market participants, general information such as educational materials



RFP EXEMPTION

- Underwriters may provide “advice” to municipal entities if a Request for Proposal for ideas from investment banks has been requested by the issuer;
- Not a “rolling” RFP;
- Issuer must make a specific request, although it doesn’t have to be a formal RFP.



FA EXEMPTION

- Underwriters may provide “advice” to municipal entities if the issuer has retained an “independent” financial advisor who can evaluate proposals from underwriters;
- “Independent” means not having been an associated person of the proposed underwriter within the last 2 years;
- Issuers are beginning to post this language to their web sites (IRMA exemption)
- Texas MAC also allows issuers to post notice of this exemption



UNDERWRITER EXEMPTION

- Underwriters may provide “advice” to municipal entities when they have been selected as underwriter for a particular negotiated transaction;
- Being in an underwriting pool does not trigger this exemption.

