



The New MA Rules and How They Apply to You Prepared for

Michigan Association of County Treasurers Conference

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Discussion Topics

**Regulatory Background and Context for
Municipal Advisors**

Implications for Bond Proceeds



Regulatory Background and Context for Municipal Advisors

Role of the Municipal Advisor



Fiduciary Duty



Reducing Borrowing
& Issuance Costs



Better Financing
Terms



Improve Capital
Formation



Positive Impact
on Taxpayers



Regulatory Oversight
Over Standards

-Source: SEC Registration of Municipal Advisors Release

Providing Municipal Financial Advice

- What is advice under Rule 15Ba1-1(d)(1)(ii)



Recommendations of municipal financial products



Recommendations for the issuance of municipal securities



Recommendations based on the structure, timing, and terms of municipal products or issuance of municipal securities



Recommendations particularized to the specific needs, objectives, and/or circumstances of municipal entity or obligated person

Definition of “Advice” under the Rule

ADVICE

- ✓ Individually Tailored recommendations
- ✓ Information that invites the borrower to act or refrain from acting
- ✓ Subjective assumptions, opinions, & viewpoints
- ✓ Advice given indirectly through a third –party professional retained by the municipal entity or obligated person

NOT ADVICE

- ✓ Educational/Factual information
- ✓ Publicly held information
- ✓ Unspecific information or hypotheticals

Borrowers and Municipal Advisors

Before July 1, 2014

Broker-dealers, underwriters, counsel, investment banks, and other market participants could contact Issuers about specific or customized analyses

July 1, 2014 effective date
Municipal Advisor Rule

After July 1, 2014

Only registered Municipal Advisors are able to provide the Issuer with specific and customized analyses (advice) *unless* an exemption or exception applies under the Rule

Other Market Participants

- Parties that do not fall under the definition of Municipal Advisor do not have a stated fiduciary duty and cannot provide “advice” unless they document an exemption to avoid being deemed a Municipal Advisor.

Who is not a Municipal Advisor (unless registered as such)?



Underwriters & Banks



Registered Investment Advisers



Attorneys, Engineers, Accountants, Public Officials and Employees



Registered Commodity Trading Advisors & Swap Dealers

What exemptions allow a non-Municipal Advisor to provide advice?



Advice Regarding Certain Investment Strategies



Responses to RFPs/RFQs



Certain Solicitations



Participation by an Independent Registered Municipal Advisor (IRMA)

Broker-Dealer Business Promotional Material

- Broker-dealers seeking to serve as underwriter can use promotional materials that provide:
 - ❖ Information regarding the broker-dealer's underwriting capabilities (lists, descriptions, terms, previously written offering materials)
 - ❖ General market or financial information even if it indicates favorable conditions to issue debt or refinance outstanding debt
 - ❖ Educational materials (information describing state requirements)
 - ❖ Factual information on the different types of debt financing structures available to finance capital projects in accordance with state law

-Source: SEC Registration of Municipal Advisors FAQs

Focus on the Underwriter Exclusion

- Underwriters could become disqualified from serving as underwriter if they inadvertently provide Advice under the MA Rule – unless an available exemption applies.
- Underwriters can be exempt from the MA Rule under the following exclusions:
 - ❖ Transaction exemption
 - ❖ RFP exemption
 - ❖ Independent Registered Municipal Advisor “IRMA” exemption:

IRMA Exemption – Who? & What?

- **Who** will likely most often rely on an IRMA exemption?
 - ❖ Underwriters & Banks
 - ❖ Attorneys, Engineers, Accountants
 - ❖ Registered Commodity Trading Advisors & Swap Dealers
- **What** is an IRMA exemption to MA Rule registration?
 - ❖ An “IRMA” is an “independent registered municipal advisor”
 - ❖ The SEC has defined within the MA Rule an “IRMA exemption”
 - An “IRMA exemption” exempts from the definition of an MA anyone engaging in municipal advisory activities if the client [municipal entity/ obligated person] is represented by an “IRMA,” provided that certain requirements are met
 - The IRMA exemption may still apply even if the IRMA’s advice is not followed as long as the IRMA’s analysis has been considered and all other requirements are satisfied

IRMA exemption – How?

- **How** the IRMA exemption applies:
 - ❖ IRMA (independent registered municipal advisor) must be providing advice on the same topic or transaction as the entity seeking to rely on the IRMA exemption.
 - ❖ A person (i.e. an underwriter) seeking to rely on an IRMA exemption must receive from the municipal entity/obligated person a representation in writing that it is represented by, and will rely on the advice of, an IRMA;
 - ❖ Such person (i.e. an underwriter) must provide the required disclosures to the municipal entity/ obligated person, and provide a copy to the municipal entity/ obligated person's IRMA.
 - ❖ All parties involved in the municipal advisory activities (IRMA entity and its employees as well as the market participant seeking exemption and its employees) must be independent from one another.

Practical Effects of the Municipal Advisor Rule

What does the MA Rule mean for Michigan Counties?

- From a practical standpoint, the MA rule is changing certain aspects of the way underwriters, broker-dealers, and financial advisors do business
- Underwriters will need to be more cautious in what they say absent a municipal advisor and will most certainly include more disclosure language with any analysis
- Unless engaged on specific transactions underwriters can only provide municipal advice if one of the three exemptions is met.

What does the MA Rule accomplish?

- **Distinguishes between regulated independent advisors that must act in the best interests of the county and other market participants that may have a potential conflict of interest.**
- Clarifies the roles of different participants on a transaction.
- Ensures that municipal advisors are registered with and regulated by the SEC and MSRB, which at some point will entail ongoing education.



Bond Proceeds Implications

What are “Proceeds”? (Rules)

- “monies derived by a municipal entity from the sale of municipal securities”
- “investment income derived from the investment or reinvestment of such monies”
- “monies of a municipal entity or obligated person held in funds under legal documents for the municipal securities that are reasonably expected to be used as security or a source of payment of the debt service”
- “investment income derived from the investment or reinvestment of monies in such funds”

Post July 1, 2014

- If “investment advice provided on or after July 1, 2014” and if it regards “investments of newly-arising proceeds received from municipal securities that are issued on or after that date, market participants should develop policies and procedures . . . to determine whether or not the advice provided involves investments of proceeds of municipal securities.”
- What are such “policies and procedures”?
- As a practical matter, will require municipal entities and obligated persons to track funds that are proceeds of municipal securities which are issued on or after July 1, 2014

Types of Advice Covered

Advice relating to investment strategies

Proceeds = advice relating to investment plans or programs for the municipal securities proceeds or brokerage of municipal escrow investments

* look to the Federal tax arbitrage rules to determine when proceeds are no longer covered proceeds

Commingled Funds = municipal issuance proceeds keep their character

Due Diligence = use reasonable due diligence

Broker obligation to ask what the nature of the funds are from

Types of Advice Covered

Advice relating to investment strategies

Pooled Investment Vehicles = Advisors to these pools must register unless an exemption applies (registered investment advisers exemption)

Employee Contributions = Employer matched salary deduction arrangements are exempted and advising the employees how to invest their funds is not covered BUT advising any municipal entity's employer contributions (depending on nature of funds) would require registration (POB's)

Bond Proceeds – GFOA Guidance

- “Investment bankers will be deemed to have made a “recommendation” when they advise their government clients to buy a particular security
- Additionally, the underwriter may not provide advice related to the investment of bond proceeds unless;
 - ❖ (1) the government issuer has in place a municipal advisor or an investment adviser, or
 - ❖ (2) the underwriter is responding to the government’s request for proposal process regarding how to invest the bond proceeds”

<http://www.gfoa.com/gfoa-alert-ma-rule-and-issuers>

Broker Letters, Representations, Certifications

- The MA Rule were initiated to protect municipal entities
- MA Rules place significant burden on brokers for compliance related issues.
- Brokers compliance departments have developed broad reaching letters requesting governmental entities to confirm funds are not bond proceeds related.
- This is not the municipality's issue; it is the broker's issue
- The rules identify the Broker as being responsible for monitoring their behavior...not the municipal entity.

What Can a Municipal Entity Do?

- Entities do not sign certificate, and instead state they will not rely on broker for advice
- Entities do not sign certificate, and instead state they will not rely on broker for advice as they have an RIA (however the RIA does not have a statutory safe harbor) - this relies upon the instruction to the broker not to provide direct advice
- Entities sign the certificate, and instruct that they have an IRMA (the IRMA must have competency with bond proceed investing within scope of services)
- On a daily basis, issue mini-RFP by means of circulating a bid/offer sheet for brokers to respond to by providing information for entities to consider/execute
- Do nothing - there is no regulatory driver behind brokers not being able to do business after July 1st

What Should a Municipal Entity Do?

- It may depend upon the size of the entity, staffing, investment portfolio, and volume of trading
- Can this have portfolio structure implications?
- What if an entity is accustomed to taking broker 'recommendations' for trades?
- What role can a registered investment adviser play?

For More Information

Municipal Securities Rulemaking Board

<http://www.msrb.org/>

Note: Website provides the rules, training, and separate resources tab for State & Local Governments

SEC MA Rules FAQ:

<http://www.sec.gov/info/municipal/mun-advisors-faqs.pdf>

GFOA Issue Brief:

<http://www.gfoa.org/gfoa-issue-brief-sec-municipal-advisor-rule>

GFOA Downloadable pdf:

<http://www.gfoa.org/sites/default/files/u2/MA%20Rule%20Issue%20Brief.pdf>

Important Disclosures

This presentation is only intended to provide you with an overview of the Municipal Advisor Rule at this particular time. As the Rule evolves, so will the corresponding regulatory interpretation and guidance relating to the Rule.

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Public Financial Management, Inc. is a registered municipal advisor with the SEC and the MSRB under the Dodd-Frank Act of 2010.

Questions?

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