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L.A. Bars Broker-Dealers in FA Bid Process, FirstSouthwest Protests.

Los Angeles is seeking financial advisors for bonds issued in several categories, but underwriters need not apply, according to two recent requests for proposals issued by the city.

FirstSouthwest sent a seven-page letter to Los Angeles officials Friday protesting the language in two RFPs seeking financial advisors but excluding firms "that underwrite or otherwise trade in municipal bonds."

That language appears in the qualifications section of an RFP seeking a financial advisor to work on the city's general obligation bonds and wastewater system revenue bonds.

"We feel very strongly that the RFPs should be changed to allow bidding by all qualified firms," wrote Jack Addams, vice chairman of FirstSouthwest. "Because other qualified firms excluded under the current wording may wish to respond, we suggest the city extend the due dates if the RFP's are modified."

Addams said in his letter that FirstSouthwest would be responding to the RFP on Nov. 22, regardless of whether changes are made and that they would protest if their response is not considered.

The city doesn't seem likely to make changes in the middle of an RFP process in which the deadline for responses was Nov. 8; and the city anticipates making a decision on Dec. 2.

Natalie Brill, Los Angeles' debt manager, said she couldn't comment on the RFP process until after the final selection is announced Dec. 2.

The protest letter was sent to Brill; City Administrative Officer Miguel Santana; City Attorney Mike Feuer; and Paul Krekorian, chair of the City Council Budget & Finance Committee.

Los Angeles' debt management policy, adopted in 2005, deems it a conflict of interest for firms to do business with the city as both an underwriter and financial advisor.

"The city has a policy that the financial advisor must be independent and can't have an underwriting arm," said Jeremy Oberstein, a spokesman in Krekorian's office.

FirstSouthwest officials don't think the issue is quite so clear cut.

Regulations adopted by the Municipal Securities Rulemaking Board, Dodd-Frank legislation, and changes proposed by the U.S. Securities & Exchange Commission that go into effect in mid-January have changed the playing field with rules regulating how FAs operate.

FirstSouthwest would like the city to remove the language excluding underwriters noted in the first RFP and in another RFP seeking a financial advisor for eight different bond categories including general fund lease financings and tax anticipation notes, in which the city explains that while it has "in the past, accepted proposals from investment banking firms to act as financial advisors, the city now only hires independent financial advisors for general financial advisory services and the city's various bond programs."

It further says, "In light of the scope of the engagement and the emphasis on non-transaction-related financial advisory services, as well as the city's desire to hire financial advisors with no vested interest in the issuance of debt, the city will not consider proposals from firms that underwrite or otherwise trade in municipal bonds to serve as the lead financial advisor, in accordance with MSRB [Municipal Securities Rulemaking Board] G-23."

In November 2011, MSRB's Rule G-23 was modified to prohibit dealers from serving as financial advisors and underwriters on the same municipal bond deal.

"Their debt policy that is available through their web page is somewhat less restrictive than what is in the current RFP," said Brian Whitworth, senior vice president for FirstSouthwest.

The city used underwriters as co-financial advisors before the MSRB came out with its rules, but typically only in special situations where it wanted sell-side advice on an issue, city officials said.

Based on the language in the RFP, Whitworth said apparently the category allowing underwriters to act as co-financial advisors is now gone.

"We feel very strongly that all qualified financial advisors should be able to submit an application," Addams said. "The city should be able to pick whoever they want. We object to the city excluding very qualified FAs from even being able to apply."

Southwest officials question why the city frequently uses KNN Public Finance as a financial advisor, when the financial advisory firm is a division of Zions First National Bank, an underwriter. FirstSouthwest also was selected to act as a financial advisor for the Los Angeles Housing Department in 2006 and 2010, but was told it would not be considered for the city itself, its port, airports, and the Department of Water and Power, Addams said.

"There is no definition of 'independent' in any regulatory rules," Addams said. "That is why we wanted them to understand the ownership structure of PFM and KNN, who currently work for the city."

PFM, an advisor the most recent Los Angeles International Airport deal, is owned by a group of private equity investors that includes at least one underwriting firm that has an ownership interest, according to FirstSouthwest's letter.

The MSRB's fair-dealing rule requires underwriters to disclose to issuers that they do not have any fiduciary duty and that the transaction will be at arm's length.

Addams thinks those disclosure rules and similar ones outlined in Dodd-Frank will ensure that if a firm that conducts underwriting business is hired as an FA there is a guarantee it will act in the city's best interest.

The SEC is about to add its take on the issue when its municipal advisor rules takes effect by mid-January. Its rule would require anyone offering advice about municipal bonds, municipal derivatives, or the investment of bond proceeds to an issuer or other municipal entity or conduit borrower to register as a municipal advisor.

"There have been a lot of changes since the city adopted its debt policy in 2005," Addams said. "We have made a decision as a company that we will challenge this where we see it."

In a city as prominent as Los Angeles, Addams said, "it's very important we challenge this."

FirstSouthwest was successful in getting Broward County, Fla. and Broward County School District to change the language in its RFPs allowing underwriters to be considered for FA work, according to Addams.

Two issuers interviewed for the story have not heard of anyone other than Los Angeles adopting such a policy, but said they understand why an issuer might do so.

"My guess is that on a practical basis, this will make it easier for all concerned to serve either in a fiduciary, or non-fiduciary role without any overlap," said Laura Lockwood McCall, director of debt management manager at the Oregon State Treasury.

Julia Harper Cooper, director of finance at the City of San Jose, said issuers might feel better with a "clear delineation" between who their FA is and who their underwriter is, without worrying whether the lines might be blurred.

"It becomes more comfortable for issuers," she said.

The Government Finance Officers Association "has discussed the issue of recommending that governments use independent FAs vs. those associated with broker/dealer firms in the past," said Timothy Firestine, GFOA president and chief administrative officer of Montgomery County, Md.

"Due to the forthcoming MA rule, it is likely that this subject will be discussed again, as GFOA looks to ensure that issuer practices are in line with the rule. From my personal experience as a CFO, it is a better practice to use an independent FA. Helps avoid even the appearance of a conflict of interest."

BY KEELEY WEBSTER