

Bond Case Briefs

Municipal Finance Law Since 1971

GFOA Alert: The MA Rule and Issuers.

Rule's Implications When Hiring Municipal Advisors and Underwriters

The Securities and Exchange Commission (SEC) has given final approval to a rule which takes effect July 1, 2014, defining the term "municipal advisor" (MA), and has produced supplementary Frequently Asked Questions about the rule. The SEC Municipal Advisor Rule specifies activities which will be covered by the Dodd-Frank Act's imposed fiduciary duty of a municipal advisor to its government client, may result in the need for underwriters to receive new written representations from issuers, and may limit the manner in which underwriters and other professionals interact with issuers. While the Rule does not regulate issuers directly, there are numerous indirect implications. The practical effect of the MA Rule on issuers is to limit the ability of underwriters to provide advice to issuers. However, a few exemptions to the Rule may apply, thus allowing underwriters to provide advice to issuers as described below. This alert seeks to assist governments in understanding key aspects of the Rule and how it will likely require modifications to how issuers interact with underwriters.

Regulating Municipal Advisors

The MA Rule, which regulates municipal advisors, places a fiduciary duty on those professionals that advise governments when they sell bonds. GFOA recommends that unless a government has sufficient internal expertise that it use a municipal advisor when considering and developing a bond transaction. Municipal advisors must also now be registered with the SEC and Municipal Securities Rulemaking Board (MSRB). Issuers can check the [MSRB's Municipal Advisor registration page](#) to ensure their professionals are registered.

The MA Rule and Underwriters

The role of the underwriter is to sell bonds for the issuer. They do not have a fiduciary duty to the issuer. However, many investment banking firms have previously provided other services to their clients, including financing recommendations and advice on bond sales. The MA Rule states that only professionals with a fiduciary duty to the state or local government may provide advice, unless an exemption is in place. While investment bankers may continue to respond to RFPs, talk in general terms with issuers about general market information, and pitch products within certain limits, specific advice from investment bankers is prohibited unless certain exemptions apply. Below is a discussion of the exemptions along with model language that issuers may wish to use themselves, or may be sent to them from underwriters or other professionals.

The MA Rule and Investment of Bond Proceeds

Due to the SEC's Municipal Advisor Rule and forthcoming MSRB rules, investment bankers may be considered municipal advisors if they provide advice on investments of bond proceeds to governments. Additionally, currently proposed MSRB rules may restrict the ability of municipal advisors to sell the products that they "recommended" as investments to their government clients. 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. The SEC is expected to issue new MA Rule guidance to clarify whether or not broker recommendations on the investment of bond proceeds will be considered advice, and the MSRB is likely to further discuss this issue in their rulemaking. This document will be updated with this clarifying information.

Key Items Issuers Need to Know About the MA Rule

- "Municipal advisor" is defined as a person (not including a municipal entity or employee of a municipal entity) who provides advice to 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 undertakes a solicitation of a municipal entity or an obligated person.
- The term "advice" is not specifically defined, but includes recommendations regarding municipal finance products or the issuance of municipal securities, including recommendations as to structure, timing, terms and other similar matters concerning such financial products or issues. Advice on the issuance of municipal securities encompasses advice given during the entire lifespan of the transaction, from earliest pre-planning stages through maturity or earlier redemption.
- In the past, issuers may have communicated with underwriters and banks about matters such as structure or timing of municipal securities or been pitched financing ideas, but such communications are likely to change upon the implementation of the MA Rule. Underwriters will not be able to provide advice to issuers unless certain exemptions apply.
- • Underwriters will be able to communicate with issuers about general market issues, facts and ideas. However, unless an exemption is met, underwriters cannot advise a government to take a specific action.
- There are exclusions and exemptions from the definition of municipal advisor that would allow freer communications between underwriters and issuers, but it is not yet clear how these exemptions will be satisfied. While there is some guidance about how the exemptions should apply, the interpretation of the Rule by compliance departments of individual underwriters may determine whether certain communications between the underwriter and an issuer are permitted.
- Issuers may still obtain advice on the investment of monies that are not bond proceeds or held in escrow to pay for bonds, but may be required to provide a written representation to their broker regarding the nature of such funds before such advice will be given.
- Exemptions from the definition of "municipal advisor" allow underwriters to provide advice to issuers in certain circumstances:

The Independent Municipal Advisor Exemption

An issuer may obtain advice from an underwriter when the issuer has retained an independent registered municipal advisor. The independent registered municipal advisor must not have been associated with the underwriter within the past two years. The issuer must represent in writing to the underwriter that it has retained and will rely on a municipal advisor for advice. The underwriter must have a reasonable basis for relying on the issuer's representation. The municipal advisor may be hired for a specific deal for which the underwriter may be providing advice, or if a government hires a municipal advisor on a retainer basis, an underwriter may approach the issuer on any type of financing, as long as the issuer states in writing that it will rely on advice of its municipal advisor. Upon request, the issuer may send the representation to the underwriter directly, or post it on its web site. The GFOA recommends posting this language on the government's website for efficient distribution and access by underwriters. It is important to note that the issuer remains in control of the scope of work it wishes to receive from its municipal advisor. GFOA discourages an underwriter

from speaking with or sending materials directly to the issuer's municipal advisor unless specifically authorized by the issuer. Additionally, for those entities that use multiple municipal advisors, suggested language is noted below for those circumstances.

Independent Municipal Advisor Exemption Language

[State or local government] has retained an independent registered municipal advisor. [State or local government] is represented by and will rely on its municipal advisor [Include name of firm here] [If desired, include name of advisor at the firm here] to provide advice on proposals from financial services firms concerning the issuance of municipal securities and municipal financial products (including investments of bond proceeds and escrow investments (if applicable)). This certificate may be relied upon until (insert date). Proposals may be addressed to [State or local government] at _____. If the proposal received will be seriously considered by [State or local government] the entity will share the document with its municipal advisor. Please note that aside from regulatorily mandated correspondence between an underwriter and municipal advisor, the underwriter should not speak directly with or send documents directly to the municipal advisor unless specifically directed to by the issuer.

Draft language for 2nd sentence to be used by larger entities - The [State or local government] uses several municipal advisors in its debt management program. To know which firm is being used for a particular credit, please contact the issuer at _____, [or see below for the appropriate listing].

[If posted on the issuer's website, add the following language at the beginning: By publicly posting the following written disclosure, [State or local government] intends that market participants receive and use it for purposes of the independent registered municipal advisor exemption to the SEC Municipal Advisor Rule.]

Issuer Uses RFP/RFQ Process/RFP Exemption

Underwriters responding to an RFP may include recommendations without violating the MA Rule. For this exemption to apply, the RFP may not be outstanding for more than six months and the issuer must widely distribute the RFP to at least three reasonably competitive firms or post it on their web site. The GFOA recommends that the RFP be posted on a government's web site to ensure wide distribution. If an issuer uses a pool of underwriters from which it chooses underwriters for a particular transaction, the issuer may have to issue a mini-RFP to receive advice from members of its underwriting pool. Issuers may be asked to provide - or may provide on their own - a disclaimer that they their RFP process is in line with the MA Rule, as noted here:

Issuer Uses RFP/RFQ Process/RFP Exemption Language

[State or local government] is aware of the "Municipal Advisor Rule" of the Securities and Exchange Commission (effective July 1, 2014) and the RFP/RFQ exemption from the definition of "municipal advisor" for a person providing "advice". In response to an RFP/RFQ, [State or local government] hereby notifies [all] [certain designated] investment banking firms that it wishes them to provide advice and recommendations on [insert description of particular objectives concerning the issuance of municipal securities and/or municipal financial products (as such terms are defined in the Municipal Advisor Rule)]. [State or local government] intends for such advice and recommendations to qualify for the RFP/RFQ exemption. The advice and recommendations may be made orally or in writing. [State or local government] reserves the right to accept or reject any proposals submitted to it and to conduct a formal procurement process, in each case if deemed by [State or local government] to be in its best interests and to comply with applicable laws or procurement policies.

This RFP/RFQ is open from _____ to [insert date no later than six months after the first date or, in the case of mini RFPs, a date that is no later than 3 months after the first date]. [State or local government] understands that by responding to this RFP/RFQ, respondents are not municipal advisors to [State or local government]. [If not posting publicly, add the following language: This RFP/RFQ is being sent to [a least three investment banking firms] [the entire pool of firms]. Underwriter is Selected for a Transaction/Letter of Intent

Upon selection of an underwriter for a specific transaction (GFOA recommends selecting underwriters through a competitive RFP process), the GFOA recommends issuing a “letter of intent”, which will allow the underwriter to more freely discuss the transaction as its being developed. Model language for this exemption is suggested as followed:

Underwriter is Selected for a Transaction/Letter of Intent Language

[State or local government] is aware of the “Municipal Advisor Rule” of the Securities and Exchange Commission (effective July 1, 2014) and the underwriter exclusion from the definition of “municipal advisor” for a firm serving as an underwriter for a particular issuance of municipal securities.

[State or local government] hereby designates [Underwriter] as an underwriter for [brief description of the Bonds] (the “Bonds”) that [State or local government/Conduit Issuer/Obligated Person] currently anticipates issuing. [State or local government] expects that [Underwriter] will provide advice to [State or local government] on the structure, timing, terms, and other matters concerning the Bonds.

It is [State or local government’s] intent that [Underwriter] serve as an underwriter for the Bonds, subject to satisfying applicable procurement laws or policies, formal approval by [governing body/issuer], finalizing the structure of the Bonds and executing a bond purchase agreement. While [State or local government] presently engages [Underwriter] as the underwriter for the Bonds, this engagement letter is preliminary, nonbinding and may be terminated at any time by [State or local government] without penalty or liability for any costs incurred by the underwriter, or [Underwriter]. Furthermore, this engagement letter does not restrict [State or local government] from entering into the proposed municipal securities transaction with any other underwriters or selecting an underwriting syndicate that does not include [Underwriter].

[Underwriter]

[[State or local government] duly authorized official responsible for public finance]

Resources

- [SEC Municipal Advisor Rule](#)
- [SEC MA Rule Frequently Asked Questions 1/16/14](#)
- [GFOA Issue Brief: SEC Municipal Advisor Rule](#)
- [GFOA Best Practice, Selecting and Managing the Engagement of Municipal Advisors \(2014\)](#)
- [GFOA Best Practice, Selecting and Managing the Engagement of Underwriters for Negotiated Bond Sales \(2014\)](#)
- [GFOA Best Practice, Selecting and Managing the Method of Sale of State and Local Government Bonds \(2014\)](#)
- [GFOA Best Practice, Investment of Bond Proceeds \(2013\)](#)

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