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Panelists Dissect MA, MCDC Impact on Issuers.

SEATTLE – Small issuers and firms will be most impacted by the imminent regulatory changes that the municipal industry will soon undergo, according to issuers, underwriters, and financial advisors speaking at The Bond Buyer's Pacific Northwest Municipal Market Symposium on Tuesday.

With just one week left before the municipal advisor rule takes full effect, market participants anticipated how the rule will impact the market.

"I've been a financial advisor for 28 years and there's no question that this is the biggest change I've witnessed in these years," Chip Pierce, a partner at Western Financial Group, LLC, said during the conference.

Once the rule takes effect July 1, firms providing advice on the issuance of muni bonds or the management of muni proceeds or escrows will be required to register with the Securities and Exchange Commission and the Municipal Securities Rulemaking Board.

The SEC has made clear that absent a firm's ability to utilize one of several exclusions or exemption available in the rule, providing muni advice bars a firm from underwriting a bond issuance on the same transaction.

The amount of time and money needed to comply with the regulations is significant, panelists said.

"There's no question this is going to disadvantage smaller firms," Pierce said.

Small advisory firms will likely take the biggest hit from rule's implementation, having to consolidate or lose staff in order to deal with the greater costs of compliance, according to Pierce.

That will particularly disadvantage less-frequent issuers, because small firms have historically sought their business and large firms may not see it as worth their while for an issuer that issues every three years or so, he said.

Bob Lamb, president of Lamont Financial Services Corporation, said his firm will likely end up spending 20% of its effort complying with new rule, adding 0% to its productivity.

Firms will take different strategies to deal with the greater need for compliance, whether they staff current employees or hire third parties.

Pierce likened his firm's deliberation on how to deal with increased compliance to a game of "hot potato"—whoever was left holding the potato will have had to be chief compliance officer.

He said they ended up deciding to pay someone else to "hold the potato," which will cost Western Financial an estimated $10,000 to $15,000 extra a year.

"This is a new landscape," he said. "It is what it is, but it's taking away from things we pride ourselves on."

Another possible outcome from the rule's implementation is a continued shift among issuers away from the tax-exempt bond market and toward the banking and direct loan market.

Leslie Norwood, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said there has already been some movement, but she wouldn't be surprised if the new rule further contributed to the shift.

Market participants also discussed the implications of the SEC's Municipalities Continuing Disclosure Cooperation Initiative, which aims to come down on municipal and underwriters that have violated federal securities laws.

Specifically, the MCDC initiative will address violations of Rule 15c2-12, which prohibits underwriters from purchasing or selling municipal securities unless the issuer has committed to providing continuing disclosure regarding the security an issuer.

It also requires that official statements contain a description of any instances in the previous five years in which the issuer failed to comply with any previous commitment to provide such continuing disclosure.

Under MCDC, underwriters and issuers have until September 10 to voluntarily fill out a questionnaire to report any type of material misstatement in return for receiving favorable settlement terms.

Smaller issuers are less likely to have the resources needed to understand and comply with the initiative, said Robert Feyer, senior counsel at Orrick, Herrington & Sutcliffe LLP, and moderator for the panel.

He added that legal counsel can help guide issuers on what might be considered material statements, but it's up to each issuer to determine its own risk tolerance and whether it's in their best interest to self-report.

Laura Lockwood-McCall, director of debt management division at the Oregon State Treasury, said she has thought long and hard about whether or not to cooperate with the initiative and self-report.

Since there's the possibility that the underwriter might report on any violations of the issuer, it's a huge risk not to report.

However, Lockwood-McCall said that before deciding whether or not to report, issuers should first go over all of their municipal bond issuances in the past ten years to see if they have, in fact, any materially inaccurate statements.

Lockwood-McCall herself created a database of all Oregon's issuances in the past ten years, and mailed a list to the bankers on each issue to ask them to notify the state if they planned to report on anything.

"We are relying on the word 'cooperation' in the MCDC Initiative's title," she said.

Brian Hellberg, an RBC Capital Markets director for municipal finance policy and procedure, also said that there will need to be a significant amount of cooperation, especially since much of the information is in the hands of the issuer.

He referred to the situation as a "prisoner's dilemma," because of the possibility underwriters will self-report a problem under the MCDC program that an issuer has decided not to.

“The next two months will be about working through the process,” Hellberg said. “Not until all the cards on the table will we be able to decide about material statements.”

The consequences for an issuer that does not participate in the MCDC self-reporting program and subsequently faces SEC charges for what it didn’t report are serious, Feyer said. And underwriters have an incentive to report as much as possible, he said, because they can reduce potential future liability while there is a cap on their total financial penalties under the program.

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