

Bond Case Briefs

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Advisor Groups Push For Clarity In Municipal Market Rules.

Banks, insurance companies and financial advisors want more clarity on principal transactions and disclosures in proposed rules drafted by regulators governing the conduct of nonsolicitor municipal advisors.

The draft rules are part of the federal government's new regulatory framework of the \$3.7 trillion municipal market.

Local and state governments tap the municipal market to raise billions of dollars every year to fund public improvement projects. Financial reforms contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act called for more scrutiny of the municipal market.

The Municipal Securities Rulemaking Board (MSRB) had already gone through a first round of comments earlier this year related to amendments to Rule G-42 on the standards of conduct and duties of municipal advisors.

Subsequent to comments received from industry groups on the MSRB's initial draft rules, the board asked for more comments following the release of revised draft rules.

The National Association of Independent Public Finance Advisors (NAIPFA) was swift to condemn parts of the revised draft rules.

The MSRB's proposal surrounding the disclosure of "inadvertent advice" would benefit "municipal advisors who are also registered broker/dealers who wish to avoid being prohibited from underwriting an issuance of securities pursuant to MSRB Rule G-23," NAIPFA said.

Rule G-23 prohibits a broker/dealer who serves as a financial advisor to an issuer — a school district or local government — for a particular municipal bond issue, from switching roles and underwriting the same bond issue.

Allowing broker/dealers an exemption under the "inadvertent advice" clause would lead to "widespread abuses by broker/dealers" looking to circumvent fiduciary duty requirements already put in place by the Securities and Exchange Commission and the MSRB, NAIPFA said.

NAIPFA further called the inadvertent advice clause "both troubling and unwarranted."

In a letter to the MSRB, the powerful Bond Dealers of America took issue with what it said was language "vague and open to interpretation" when it came to prohibiting municipal advisors or affiliates from engaging in transactions "directly related to the same municipal securities transaction or municipal financial product as to which the municipal advisor is providing advice."

"It is not clear to us exactly what transactions would be considered 'directly related to' other transactions, the BDA said in the letter. "Would acting as a municipal advisor for a swap while acting as the underwriter on a related series of variable rate bonds be too 'directly related'?"

Underwriters and big financial services companies also had questions for MSRB regulators about the prohibition of principal transactions for an advisor's own account.

The Financial Services Roundtable, which represents 100 financial services companies offering banking, insurance, payment and investment products, said regulators should include in the revised draft rules alternative mechanisms for advisors "that would permit them to engage in principal transactions with municipal entities subject to disclosure and consent requirements."

FSR members also said G-42's draft rules around disclosure requirements for advisors and the advisors' affiliates were "vague and overly broad," and would make it "very difficult for a municipal advisor to comply with if it is part of a large, multiservice financial conglomerate."

For decades, municipal market players — including bond dealers, securities broker/dealers, bond issuance advisors, bond counsel, advisors to the municipal governing body, and consultants — have plied a lucrative trade with little oversight.

In the municipal market, it is often difficult to discern who is representing whom, and where to draw the line between who has a fiduciary standard of care toward the municipal entity — the taxpayer — and who doesn't, and how far that standard extends.

Last year, the SEC filed suit against the Greater Wenatchee Regional Events Center Public Facilities District, in Wenatchee, Wash., in connection with a real estate project that soured during the financial crisis.

In its complaint, the SEC noted that the director of executive services for the City of Wenatchee, while "on loan" to the facilities district, signed off on financial documents for a development project despite no formal financial background.

The director of executive services, at the behest of the local mayor, found herself the de facto liaison between the municipality, the developer, attorneys and underwriters.

Unlike U.S. Treasury securities that are traded every day and subject to transparent pricing, price-setting in the municipal market remains an exercise shrouded in relative opacity with layers of intermediaries, often politically connected, benefiting from every transaction.

Proponents of municipal market reform say the difficulty with which to pin down advice when it comes to the municipal market is exactly why this market is in need of a robust regulatory framework.

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