

Bond Case Briefs

Municipal Finance Law Since 1971

Conduit Issuers, Dealers Face Some MA Challenges.

WASHINGTON - Conduit issuers and dealers face challenges under the eight month-old municipal advisor registration rule, though most market participants say the new regime is running fairly smoothly.

The Securities and Exchange Commission's MA rule took final effect July 1 last year, codifying the Dodd-Frank Act's requirement that firms giving muni bond-related advice to a state or local government owe those issuers a fiduciary duty to put their interests first.

Initial industry panic about the rule's potential to put the deep freeze on mutually beneficial relationships between investment bankers and muni issuers has subsided, but practical issues involving the fiduciary duty and the use of certain exemptions from the rule continue to be problematic for issuers and dealers.

Robert Donovan, executive director of the Rhode Island Health and Educational Building Corporation, said the MA rule has badly complicated the RIHEBC's mission to provide capital access to its eligible borrowers. Donovan said the corporation engages an MA on every one of its deals, and makes that MA available to its borrowers.

But while the SEC rule says that the MA has a fiduciary duty to the RIHEBC as a conduit municipal issuer, there is no such explicit duty to a conduit borrower. The Municipal Securities Rulemaking Board has floated a proposed Rule G-42 on the core standards for MAs that would spell out the fiduciary duty in more detail. That proposal states that the fiduciary duty would not apply to borrowers, but it is not yet at the SEC for approval and could still be months away from taking effect.

"It has created some type of a rift," Donovan said of his relationship with borrowers, to whom he now sends letters asking that they acknowledge that the MA working on the transaction does not owe them a fiduciary duty and is actually RIHEBC's MA and not theirs.

"I think a lot of the borrowers don't have a great understanding of the rule," Donovan said. "It has created some confusion. It has caused some additional work for us."

Donovan said he fully understands the rule's motivation and thinks it does provide good benefits for many issuers, especially those issuing primarily straightforward general obligation bonds.

"For conduit issuers it just complicates it," he said. "I just have to send out a lot more letters than I used to accomplish the same thing."

Dave Sanchez, a California-based lawyer who worked on the MA rule as a lawyer in the SEC's muni office from 2010-2013 and now runs his own practice, said the presence of an MA advising both a conduit issuer and borrower is a conflict of interest that likely should be fully disclosed because the issuer and borrowers sit on opposite sides of the negotiating table.

Dealers, who have been extremely vocal about the potential negative impacts of the rule on their

relationships with issuers, said they are having trouble getting the documentation they need in order to rely on the registration rule's independent registered municipal advisor, or IRMA exemption.

An investment banker who wants to give bond-related advice to a state or local government generally wants to avoid having to register as an MA because doing so saddles them with the fiduciary duty and bars them from underwriting any resulting deal. The IRMA exemption allows a dealer to give that advice without registering as an MA if the issuer retains its own MA that has no relationship to the dealer firm and certifies that it will rely on that that IRMA's advice.

Many market participants have said that the IRMA provision, which is one of several exemptions and exclusions in the rule, is generally the exemption of choice for underwriters because it offers the most wide-ranging MA rule immunity and because most medium to large issuers have their own MAs already.

But Jessica Giroux, general counsel and managing director for federal regulatory policy at the Bond Dealers of America, said verifying that an IRMA is in place and properly registered involves wading through sometimes hundreds of filings on the SEC's EDGAR system to find the IRMA's MA registration forms and make sure they are in order.

"Our firms don't want to rely on the IRMA exemption unless they can verify that everything is in place and as it should be," Giroux said.

Leslie Norwood, a managing director, associate general counsel, and co-head of municipal securities at The Securities Industry and Financial Markets Association, said firms want to use the IRMA exemption but that it can be cumbersome to find the documentation that makes them comfortable doing so.

"You have to keep digging," she said.

Most issuers said the rule, which does not directly regulate them, has not impacted their operations.

"It has kind of been a non-event," said Jonas Biery, debt manager for Portland, Ore.

Rodney Miller, finance director for Catawba County, N.C., said some of the financial institutions he invests with have reached out wanting to make sure that bond funds are not being comingled with tax revenues in a way that could make their accounts subject to the MA rule, but that the rule has not been disruptive.

Katherine Kardell, an administrator in the budget and finance office of Hennepin County, Minn., said the rule is not a big deal for her or other issuers to whom she has spoken. Kardell said she uses an IRMA and shows them most pitches the county receives from banks.

Giroux said that the SEC's muni office has been responsive and helpful in answering one-off questions about the rule, and that her group's member dealers are less concerned about it now than they were in the past.

"Operationally, I think firms are getting more comfortable with issuers' understanding of the rule," she said.

National Association of Municipal Advisors president Terri Heaton said regulators have done a good job with outreach on the rule but that her group remains concerned that there may still be rule breakers out there.

"We believe more municipal issuers are more aware of the roles of municipal securities transaction participants," Heaton said. " NAMA members have noted increased interest by issuers to engage municipal advisors in transactions, however such is not the case in all parts of the country."

"We note concern there may be entities which continue to provide MA services that are not in compliance with rules which are now in effect," she continued. "We note concern there may be entities that are providing MA services which are registered with the MSRB and SEC, but may lack the core competencies and qualifications which may be deemed necessary by the SEC to achieve a fiduciary duty standard."

Several MSRB MA rules have yet to be finalized, including one requiring a basic competency test. The MSRB has said finishing the MA rules is a top priority.

THE BOND BUYER

BY KYLE GLAZIER

FEB 25, 2015 2:14pm ET

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com