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Issuing Bonds Under the SEC Municipal Advisor (MA) Rule

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As part of the fallout of the financial crisis in 2008, in July 2010 Congress passed a financial reform bill known as “Dodd Frank” to protect various parties, including issuers of municipal securities.

Dodd Frank caused a review of practices in the municipal marketplace and required the SEC to define financing roles, municipal advice and thus who should be regulated.

- Authorized the SEC to adopt rules for the registration of Municipal Advisors (MAs) and the Municipal Securities Rulemaking Board (MSRB) to adopt rules governing municipal advisors.

The roles of a MA and Underwriter are distinct and separate.
• MA Rule became effective July 1, 2014
  – 777 pages

• Objectives:
  – Defined categories of persons considered MAs
  – Established a permanent MA registration regime (with the SEC and FINRA)
  – Other MA requirements include: (1) training and continuing education, (2) supervision, (3) record keeping, (4) Code of Conduct and (5) Compliance exams
  – Examination of municipal advisory firms is conducted by the SEC and FINRA
• A person (not a municipal entity or an employee of a municipal entity) who provides advice to or on behalf of a municipal entity or obligated person with respect to the investment of the proceeds of municipal securities or the issuance of municipal securities

• A person who solicits a municipal entity or obligated person, but only if such person receives either direct or indirect compensation

• One does not have to be engaged or hired as a Municipal Advisor, financial advisor or in any other capacity whatsoever to be deemed a Municipal Advisor under the Rule
The Municipal Advisor takes the lead on many services, including advising and assisting the college in formulating and executing a debt financing plan, including the bond structure, timing and process.

- The MA does not sell the bonds to investors, but it assists the college in determining the appropriate method of sale.
  - The MA manages the competitive bond sale process.
  - Assists the college with the selection of an underwriter, if a negotiated sale.
  - Often prepares the Official Statement (which is still the college’s disclosure document) and rating agency presentation.

The Underwriter’s primary duty is to buy the bonds from the college and then market and sell them to investors.

A MA may not switch roles and become an Underwriter.
Municipal Advisor (IRMA) – **Fiduciary Duty**

- Fiduciary duty requires the MA to act in the best interests of its client and place the client’s interests ahead of its own
- Disclose all material conflicts of interest
- Review and provide inquiry into reasonable financial alternatives to the financing
• **Underwriter – Standard of Fairness**

- Serves two clients: Issuer and Investors
- Issuer and investors have differing interests
- Results in holding Underwriter to a standard of fairness to both parties
- Duties to Issuer include providing capital, selling bonds and providing advice specific to a bond issue
- Fair dealing includes full disclosure and fair execution and requires balancing the interests of its issuer-client and investor-client
- Dodd Frank imposed limitations on the manner and content of information communicated by underwriters to colleges prior to engagement, with some exemptions

**Note:** Same if you hire one or both of these professionals for a specific bond issue
• Advice is a:
  – recommendation or call to action;
  – relating to bonds or other financing instruments;
  – that is particularized to the specific needs, objectives or circumstances of the college;
  – including bond structure, timing and terms.

• Certain exemptions from advice exist
**SEC Municipal Advisor (MA) Rule**
**Definition of “Advice” Under the Rule**

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<th>ADVICE</th>
<th>NOT ADVICE</th>
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<td>• Individually tailored recommendations</td>
<td>• Professional qualifications and experience</td>
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<td>• Information that invites the Issuer to act or refrain from acting</td>
<td>• General market and financial information</td>
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<td>• Subjective assumptions, opinions and viewpoints</td>
<td>• Educational information of various government financing programs</td>
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<td>• Advice given indirectly through a third-party professional retained by the Issuer</td>
<td>• Available investments and related prices</td>
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<td>• Unspecific information or hypotheticals, i.e. vanilla (not tailored) refunding analyses</td>
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• So, anyone who provides advice without one of the exceptions to follow becomes a Municipal Advisor
  – Exemptions for engineers, lawyers, commercial bankers, auditors as well as college staff and board members

• Once a firm has served as Municipal Advisor related to a particular bond transaction, they cannot move into role of underwriter
What has changed since the MA Rule went into effect?

- Underwriters cannot provide advice and assistance relating to specific advice on bonds without meeting one of the exemptions:
  - Engaged
  - General and Factual information
  - RFP
  - Reliance upon an IRMA
SEC Municipal Advisor (MA) Rule
Exemptions for Underwriters to Give Advice

• Underwriters can easily be considered a Municipal Advisor if information given to an Issuer is deemed “advice” and/or a “call to action”

• Providing any information deemed “advice” and/or a “call to action” would preclude a firm from underwriting the Issuer’s transaction

• Therefore, the Underwriter needs to put one of four MA Rule Exemptions in place:

**Exemption #1**
The Underwriting Exemption

- Underwriter disclosure states the following for a particular transaction:
  - Underwriter is not a fiduciary and is not acting as a municipal advisor
  - Underwriter is a principal and its interests differ from Issuer
  - Issuer should consult legal counsel or financial advisor it deems appropriate.

This is often referred to as an Underwriter letter of Intent or engagement letter that is non-binding.

**Exemption #2**
The IRMA Exemption

- Issuers retain an Independent Registered Municipal Advisor on same transaction that Underwriter is working on/proposing on
  - Underwriter sends Issuer an email citing IRMA exemption and identifying IRMA
  - Issuer must acknowledge named IRMA is on retainer and that they will rely on the IRMA’s advice respect to the issue/program

**Exemption #3**
The RFP Exemption

- Underwriter is allowed to submit ideas, advice, etc. as part of a Request for Proposals/Qualifications process
  - “Open ended” RFPs not allowed; must be issue or program specific
  - States that the Issuer understands that respondent to RFP is not an MA
  - The RFP must be sent to at least three qualified firms and/or be posted on the College’s website
Outside of a specific engagement, an underwriter may also provide many other types of information to municipal issuers that does not rise to the level of advice without acting as a municipal advisor:

- General market information
- Educational information
- Professional qualifications
- Level savings refundings
- Factual descriptions and comparisons of financing alternatives
• Receiving information related to borrowing options and refundings is not as simple as it used to be.
• In order to assure that your college receives the most robust array of ideas regarding your existing debt and/or financing new projects, focus on:
  – Understanding the roles and responsibilities of the financing parties you engage
  – Understanding the professional standards that each financing role entails
  – Retain documentation that supports each role a financial professional is engaged to fill
  – Get contracts for financing engagements in place as early as possible
  – Ask questions and consult your legal professional if necessary
The information contained herein is solely intended to suggest/discuss potentially applicable financing applications and is not intended to be a specific buy/sell recommendation, nor is it an official confirmation of terms. Any terms discussed herein are preliminary until confirmed in a definitive written agreement.

The analysis or information presented herein is based upon hypothetical projections and/or past performance that have certain limitations. No representation is made that it is accurate or complete or that any results indicated will be achieved. In no way is past performance indicative of future results. Changes to any prices, levels, or assumptions contained herein may have a material impact on results. Any estimates or assumptions contained herein represent our best judgment as of the date indicated and are subject to change without notice. Examples are merely representative and are not meant to be all-inclusive.

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