Critical Financing Team Members

- Bond Registrar/Paying Agent
- Local Counsel
- The College (Board of Trustees)
- Bond Counsel
- Credit Rating Agency

What is the role of the financial advisor and underwriter in structuring, marketing and placing bonds with investors?
• **Role of a Financial Advisor:** to advise and assist the College in formulating and executing a debt financing plan
  – Assist the College in determining an optimal financing structure
  – Incorporate how the College’s debt needs connect with its operating needs and expectations
  – Assist the College in determining the appropriate method of sale
  – Prepare the Official Statement and rating agency presentation
  – Help ensure that the College secures the lowest borrowing cost possible, given current market conditions

• **Role of an Underwriter:** to purchase bonds from the College with the intent to resell them to investors
Sample of Potential Investors

- The College (Board of Trustees)
- Retail Buyers (Sales to Individuals)
- Insurance Companies
- Bond Funds
- Banks
- Trust Companies
The College (Board of Trustees)

Financial Advisor

Bidding Underwriter Number One
Bidding Underwriter Number Two
Bidding Underwriter Number Three
Bidding Underwriter Number Four
Bidding Underwriter Number Five

Retail Buyers (Sales to Individuals)
Insurance Companies
Bond Funds
Banks
Trust Companies

Winning bidder determined by lowest cost.
• Bids for the bonds are submitted to the issuer at a specific time on a specific date.
• Bonds are awarded to the underwriter who offers the combined lowest interest rate and underwriting fee.
• Eliminates potential concern about the fairness of underwriter selection.
• PMA works with one of the online bidding platforms (eg: MuniAuction and Parity)
  – In a closed auction, bidders submit one bid
  – During an open auction process, bidders are notified of the ranking of their bids (i.e. “Leader,” “Cover,” 3rd, etc.) and have the opportunity to change and resubmit bids as many times as they would like during the allotted time period.
The College (Board of Trustees)

Financial Advisor

Underwriter Number One
- Retail Buyers
- Trust Accounts

Underwriter Number Two
- Insurance Companies
- Intermediate Bond Funds

Underwriter Number Three
- Long-Term Bond Funds
- Insurance Companies

Financial advisor helps select underwriter(s) with strengths that match the College’s needs.
• A competitive sale is appropriate when:
  – Issuer has a strong underlying credit rating at least in the “A” category
  – General obligation bonds or full faith obligations (e.g. alternate revenue bonds or debt certificates)
  – Structure does not include special features that would require extensive explanation to the market
  – Issue size is conducive to attracting investors

• A negotiated sale is appropriate when:
  – Issuer has a credit rating lower than “A”
  – Bond insurance is unavailable
  – Debt structure is complicated
  – Issuer wants input in how bonds are allocated among underwriting firms

Source: Selecting and Managing the Method of Sale of State and Local Government Bonds (1994 and 2007) (DEBT), Government Finance Officers Association (Best Practice)
• “There is a lack of understanding among many debt issuers about the appropriate roles of underwriters and financial advisors and the fiduciary relationship that each has, or does not have, with respect to state and local government issuers.”

• “The relationship between issuer and financial advisor is one of ‘trust and confidence’ which is in the ‘nature of fiduciary relationship’. This is in contrast to the relationship between the issuer and underwriter where the relationship is one of some common purposes but also some competing objectives, especially at the time of bond pricing.”

• Prior to 2010, the Municipal Securities Rulemaking Board (the “MSRB”) regulated securities firms and banks that underwrite, trade and sell municipal securities.

• The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) broadened the mission of the MSRB to protect state and local government issuers.
• The Dodd-Frank Act required registration of all municipal advisors
  – Securities and Exchange Commission (“SEC”) by October 1, 2010
  – MSRB by December 31, 2010

• The Dodd-Frank Act promulgated a fiduciary duty for a financial advisor, defined as a municipal advisor, to the Issuer
  – Section 15B(c)(1) of the Securities Exchange Act of 1934 states: “A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor….”
  – Must act in the best interest of clients and disclose material conflicts of interest
• Provides advice concerning:
  – the issuance of municipal securities (financial advisor)
  – the investment of the proceeds of municipal securities
  – guaranteed investment contracts
  – use of municipal derivatives (e.g. swaps)
  – municipal escrow investments

• The definition specifically excludes a broker, dealer or municipal securities dealer serving as an underwriter

• Also excludes registered investment advisers and attorneys offering legal advice and engineers offering engineering advice

• The MSRB Board of Directors drafted a new G-36 rule relating to the fiduciary duty for municipal advisors that will be completed once the SEC finalizes its definition of municipal advisor
• Financial Advisors have a fiduciary duty to act in the best interest of its clients
  – Disclose all material conflicts of interest
  – Review and provide inquiry into reasonable financial alternatives to the financing
  – Act in the issuer’s best interest without regard to financial and other interests of the municipal advisor

• A broker dealer acting as underwriter is not subject to a fiduciary duty (an underwriter has a fair dealing requirement, Rule G-17)

• The roles of an underwriter and financial advisor are definitive, separate, and sometimes adversarial roles in a bond financing
  – They cannot be provided by the same party
Revised MSRB Rule G-23, effective November 27, 2011, prohibits role-switching once a firm is deemed to be a financial advisor.

Under the new rule an underwriter could be perceived to have a financial advisory relationship regardless of the existence of a written agreement.

Firms that may have previously performed both roles or were perceived to have performed both roles on the same transaction need to identify their role at the “earliest stages of its relationship.”

Once that is determined, the proper disclosure on that role should be received by the issuer.
• “We have come to believe that the conflict of interest – whether actual or perceived – inherent in switching roles from financial adviser to underwriter is not in the best interest of the municipal market… By eliminating the potential for role-switching, the MSRB is supporting an environment that will ensure the dealers operate with the highest professional standards when acting in either of these distinct roles.”

– Lynette Hotchkiss, MSRB Executive Director

“G-23 Change Would Bar Dealer Role-Switch”

The Bond Buyer
February 20, 2011
• Rule G-17 promulgates the fair dealing requirements for broker-dealers (underwriters)

• The MSRB set forth draft guidance on the implementation for this rule last year and filed it with the SEC
  – Final determination is due by May 4

• As currently drafted, the guidance contains the following requirements or prohibitions:
  – Underwriters would have to tell local and state governments they are not fiduciaries
  – Underwriters would be prohibited from telling issuers not to hire a financial advisor
  – Also, an underwriter would have to disclose their primary role is to purchase securities with a view to distribute in an arm’s length transaction
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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Appendix
• Joe Mysak
  – 29 years as a municipal bond advisor
  – Columnist for *Bloomberg News* for the past 11 years
  – Former editor of *Grant’s Municipal Bond Observer*
  – Former editor and publisher of *The Bond Buyer*
Who Is Your *Advocate* When You Issue Debt?

• “…unless the issuer has a dedicated debt management staff, it should hire a financial adviser. Due to the potential conflict of interest, ‘issuers should not use a broker/dealer or potential underwriter to assist in the method of sale selection unless that firm has agreed not to underwrite that transaction.’”

• “The real scandal… is that many unsophisticated issuers don’t use financial advisers at all. They instead rely on their underwriters to help them put together their transactions. The underwriters, many of them, consider financial advisers a waste of time and money. They also dislike having people looking over their shoulders.”

• “Most issuers need objective, independent help when it comes to navigating the municipal bond market. Most of them get it from their underwriters, hardly disinterested sources of advice.”

“Issuers Advised to Step Off Conflict Merry-Go-Round”
Joe Mysak
Bloomberg
June 14, 2007
• Mark D. Robbins & Bill Simonsen
  – Professors of Public Policy at University of Connecticut at Storrs
  – Robbins is a member of GFOA Debt and Fiscal Policy Committee
  – Simonsen co-authored several studies and articles on municipal debt

• They have found in “three studies since 1996 that competitive sales were less expensive for municipalities than negotiated bond sales.”

• “In reality, there is little negotiation in negotiated transactions because most government officials don’t challenge bankers.”
A recent Bloomberg Brief on the Municipal Market entitled stated the following regarding bond sales:

“Academic studies and a Government Accountability Office report in 2008 have shown that municipalities pay more than necessary to borrow when they don’t seek competitive bids. Securities sold in negotiated transactions are underpriced by as much as 4.7% according to a study this year by Craig Brown, who teaches finance at the National University of Singapore.”