REGULATORY CHANGES IN THE MUNICIPAL BOND MARKET: CONSIDER THE IMPACT ON YOU

TAMMIE BECKWITH SCHALLMO
MANAGING DIRECTOR
PMA SECURITIES, INC.

APRIL 22, 2014
• Prior to 2010, the Municipal Securities Rulemaking Board ("MSRB") created rules for securities firms and banks that underwrite, trade and sell municipal securities
  • The MSRB is a self-regulatory organization that makes rules for the municipal bond market

• The Dodd-Frank Act of 2010 broadened the mission of the MSRB to include:
  • Create rules for municipal advisors which includes financial advisors
  • The protection of state and local government issuers

• The Securities and Exchange Commission ("SEC") was given the responsibility to define what is a municipal advisor
  – A government organization that makes rules, definitions and enforces securities regulations
• Due to the Dodd-Frank Act, a financial advisor has 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 (“MA”)

• Underwriters are not subject to a fiduciary duty

• The roles of an underwriter and financial advisor are definitive, separate roles
• 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 even without the existence of a written agreement

• Rule G-17 promulgates fair dealing requirements

• The MSRB set forth new guidance Rule G-17 for underwriters which contains the following requirements or prohibitions:
  – Underwriters must tell local and state governments they are not fiduciaries
  – Underwriters are prohibited from telling issuers not to hire a financial advisor
  – Also, an underwriter must disclose their primary role is to purchase securities with a view to distribute in an arm’s length transaction
  – Underwriters must provide detailed written disclosures about the transactions they recommend to issuers

• Draft Rule G-42 on Municipal Advisors Duty of Loyalty and Duty of Care is in its comment period
MUNICIPAL ADVISOR DEFINITION TIMELINE

• July 21, 2010 – Dodd-Frank Act Signed
  – Amended Section 15B of the Securities Exchange Act of 1934
  – Includes Section 975 – Regulation of Municipal Securities

• October 1, 2010 – Temporary Rules
  – Required “Municipal Advisors” to register with SEC & MSRB
  – About 1,150 municipal advisors registered

• December 20, 2010 – SEC Proposed Rules with Concerns
  – Treatment of appointed board members of municipal entities
  – Investments of all municipal funds (versus bond proceeds)
  – Impact on traditional banking activities
  – Lack of guidance on what is “advice”

• September 18, 2013 – Final Rules Adopted
  – Rules effective January 13, 2014

• **July 1, 2014** – Effective Date
• Underwriters may provide advice on the structure, timing, terms, and similar matters concerning a transaction under the “underwriter exemption”
  – Only during the period of time beginning when they are engaged for a particular transaction and ending at the end of the underwriting period

• Outside of a specific engagement, underwriters may also provide further advice
  – When the government has hired an independent MA for the specific transaction
  – “RFP” exemption applies
  – Underwriters may also provide many other types of information to municipal entities (including general market information and information about their qualifications) that does not rise to the level of advice without acting as a municipal advisor
• The SEC recently provided an FAQ which clarified some of the provisions of the underwriter exemption for providing advice
• Underwriters, for example, can provide debt refunding advice which must be based on the existing debt structure with the same final maturity of the debt to be refunded to avoid violating the general advice exception

• Also, underwriters can provide information regarding a range of hypothetical interest rates or debt service requirements for a new money debt with various maturities (e.g., a level debt service payment schedule for a fixed rate debt with a 20-year or 30-year maturity

• The SEC FAQ can found at the following link: http://www.sec.gov/info/municipal/mun-advisors-faqs.shtml
• Advice that is not specific to a particular issue of municipal securities for which a firm is serving as underwriter
• Advice on method of sale
• Advice on whether a governing body of an issuer should approve or authorize an issue of municipal securities
• Advice on a bond election campaign
• Preparation of financial feasibility analyses with respect to new projects
• Budget planning and analyses and budget implementation issues with respect to debt issuance and collateral budgetary impacts
• Advice on an overall rating strategy that is not related to a particular issue of municipal securities for which a firm is serving as an underwriter
• Advice regarding the terms of RFPs or RFQs for underwriters or other professionals
• Advice with respect to the investment of bond proceeds

• Other items not exempt as well as additional information on the MA definition can be found in the GFOA’s Issue Brief at the following link: http://gfoa.org/downloads/GFOAmarulebriefoct8FINAL.pdf
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.

The information set forth herein was gathered from sources which we believe, but do not guarantee, to be accurate. Neither the information, nor any options expressed, constitute a solicitation by us for purposes of sale or purchase of any securities or commodities. Investment/financing decisions by market participants should not be based on this information.

You should consider certain economic risks (and other legal, tax, and accounting consequences) prior to entering into any type of transaction with PMA Securities, Inc. or PMA Financial Network, Inc. It is imperative that any prospective client perform its own research and due diligence, independent of us or our affiliates, to determine suitability of the proposed transaction with respect to the aforementioned potential economic risks and legal, tax, and accounting consequences. Our analyses are not and do not purport to be appraisals of the assets, or business of a District or any other entity. PMA makes no representations as to the actual value which may be received in connection with a transaction nor the legal, tax, or accounting effects of consummating a transaction. PMA cannot be relied upon to provide legal, tax, or accounting advice. You should seek out independent and qualified legal, tax, and accounting advice from outside sources. This information has been prepared for informational and educational purposes and does not constitute a solicitation to purchase or sell securities, which may be done only after client suitability is reviewed and determined.

Securities, public finance and institutional brokerage services are offered through PMA Securities, Inc. PMA Securities, Inc. is a broker-dealer and municipal advisor registered with the SEC and MSRB, and is a member of FINRA and SIPC. Prudent Man Advisors, Inc., an SEC registered investment adviser, provides investment advisory services to local government investment pools and separately managed accounts. All other products and services are provided by PMA Financial Network, Inc. PMA Financial Network, Inc., PMA Securities, Inc. and Prudent Man Advisors (collectively “PMA”) are under common ownership. Securities and public finance services offered through PMA Securities, Inc. are available in CA, CO, FL, GA, IL, IN, IA, KS, MI, MN, MO, NE, OH, OK, PA, SD, TX and WI. This document is not an offer of services available in any state other than those listed above, has been prepared for informational and educational purposes only and does not constitute a solicitation to purchase or sell securities, which may be done only after client suitability is reviewed and determined. All investments mentioned herein may have varying levels of risk, and may not be suitable for every investor. For more information, please visit us at www.pmanetwork.com.

© 2014 PMA Securities, Inc. For institutional use only.
Appendix
“Municipal Advisor” Definition – Rule 15Ba1-1(d)

- Provide Advice OR Solicitation
  - To a Municipal Entity OR Obligated Person
  - RE: Muni Securities Issue OR Muni Financial Products

- Includes Advice Regarding Structure, Timing, Terms, or Other Similar Matters
• “Municipal Entity” Definition – Rule 15Ba1-1(g)
  – State and political subdivisions
  – Agencies, authorities and instrumentalities
  – Plan, program, or pool of assets sponsored or established by State or political subdivision
  – Any other issuer of municipal securities
• Exclusions and exemptions from MA definition

• Public Officials, Boards, Committees, employees of a municipal entity or obligated person (conduits) while acting within the scope of their official capacities

• Registered Investment Advisors providing investment advice

• Registered Commodity Trading Advisors providing advice related to swaps

• Banks providing investment and credit advice

• Accountants providing audit opinion or other services (e.g. preparation of financial statements, issuance of letters for underwriters)

• Engineers providing services related to certain feasibility studies, cash flow modeling, and projections (e.g., output capacity, utility project rates, project demand or revenues)

• Attorneys providing services of traditional legal nature