



SPEER FINANCIAL, INC.

JULY 2011 NEWSLETTER

INDEPENDENT PUBLIC FINANCE CONSULTANTS SINCE 1954

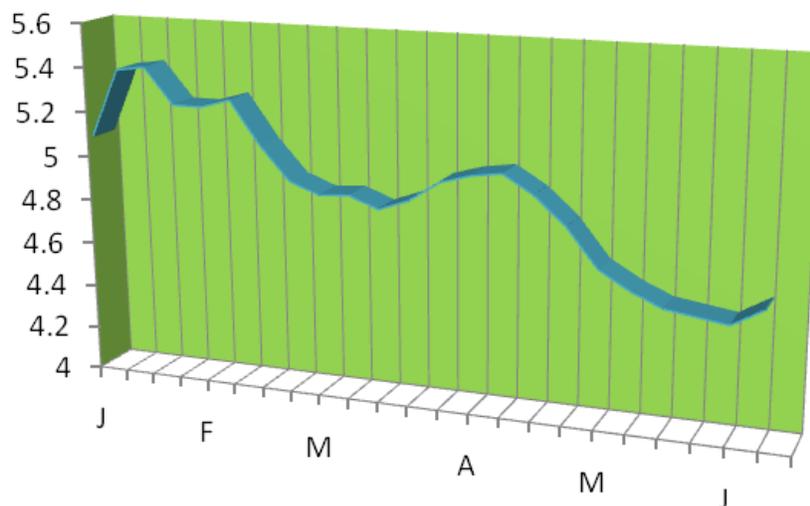
The Market

The Bond Buyer Index for General Obligation Bonds (defined as the average tax-exempt market value, expressed in terms of yield, on general obligation bonds of twenty selected issuers with ratings averaging Aa2/AA and maturing in twenty years) is shown below. The June 30th rate is 4.59%. The comparable revenue bond rate is 5.34%. The Index is used as a market barometer.

20-Bond G.O. Index

Monthly Rate Average	Jan 5.28%	Feb 5.14 %	Mar 4.91 %	Apr 4.98 %	May 4.59 %	June 4.51%
Week 1	6...5.08%	3...5.25%	3...4.90%	7...5.04%	5...4.69%	2...4.51%
Week 2	13...5.39%	10...5.29%	10...4.91%	14...5.06%	12...4.61%	9...4.49%
Week 3	21...5.41%	17...5.10%	17...4.86%	20...4.98%	19...4.55%	16...4.49%
Week 4	27...5.25%	24...4.95%	24...4.91%	28...4.86%	26...4.53%	23...4.46%
Week 5			31...5.00%			30...4.59%

20 G.O. Bond Buyer Index – 2011 Weekly Average



Regulation of Financial Advisors - Implementation of Dodd-Frank Act

The basic premise is that financial advisors in the municipal bond market are unregistered and an unregulated, untaxed area offends some. This is not to say that there are not problems, although the biggest scandals have all involved regulated persons acting as advisors (often a banker acting with an underwriting or counterparty role in the same transaction).

Some aspects about regulation that are certain:

1. The Municipal Securities Rulemaking Board (MSRB) is in charge, with oversight by the Securities and Exchange Commission.
2. All advisory firms must register.
3. Fees are assessed annually to support regulation. Currently very low.
4. The rules are to apply to all advisory personnel and any persons associated with the firms.
5. Rule G-17 applies to all underwriters and financial advisors. It will likely be the basis for many disciplinary procedures.

“In the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.”

The MSRB comments note that Rule G-17 applies even in the absence of fraud. In particular, failure to disclose material information is highlighted. In light of various court and regulatory actions about lack of disclosure on pensions and other post employment benefits obligations (OPEB), it can be expected that advisors just like bankers will get more detailed in discussing disclosure with clients (due diligence).

Ancillary to these rules is the increase in recordkeeping. In an era where “paperless is better” is the watchword, Speer Financial is now having to make a record of all client contacts and keep files of all work product. Financial advisors are to be audited, and need to have ready records. As someone who never paid attention to the amount of time spent answering questions or helping a client, this is a new world. It seems necessary to justify to an outsider that our clients are correct in believing that we provided services and that those services were beneficial.

Other aspects of regulations that are proposed include the following:

1. Transaction fees. The MSRB has proposed that a fee be paid by the advisor to the MSRB on every transaction. Ultimately this is an additional cost of issuance to the governmental issuer. Such charges are already paid by underwriters, who build this regulatory cost into their fees.
2. Pay to play rules. Such a rule (Rule G-37) already applies to some extent to bankers and underwriters. Campaign contributions to persons running for office are limited to persons for which the banker can vote and this amount is capped. The same rule essentially is to apply to advisors and is enlarged to apply to referenda campaigns. This is a new area and one which will surprise many municipal officials in the next election cycle. Apparently only attorneys, especially bond counsel, and engineers will be able to contribute.

3. Related to this is the Rule G-20 gift ban. This rule would be expanded from just underwriters to financial advisors and prohibits gifts and gratuities of more than \$100 annually “in relation to” advisor activities. However, there are exceptions for “occasional” gifts, such as meals and tickets to entertainment. The national advisor group is seeking to get this tightened up to have strict limits of no single gift worth more than \$100 and an annual cap of \$250, which is the same limit on certain campaign contributions. The debate revolves around the term “occasional” for gifts and whether anyone actually enforces a strict interpretation. Additional areas of discussion include contributions and gifts by family members and gifts to charities that were solicited by municipal officials.
4. Fees. As anything dealing with money, this is one of the most contentious. The proposed rule and commentary about fair dealing calls for disclosure of advisory fees, although underwriting fees are not required to be disclosed, except in certain areas. As a firm which works under written contracts with clients, this seems odd but apparently many issuers do not get information from their service providers. Additionally some proposals suggest that fees should be on a hourly basis – which is extremely unusual for bond issues. Just as underwriters, bond counsel, and many municipal attorneys charge on a transaction size basis, most financial advisors do as well.

At a minimum, it appears that a form will need to be signed by the issuer in each transaction acknowledging that they have to pay for advisory services and that they understand the contingent nature of fees; it is fairly common that if an issue fails to proceed, most parties do not get paid.

All of this is related to the concept of conflict of interest. The idea is that unscrupulous advisors are convincing issuers to sell unneeded and unwanted bonds. This is certainly not our experience, as we are seldom asked if a project should occur, just about the best financing options.

Regulation. Smegulation G-23. Bingo!

As noted in the prior article, the MSRB has been assigned the task of regulating the financial markets. It has initiated steps to now regulate municipal advisors, initially as firms but eventually with certification of individuals. Firms like Speer Financial, Inc., as a member of the National Association of Independent Public Financial Advisors (NAIPFA) have had our professional staff tested and certified by NAIPFA for almost 20 years.

On February 9, 2011, the MSRB filed a proposed amendment to Rule G-23 addressing concerns of real or perceived conflicts of interest. Effective November 27, 2011, this will now disallow a broker dealer from serving in both advisor and underwriter roles in the same transaction. The municipal advisor has a fiduciary responsibility (trust and confidence) to the issuer while the underwriter has some common interests (buying what you want to sell) but also some competing objectives (pricing and terms attractive to its purchasing clients). This amendment was adopted by the Securities and Exchange Commission (SEC) on May 31st.

By disallowing the same firm the ability to serve the issuer in two adversarial roles (advisor and underwriter), the MSRB is clearly seeking to protect issuers from costly mistakes in structuring and pricing that may benefit investors to the detriment of the issuer that does not know what they do not know. Municipal advisors have an obligation to put their clients (issuers) interest ahead of their own. Broker-dealers serving solely as underwriters are exempt from Rule G-23 as they make no claims of meeting the fiduciary standard and putting issuer interests ahead of their own. Broker-dealers must disclose that their relationship to the issuer is an arm’s-length relationship and that its interests differ from those of the issuer. Previously, a dealer acting as a financial advisor could act as a marketing agent with written disclosure of the conflict of interest along with their compensation coupled with the issuer’s written acknowledgment and consent.

The Market Continues to Evolve

Credit Enhancement

Insurance, which was an inexpensive way to add a AAA/Aaa rating to an investment grade issue, has fallen into hard times. Of the six former AAA/Aaa insurers, none exist today as AAA/Aaa insurers and only one of the six is even AA/Aa grade. In 2007 40% of our Official Statement (OS) issuers were insured (either with or without an underlying rating). Through December of 2010, this has fallen to 7%. Conversely, in 2007, 34% of our OS issuers were rated without insurance while in 2010 this rose to 85%.

This reliance on the credit strength of the issuer versus the credit strength of the insurer is probably an irreversible trend. Certainly cheap insurance is not expected to rebound any time soon.

Technology

Bidding through the 1980's was primarily conducted by runners from banks hand delivering a bid to our office and waiting for the results of the opening of the envelopes. In 2010, 93% of our competitive OS sales were bid in a 15 minute bidding window utilizing our auction site (www.SpeerAuction.com). Sixty seven percent of those electronic auctions were bid as closed (blind) auctions and 33% as open (rank known) auctions which permits a bidder to try to improve their bid knowing their rank, but not knowing by how much they lead or trail. About 20% of open auctions result in bid improvements that create savings for the issuer.

Number of Banks Bidding

Community banks are getting purchased by bigger banks, and becoming branches, while weakened banks who were heavily leveraged with real estate loans are being acquired as well by banks with more resources. Even fairly large commercial or investment banks are being acquired by even bigger banks thereby reducing the numbers of bidders. Unfortunately many of the acquiring banks are not as "community" focused and while they seek the deposits of local governments, may not be a bidder on small and short bonds being issued, let alone larger and longer issues.

While selected issues still may see six or more bidders, there are generally fewer bidders.



WE HAVE GONE GREEN

Visit our website www.speerfinancial.com for newsletters, training seminars, and to join our email list.

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