

SPEER FINANCIAL, INC.

CLIENT UPDATE- THE UPCOMING MUNICIPAL ADVISOR RULES AND THE EXPECTED EFFECT ON MUNICIPAL ISSUERS JUNE 2014

Introduction

The upcoming Municipal Advisor (“MA”) Rules define who is a municipal advisor and when an advisor is engaging in municipal advisory activities which give rise to a fiduciary duty to the municipal issuer. These rules will affect municipal issuers on future bond issuances as their service providers, specifically MAs and Underwriters, adapt to providing their traditional services within the construct of the MA Rules.

This write-up seeks to provide a summary on how the rules may affect the interaction between the municipal issuer and its Municipal Advisor and Underwriter. This document does not represent to be a complete summary of the MA Rules in their entirety. You can obtain a complete copy of the final rule issued by the Securities and Exchange Commission (“SEC”) by going to <http://www.sec.gov/rules/final/2013/34-70462.pdf>. You can review the Municipal Securities Rulemaking Board’s (“MSRB”) proposed rules by going to <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules.aspx>.

Background on the MA Rules

On September 18, 2013, the SEC approved the final MA definition and registration rule (the “SEC MA Rule”), as authorized under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). The SEC MA Rule will become effective on July 1, 2014. The Act also directed the MSRB to adopt rules regarding MAs.

The SEC and the MSRB regulate the conduct of municipal advisors. Under the SEC MA Rule, a Municipal Advisor must register with the SEC and the MSRB and is subject to SEC disciplinary action similar to a municipal securities dealer. The SEC MA Rule establishes a definition of an MA and imposes new record keeping and registration requirements. The MSRB will finalize a number of other regulations, such as MA qualifications and conduct standards.

The Fiduciary Duty and Standards of Conduct for MAs

As part of the MA Rules, an MA is deemed to have a fiduciary duty to any municipal entity for whom it acts as MA. This fiduciary duty requires the MA to act in the best interests of its municipal entity client and to put the client’s interest ahead of its own. The MSRB defines the fiduciary duty as including a duty of care and duty of loyalty.

Separate from its fiduciary duty, the MA is also subject to a detailed code of conduct to all of its municipal entity clients, as defined by the MSRB.

Established 1954

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GFOA Best Practices

The Government Financing Officers Association (GFOA) has revised their Best Practices in the wake of the upcoming MA Rules. As stated in the Best Practice titled “Selecting and Managing the Engagement of Municipal Advisors (2008 and 2014), the GFOA recommends that Issuers “hire a municipal advisor prior to the undertaking of a debt financing unless the issuer has sufficient in-house expertise and access to current bond market information. The GFOA defines in-house expertise as, a dedicated debt management staff whose responsibilities include daily management of a debt portfolio¹.

The President of the GFOA, addressing the MA Rule, said “the spirit and letter of the rule is in line with the GFOA’s Best Practices that will help to ensure that our citizens receive the best deal possible for the financing of essential infrastructure that our taxpayers depend on and deserve”.

The GFOA Best Practice regarding the selection and management of municipal advisors can be found here: <http://www.gfoa.org/selecting-and-managing-municipal-advisors>

Who is a Municipal Advisor?

An MA is any person who solicits and/or provides advice to, or on behalf of, a municipal entity or obligated person regarding a municipal financial product or an issuance of municipal securities.

Three key elements of the MA Definition are:

- 1) **Advice** – The MA Rules provide that a recommendation with respect to the structure, timing, terms or similar matters concerning a municipal financial product or an issuance of municipal securities will constitute “advice.” The SEC has stated that “advice” is not susceptible to a bright-line definition; depends on all relevant facts and circumstances, and can be construed broadly. “Advice” includes a recommendation that is *particularized* to the specific needs, objectives, or circumstances of a municipal entity or obligated person and is information that is *individually tailored* to a particular municipal entity, obligated person or target group of municipal entities.

General information regarding professional qualifications, experience, market information, factual descriptions or comparisons, and information presented in an effort to win business (subject to certain restrictions) is not considered advice.

- 2) **Municipal Entity and Obligated Person** – A Municipal Entity includes any State, political subdivision of a State, or municipal corporate instrumentality of a State or of a political subdivision of a State. An Obligated Person is any person, including the issuer of municipal securities, who is generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in any offering.
- 3) **Subject Matter of Advice** – Advice given to a municipal entity or obligated person constitutes municipal advisory activity if it covers the following subjects:
 - The issuance of municipal securities: including advice with respect to structure, timing and terms of municipal securities, and other similar matters; and
 - Municipal financial products: including advice with respect to structure, timing and terms of municipal financial products, and other similar items.

¹ Government Finance Officers Association, Best Practice: “Selecting and Managing the Method of Sale of State and Local Government Bonds (1994, 2007 and 2014)”.



Speer Financial, Inc. is an Independent Registered Municipal Advisor (IRMA) and has operated solely in this capacity since our founding in 1954.

The Role of an IRMA

Below is a summary of a few of the roles and expected MSRB duties of an IRMA:

Fiduciary Duty – Once engaged, the IRMA has a duty to put the interests of its municipal entity client ahead of its own. This means all recommendations and advice received from an IRMA must take into account the IRMA's Duty of Care and Duty of Loyalty to the client. The recommendation or advice must be in the best interest of the client, taking into account all other alternatives.

Determining a Method of Sale – Under most circumstances, the IRMA should recommend a method of sale to the municipal issuer client that best serves its needs and will accomplish the lowest borrowing costs. This recommendation should take into account the market conditions at the time of sale, size and security of the transaction and the anticipated credit rating.

Assisting an Issuer in a Competitive Sale – If a competitive sale method is chosen for an issuance of municipal securities, the IRMA can assist the issuer by coordinating the sale process.

Advice on Security, Terms, Structure and Other Items – An IMRA will generally work with its municipal client to decide on a type of security and the specific terms and structure of a transaction that will best fit the client's needs. The recommendation given by the IRMA must be suitable to its client. Suitability, as defined by the MSRB, should take into account certain factors, including:

- General experience of the client with municipal securities and municipal financial products, and the client's specific experience with the type and complexity being recommended.
- Financial situation, needs and objectives of the client.
- Risk tolerance, liquidity needs and financial capacity of the client to withstand changes to market conditions during the term of a proposed transaction.

Assisting with RFPs/RFQs and Reviewing Responses – The IRMA can assist its client in the preparation, review and recommendation of RFPs and RFQs for other service providers, such as underwriters, on a transaction.

Advice on a Rating Strategy – The municipal issuer and its IMRA can have an open dialog regarding its investment rating strategy. This strategy does not necessarily have to be tied to a specific series of bonds.

While the full role of an IRMA encompasses more than the items listed above, these items highlight several of the roles and duties of an IMRA and how the engagement of an IMRA can benefit a municipal issuer.

Firms Seeking Appointment as Underwriter must be Exempt from the MA Definition.

A firm seeking to provide underwriting services to a municipal issuer is seeking to engage in an arm's length commercial transaction with that issuer. A firm acting as underwriter cannot also act as municipal advisor on the same issuance of municipal securities. While, according to MSRB Rule G-17, the underwriting firm has a duty of fair dealing with both the investor and municipal issuer, the addition of a fiduciary relationship with the issuer would create a serious conflict of interest. **Therefore, underwriters will need to rely on certain exemptions from the MA Definition in order to provide more than just general information to a municipal issuer.**



Exemptions from the MA Definition.

In a typical negotiated transaction, an underwriter will need to rely on an exemption from the definition of a MA. Therefore, underwriters will need to provide their services to an issuer on the basis of three exclusions from the MA definition:

- 1) An exclusion for dealers acting within the scope of underwriting activities.
- 2) An exclusion for advice provided in response to a request for proposal.
- 3) An exclusion for advice given to issuers when they have retained an independent registered municipal advisor (IRMA).

As described further below, issuers should expect the underwriter to make certain disclosures at the onset of their engagement. Underwriters may require the issuer to make a representation to the underwriter related to one or more of these exemptions.

The type of information to expect from an Underwriter when an issuer has NOT engaged an IRMA.

General Information – Information relating to general market conditions, a firm’s professional qualification and experience, factual descriptions, educational information or other related pitch materials are generally outside of the “Advise Standard” and can be sent by firms wishing to be appointed as underwriter.

New Issue and Refunding Analysis – Information provided regarding a potential new issue or refunding can be considered general information and sent by a perspective underwriter as long as only a “hypothetical range” of interest rates are provided and the refunding is “plain vanilla”. The information cannot in any way provide a recommendation that the issuer pursue the refunding.

Responses to RFPs or RFQs – A firm wishing to serve an issuer as underwriter that provides advice to an issuer as part of a response to a Request for Proposals (RFP) or Request for Qualifications (RFQ) is exempt from the MA definition. To qualify for this exemption, the RFP/RFQ must state a particular objective, be open for a specific amount of time and be a competitive process (at least three competitors). This exemption does not include preparing the RFP/RFQ or evaluating any of the responses received.

Acting within the Scope of Underwriting Activities – A firm that has been engaged by a municipal issuer as underwriter on an issuance of municipal securities is exempt from the MA definition to the extent that that firm is acting within the scope of the underwriting. This exemption only covers advice regarding what the SEC deems to be traditional underwriting activities and is limited in its duration and scope. The “Underwriter Exclusion” begins once the underwriter is engaged and terminates at the end of the underwriting period (generally considered the bond closing).

The Underwriter Exclusion Includes:	The Underwriter Exclusion Does Not Include*:
<ul style="list-style-type: none"> • Advice regarding the structuring, timing, terms and other similar matters concerning a specific issue. • Preparation of rating strategies and presentations related to the issue being underwritten. • Preparation and assistance with investor discussions related to the bond issue. • Advice on retail order periods and institutional marketing strategies (as applicable). • Assistance in the preparation of an Official Statement. • Assistance in the closing of a bond issue. • Coordination regarding CUSIP numbers and the registration of the deal with DTC. • Preparation of post-sale reports for the issue. • Structuring of refunding escrow cash flow requirements, but not the recommendation of, and brokerage of, particular escrow investments. 	<ul style="list-style-type: none"> • Advice on method of sale (competitive vs. negotiated) • Advice on whether a governing body should approve or authorize an issue. • Analysis regarding overall financing objectives, debt capacity or debt portfolio impacts that are not related to a specific issue for which the firm was hired on. • Advice regarding the terms of RFPs or RFQs and advice regarding the review of responses to such requests. • Assisting issuers with competitive sales. • Preparation of financial feasibility analysis. • Budget planning and analysis. • Advice on overall rating strategy that is not related to a particular issue for which the firm was hired on. • Advice on overall financial controls that are not related to a specific issue for which the firm was hired on.

*Does not show all activities deemed outside the scope of the Underwriter Exclusion by the SEC.



The type of information to expect from an Underwriter when an issuer has engaged an IRMA.

The MA Rules exempt almost all advice or recommendations given to any covered municipal entity that is represented by an IRMA. Therefore, the IRMA exemption allows the underwriter to provide generally the same services it would have historically provided on a transaction, as long as the municipal issuer client is represented by an IRMA.

To qualify for this exemption, the underwriter relying on the exemption and the IRMA must be providing advice with respect to the same municipal financial product or municipal securities issuance for which the municipal issuer engaged its IRMA. The IRMA cannot have been associated with the underwriting firm relying on the exemption for the last two years and the underwriter must receive representations in writing from the issuer that it is represented by an IRMA and will rely on the advice of its IRMA.

Additional Resources

For complete information regarding the MA Rules, please see the references below:

The Securities and Exchange Commission: <http://www.sec.gov/rules/final/2013/34-70462.pdf>

The Municipal Securities Rule Making Board: <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules.aspx>

The Government Finance Officers Association: http://www.gfoa.org/index.php?option=com_content&task=view&id=122&Itemid=135

The GFOA Brief: SEC Municipal Advisor Rule: <http://www.gfoa.org/gfoa-issue-brief-sec-municipal-advisor-rule>

