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Understanding the Role of the Municipal Advisor

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Katie Kramer

Vice President
Council of Development Finance Agencies
Columbus, OH

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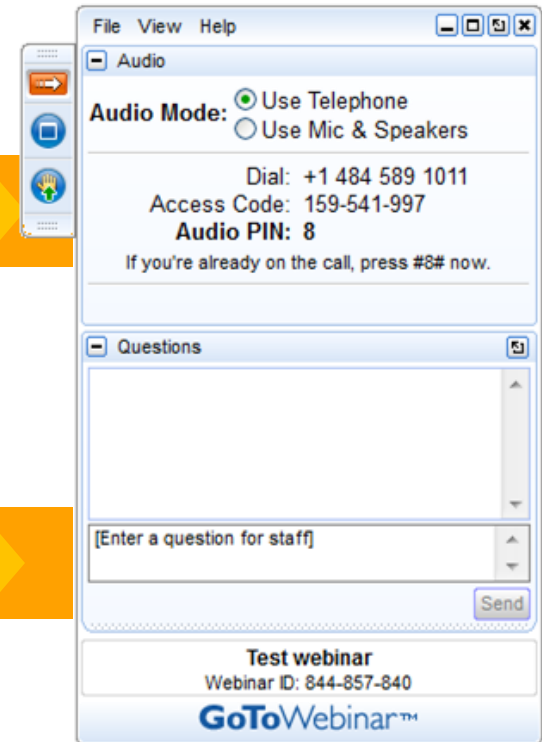


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Understanding the Role of Municipal Advisors



David Safer

Vice President
BNY Mellon
New York, NY

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Understanding the Role of Municipal Advisors

Panelists

David Safer, *Moderator*

Vice President

BNY Mellon

John McNally

Partner

Hawkins, Delafield & Wood LLP

Lynnette Kelly

Executive Director

Municipal Securities Rulemaking Board

Leo Karwejna

Chief Compliance Officer

Public Financial Management

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Understanding the Role of Municipal Advisors



John McNally

Partner
Hawkins, Delafield & Wood LLP
Washington, DC

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Council of Development Finance Agencies

Municipal Advisor Rules Webinar



Sources of Guidance

- Statute (Dodd-Frank Act; Oct. 1, 2010)
- Rules (Sept. 18, 2013)
 - Stayed (on Jan. 13, 2014, until July 1, 2014)
- Adopting Release (Sept. 18, 2013)
- FAQs (Jan. 10, 2014)
 - FAQs II expected before July 1, 2014)
- MSRB Rules


Statute – Definition of Municipal Advisor

Person (who is not a municipal entity or an employee of a municipal entity) that

- Provides Advice
 - To or on behalf of a municipal entity or obligated person
 - With respect to **municipal financial products** or the issuance of municipal securities
- Undertakes a **solicitation** of a municipal entity (or an obligated person)

Statute – Key Definitions

- “Municipal financial products” means municipal derivatives, guaranteed investment contracts, and investment strategies
- “investment strategies” defined to include “plans or programs for the investment of the proceeds of municipal securities”
- “obligated person” has same definition as used in Rule 15c2-12 (committed by contract or other arrangement to support debt service on municipal securities)



What are implications of being a Municipal Advisor?

- Required to register with the SEC and the MSRB
- Statutory Fiduciary Duty
- Subject to MSRB rules (e.g., record-keeping, professional qualifications)



Statute - Exclusions

- Underwriter
- Investment adviser registered as such with the SEC
- Attorneys “offering legal advice or providing services that are of a traditional legal nature”
- Engineers providing engineering advice



Underwriter Exclusion

- Broker-dealer seeking to rely on exclusion must have “a relationship to a particular transaction” (Release)
- Such relationship can be established by “a contractual engagement . . . on a specific planned transaction” (Release)



Underwriter Exclusion

- Engagement to serve “as underwriter for some period of time” or “as a member of an underwriting pool” would not meet exclusion (Release)
- Release provides numerous examples of activities both within (e.g., preparation of rating strategies relating to the particular bond issuance) and without the underwriter exclusion (advice on investment strategies)



Underwriter Exclusion

- FAQs (1) provide guidance regarding elements of an engagement letter and (2) note that in the alternative, a telephone call or an email from a duly authorized official of the issuer will suffice, if the broker-dealer has otherwise made the disclosures required by MSRB Rule G-17 (i.e, arm's length commercial transaction, no fiduciary duty)



Rules – Key Elements

- “Advice” standard (done in the negative): “excludes . . . the provision of general information that does not involve a recommendation”
- Exemption if the issuer has an independent registered municipal advisor
- Exemption for responses to issuer requests for proposals or qualifications (RFPs/RFQs)



Advice Standard (Release)

- Not “susceptible to a bright-line definition”
- Whether or not “advice” will depend on “relevant facts and circumstances”
- The more “individually tailored . . . the more likely it will be a recommendation that constitutes advice”



Advice standard (FAQs)

- Focus is whether there is a “recommendation that constitutes advice”
- Some leeway provided for advice “that is particularized to the municipal entity or obligated person in limited respects.” Examples: (1) providing current market prices and yields on issuer’s outstanding bonds,

Advice standard (FAQs)

Cont'd

(2) business promotional materials that are factual in nature, and (3) refunding analyses “based on the assumption that the refunding bonds had the same debt structure involving substantially level annual debt service payments and the same final maturity date as the outstanding bonds”



Advice standard (FAQs)

- Useful guidance regarding appropriate disclaimers that a broker-dealer can use to avoid information being considered “a recommendation that constitutes advice”



Rules – IRMA Exemption Elements

- Providing “advice with respect to the same aspects of the municipal financial product or issuance of municipal securities”
- “independent” – municipal advisor not associated within the past two years with the person (e.g., broker-dealer) seeking to rely on exemption
 - Unclear whether non-association tested at firm level or intended to reach only individuals at firm on the account

Rules – IRMA Exemption Elements

- Municipal entity (or obligated person) provides “a representation in writing that it is represented by, and will rely on the advice of, an IRMA”
- Person (e.g., broker-dealer) seeking to rely on exemption must disclose in writing to the municipal entity that “such person is not a municipal advisor and is not subject to the [statutory] fiduciary duty”



IRMA – FAQ Guidance

- Municipal entity could provide required representations (i.e., is represented by and will rely on advice of its MA) by publicly posting on its website and clearly stating that posting is to assist in establishing the IRMA exemption



MSRB Rules

- Current Rule G-23
 - Prohibits a “financial advisor” from switching roles to serve as an underwriter on a particular transaction
- Application to Municipal Advisors
 - SEC advice in FAQs that, in effect, municipal advisors subject to same G-23 restrictions as financial advisors



MSRB Rule G-23 in MA context

- If a broker-dealer makes a “pitch” that is considered “advice” because “tailored” to a specific municipal entity (e.g., refunding analysis), such broker-dealer could not become underwriter on that same transaction



MSRB Draft Rule G-42

- “Cornerstone” of “regulatory framework . . . establishing certain core standards of conduct and duties of municipal advisors”
- Relates to “advice” component of MA definition, not the “solicitation” component (coming at later date)



MSRB Draft Rule G-42

- Would prohibit MA from engaging in “any transaction in a principal capacity” for which municipal entity or obligated person client is a counterparty
- Exception for those activities expressly permitted by MSRB Rule G-23



MSRB Draft Rule G-42

- As default option, would require MA to “undertake a thorough review of the official statement” unless issuer advises otherwise
- MSRB requesting comment on whether fiduciary duty should extend to obligated persons



MSRB Draft Rule G-42

- For municipal entity client, MA would have “fiduciary duty that includes a duty of loyalty and duty of care”
- For obligated person client, MA would have duty of care
- Comments requested by March 10, 2014

The End



Understanding the Role of Municipal Advisors



Lynnette Kelly

Executive Director
Municipal Securities Rulemaking Board
Alexandria, VA

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MSRB Regulatory Update Municipal Advisor Regulation

Lynnette Kelly, Executive Director

*CDFA Webinar:
Understanding the Role of
Municipal and Financial Advisors*
February 18, 2014



Advancing Municipal Advisor Regulation



- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 charged MSRB with developing regulatory framework for municipal advisors to:
 - Protect state and local governments and other municipal entities that engage the services of a municipal advisor
 - Promote a fair and efficient market
 - Preserve municipal market integrity

Advancing Municipal Advisor Regulation

- In September 2013, the SEC promulgated a final registration rule (SEC Final Rule) which among other things:
 - Defined the categories of persons deemed municipal advisors
 - Established a permanent registration regime
 - Established broad recordkeeping requirements for municipal advisors
 - Provided that the examination of municipal advisory firms would be conducted by SEC and FINRA
- Effective on July 1, 2014

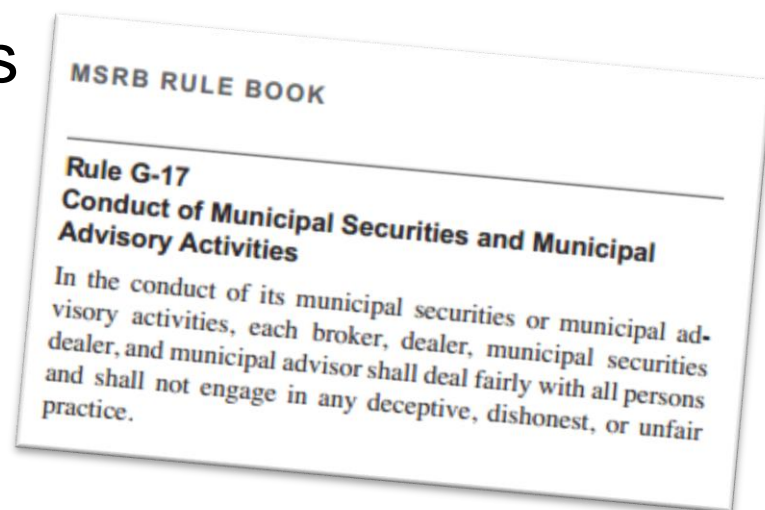
Registering as a Municipal Advisor



- Issuers can verify a municipal advisor's registration on the MSRB's website at msrb.org/msrb1/pqweb/MARegistrants.asp
 - Unregistered municipal advisors are in violation of federal law

Dealing Fairly

- MSRB Rule G-17 currently applies to municipal advisors as well as municipal securities dealers
- Must deal fairly with all persons
- Must not engage in any deceptive, dishonest or unfair practice



Regulatory Framework



- MSRB is developing a comprehensive regulatory framework that includes:
 - Development of rules governing the professional conduct of municipal advisors
 - Establishment of a professional qualifications program that ensures municipal advisors are qualified in their duties
 - Extensive education and outreach to municipal advisors on duties and obligations

Regulatory Framework

- The MSRB has prioritized the development of municipal advisor rules and expects to publish draft rules covering the following areas:
 - Standards of conduct (January 2014)
 - Supervision
 - Gifts and Gratuities
 - Political Contributions
 - Duties of Solicitors
- Also focused developing professional qualifications program for municipal advisors

Core Standards of Conduct Rule




- First MSRB draft rule G-42 for municipal advisors focuses on core standards of conduct for municipal advisors
 - Seeks to balance broad principles with prescriptive requirements
 - Offers necessary flexibility for diverse municipal advisory industry
 - Facilitates understanding and compliance
 - Incorporates MSRB's preliminary economic analysis of the benefits, burdens and potential alternatives

Request for Comment



- MSRB invites public input through extended 60-day comment period
 - Published January 9, 2014
 - Comment period ends March 10, 2014

**2014-01**

Publication Date
January 9, 2014

Stakeholders
Municipal Advisors,
Issuers, General
Public

Notice Type
Request for
Comment

Comment Deadline
March 10, 2014

Category
Fair Practice

Affected Rules
[Rule G-8](#); [Rule G-9](#)

Regulatory Notice

Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors

Overview

The Municipal Securities Rulemaking Board ("MSRB") is seeking comment on draft Rule G-42 on standards of conduct and duties of municipal advisors when engaging in municipal advisory activities other than the undertaking of solicitations. The MSRB is also seeking comment on associated draft amendments to Rules G-8, on books and records, and G-9, on the preservation of records.

Comments should be submitted no later than March 10, 2014, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here](#). Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314. All comments will be available for public inspection on the MSRB's website.¹

Questions about this notice should be directed to Michael L. Post, Deputy General Counsel, or Kathleen Miles, Associate General Counsel, at 703-797-6600.

Background

In the aftermath of the financial crisis of 2008, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").² Congress, among other things, amended Section 15B of the Securities Exchange Act of 1934 ("Exchange Act") to provide for the

¹ Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

² Pub. Law No. 111-203, 124 Stat. 1376 (2010).

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Submitting Comment Letters

- Public comment period ends March 10, 2014
- Submit comments electronically or by mail
- All comment letters received are published on the MSRB website

Request for Comment on Draft MSRB

Rule G-42, on Duties of Municipal Advisors

Overview

The Municipal Securities Rulemaking Board ("MSRB") is seeking comment on draft Rule G-42 on standards of conduct and when engaging in municipal advisory activities solicitations. The MSRB is also seeking comment on proposed amendments to Rules G-8, on books and records, and on the preservation of records.

Comments should be submitted no later than March 10, 2014, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here.](#) Comments submitted in paper form should

Requests for Comment

The MSRB requests comment from municipal market participants and the general public about rulemaking proposals. Current and past requests for comment are listed below.



All ▼ Most Recent ▼				
Full Title	Comment	Publication Date	Notice Number	Comment Due by
Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors	Submit View	1/09/2014	2014-01	3/10/2014

Scope of Draft Rule G-42

- Duties and responsibilities of a municipal advisor engaging in municipal advisory activities
 - Standards of conduct
 - Disclosure of conflicts of interest
 - Documentation of the relationship
 - Recommendations
 - Principal transactions
 - Prohibitions related to compensation, fees and the retention of business
- Duties created by the draft rule are in addition to fiduciary duties under state or other laws
- Duties of solicitors will be addressed in a separate rule

Duty of Care



- Principle of duty of care in proposed MSRB Rule G-42 applies to municipal advisors' conduct with all clients
- Would require a municipal advisor to, among other things:
 - Disclose conflicts of interest
 - Document the relationship with the client in writing
 - Make suitable recommendations

Duty of Loyalty



- Duty of loyalty applies when advising a state or local government client
- Proposed rule requires a municipal advisor to act with utmost good faith and in the best interests of the client
 - Provides guidance on the application of the municipal advisor's fiduciary duty to municipal entity clients
 - Request for comment asks if the fiduciary duty should be extended to municipal advisors working with obligated persons

Disclosure of Conflicts of Interest and Other Information



- At or prior to the inception of a municipal advisory relationship, provide the client with written disclosure of all material conflicts of interest
- Specified conflicts that must be disclosed include:
 - Advice, services, or products provided by an affiliate, if related to the municipal advisory activities
 - Payments to obtain or retain the client's municipal advisory business
 - Conflicts related to the form of compensation
 - Information pertaining to the scope and amount of the municipal advisor's professional liability insurance, if carried
 - Payments received from third parties to enlist the municipal advisor's recommendation of its services, any transaction or financial product
 - Fee-splitting arrangements with any provider of investments or services to the client
 - Legal or disciplinary events that are material to the client's evaluation or disclosed on the Form MA or Forms MA-I filed with the SEC

Documentation of the Relationship

- Evidence each municipal advisory relationship in writing prior to, upon or promptly after the inception of the relationship
- The documentation must include, at a minimum:
 - Form and basis of compensation
 - Reasonably expected amount of compensation, if quantifiable
 - Required disclosures, including those relating to material conflicts of interest
 - Scope of the engagement
 - Any terms relating to the termination of the relationship
 - Specific undertakings if requested by the client with respect to the preparation and finalization of the official statement, if the municipal advisory activities relate to a new issue or reoffering

Recommendations Made by the Municipal Advisor



- Must have a reasonable basis to believe its recommendation is suitable for the clients
- Must discuss with its client:
 - Its evaluation of the material risks, potential benefits, structure and other characteristics
 - The basis for its suitability determination
 - Whether it considered other reasonably feasible alternatives
 - A municipal advisor that has a duty of loyalty is required to investigate or consider other reasonably feasible alternatives
- If requested to do so and within the scope of its engagement, must thoroughly review any recommendation made by a third party

- Relevant factors for a municipal advisor's suitability analysis include the client's:
 - Financial situation and needs
 - Objectives and experience
 - Risk tolerance
 - Tax status
 - Liquidity needs
 - Financial capacity to withstand changes in market conditions
 - Any other material information known, after reasonable inquiry, by the municipal advisor

- “Know Your Client” obligation
 - Must use reasonable diligence to know and retain the essential facts about the client and the authority of each person acting on the client’s behalf
 - These facts include those required to:
 - Effectively service the municipal advisory relationship with the client
 - Act in accordance with any special directions from the client
 - Understand the authority of each person acting on behalf of the client
 - Comply with applicable laws, regulations and rules

Principal Transactions



- Proposed rule prohibits principal transactions by municipal advisors and any affiliates
 - Aims to preserve the highest standards of impartiality and the provision of unbiased advice
 - Addresses inherent conflicts of providing advice while simultaneously acting as counterparty to a transaction
 - Limited exceptions for activity permitted under existing Rule G-23
 - Asks if principal transactions should be permitted, and if so, under what circumstances

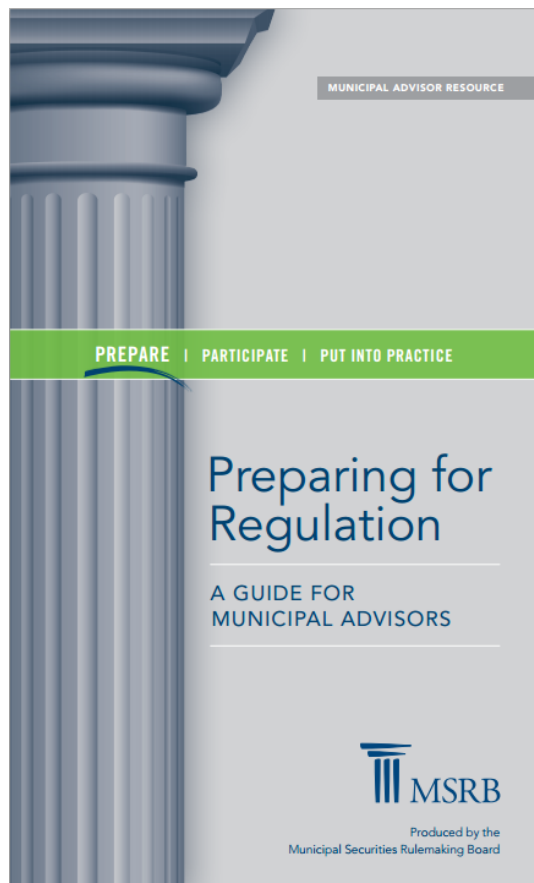
Specifically Prohibited Conduct

- Excessive Compensation
- Fees
 - Invoices that do not accurately reflect the service performed
 - Fee-splitting with underwriters or undisclosed fee-splitting with providers of investments or services
- Other Conduct
 - Materially false or misleading representations to obtain or retain municipal advisory business
 - Payments to obtain or retain municipal advisory business other than reasonable fees paid to a registered municipal advisor

Economic Analysis

- The request for comment on draft Rule G-42 and the draft amendments to Rules G-8 and G-9 incorporate the MSRB's preliminary economic analysis, including the following factors:
 - The need for the draft rule
 - Relevant baselines against which the likely economic impact of elements of the draft rule can be considered
 - Reasonable alternative regulatory approaches
 - The potential benefits and costs of the draft rule and the main alternative regulatory approaches

Resources for Municipal Advisors



- Educational resources on MSRB website at msrb.org
 - Preparing for Regulation
 - Participating in the Rulemaking Process
- Sign up for quarterly newsletter and email updates at msrb.org
- Webinars about proposed rules and other outreach events
 - msrb.org/Home/News-and-Events/Upcoming-Events.aspx

Contact the MSRB



MSRB Online

msrb.org

emma.msrb.org

MSRB Support

703-797-6668

Hours of Operation:

7:30 a.m. - 6:30 p.m. ET

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Leo Karwejna

Chief Compliance Officer
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Leo Karwejna
Managing Director,
Chief Compliance Officer



MA Responsibilities and Implications for MA Compliance

- Establishing **an effective compliance program is a necessity** to engage in MA regulated activities.
- At its core, an **effective compliance program protects all industry participants by detecting and preventing improper conduct, and by promoting adherence to the regulatory, legal, and ethical obligations.**
 - Remember: these are rules and regulations focused to protect state and local governments and municipal financial product investors.

Building blocks for MA Compliance Program

- While **there is no "one-size-fits-all" program** for every MA, there are **several basic components** that really must exist to have **an effective compliance program**, including:
 - **standards** and procedures;
 - **organizational leadership**, and a **culture** of compliance;
 - **training** and **education**; and
 - ongoing **monitoring**, and **evaluation** of the compliance program's **effectiveness**.

A Few Illustrative Basics for MA Compliance Program

- Analyzing **activities and relationships** in light of the MA definition and exemptions, the **SEC interpretive guidance**, and **MSRB rules / proposals**.
 - Are there **mismatches**?
- **Personnel**: compiling information to file **Form MA-I** and eventual individual registrations.
- **Record-keeping** requirements and implications.
- Being **prepared** for SEC or FINRA **examination**.

The Role of the MA: Regulatory Viewpoint

From an **SEC viewpoint** (excerpt from the MA Rule):

- “A **municipal entity represented** by an independent registered MA **will have the benefits associated** with the **regulation of municipal advisors.**”

SEC Rule References Incentives for Using MAs

- **Fiduciary** duty
- Reduced **borrowing and issuance costs**
- **Better financing terms**
- Improve **capital formation**
- Positive **impact on taxpayers**
- Regulatory **oversight** over standards, training and conduct

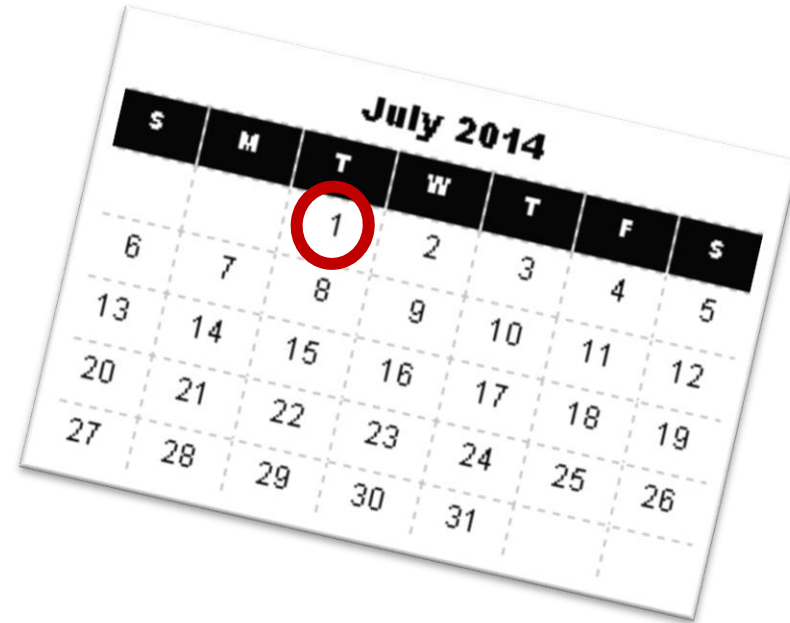
The Role of the MA: Compliance Viewpoint

From one **Compliance Officer's perspective:**

- **The environment** amongst underwriters, municipal issuers, and municipal advisors **continues to develop** in accordance with the final SEC MA regulations and MSRB rules and proposals.
- **Interpretation** of the rules, the exemptions, the corresponding standards are **ongoing by Regulators and the financial community alike**; however, putting aside the near-term (even though sometimes noisy) interpretive wrangling, an **MA must continually endeavor to focus themselves professionally within the best interests of their clients.**
- Regulatory bodies and industry participants will need to **concentrate on the clarity of transactional roles, the transparency of interests, and formality of relationships.**

The Role of the MA: Your Own Viewpoint?

- Issuer
- Regulator
- Municipal Advisor
- Municipal Securities Underwriter
- Bank / Trustee
- Attorney
- Additional Municipal Service Providers
- Municipal Investors



If there is any one secret of success, it lies in the ability to get the other person's point of view and see things from that person's angle as well as from your own.

— Henry Ford

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Tuesday, March 18 @ 1:00 pm EDT

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David Safer

Vice President

212-815-4959

david.safer@bnymellon.com

**Katie Kramer**

Vice President

614-224-1316

kkramer@cdfa.net

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