



**CDIAC**

**CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION**

# Welcome to the Pre-Conference

## MSRB Rule G-17 and Other Market Disclosures: A Pathway to Clarity or Not?

September 25, 2013

# MSRB Rule G-17: What Does it Mean?

Jay Goldstone, Board Chair  
*Municipal Securities Rulemaking Board*

California Debt and Investment Advisory  
Commission Pre-Conference Program

September 25, 2013



**MSRB**

Municipal Securities  
Rulemaking Board

# Presentation Overview

- About the MSRB
- MSRB Rule G-17
- Update on Financial Disclosure Resources for Issuers

# About the MSRB



- A self-regulatory organization created by Congress in 1975
- Regulates municipal securities firms, banks and municipal advisors
- Protects investors and issuers of municipal securities
- Promotes a fair and efficient municipal market

# How the MSRB Fulfills its Mission

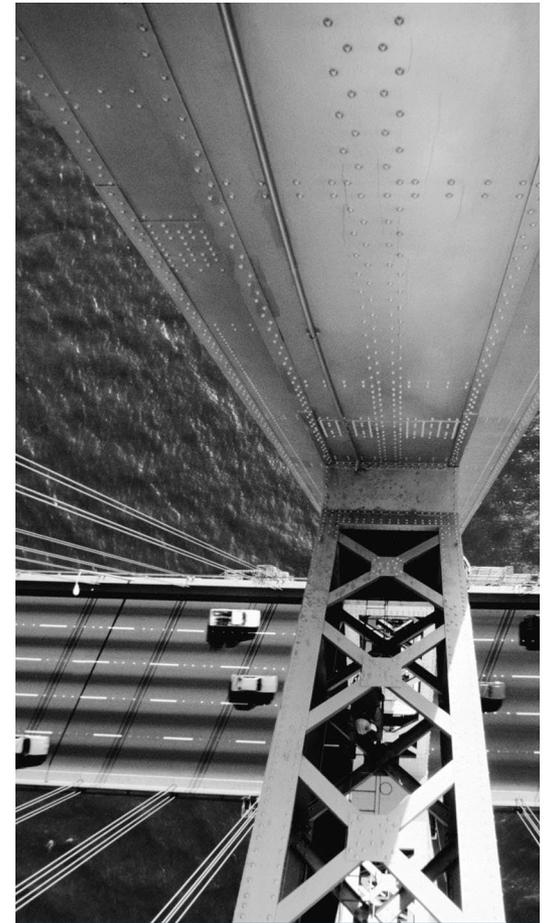
- Regulates municipal securities dealers and municipal advisors
- Operates market transparency systems including the **EMMA**® website
- Conducts education, outreach and market leadership

# Dodd-Frank and the Municipal Market



- Expanded the MSRB's mission to protect state and local governments that issue municipal bonds
- Established framework for regulation of municipal advisors by the MSRB

# MSRB Rule G-17

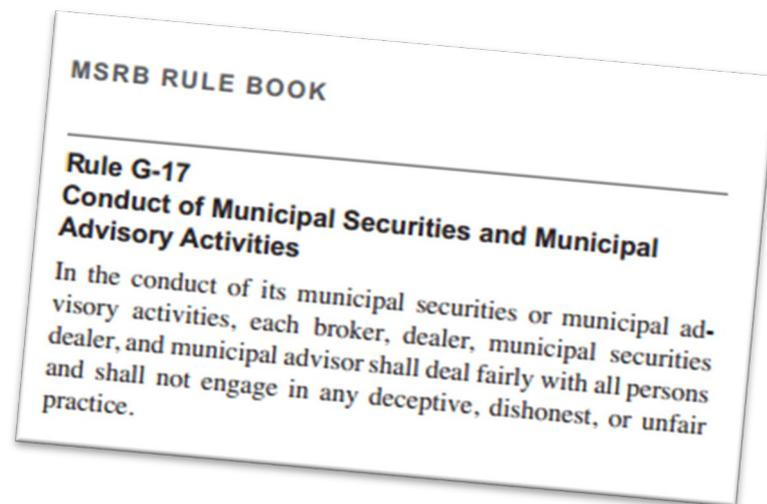


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# MSRB Rule G-17

- Outlines basic duties of fair dealing in one sentence
- Requires municipal securities dealers and municipal advisors to:
  - Deal fairly with all persons
  - Not engage in any deceptive, dishonest or unfair practice



# Obligations of Underwriters to State and Local Governments



- Interpretive notice on Rule G-17 effective August 2, 2012
- Fundamental issuer protection rule
- Goals of interpretive notice:
  - Requires an underwriter to disclose the nature of its relationship with issuers
  - Creates affirmative obligations for underwriters to engage in specific conduct
  - Requires an underwriter to disclose material information needed for issuers to assess proposed financial transactions

# Fair Practice Obligations

- Rule G-17 notice covers three main areas of fair practice obligations for underwriters:
  - Disclosures to issuers
  - Financial aspects of underwriting transactions
  - Statements and representations to issuers

- Required underwriter disclosures
  - Role
  - Real or potential conflicts of interest
  - Elements of routine and complex financings
- Manner and timing of disclosures

# Financial Aspects



- Compensation
- New issue pricing
- Profit sharing arrangements
- Payments to issuer personnel
- Retail order periods

# Statements and Representations

- All representations made in writing or orally by underwriters to issuers must:
  - Be truthful and accurate
  - Not misrepresent or omit material facts
  - Not be misleading
  - Have a reasonable basis
  - Not misrepresent knowledge or expertise
- Statements found in:
  - Requests for proposals (in negotiated underwritings), issue price certificates and materials used in official statements
- Prohibition on discouraging use of municipal advisor

# MSRB Outreach on Rule G-17 Obligations



- Educational webinar and conference calls
- Industry events
- Implementation guidance
- FAQs based on market feedback

# Underwriter Feedback

- Delivery of disclosures
- Complex versus routine financings
- Conflicts disclosures
- Conduit financings

# Issuer Feedback



- Acknowledgement of receipt of disclosures
- Volume of disclosures
- Role of syndicate manager
- Conduit issuers

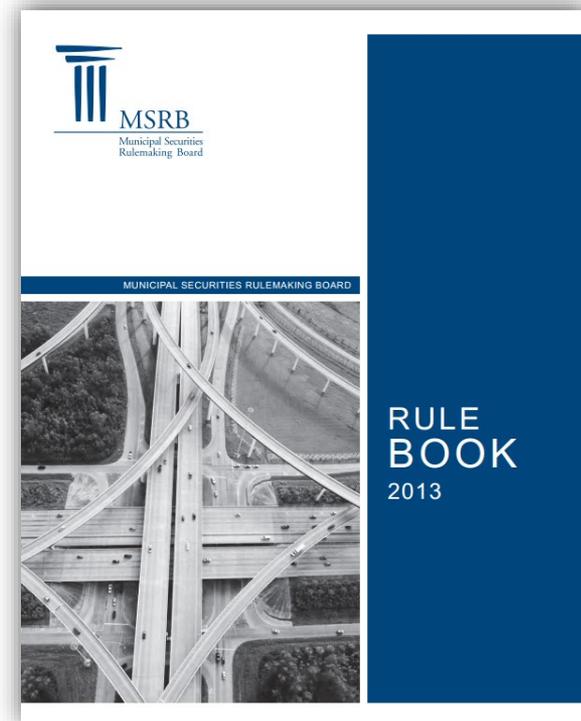
# Rule G-17 Interpretive Notice FAQs



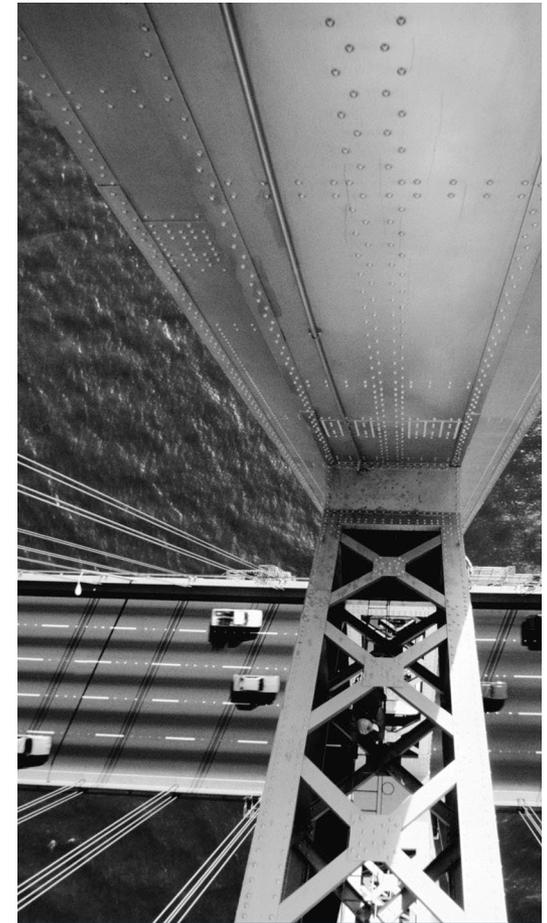
- Help underwriters understand their obligations
- Help state and local government officials know what to expect

# Promoting Regulatory Efficiency

- Re-examining entire rule book to:
  - Determine whether revisions are necessary due to changes in market practices or conditions
  - Identify areas where rules could be more closely aligned with rules of other self-regulatory organizations
- MSRB reviewing and prioritizing recommendations from commenters
- Public input on rules always welcome



# Update on Financial Disclosure Resources for Issuers



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# Improving Financial Disclosure by Issuers



- Recent SEC enforcement actions focusing on inadequate disclosure
- Securities fraud charges against:
  - State of Illinois: *Inadequate pension disclosures*
  - Harrisburg, PA: *Inflated property valuations of security for bonds*
  - Victorville, CA: *Misleading financial information*
  - South Miami: *Failure to disclose threats to tax-exempt eligibility*
  - City of Miami: *False and misleading statements*
  - West Clark Community Schools, IN: *False statements and noncompliance with continuing disclosure obligations*

# New Financial Disclosure Resources

- MSRB provides resources to support issuers with:
  - Identifying required financial disclosures
  - Establishing disclosure policies and procedures
  - Scheduling email reminders for recurring financial disclosures
  - Making disclosures publicly available on **EMMA®**
- Access in State and Local Government Toolkit on [www.msrb.org](http://www.msrb.org)

# Getting Started: Sign Up for Financial Disclosure Email Reminders



- Financial Disclosure Email Reminders on the EMMA® website
  - Keep track of filing deadlines
  - Ensure anyone responsible for timely filing receives an automated reminder
  - Sign up by logging into MSRB Gateway from [dataport.emma.msrb.org/AboutDataport.aspx](http://dataport.emma.msrb.org/AboutDataport.aspx)

# Stay Informed



-  Subscribe to MSRB email updates at [www.msrb.org](http://www.msrb.org)
- Follow the MSRB on Twitter **@MSRB\_News**

# Contact the MSRB



## MSRB Online

[www.msrb.org](http://www.msrb.org)

<http://emma.msrb.org>

## Main Phone

703-797-6600

## MSRB Support

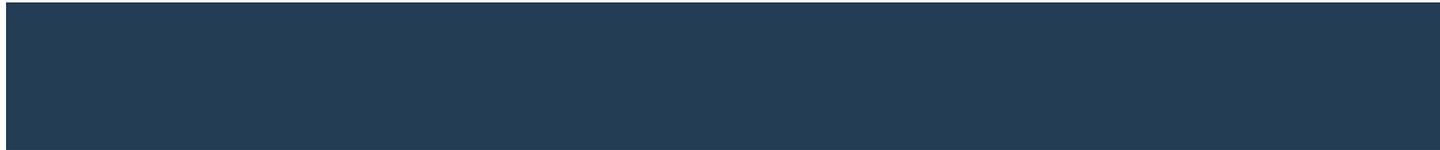
703-797-6668

Hours of Operation:

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

[MSRBsupport@msrb.org](mailto:MSRBsupport@msrb.org)

# Questions & Answers



# CDIAC Pre-conference at the BOND BUYER

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## Understanding Costs and Incentives in Municipal Bond Pricing

Presented by:

*Chris Mier, CFA*

*Managing Director, Analytical Services*

*September 25, 2013*

 **Loop Capital Markets**

*Privileged & Confidential*

## What are the two biggest myths in Public Finance?

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**Banker: “I am here to help you!”**



**Issuer: “I am glad you are here!”**

## The process of securing funds in the municipal bond market is:

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- **Complex**
- **Confusing**
- **Conflict-ridden (potentially)**
- **Chock-full of difficult decisions**

**The issuer may feel bewildered and wondering how to get the most accurate information from the team of professionals that they have assembled.**

# Today's Session

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- **Today we will try to illuminate various aspects of this complex process so that you will feel as comfortable as possible about the decisions you will have to make.**
  
- **We will cover:**
  - The issuing chronology
  - The various roles hired professionals have
  - Bringing a deal to market
  - Incentives of the participants
  
- **Special Topics**
  - Bond pricing violations (Morgan Stanley case)

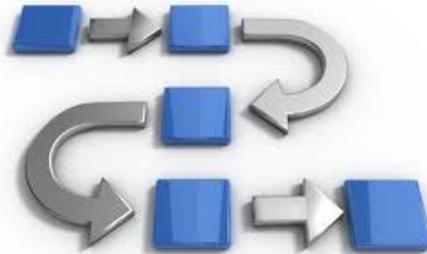
## Negotiated or Competitive?

Conditions for a Competitive Sale	Conditions for a Negotiated Sale
The issuer has significant public borrowing experience with a positive reputation in the financial debt markets	The issuer has limited public borrowing experience and no reputation in the financial debt markets
There is an active secondary market for the issuer's securities	The issue has a non-enhanced credit rating of below A and can obtain a credit enhancement prior to the sale
The debt structure is backed by the issuer's full-faith-and-credit or a strong, historically performing revenue source backs the debt structure	The revenue stream backing the debt is weak, uncertain, or has no history
The issue is not viewed by the market as carrying complex or innovative features or requires explanation as to the bonds' security	The issue is too large to be easily absorbed by the market or too small to attract investors without a concerted sales effort
Interest rates are stable, market demand is strong, and the financial debt market is able to absorb a reasonable amount of buying or selling at reasonable price changes	The issue is viewed by the market as carrying complex or innovative features or requiring explanation as to the bonds' soundness
Policy considerations can be reasonably addressed through specifications of the Notice of Sale. An example of a policy consideration would be a disadvantaged business enterprise (DBE) and regional firm participation that relate to syndicate membership and bond allocations	Last minute changes in disclosure are likely due to legal or legislative issues
	Policy considerations, such as disadvantaged business enterprise (DBE) participation and regional firm participation that relate to syndicate membership and bond allocations, or targeting specific investors

## Getting the lowest cost financing—it starts with the team

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- **In order to get the lowest financing cost possible, issuers should establish a process that leads to the selection of the best professional team possible, and that meets their needs for the transparency.**



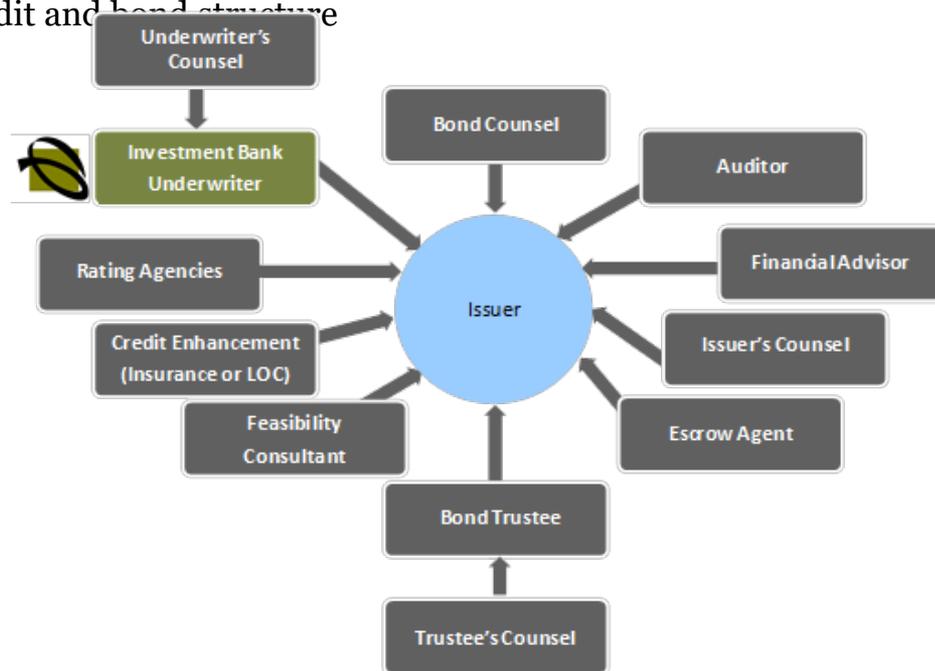
# Advisors or Other Consultants

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- **Issuers often hire advisors to assist them with a range of services, including the process of issuing municipal securities.**
- **Factors to consider when assessing what services issuers need:**
  - Staff resources
  - Advisor expertise
  - Number, size and frequency of planned bond issues
  - Complexity of transaction
- **Financial advisors may assist in the development of a financing plan, underwriter evaluation and selection, rating agency presentation, preparation of offering documents, evaluating pricing**
- **Possible ways to compensate advisors for their services:**
  - Fixed fees
  - Hourly fees
  - Contingent fees
  - Retainer agreement
  - Fees based upon the amount of a transaction

## Selecting the Finance Team and Preparing for the Financing

- **One of the first steps in the underwriting process is selecting the team. Once the deal team is selected, the “Kick-off meeting” is the starting point to plan a course of action for the transaction, including:**
  - Familiarize team and establish roles
  - Financing Timetable
  - Review market conditions
  - Discuss any potential issues that may affect the credit and bond structure
  - General Financing Structure
    - Fixed rate versus variable rate bonds
    - Derivate products
  - Discuss if any credit enhancements are anticipated
    - Bond Insurance
    - Letter of Credit
    - Liquidity Facility
    - Determine Strategy



## Deal Participants and Responsibilities

Participant	Description of Role(s)
<b>Issuer</b>	Defining Financing Requirements
	Setting and Implementing Debt Management Policy
	Identify Services Required
	Establishing a Financing Process
<b>Underwriter</b>	Work with issuer and financial advisor to design the financing plan
	Assist in the development of bond documents as well as other negotiations
	Assist in preparing rating agency strategy and presentations
	Obtain and evaluate letter of credit or bond insurance bids
	“Run Numbers” - quality of analysis and models to present alternative structures is key
	Pre-sale marketing
	Recommend optimal timing for pricing
	Manage the pricing process
	Provide proceeds at closing and obtain funds from investors
	Prepare distribution analysis
Assure secondary market support: orderly marketing research and analysis	
Reinvestment of bond proceeds	
<b>Financial Advisor</b>	Assists in developing the financing plan
	Drafts or assists in the preparation of the Notice of Sale and preliminary Official Statement for competitive issues
	Assists in underwriter evaluation and selection
	Prepares rating agency presentations
<b>Rating Agencies</b>	Evaluates market conditions and pricing performance of senior manager
	Assigns credit rating to the issue
	Update ratings periodically while debt is outstanding
<b>Rating Agencies</b>	May be consulted on potential credit structures and fiscal actions

## Deal Participants and Responsibilities (Continued)

<b>Bond Counsel</b>	<p>Affirms issuer's conformity with all legal requirements and authorization of the bond offering</p> <p>Attests to validity and enforceability of the bonds</p> <p>Confirms tax-exempt status of offering</p> <p>Discloses and examines litigation that may jeopardize the validity of the offering</p> <p>Interprets arbitrage regulations and tax law and provides guidance in structuring issues</p> <p>Drafts certain documents, including the Resolution or Indenture Series Resolution, tax certificate and other required documents</p> <p>Drafts enabling legislation</p> <p>Interprets existing legislation, Constitution and local finance law</p>
<b>Underwriter's Counsel</b>	<p>Share drafting responsibilities including Preliminary Official Statement, final Official Statement, Bond Purchase Agreement, Blue Sky Memorandum and Agreement among Underwriters</p> <p>Advise underwriters regarding their legal positions with respect to the issue</p> <p>On occasion bond counsel may act as underwriters counsel</p>
<b>Syndicate</b>	<p>The main functions of a syndicate are distribution and sharing underwriting risk</p> <p>Composed of different types of firms; role and capabilities should be well defined</p>
<b>Credit Enhancers</b>	<p>Provide substitute for or support of a issuer's credit in exchange for a fee or premium</p> <p>Consult for program structures</p> <p>Maximize pricing competition between providers</p>
<b>Trustee</b>	<p>Acts in fiduciary role for the benefit of bondholders</p>
<b>Feasibility Consultant</b>	<p>Conducts a study and provides a written report that summarizes the project is viability which is used by potential investors in determining if they should purchase the bonds</p>

# The Syndicate

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## ■ Factors in Determining Size and Structure of the Syndicate Group

- Size of offering
  - Will need more managers to optimally distribute larger issues
- Nature of services required
  - Structuring
  - Marketing
  - Pricing
- Anticipated distribution across buyer segments
  - Select well-balanced group with varying specialties
  - Retail/Institutional
  - National/Local
  - Syndicate Group vs. Selling Group

Syndicate Group
Syndicate members share underwriting risk
Ability to price aggressively
Ability of group to price quickly
Importance of on-going investment banking relationship and continuous service
Importance of affirmative action goals
Selling Group
Selling group members do not share underwriting risk
Ability to underwrite

## Additional Syndicate Considerations

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- **Minimizing the size of the management group increases the co-managers participation and broadens distribution**
- **The utilization of special bracket managers can increase selling incentive and broaden the investor base**
- **Varying the types of firms in the management group diversifies investor network improving bond allocations**
- **Rotating management groups and senior managers**
- **Set participation's for managers and each tier of syndicate**
- **National retail vs. in-state retail**
- **Members of the management group go beyond traditional sales role in educating the marketplace or bringing new ideas**
- **Management group can facilitate broader administration goals and policies**

*Remember:  
The goal is always to broadly distribute the bonds  
to final investors to obtain the lowest cost of  
capital*

## Distribution Agreements

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- **An example would be a distribution agreement between an investment bank and another broker-dealer that has retail customers, but no investment banking function.**
- **By entering into the agreement, the investment bank gains access to retail customer base, thus expanding the universe of potential buyers for the bonds they are underwriting.**
- **The broker-dealer with no investment banking function gains access to new bond issues as if they were the underwriter, which allows them to better serve the interests of their retail clientele.**

**Such agreements are fully disclosed to the issuers, who are free to disclose them in the Official Statement as well. The distribution agreement is good for the issuer because it brings the distribution capabilities of a firm who would not otherwise be involved into the syndicate team.**

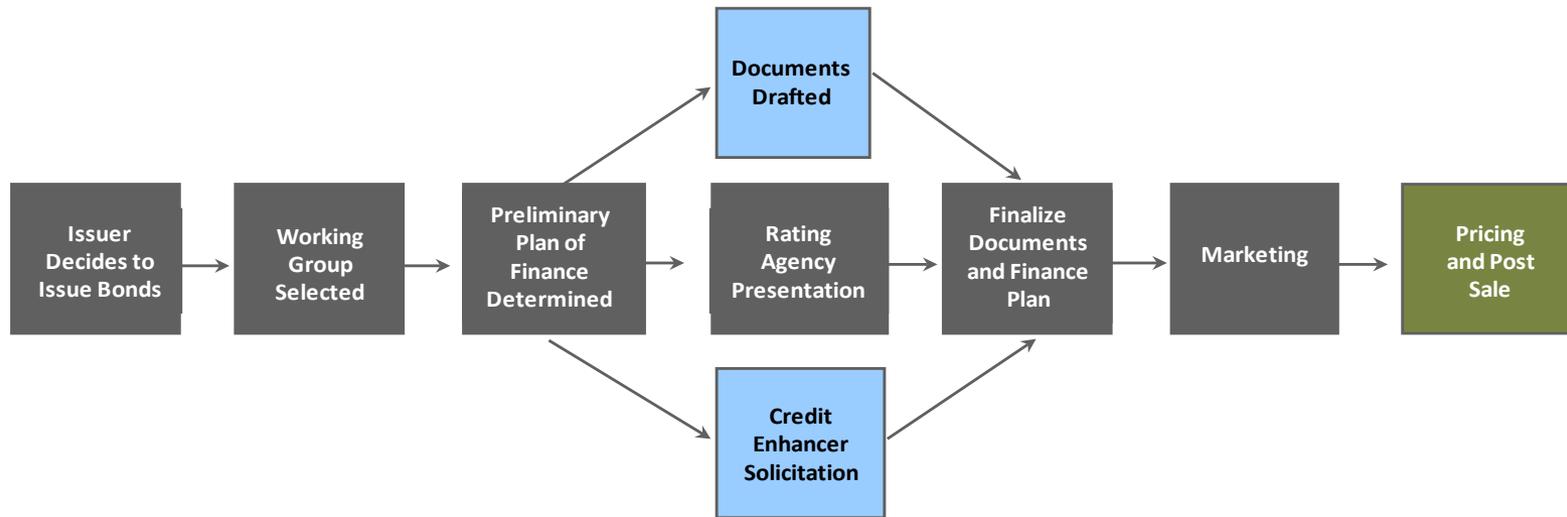
## Underwriter's Compensation

- **Difference between price paid to the Issuer for a new issue and the price at which securities are offered to the public is gross spread.**

Gross Spread Components	
Item	Description:
<b>Management Fee:</b>	Compensates managers for work involved in structuring the issue
	Can be split among entire management group based upon percentages determined by issuer.
	Book running senior manager typically receives substantial portion of management fee
<b>Underwriters' Risk:</b>	Compensates managers for market-related risk involved in underwriting the issue
	Split among all underwriters according to percentage of participation in the financing
<b>Takedown:</b>	Compensation firms receive for the cost of selling the securities; the amount of the takedown increases with maturity of the bonds
	Apportioned on a per bond basis to any firm that actually sells bonds
<b>Expenses:</b>	Compensates senior managers for out-of-pocket expenses, such as underwriters' counsel, interest expense, DTC charges, travel, syndicate expenses, communication expenses and postage
	Some firms claim computer time as an expense
	Clearance - although increased use of DTC has curtailed pure clearance expenses, legitimate back office expenses remain

# The Underwriting Process

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# Pricing Timeline

Pricing Timeline						
Forward Calendar	Set Pricing Schedule	Investor Information	Book-runner Polls Managers	Release Pricing Wire	Allotments	Closing
Notify Bond Buyer	Economic	Mail POS	Market Call	Run Order Period	Written Award	
Establish Schedule	Credit Market	Rating Release	Discuss Sale Timing	Review Order Book		
	Treasury Borrowing Schedule	Sales Memorandum	Solicit interest rate views from managers	Adjust Interest Rates and Structure		
	Holidays	Information	Identify Comparables	Verbal Award		
	Marketing Strategy	One-on-One Investor	Order Period			
	Settlement Needs	Public Information	Retentions			
	Visible Supply at 30-Day Mark	Notice for Bond Buyer, Times, WSJ, Local				
		Managers Call				
		Review Timing - Forward Calendar and Credit Market				
		Discuss Sales				
		Agree on Management Rates				



## Bringing the deal to market – Game Day

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### Transaction Summary as of August 22, 2013

August							September						
S	M	T	W	T	F	S	S	M	T	W	T	F	S
				1	2	3	1	2	3	4	5	6	7
4	5	6	7	8	9	10	8	9	10	11	12	13	14
11	12	13	14	15	16	17	15	16	17	18	19	20	21
18	19	20	21	22	23	24	22	23	24	25	26	27	28
25	26	27	28	29	30	31	29	30					

Board Meetings: Aug 20, Sep 17; Holiday: Sep 2

#### ■ Schedule

- Syndicate Call: Monday, August 26, 12:00 PM Eastern
- Price Views Due: Monday, August 26, 4:00 PM Eastern
- Order Period: Wednesday, August 28
- BPA Signing: Thursday, August 29
- Closing: Tuesday, September 10
- Settlement: Thursday, September 26

## Designations—An Example

### Designation Options - For \$1,000,000 Order

Assume Takedown = \$5.00/Bond

Total Profit = \$ 5,000

Role	Liability	Percentage
Senior Manager	\$ 25,000,000	50.00%
Co-Senior	15,000,000	20.00%
Co-Manager A	5,000,000	10.00%
Co-Manager B	2,500,000	10.00%
Co-Manager C	2,500,000	10.00%
<b>Total</b>	<b>\$ 50,000,000</b>	<b>100.00%</b>

### Sample Designation Policy

#### Priority of Orders as Follows:

1. Retail (during Retail Order Period)
2. Net Designated
3. Member

#### Designation Policy:

At least 3 firms must be designated

No firm may receive more than 50% of any designation

The Senior Manager requests the identification of all priority orders at the time the orders are entered

There are to be no soft-dollar designations

Selling group members may not enter priority orders, and may not be designated

In-State Retail orders will be given special consideration. Please specify when entering your orders

## How can issuers know if they got a good price for their bonds?

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- **Signs the yields proposed were too high:**

- The deal is oversubscribed quickly (within 30 minutes)
- The deal is very heavily oversubscribed (5X +)
- The deal has attracted speculators (example: taxable bond funds) along with “traditional” buyers

- **Signs the yields proposed were too low:**

- The order period concludes without full subscription
- There are “holes” in certain maturities where no orders are present
- Institutions that have been heavy buyers recently are not present

- **The difference between “too high” and “too low” can be amazingly small.**

- **What is the proper balance between takedown and yield that best delivers the lowest overall cost of funds?**

- Takedown speaks to rewarding sales motivation
- Yield is the terms of the transaction
- If the yield is too low, there is no takedown that will induce a sale

## How is pricing transparency achieved in the markets?

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- **All trades get posted to EMMA, including new issue prices at settlement.**
- **All new issue deals go through a closing process with attorneys and review of relevant documents.**
- **Deals are frequently covered in financial media, watched carefully by market participants, especially the investors.**



## Is there any such thing as a “Perfect Deal” where every party is satisfied?

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- **No. The deal is the result of a negotiation between a buyer and a seller. In every case the seller thinks the rate of interest they pay is too high, while the buyer thinks the rate is not high enough.**
- **The closest approximation to a “perfect deal” would be an “aggressive” price, per the Financial Advisor, oversubscription by 1.5X to 1.75X, one price bump that resulted in 1.25X oversubscription, and allotment on the same day. This set of circumstances would result in all parties generally feeling good about the transaction.**



# Why do institutional buyers receive better pricing than retail buyers?

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- **To the extent that institutional investors in fact do receive better pricing on new issues than retail buyers, the difference would relate to *the difference in trade processing costs, commissions to brokers and increased regulatory burden of maintaining a retail business.***
- **Retail buyers are less price sensitive and rely on advisors for pricing.**
- **The advantage of ‘buying in bulk’.**
- **Broker-dealers are extra careful to comply with rules and regulations when pricing bonds in order to protect their reputation and avoid the fines.**
  - Morgan Stanley agreed to pay a \$1 million fine and compensate harmed investors in connection with allegations that they failed to charge fair prices for corporate and municipal bonds.
  - While FINRA did not allege any willful or fraudulent conduct by the firm, Morgan Stanley was charged with failure to use "reasonable diligence" to ensure that prices were fair and reasonable under current market conditions in 116 corporate bond and 165 municipal bond transactions.
  - These transactions took place from January 2008 through September 2011, a period during which Morgan Stanley conducted some 4 million such trades.

Do smaller or less frequent issuers find it difficult to ascertain the “real” cost/price that they are paying to borrow money?

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- **No. The real cost should be very evident at closing, if not prior.**
- **Municipal bonds are highly differentiated and are bought and sold on over-the-counter market. Even in exchange markets, the price of execution for a stock may be different than what you see on your screen.**
- **For that reason, there is no way of knowing in advance the ‘true’ cost an issuer is paying for borrowing because the clearing price can never be completely accurately known in advance.**
- **There are more than 1 million muni CUSIPS, there is no such thing as an ‘exact’ price! Almost all transactions are negotiated between buyer and seller.**

## The motivations of the participants

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- All participants have an incentive for the deal to close, so that they can achieve their objectives. If the deal does not close, the issuer will not receive the funds and financial professionals involved in the process will not get paid.
- Participants in this transaction, at some point, begin to look ahead to the next deal.
- Since issuers may access market on a recurring basis, everyone knows that they will see many of the same participants from this deal on future deals.

**The motivations all boil down to results, revenue, relationships and reputation. The underwriting of municipal bonds is a sequential process where the hired professionals seek to boost revenue by cultivating relationships based upon performance, results, and reputation.**

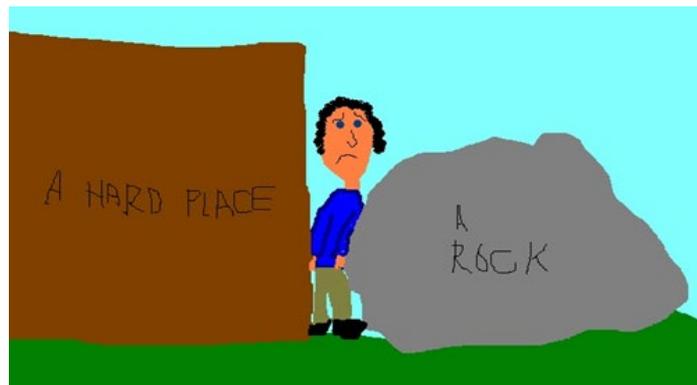


What incentives do realtors have?

## The Underwriter – An Excedrin kind of job

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- **The Underwriter doesn't make any more money if the price is higher or lower. The desired outcome is the mutually satisfied client scenario achieved by balancing investors' interests with issuer fairness.**
- **The Underwriter has to manage the expectations of the issuer and his Financial Advisor, get a good price (low yield) and yet satisfy the investors, who usually either dislike their allocation, the ultimate price, or both. Since the investor has the option of dropping on a price change, price “bumps” are very tricky.**
- **The Senior Manager must communicate with the syndicate members. If that were not the case, the syndicate members would let the issuer know.**
- **Underwriter's job is difficult because they are constantly pressured from all sides to accommodate competing interests.**

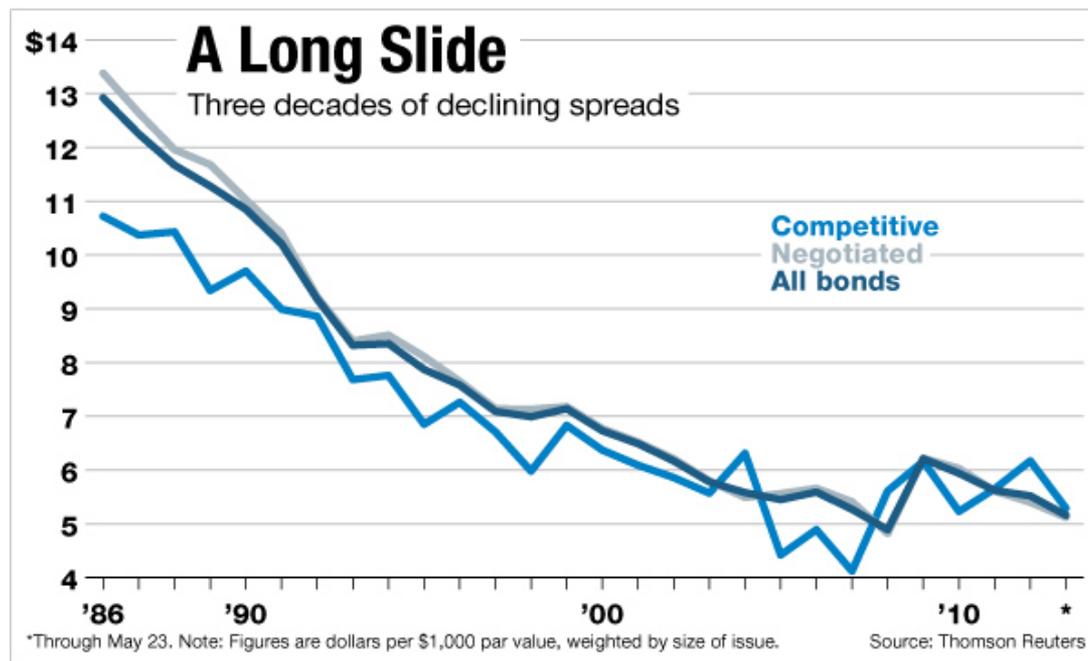


## Recommendation: The issuer should not lose control of the transaction!

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- **Strong leadership from the issuer is not only in the issuer’s best self-interest, but makes the job of the syndicate much easier.**
- **Decide in advance what decisions you want to be involved in and which ones you do not.**
- **Examples:**
  - Do you have an opinion about how the allocation process should work? Do you want to see the order book? At what times?
  - How do you want the relationships between the professionals to work?
  - Do you want all the other managers beside the senior to have more involvement or less?
  - Are you going to be physically present when the deal is priced and sold?
  - Who is giving you information and is it unbiased?
- **Select professionals you can trust.**
- **Be involved in the transaction from beginning to end.**
- **“Trust but Verify”**

## Underwriting Spreads



- The average spread on a new municipal issue is about 50%-75% of what a Fortune 500 firm willingly pays their corporate bond syndicate.

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# Questions & Answers

Break 10:45-11:00 AM

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# The Dynamics of Underwriter Disclosures under G-17

## MODERATOR:

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Managing Director and  
Associate General Counsel  
Securities Industry and Financial Markets  
Association

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Assistant Director of Finance  
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Counsel-Office of the County of Los  
Angeles

Brian Hellberg  
Director of Policy and Procedure-Municipal  
Finance  
RBC Capital Markets

Charles Turner  
Director of Finance  
Eastern Municipal Water District



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# THE DYNAMICS OF UNDERWRITER DISCLOSURES TO ISSUERS UNDER MSRB RULE G-17

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DAVID L. COHEN  
SIFMA  
MANAGING DIRECTOR & ASSOCIATE GENERAL COUNSEL  
SEPTEMBER 25, 2013

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## Purpose of G-17 Interpretive Notice

- The Dodd-Frank Act, for the first time, gave a U.S. securities regulator/SRO authority to protect issuers
- As part of the MSRB's expanded mission to protect issuers, MSRB Notice 2012-25 seeks to ensure that issuers understand and acknowledge receipt of disclosures relating to the municipal securities transactions they are entering into
- Requires underwriters to make specific written disclosures to all issuers
- Requires additional disclosures to issuers in the case of recommended complex transactions, or if the issuer or issuer personnel is inexperienced

## SIFMA G-17 Model Disclosures

- Models produced:
  - Underwriter's disclosure letter
    - Role disclosure
    - Compensation disclosure
    - Conflicts disclosure
  - Model risk disclosures for certain common products/common features in the industry
  - Policies and procedures
- Includes explanatory notes and commentary

# SIFMA Model Underwriter's Disclosure Letter

- Needs to be sent to municipal securities issuer
- Neither G-23 nor G-17 requires disclosures to conduit obligors
- However, many firms are also sending to the obligor and/or municipal guarantor
- SIFMA's Model Clarifying Statements for Municipal Securities Underwriters covers G-23 role disclosures, however, this model letter covers G-23 required disclosures as well

## SIFMA Model Underwriter's Disclosure Letter

- Senior managing underwriter will send all disclosures to issuer on behalf of syndicate
  - Should also send disclosures to co-managers
- However, all co-managers need to send their own conflicts disclosures, if conflicts exist
  - Co-managers should also send disclosures to senior manager
- Conflicts disclosures may need to be updated during transaction

# SIFMA G-17 Model Risk Disclosures

- SIFMA model risk disclosures
  - Generally only necessary for recommended complex municipal securities transactions
  - Disclosures should be tailored to the unique features and risks of the specific financing
  - SIFMA models:
    - Fixed rate bonds (for inexperienced issuers/personnel)
    - VRDOs
    - Floating rate notes
    - Interest rate swaps

# Material Risk Disclosures Generally

- G-17 disclosure for recommended complex transactions
  - Must explain “magnitude” of risks
    - Understanding of rate fluctuations
    - Understanding of termination payments

## Swaps Covered by G-17 Interpretive Notice

- New swaps related to new municipal bond transactions
- Material amendments to existing swaps in new municipal bond transactions
- Refunding bond transactions with existing swaps

# Acknowledgments by Issuers

- Issuer officials need to be identified
  - Need to be authorized to bind issuer and not have a conflict
  - Underwriter may rely on written delegation by authorized issuer official (including RFP)
  - Acknowledgements need to be retained by underwriter
  - Attempts at obtaining acknowledgements should be tracked
  - Underwriter should document why it was unable to obtain acknowledgement
  - If multiple rounds of disclosures are sent, additional acknowledgements may be necessary

# Timing of Disclosures

- Initial underwriter's disclosure letter should be sent at earliest possible time
  - When being considered as underwriter
  - After being selected as underwriter
- If type of transaction is known at that time, risks for complex transactions can be sent at the same time
- If type of transaction is not known at that time, risks for complex transactions can be sent later if a complex transaction is recommended
- Issuer needs time to consider and evaluate disclosures prior to signing a bond purchase agreement

## Next Steps

- Q1. Are issuers receiving G-17 disclosures from underwriters?
- Q2. Are the disclosures helpful?
- Q3. Are issuers black-lining the disclosures they receive against SIFMA's model documents?
- Q4. Are issuers readily returning written acknowledgements to underwriters?

Some issuers have said that as a policy they will not acknowledge the G-17 disclosures. Others have only been willing to acknowledge "receipt".

- Q5. What can be done to simultaneously streamline the written disclosures AND give comfort to underwriters that their disclosures fulfill their regulatory obligations?
  - A. Additional clarifying guidance issued by the MSRB: conflicts, non-complex transactions, de minimis exception for co-managers, sophisticated issuers . . .

# SIFMA Information on G-17 Implementation

Models available at: [www.sifma.org/g17disclosures](http://www.sifma.org/g17disclosures)  
or [www.sifma.org/muni](http://www.sifma.org/muni)

# Questions & Answers



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# LUNCHEON KEYNOTE SPEAKER

HONORABLE STATE TREASURER  
BILL LOCKYER

Sessions Resume at 1 PM

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# The Fiduciary Obligations of Financial Advisors

Lynnette Kelly  
Executive Director  
Municipal Securities Rulemaking Board

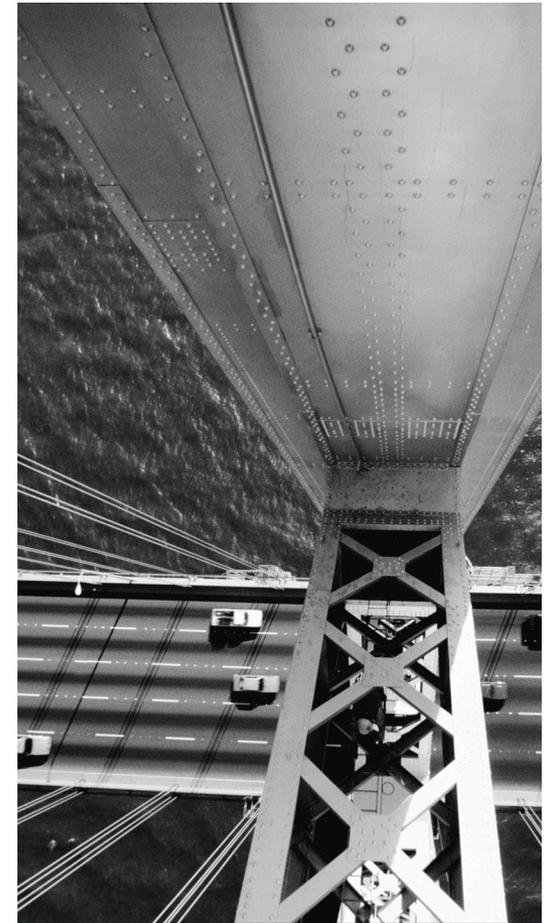
David Leifer  
Senior Managing Director  
KNN Public Finance

# Fiduciary Obligations of Financial Advisors

Lynnette Kelly, Executive Director  
*Municipal Securities Rulemaking Board*

California Debt and Investment Advisory  
Commission Pre-Conference Program

September 25, 2013



**MSRB**

Municipal Securities  
Rulemaking Board

# MSRB Mission



- Protect investors, state and local government issuers, other municipal entities and the public interest by promoting a fair and efficient municipal market through:
  - The establishment of rules for dealers and municipal advisors
  - The collection and dissemination of market information
  - Market leadership, outreach and education

# Dodd-Frank and the Municipal Market



- Expanded the MSRB's mission to protect state and local governments that issue municipal bonds
- *Today's Focus:* **Established framework for regulation of municipal advisors by the MSRB**

# Municipal Advisor Regulation



- Rules and standards for professional conduct and qualification
  - Promote a fair and efficient market
  - Preserve municipal market integrity
  - Protect state and local governments and other entities that engage the services of a municipal advisor

# Goals of Municipal Advisor Rulemaking



- Prohibit fraud and manipulative practices
- Establish fiduciary obligation to municipal entity clients
- Require fair treatment of investors, municipal entities and obligated persons
- Address real and perceived conflicts of interest

# Defining Municipal Advisors

- Dodd-Frank defines municipal advisors broadly
  - Advise on municipal securities transactions
  - Advise on municipal financial products, including derivatives, guaranteed investment contracts and investment strategies
  - Third-party marketers, placement agents, solicitors, finders and certain swap advisors
- SEC approved final definition on September 18, 2013

# Current Municipal Advisor Duties

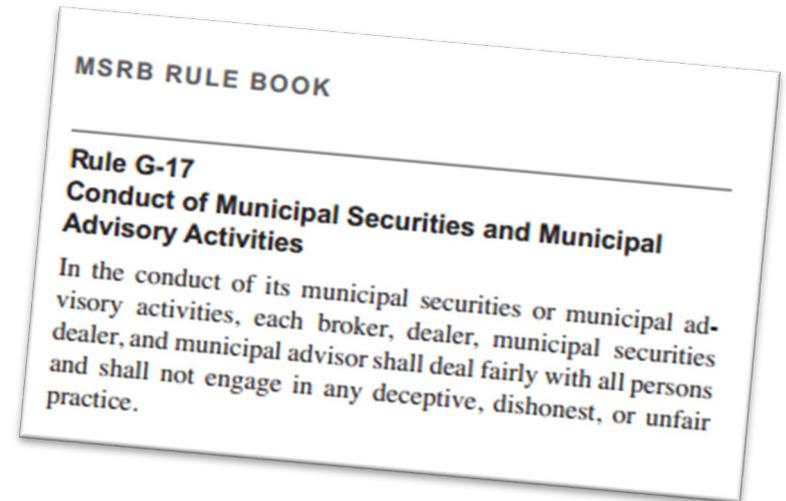
- Registration with the MSRB and the SEC
- Fair Dealing
- Fiduciary Duty

# Municipal Advisor Registration

- Municipal advisors must register first with the SEC and then with the MSRB
- Issuers can verify a municipal advisor's registration on the MSRB's website
  - <http://www.msrb.org/msrb1/pqweb/MARegistrants.asp>
- Unregistered municipal advisors are in violation of federal law in conducting traditional municipal advisory business
  - May be unaware of or disregarding obligations under MSRB rules

# Fair Dealing

- MSRB Rule G-17 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



# Fiduciary Duty



- Dodd-Frank requires municipal advisors to put their clients' interests first without regard to their own financial or other interests
- MSRB rulemaking will address application of fiduciary duty

# Application of Fiduciary Duty of Municipal Advisors to Issuers



- Elements of expected MSRB rule proposal
  - Duty of loyalty and care to municipal entity
  - Recommendations must be in best interest of municipal entity
  - Achieved necessary qualifications to render informed advice
  - Obligation to investigate reasonably feasible alternatives

# Application of Fiduciary Duty of Municipal Advisors to Issuers *(cont.)*



- Disclosure of conflicts of interest and receipt of municipal entity's informed consent
  
- Addressing certain unmanageable conflicts
  - Kick-backs
  - Fee-splitting
  - Excessive compensation

# Advancing Municipal Advisor Regulation



- In addition to clarifying the application of fiduciary duty, the MSRB is creating a regulatory framework and professional standards for municipal advisors
- Will reexamine draft rules for municipal advisors, revise them if necessary in light of the SEC's final guidance and seek public comment

# Proposed Areas of Municipal Advisor Regulation



- Conflicts of Interest
- Political Contributions
- Gifts and Gratuities
- Preservation of Records
- Books and Records
- Assessments

# MSRB Rulemaking Process

## Identify an Issue

- Board discussion
- Does this issue warrant rulemaking?
- Are there other alternatives?

## Rule Proposal

- Publish for comment
- May be preceded by concept release

## Board Discussion of Comments

- All comment letters go to the Board

## Proposed Rule filed with SEC for Approval

- All points made by commentators must be addressed in filing

## SEC Publishes Proposed Rule in Federal Register for Comment

- Additional comment period
- SEC generally asks MSRB to respond to any comments made

## SEC Approval Order

- Final action required
- Has the force and effect of Federal law
- Goes into effect on specific date

# Professional Qualification Standards



- MSRB establishing an exam to assess competency of advisors
  - Developed with external input on common advisory activities
  - Evaluated for consistency with SEC definition
  - SEC approval required for the exam
- Signals baseline qualifications of advisors to issuer clients

# Planned MSRB Resources for Municipal Advisors



- **Prepare**

- Preparing for Regulation: A Guide for Municipal Advisors

- **Participate**

- Overview of the MSRB rulemaking process

- **Put into Practice**

- Complying with MSRB rules and standards

# Municipal Advisors: Prepare for Regulation



- ✓ Understand the Importance of Registration
- ✓ Learn about the MSRB
- ✓ Review Existing Business Practices
- ✓ Access Available Resources on [www.msrb.org](http://www.msrb.org)

# Stay Informed



-  Subscribe to MSRB email updates at [www.msrb.org](http://www.msrb.org)
- Follow the MSRB on Twitter **@MSRB\_News**

# Contact the MSRB



## MSRB Online

[www.msrb.org](http://www.msrb.org)

<http://emma.msrb.org>

## Main Phone

703-797-6600

## MSRB Support

703-797-6668

Hours of Operation:

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

[MSRBsupport@msrb.org](mailto:MSRBsupport@msrb.org)

# The Fiduciary Obligations of Financial Advisors

September 25, 2013



1300 Clay St., Suite 1000, Oakland, CA 94612  
phone 510-839-8200 fax 510-208-8282

A Division of Zions First National Bank

# Fiduciary Obligations of Financial Advisors

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- Dodd-Frank establishes standard of care that most FA's previously assumed to be the norm
- Formalizes substantive distinction in roles/duties between advisors and broker-dealers
- Puts focus squarely on real and potential "conflicts of interest" between advisors and municipal clients

# Recent SEC Action

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- Final registration rule adopted for MA's clarifying who is and isn't a "municipal advisor" and offering guidance on when a person is providing "advice" for purposes of the MA definition
  - Certain exemptions based on activities of advisor rather than type of participant
  - Members of governmental boards not subject to registration
- MSRB to follow with rules establishing standards for training, qualification and conduct, including treatment of conflicts of interest

# 2011 Draft MSRB Rule G-36 and Draft Interpretive Notice

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- Duty of Loyalty:
  - Emphasizes written disclosure and informed consent regime regarding conflicts of interest
  - Introduces concept of “unmanageable conflicts” for kick-backs, fee splitting, finders fees, etc.
  
- Duty of Care:
  - Necessary qualifications
  - Consideration of alternatives
  - Duty of inquiry
  - Advisor not a guarantor

# Potential Conflicts of Interest

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- Start with premise that no relationships involving compensation are without potential conflict of interest
  
- Potential conflicts include:
  - Over servicing, where paid hourly
  - Under servicing, where fixed fees paid
  - Potential for “self-serving” advice where compensation is contingent or based on par amount
  
- Draft Rule G-36 and Interpretive Notice proposed form of “Disclosure of Conflicts of Interest with Various Forms of Compensation,” by which the MA may satisfy it’s obligation to provide written disclosure of potential conflicts

# Other Potential Conflicts of Interest

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- Excessive compensation
  - Consider focus on under compensation too?
  
- Dual roles or selling of multiple services within a transaction
  - Investment management, swap advisory, GO bond election services, underwriting
  
- Payments to or from third parties
  
- Non-client alliances – e.g., with underwriters, bond counsels, etc.

# Still Other Potential Conflicts of Interest

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- Refundings
- Use of complex products or structures
- Best addressed through client debt management policies

# Ways in Which Issuers are Protected

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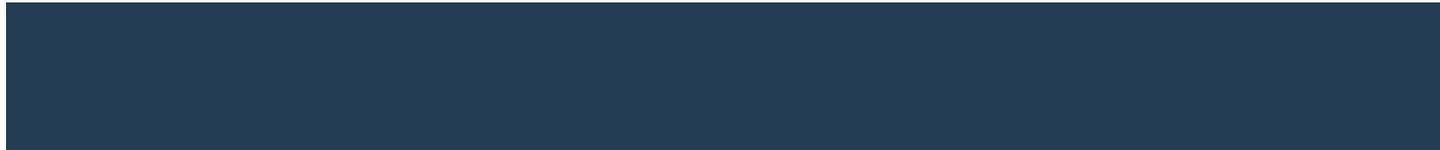
- MA reputational risk
  
- Emphasize competency and experience in selection process
  
- Inquire about MA firm internal policies, practices, education and training
  
- Regulation
  - Rule G-17 – fair dealing
  - Revised Rule G-23 – no role switching
  - Proposed Rule G-36
  - Other MA rules – political contributions, gifts and gratuities, record keeping, etc.
  - Implement meaningful competency and continuing education requirement

# Rulemaking Considerations

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- Regime for disclosing conflicts and competency requirements are important
  - But, beware pitfalls of G-17 like disclosure. Purpose should be meaningful issuer education
  
- Need for other MA rules – political contributions, gifts and gratuities, etc.
  
- Regulation should be appropriate in scope and burden
  - MA firms are generally smaller and have far fewer resources than broker-dealers
  - Avoid overly burdensome and costly regime which drive MA's out of the market
  - MA's already are subject to a higher standard of care (e.g., fiduciary duty) than broker-dealers are
  - MA's are not selling products nor guaranteeing successful financings

# Questions & Answers



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# Considering Best Practices and Principles for Improving Disclosure in the California Market

Robert Doty  
Senior Counsel and Advisor  
Government Financial Strategies

Dave Sanchez  
General Counsel  
De La Rosa and Company

Tim Schaefer  
Founder & Principal Owner  
Magis Advisors

Session 5

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**THANK YOU FOR PARTICIPATING TODAY!**

**UPCOMING FALL SEMINAR**

**MUNICIPAL DEBT ESSENTIALS**

**10/22: DEBT 1: DEBT BASICS**

**10/23: DEBT 2: ACCESSING THE MARKET**

**10/24: DBET 3: DEBT ADMINISTRATION**

**PLEASE COMPLETE EVALUATION FORM**