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REGULATORY UPDATE: THE MUNICIPAL ADVISORY RULES AND THEIR EFFECT ON PUBLIC INVESTMENTS

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MUNICIPAL ADVISOR RULES AS THEY APPLY TO INVESTMENT ADVICE

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Introduction and Context

2

- ❑ Today's topic and discussion focus
- ❑ The presentation panel
- ❑ Questions and answers to practical considerations
- ❑ Your participation

Background

3

- ❑ SEC Municipal Advisor Rule
 - Definitions
 - Advice Standard
 - Exclusions
 - Exemptions

Municipal Advisor Definition

4

- ❑ “Municipal Advisor” defined to include a person (who is not a municipal entity or an employee of a municipal entity) who provides **advice** to a municipal entity or obligated person with respect to **municipal financial products** or the **issuance of municipal securities**
- ❑ Today’s webinar focuses on the municipal financial product part of this definition

Municipal Advisor Definition

5

- ❑ “Municipal Financial Product” defined to include:
 - Guaranteed investment contracts
 - Investment strategies
- ❑ “Investment Strategies” defined to include:
 - “plans or programs for the investment of the proceeds of municipal securities”
 - “recommendation of and brokerage of municipal escrow investments”

What Are the Implications of Being a Municipal Advisor?

6

- ❑ Required to register with the SEC and the MSRB
- ❑ Statutory Fiduciary Duty
 - For municipal entity clients, not obligated person clients
- ❑ Subject to MSRB rules (e.g., record-keeping, professional qualifications)
 - MSRB G-42 as proposed would have prohibited a municipal advisor and its affiliates from doing principal trades if municipal entity or obligated person were the counterparty

How Not to Be a Municipal Advisor

7

- ❑ Don't meet the statutory definition
 - Not “advice”
 - Not either bond proceeds or municipal escrow investments
 - You are a “municipal entity” or “an employee of a municipal entity”
- ❑ Meet one of the Statutory Exclusions
- ❑ Meet one of the Exemptions established by SEC Rules

Advice Standard

8

- ❑ SEC Rules provide that “advice excludes . . . the provision of **general information** that does not involve a **recommendation** regarding municipal financial products.”
- ❑ Brokerage distinguished: “purchase and sale of escrow investments upon the direction of an obligated person or its financial advisor without rendering advice is merely a provision of brokerage services and does not render such person a municipal advisor.” [Release]

Municipal Advisor Exclusions

9

❑ Underwriter Exclusion

- But only applies for underwriting activities, and SEC has stated that “advice on investment strategies” is outside the scope of the underwriter exclusion

❑ Investment Adviser Exclusion – for “any investment adviser registered under the Investment Advisers Act of 1940”

Municipal Advisor Exemptions

10

- ❑ Banks, if providing advice with respect to:
 - “any investments that are held in a deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank”
 - “any extension of credit . . . including the issuance of a letter of credit, the making of a direct loan, or the purchase of a municipal security by the bank for its own account”
 - “any funds held in a sweep account”
 - “any investment made by a bank acting in the capacity of an indenture trustee or similar capacity”

Municipal Advisor Exemptions

11

- ❑ Independent Registered Municipal Advisor (“IRMA”)
 - More commonly used in context of the “issuance of municipal securities” part of the municipal advisor definition
- ❑ Rules establish elements to qualify for IRMA exemption
 - Independent – measured at firm and individual level
 - Person seeking to use exemption “receives a representation in writing that it is represented by, and will rely on the advice of, an independent registered municipal advisor”

Municipal Advisor Exemptions

12

❑ RFP/RFQ

- Exemption for any person “providing a response in writing or orally to a request for proposals or qualifications from a municipal entity or obligated person for services in connection with a municipal financial product or the issuance of municipal securities.”

Bond Proceeds

13

❑ Definition

❑ MA Rule implications

- Both GFOA and NAST have issued guidance to their members regarding the implications for investment portfolio
- NAST approach of letter to broker-dealers to the effect that b-d is not providing advice and does not owe a fiduciary duty

❑ Post July 1 activities

What Are “Proceeds”? (Rules)

14

- ❑ “monies derived by a municipal entity from the sale of municipal securities”
- ❑ “investment income derived from the investment or reinvestment of such monies”
- ❑ “monies of a municipal entity or obligated person held in funds under legal documents for the municipal securities that are reasonably expected to be used as security or a source of payment of the debt service”
- ❑ “investment income derived from the investment or reinvestment of monies in such funds”

What Are “Proceeds”?

15

- ❑ SEC did not agree that once proceeds of a municipal offering are commingled with other funds, they lose their character as proceeds
- ❑ But did provide that once the proceeds “are spent to carry out the authorized purposes of municipal securities, they cease to be proceeds of municipal securities.” (Rules)
- ❑ Pension Bonds – “proceeds of pension obligation bonds lose their character as proceeds of municipal securities . . . upon their contribution to the public pension plan.”

How to Track “Proceeds”

16

- ❑ Establish different rules depending on whether proceeds held in existing accounts or investments before July 1, 2014
- ❑ “unless a market participant actually knows or reasonably should have known that an existing account or existing investment contains proceeds of municipal securities, a market participant may determine that such existing accounts or existing investments do not contain proceeds of municipal securities” FAQ 11.1

Post July 1, 2014

17

- ❑ If “investment advice provided on or after July 1, 2014”
- ❑ And if it regards “investments of newly-arising proceeds received from municipal securities that are issued on or after that date, market participants should develop policies and procedures . . . to determine whether or not the advice provided involves investments of proceeds of municipal securities.”

Post July 1, 2014

18

- ❑ What are such “policies and procedures”?
- ❑ As a practical matter, will require municipal entities and obligated persons to track funds that are proceeds of municipal securities which are issued on or after July 1, 2014

Investment of Bond Proceeds

19

- ❑ Questions and answers
- ❑ Certifications / acknowledgements
- ❑ Guidance and practical application

Questions and Answers

20

- ❑ When is a broker-dealer providing investment advice that would result in the broker-dealer being considered a municipal advisor?
 - General information versus specific recommendations

Questions and Answers

21

- ❑ Can government entities rely upon an independent registered municipal advisor (IRMA) or registered investment advisor (RIA) for advice and exempt broker-dealers from the Municipal Advisor Rules when recommending securities to an issuer for the investment of bond proceeds?
- ❑ What form of notice or acknowledgement can be provided to broker-dealers to invoke this exemption?
- ❑ How does this topic apply to obligated persons / conduits?

Questions and Answers

22

- ❑ What should agencies do with the letters and certifications received from brokerage firms?
- ❑ Why do these letters vary among brokerage firms?
- ❑ Are all brokerage firms required to submit letters to governmental entities?
- ❑ What will occur if a municipal entity does not complete and return the certification / acknowledgement?

Questions and Answers

23

- ❑ How do the MA Rules apply to pooled investments?
- ❑ What does the advisor need to know to provide advice on pooled funds?
- ❑ How will pooled structures handle the investment of bond proceeds?

Questions and Answers

24

- ❑ For those Counties who run separately managed accounts (non-pooled investments) containing bond proceeds belonging to school districts and are structuring the investment product, would the County and/or its employees be considered a Municipal Advisor to the school district?
- ❑ If the County insisted that the school district hire an advisor to perform the portfolio structuring work and the County did the implementation (buying securities, specific maturities as guided), would this circumstance substantially change the County's role with respect to its client?

Questions and Answers

25

- ❑ What are the different rules and assumptions that apply depending on whether the bond proceeds relate to municipal securities issued before or after July 1, 2014 (the effective date of the Rules)?
- ❑ As a practical matter, will municipal entities and obligated persons be required to track what funds are proceeds of municipal securities that are issued on or after July 1, 2014?

Questions and Answers

26

- ❑ Where do I go from here?

QUESTIONS

Thank you for your participation.

A Certificate of Attendance will be emailed to you by the end of the week.

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