THE ROLE OF A MUNICIPAL ADVISOR

Presented as Part of the Presentation:

Roles and Responsibilities of Professionals in a Negotiated Bond Transaction

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Today I'm happy to discuss the role of a financial advisor also known as a municipal advisor. A municipal advisor's primary role is to provide services relating to the structure and sale of securities and to ultimately assist issuers in obtaining the lowest financing cost. A municipal advisor also provides services that are designed to reduce the work that issuers would otherwise incur in designing, implementing and negotiating the sale of securities.

In the absence of a municipal advisor, an underwriter assists the issuer in structuring the securities in order that the issue can be sold; however, this is not the same as serving as a financial advisor. An underwriter primarily represents the buyers of the securities. In contrast, a municipal advisor acts in a fiduciary capacity solely as agent to the governmental unit.

Because advice may come from either an underwriter or a municipal advisor, it's important for issuers to understand the regulations affecting the advice given by a municipal advisor compared to advice given by an underwriter.

The relationship between a municipal advisor and the issuer and the relationship between an underwriter and the issuer were codified by the Securities and Exchange Commission ("SEC") in 2014 as part of the rulemaking required by the Dodd–Frank Wall Street Reform and Consumer Protection Act (the "Act") passed in 2010. A "Municipal Advisor" is generally defined as any person that provides advice to or on behalf of a municipal entity with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues.

Municipal advisors are regulated by the SEC and primarily by the Municipal Securities Rulemaking Board (the "MSRB"). In addition to regulating the activities of municipal advisors, under the Act the SEC and the MSRB regulated the activities of underwriters including in particular when and what advice could be given by an underwriter. The municipal advisor rules insure that the advice issuers are receiving is being given by an individual with a fiduciary duty.

Alternatively, when the advice is given by an underwriter, disclosures must be made to issuers so that they know the advice does not necessarily reflect their best interest. More specifically, the relationship of an underwriter to issuers must now be provided in writing under the MSRB's Rule G-17. Rule G-17 requires underwriters to disclose that they are not acting as your municipal advisor and that their role is to purchase securities with a view to distribution of the securities in an arms-length commercial transaction. Rule G-17 also requires the following written disclosure: **"Unlike municipal advisors, an underwriter does not have a federal fiduciary duty to issuers and is not required to act in the issuer's best interest without regard to its own financial or other interests."** In other words, the MSRB requires underwriters to disclose that they are not required to act in your best interest. Consider that the underwriter's goal is to sell securities to investors. What do investors want? Answer: They want the highest possible interest rates. What do issuers want? Answer: The lowest possible rates.

While underwriters often tell issuers that they do not need a municipal advisor, issuers need to know that such a statement is a violation of MSRB regulations. Rule G-17 prohibits underwriters from advising issuers not to have a financial advisor.

Regardless of any disclosures, the SEC granted only three exemptions by which an underwriter may provide advice on municipal securities.

1) Request for Proposal. One exemption, called the Request for Proposal ("RFP") exemption, allows an underwriter to provide ideas, advice and recommendations in connection with a request for proposals. However, certain conditions apply. In particular, the RFP must be prepared by either the government entity or by its municipal advisor and must be publicly posted or sent to at least 3 underwriting firms that are considered to be reasonably competitive market participants.

2) Underwriter Exemption. Another exemption, called the underwriter exemption, permits an underwriter to provide advice relating to the structure, timing, or the terms of a municipal securities issue when the underwriter is engaged for a **specific transaction**. Because this exemption relates to a specific

transaction rather than to a particular client, the exemption begins at the time of engagement, on the specific transaction and terminates when the underwriting period has ended.

3) Independent Registered Municipal Advisor. Another exemption is called the Independent Registered Municipal Advisor exemption (otherwise known as the IRMA exemption). If you have a municipal advisor and rely on your municipal advisor for advice then, under certain circumstances, the underwriter can also give you advice.

Unless an issuer has engaged an Independent Registered Municipal Advisor, the underwriter is precluded from providing the 12 services summarized below. The SEC indicated that these "activities are outside the scope of serving as an underwriter" under the underwriter exemption.

Underwriter Prohibited Activities

1) Investment Strategies	7) Competitive sales
2) Derivatives	8) Financial feasibility
3) Method of Sale	9) Budget planning
4) Determination to Issue	10) Overall rating strategies
5) Election Campaign	11) Financial Controls
6) Capital Planning	12) Terms of RFPs

In the context of a negotiated sale the services provided by a municipal advisor typically include the following:

1. Assistance in determining the amount to be borrowed,
2. Assistance in determining the debt structure,
3. Preparing or assisting in the preparation of the official statement,
4. Assistance in preparing the other financing documents,
5. Assistance in obtaining the rating,
6. Assistance in determining the timing of the sale and scheduling events relating to the sale,

7. Preparing a request for proposals used to select an underwriter, and
8. Negotiating the final rates and prices with the underwriter selected.

For any municipal transaction an important question is whether you need a municipal advisor. First it's important to know that there are no Federal laws requiring the engagement of a municipal advisor. However, I can't imagine why an issuer would want to engage in a major capital project without having a municipal advisor. Issuers benefit from the engagement of a municipal advisor with the exception of very small private placements such as bank financings for vehicles and equipment. Certainly issuers would benefit from the advice provided by a financial advisor for any transaction over $1,000,000.

This is a perfect segue to private placements. If you are planning to lease vehicles or equipment or finance a small capital project (something less than $1,000,000) it may make sense to arrange the financing with a local bank (which is of course a private placement). However, for any large transaction it is a terrible practice to obtain a bank loan without the benefit of a municipal advisor. A municipal advisor can prepare a request for proposals and help you obtain favorable rates and terms by selecting the bank lender submitting the most favorable proposal. Alternatively, a municipal advisor can analyze the cost of a private placement or bank loans compared to a public sale. I know many municipal officials like bank loans because they are easy to obtain, don't require a lot of your time and have lower costs of issuance. However, bank loans often have much higher rates than publicly sold securities. In addition, banks generally will not enter into municipal loans that extend beyond 10 years unless the loan includes a rate reset and bank loans often include unfavorable terms such as resetting rates if there is a tax law change. In fact, the terms can be so unfavorable that the loans can negatively impact your bond rating. Yes, the process of obtaining a bank loan is easier than a public sale, however, the role of a finance director is not to obtain the easiest available financing. The role of a finance director is to obtain the most favorable financing available based on terms and cost.

In conclusion, I would like to emphasize that if you don't have a municipal advisor there is no party to your transaction working solely in your interest to establish favorable financing terms and to reduce your financing costs. A municipal advisor is like having an insurance policy that guarantees you will receive favorable financing terms and low financing costs.