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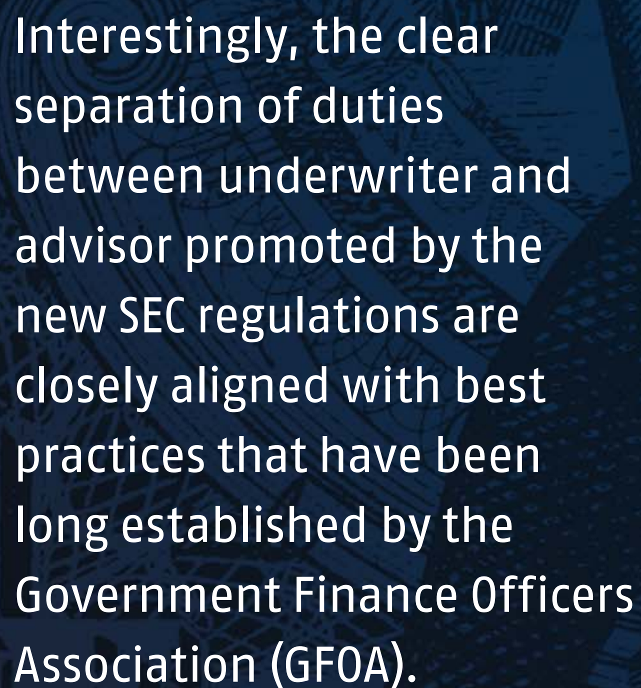

Interestingly, the clear separation of duties between underwriter and advisor promoted by the new SEC regulations are closely aligned with best practices that have been long established by the Government Finance Officers Association (GFOA).

By Mike Sudsina

How New SEC Regulations Will Impact Your Next Bond Issue

In September 2013, the Securities and Exchange Commission finalized its municipal advisor (MA) definition in accordance with requirements dictated by the Dodd–Frank Wall Street Reform and Consumer Protection Act.

Dodd-Frank was enacted by Congress to ensure that the public was protected against unscrupulous financial products and activities by various sophisticated financial market participants that were largely responsible for the 2008 economic meltdown blamed on the mortgage loan crisis.

Dodd-Frank's impact has reached the municipal debt market in the form of regulations intended to protect issuers of municipal debt (for example, Ohio school districts) from advice that might not be in their best interest. To do this, the SEC has begun to regulate municipal advisors (commonly known as financial advisors) that had never before been regulated. In doing so, the SEC also recognized that bond underwriters, whose role is to find investors for municipal debt, have traditionally provided advice to issuers on how the debt should be structured and sold to investors. The SEC determined that such advice could create a conflict of interest since the bankers are looking to provide investors the highest possible interest rates and advantageous debt structures to meet investors' objectives, while, at the same time, representing to issuers of debt that they are seeking the lowest possible interest rates and most optimal structures for the issuer, for the purposes of this article, Ohio school districts.

At the same time, the SEC recognized that independent advisors, who are solely interested in what is best for the issuer, should be monitored thereby giving rise to the new MA regulations. To that end, not only are specific regulations and new reporting requirements aimed at the MA, but the SEC has also levied a fiduciary duty on advisors requiring a duty of loyalty to their clients and that they place client interests ahead of their own.

The SEC, through its regulatory arm, the Municipal Securities Rulemaking Board (MSRB), has long held that an underwriting firm cannot serve as financial advisor for an issuer then later switch roles to underwriter for any given transaction (MSRB Rule G-23).

To be in position to offer advice to a school district regarding a bond issue or other debt transaction, yet clearly set itself apart from the MA and avoid a fiduciary duty to the district, bond underwriters must meet newly created exemptions designed by the SEC.

There are three primary methods for an underwriter to be exempt from the MA regulations:

1. Have the district conduct a request for proposal process open to at least three different underwriting firms,
2. Have officially engaged the underwriter prior to advice being rendered, or
3. Have a municipal advisor on board to represent the district's interests prior to engaging the underwriter.

Rendering advice without meeting the exemption standard will exclude the underwriting firm from being able to underwrite the bonds.

According to the SEC, advice includes recommendations with respect to the issuance of municipal securities, including the structure, timing, terms, and other similar matters concerning such debt issues.

Advice does NOT include:

- Information of a factual nature without subjective assumptions, opinions, or views.
- Information that is not particular to a specific municipal entity or type of municipal entity, that calls for action.
- Information that is widely disseminated for use by the public, clients, or market participants other than municipal entities.
- General educational materials.

Being independent, yet well versed in the financial markets, puts the MA in a unique position to assist a school district with the RFP process and negotiating the terms of the underwriter engagement. Whether or not represented by a municipal advisor, issuers are now required by MSRB Rule G-17 to acknowledge that they understand the underwriter has financial and other interests that differ from those of the issuer.

Interestingly, the clear separation of duties between underwriter and advisor promoted by the new SEC regulations are closely aligned with best practices that have been long established by the Government Finance Officers Association (GFOA).

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The GFOA recognizes that most issuers of municipal debt (like Ohio school districts) do so infrequently and therefore lack in-house expertise in debt management. As such, the recommendation is that an advisor without an interest in the sale of the debt be engaged to provide relevant advice. All the SEC has done is to recognize this recommended practice and develop regulations to guide the effort. At the same time, the MSRB is charged with developing training and certification requirements for MA's. Fortunately the National Association of Independent Public Finance Advisors has been providing testing and certification for its members for many years.

Although this topic can be quite complex, the aim of the new regulations is to encourage best practices by issuers and other professionals, resulting in a stronger municipal market.

The effective date for the new regulations was to be January 13, 2014 but the SEC has since move it to July 1, 2014.

Additional resources can be accessed on the web at:

www.gfoa.org/downloads/GFOAmarulebriefjan2014.pdf

naipfa.com/wp-content/uploads/2014/01/MA-Misconceptions-Final-v2.pdf

www.gpo.gov/fdsys/pkg/FR-2013-11-12/pdf/2013-23524.pdf.

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