

Comment on Notice 2014-01

from Lex Warmath, Raftelis Financial Consultants, Inc.

on Monday, March 10, 2014

Comment:

Please see attached.

1 file(s) uploaded successfully.

Questions for Draft MSRB Rule G-42.docx

Draft MSRB Rule G-42 on Duties of Non-Solicitor Municipal Advisors Comments and Questions

Background Information and Context:

Our firm provides financial planning and rate consulting services primarily to government-owned water, wastewater and storm water utilities. This assistance includes developing financial planning models that provide forecasts of utility revenues and expected financial results, particularly as these results are impacted by various capital planning and debt financing strategies and alternatives. This information often includes general assumptions related to funding sources to meeting capital investment needs, including various forms of borrowing. In addition, our firm is often engaged to provide financial forecasts and supporting documentation, in the form of a financial feasibility study report, for a particular debt issue or borrowing, and these reports are typically included as a component of the Official Statement for revenue bonds, or as a component of the applications and formal documentation required for private placement loans or applications for State Revolving Fund Loans and other types of borrowing.

Our interpretation of the rules and regulations related to Municipal Advisors, both adopted and proposed, as they relate to the general financial planning and rate studies that we provide for government-owned utilities, is that this level of assistance may, or may not, fall under the regulations for a Municipal Advisor. For example, in some studies our revenue forecasts may be based on assumptions for the timing of capital expenditures, including the timing, amount and terms of future bond issues developed internally by the client, or by other advisors engaged by the client. In other studies, the forecast is more general and does not address specific borrowing assumptions and is similar to the general forecasts of demand and capital investment needs that might be developed by an engineering firm as part of a master planning engagement or similar type of study; and that are excluded from the activities that constitute Municipal Advisory services. In other cases, our scope of work may include developing assumptions as to the amount, timing and terms for future bond issues as a component of a more comprehensive financial plan, which would be more likely to fall under the definition of Municipal Advisory services.

However, for any engagement related to a specific bond issue, loan, or borrowing, we believe our services and role clearly does fall under these regulations and we have been registered as Municipal Advisor since the new guidelines and regulations were first proposed. Although we do not provide specific recommendations with respect to the structure, timing, terms and other similar matters concerning a specific financial product or loan, we do incorporate this type of information, as provided by the client's Financial Advisor or underwriter, into our models and forecasts. The resulting impacts on customers, rates, financial results and debt service coverage, as generated by our financial forecast models, may then be used by the issuer and their other financial advisors to adjust or fine-tune the terms of the loan to provide a more feasible and acceptable plan for financing the necessary capital investments. In other words, although we do not provide specific recommendations on the structure, timing, terms and other similar matters, we do participate with the other members of the financial advisory team (including the Financial

Advisor, underwriter, underwriter's counsel, bond counsel, municipal attorneys, and other members of the issuer's staff and/or governing body) to help structure the borrowing to meet a broad range of financial planning objectives. As an integral part of these types of engagements, we consider ourselves to have a clear fiduciary duty to the municipal entity, including a duty of loyalty and care.

Questions and Comments:

- 1) We recognize that our interpretation of the rules and regulations affecting Municipal Advisors may not be consistent with the intent of the MSRB and SEC. In particular, we are concerned that since most of our financial planning models include assumptions related to future borrowing needs, including the expected timing of the loans and assumptions related to the term and interest rates that may be applicable, that almost all of our financial planning studies might fall within the definition of Municipal Advisory services. In many cases, the assumptions used are not particularly detailed and are not represented as terms that could actually be secured for a loan, but are intended only to provide a reasonable basis for general planning and to assist in the evaluation of different capital investment plans and funding sources to address those plans. In some cases this information may never be used to support the issuance of debt. In other cases, this information may be updated to include the terms and conditions for a specific bond issue and included in a formal feasibility study, as described above, as part of a separate and distinct engagement to provide assistance with issuing a specific bond or loan. In some cases, the forecast provided by our financial planning models may be used as part of the documentation supporting a loan application without any adjustment to reflect the particular structure of a proposed loan. Since the financial planning models we develop become the property of our clients, the forecasts generated by the models may be included as part of an official statement or other loan documentation without our involvement or even our knowledge and consent. In this case, the forecast would be represented as having been prepared by the municipal entity, and not by our firm.

In other words, we have tended to make a distinction in our interpretation of the Municipal Advisor rules that financial forecasts developed as part of a broader financial planning engagement would not fall under the regulations for a Municipal Advisory Relationship; whereas engagements related to a specific bond issue or financing involving preparation of a financial forecast as part of a bond feasibility study would fall under these regulations. Clearly, based on the guidance provided so far, there is much room for interpretation and a lot of gray areas that need clarification. Any information you can provide to help address this concern or to identify specific circumstances or conditions where the Municipal Advisor rules would apply would be useful. This determination has significant implications for the disclosure requirements and other aspect of the draft Rule G-42, as discussed below.

- 2) Comments related to Section (c) - Documentation of Municipal Advisory Relationship:

If our interpretation of the Municipal Advisor regulations is appropriate, then it would not be difficult to address and comply with the requirements specified in this section. Our intention is to develop a specific document, for acknowledgement by each client, to address most of the requirements outlined in this section as part of any engagement to provide debt

issuance support or a bond feasibility study associated with a particular loan or financing. However, if it becomes evident that a Municipal Advisory Relationship is deemed to exist for a significant majority of our ongoing engagements to provide general financial planning and rate setting assistance, this requirement would become significantly burdensome. At any one time, our firm might be engaged in as many as 50 to 75 active projects that would fall into this category and reporting and updating this information would be time consuming and provide little or no value to an individual client. Requirements to provide information on the form or basis of compensation and the reasonably expected level of compensation would be problematic since the scope of work included in the various types of projects that might be included under this broader interpretation can vary significantly, with comparable variations in the level of compensation.

In comparison, active engagements to provide debt issuance support or bond feasibility studies associated with a specific loan or financing would typically include fewer than 10 engagements. These projects typically have a fairly limited and clearly defined scope of work and related costs that would be easier to document and update. To this point, we would also include language in our written documentation to define the scope and limitations of the engagement that clearly states that once the debt has been issued and all documentation for the specific financing has been completed, that our role as a Municipal Advisor would be complete and terminated (per section (c)(vi)), even if we remain actively engaged in providing other services to the same client. Only in this way will it be possible to meet the reporting and disclosure requirements outlined in this section. We believe this to be an appropriate approach since by the nature of the services we routinely provide, we always maintain a fiduciary duty to our clients, including a duty of loyalty and care, regardless of whether a Municipal Advisory Relationship is currently in effect.

Response to specific questions listed in the Regulatory Notice (pp 15-16):

- 1) No comment.
- 2) We believe that a Municipal Advisory should be allowed to limit their responsibility to review the official statement. Since our firm does not include attorneys, it would not be appropriate to opine on most of the information in an official statement. We would seek to limit our responsibility to reviewing the financial feasibility report (usually included in a separate appendix) and any sections of the official statement that addressed information relevant to the financial feasibility report, such as descriptions of the utility system; planned capital improvements; forecasts or projections of revenues, coverage, rates, customer demand and demographics; rate structure information and proposed rate adjustments; coverage requirements and the additional bonds test; comparisons of utility costs and rates to other jurisdictions; and other similar and related information.
- 3) Generally we believe Rule G-42(c)(vi) would have this effect and would benefit the municipal entity.
- 4) We agree.
- 5) Not applicable to our firm.

- 6) We agree.
- 7) No opinion, although it is our intention to request a written acknowledgement that addresses this issue.
- 8) Yes.
- 9) Yes, we believe professional liability insurance should be required, but the amount of that insurance should be determined by the municipal entity, not the MSRB.
- 10) No comment.
- 11) Similar to our position that it is not beneficial to the municipal entity to require all Municipal Advisors to review the entire official statement, it may not be beneficial to require all Municipal Advisors to review the feasibility study. But the same type of written acknowledgement that this was not part of a particular Municipal Advisors scope should be required.
- 12) Not applicable to our firm.
- 13) No comment.