

CDIAC Webinar Transcript
Regulatory Update: The Municipal Advisory Rules
and Their Effect on Public Investments
June 23, 2014

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The Municipal Advisory (MA) Rules become effective July 1, 2014. With the implementation date fast approaching, this webinar focuses on the MA Rules and their implications for treasury management and the investment of bond proceeds. This webinar addresses the issues related to investment advice provided by broker-dealers, the MA Rules' exemptions and exclusions that apply to broker-dealers selling and managing public investments, and the application of the rule to the management of pooled investments.

Title Slide: Regulatory Update: The Municipal Advisory Rules and Their Effect on Public Investments

Mark Campbell: Good morning, everyone. This is Mark Campbell, the Executive Director with CDIAC. I want to welcome you to our webinar this morning - Regulatory Update on the Municipal Advisory Rules and Their Effect on Public Investments. Our program today will run until 11 o'clock, but we certainly want to recognize there may be follow-on questions, and we will try and address those through the panel. Again, welcome. Our presentation slides are available the CDIAC website. Your slide on your screen should have the URL for that link. Captioning is also provided during the program. Participants may click on the link in the chat section at the bottom of the control panel to access remote captioning. And then, again, to submit questions during the webinar at any time, send us your comments or questions in the box marked questions near the bottom of the control panel. I want to cover just a couple points on certificates of attendance. If you do need one, you must first register and log into the webinar under your own name. A certificate will be e-mailed to participants hopefully by the end of the week. For those requiring MCLE credit, please e-mail CDIAC at CDIAC_education@treasurer.ca.gov. So I know we've got a lot of material here to cover on a very timely issue. I'm going to turn it over very quickly by introducing our moderator.

Slide 1: Municipal Advisor Rules as They Apply to Investment Advice

(01:38)

Mark Campbell: Arto Becker is a partner with Hawkins, Delafield & Wood. He has over 30 years of experience in many areas of public finance, including general obligation bond financing, cash flow financing, COPs and lease revenue bonds financing, revenue bond financing, education financing and a whole slew of other things. He served as bond counsel, underwriter counsel, and disclosure counsel for many types of issuances by a variety of public issuers in California. So with that, Arto, I'll turn it over to you.

Slide 2: Introduction and Context**(01:47)**

Arto Becker: Thank you, Mark. Good morning to all. This presentation will review the application of the Municipal Advisor Rules on treasury management and the investment of bond proceeds. While several aspects of the potential impact of the Municipal Advisor Rules have been reviewed widely and in great detail, the effect that these Rules will have on the management of public funds has not received specific attention. The panelists will review some of the most important details of the Rules, but will also focus on the practical and immediate implication of these Rules, including how they will affect pool investment funds and the investment of bond proceeds as well as the relationship between public agencies and brokerage firms. The panelists, who will review and discuss this subject, are uniquely capable of explaining this complex subject.

My partner, John McNally, is a nationally recognized expert in the area of public finance securities law. John has almost 40 years' experience in public finance. He has worked with municipal issuers throughout the country and is currently serving as disclosure counsel to the District of Columbia, the City of San Diego, and the County and City of San Francisco. He is a past president of the National Association of Bond Lawyers.

Leo Karwejna is the Chief Compliance Officer at PFM Asset Management. Leo has over a decade of experience providing compliance support to firms in the investment advisory and securities trading businesses.

Marty Margolis is the Chief Investment Officer for PFM Asset Management. Marty has been involved in the development of many statewide pooled investment programs for public agencies for more than 20 years and in structuring and pricing collateralized investment agreements, interest rate swaps, and other financial products for bond proceeds.

Jennifer Christiansen is the Investment and Debt Officer for the Santa Barbara County Treasurer-Tax Collector. Jennifer is responsible for managing the County's investment portfolio of approximately \$1 billion. Notably for us bond lawyers, Jennifer joined the County of Santa Barbara in 2001 as a municipal finance attorney with the Office of County Counsel.

John and Leo will provide a description of the legal framework of the Rules, including the applicable regulations and the FAQs released by the SEC, and will identify several legal issues presented by these requirements. Marty and Jennifer will cover some of the practical implications of doing business under the Rules. Afterwards, the panelists will answer a few questions from the audience. John, please go ahead.

Slide 3: Background**(05:33)**

John McNally: Arto, thanks. In looking at Slide 3 – this is an overview. What we are basically doing is condensing all of the materials we have available to us to guide us as we make these interpretations. And as I go through this, I'll try to identify what the source is to the extent that it is relevant. What are

the guidelines we have? We have the statute itself, which is the Dodd-Frank Act, which is going back to October 2010. The Rules were adopted in an Adopting Release in September 2013, and that gives us an extensive guidance on how to interpret these Rules.

We have the Rules themselves and their text, and the reason we're having this very timely webinar is the Rules go into effect on July 1, 2014. And then even with almost 800 pages of the release giving us information about the Rules, we have two sets of FAQs, one which came out on January 2014, the other in May 2014, and the statute gives us guidance on the definitions. It really has been in effect since October 2010 so to the extent that anyone was a municipal advisor, they had to register at that point. And also the statutory fiduciary duty was established since October 2010. In addition, the statute is the source of where we get the exclusions. So as we go through this, once again we will be drawing upon all those sources. We will be going through what we think are the key definitions to this. We will look to the advice standard, which is the heart of whether or not something is municipal advice. We will be looking to the exclusions, which by that, we mean what are in the statute. It (Editor: the Rules) say [when] you are not a municipal advisor, and through the Rules, we have a series of exemptions that the SEC has created.

Slide 4: Municipal Advisor Definition

(07:35)

John McNally: So looking at Slide 4 as we work through the definition (Editor: of a municipal advisor), and once again this is a definition that is in the statute itself. Really almost every word in this is key to the analysis we are going to go through. So it's a person who is not either a municipal entity or an employee of a municipal entity who provides advice and that advice relates to either municipal financial products or the issuance of municipal securities. Most of the webinars to date, most of the conferences to date, most of the various advisories you might have received to date deal with the second aspect of it – the issuance of municipal securities. Because of the concern that to the extent a broker-dealer is making what we call a pitch for new business, what does that mean? Does it make them a municipal advisor? What are the implications for being a municipal underwriter, etc.? And once again, there's been extensive analysis of that. What we are focusing on uniquely for this panel is: what are the implications for municipal financial products?

Slide 5: Municipal Advisor Definition

(08:41)

John McNally: And as we look to Slide 5, we then see what does it mean to be a municipal financial product. What does that definition include? And once again these are right out of the Dodd-Frank statute. So municipal financial products pick up both guaranteed investment contracts and investment strategies. And investment strategies in turn pick up the two defined terms you see here, so, in short, it picks up both bond proceeds and municipal escrow investments. So to the extent that someone is giving advice dealing with investing either bond proceeds or municipal escrow investments, that is going to trigger potentially becoming a municipal advisor.

Slide 6: What Are the Implications of Being a Municipal Advisor**(09:28)**

John McNally: So why does a broker-dealer care, looking at Slide 6, why does the broker-dealer care whether or not they are a municipal advisor? Well, once again, the statute has been in effect since October 2010, and they have had to register with both the SEC and the MSRB as such. There's a statutory fiduciary duty and we just note there that, under the statute, that applies – even though the definition of municipal advisor is providing advice to on behalf of a municipal entity or obligated person, at least as far as the fiduciary duty that applies to the municipal entity clients, not to the obligated person clients. There is the MSRB Rules, some of which are in effect currently, for example G-17 dealing with fair dealing. But most of the MSRB Rules were withdrawn – they were proposed and withdrawn until they had some further sense of just how the SEC Rules were coming out. And now we have a series of MSRB Rules coming out in proposed form, one of the more critical ones being G-42, which basically says that neither a municipal advisor nor its affiliates could do a principal trade with a municipal entity or obligated person if that was the counterparty.

The other interesting note that's not on the slide, as far as the implications, is that when you look to FAQ, Frequently Asked Questions 5.2, what the SEC said was, if you, a broker-dealer, are a municipal advisor, that in the SEC's view [that] is inconsistent. The fiduciary duty that attaches by statute is inconsistent with then becoming an underwriter of that issue. In addition, in that answer they cite to MSRB Rule G-23. So the distinction here is, if you are a municipal advisor under the Dodd-Frank statute, the SEC has concluded that there's a fiduciary duty that means you can't underwrite. In addition, they point us to MSRB Rule G-23, which has been on the books for a long time, and basically it says if you are a financial advisor, you cannot underwrite. So that's why for those that are broker-dealers, these are the concerns they have. They have significant impacts were they to be considered to be a municipal advisor. So if they were, how can they avoid being – I guess is a better way to put it – how can they avoid being a municipal advisor?

Slide 7: How Not to Be a Municipal Advisor**(12:02)**

John McNally: Well, one, in the first instance you simply don't meet the statutory definition. As we work through that definition, if it is not advice – once again the key components are: it's advice; you're giving that advice to a municipal entity or obligated person; you are not yourself a municipal entity or an employee of a municipal entity; and it doesn't relate to either bond proceeds or municipal escrow investments. So in the first instance, you can simply not meet the statutory definition and we'll work through the key components of that definition. If, nevertheless, after working through that, you conclude you may be a municipal advisor, then what you are going to look to is whether or not you meet one of the statutory exclusions, and we will discuss what they are, or do you meet one of the exemptions that the SEC has established by rule.

So now we are going to get into more of the detailed analysis and for that I will turn it over to Leo, who with Slide 8 will pick it up with the advice standard.

Slide 8: Advice Standard**(13:06)**

Leo Karwejna: Thank you, John. So now looking at providing that analysis and going to a point where you can begin to apply that to your day-to-day activities and the interactions that you have with the broker-dealer community as well as others that you may work with in the marketplace. It's important to look at the advice standard primarily and what falls within and what falls without.

So the Rule itself provides that advice excludes the provision of general information and does not involve a recommendation regarding municipal financial products. And it is important to note the SEC has provided additional clarity in the form of the FAQs to tell us more about what this means from a day-to-day perspective. And you may be surprised, but you will see that there is a good deal of information that can be shared in terms of general market information, in terms of credit quotations and additional relevant detail that you can look to in the day-to-day workings. Now, distinguish this from brokerage, where we look at the purchase and sale of escrow investments, really upon that direction of an obligated person or its financial advisor, without providing advice. And that's merely the provision of brokerage services and does not render someone into the position of being a municipal advisor. So perhaps while I try to get my microphone worked out, maybe I can bring Jennifer and Marty into the discussion a bit more for practical day-to-day perspective to talk about the inner workings of their experience and whether or not they are being provided advice in trading activities.

Jennifer Christensen: Sure I'm happy to comment on that. From my perspective and kind of going through this General Information exclusion from advice with some of the folks at the SEC, those exclusions and the examples specifically that were laid out in the FAQs sound exactly like what I am doing today and like what I will be doing after July 1 in terms of receiving information from my broker-dealers as to available inventory and then applying that to my portfolio and cash flow needs. And so for those practitioners out there, I'd really guide you to that section of examples of General Information exclusions for advice because I think you will find that it lines up very well with your daily practices and keeps you and your broker-dealers outside of the box of you receiving advice or them providing advice.

Marty Margolis: Just a couple of comments here. One is whether or not you [echoing audio feed] ask the broker for advice and expect the broker to give advice, and the second is, as Jennifer said, the way we generally operate as investment advisers, the way many investment officers operate, we expect to receive market information, we expect to receive offerings on inventory, but we don't expect to receive recommendations or advice from brokers. This is true prior to July 1st and we see ourselves continuing to operate after July 1 in exactly the same manner.

Slide 9: Municipal Advisor Exclusions**(17:15)**

Mark Campbell: Excuse me. This is Mark. I'm going to ask you to mute the speakers on your computer. You've got an echo so if you could do that, that may clear that up. Thanks.

Leo Karwejna: I think we both have it that way, unfortunately. Let's see if we can move on. So the municipal advisor exclusions.... John, I might ask you if you might take the lead here as I get reconnected. I'm going to hang up and dial back.

John McNally: Okay

Leo Karwejna: Thank you.

John McNally: Happy to do it. So the advice standards we did on Slide 8....

[Several people speaking]

John McNally: Guys, you're not on mute. Okay. So going to Slide 9 – as we mentioned there's a couple of exclusions right in the statute. One of the exclusions is whether or not you are an underwriter, and that exclusion works well for the other aspect of being a municipal advisor, namely whether or not you are dealing with making recommendations, dealing with the issuance of municipal securities. It doesn't work well in the context in which we are speaking, however, because the way the underwriter exclusion works is the SEC... the underwriter exclusions established by statute but in the release, what the SEC has done has said that there are a number of activities that they think are outside of the underwriter exclusion and one of them is advice on investment strategies. So the very thing we are saying here, we are focusing on here, would not provide an exclusion from being a municipal advisor.

The other exemption or exclusion matter is established by statute and it's for any investment advisor under the 1940 Act. And that investment advisor, and we can get into this in more detail later, but that investment advisor itself, will not be, therefore, a municipal advisor. However, as we get into the exemptions, we will see the exemption is uniquely for independent registered municipal advisors. And because the investment advisor itself has an exclusion from being an MA, they are not going to be registered. And at least on its face, that would mean the IRMA exemption would not apply to the extent a municipality were using a registered investment advisor. Dealing with Slide 10.... Leo, you let me know when you're back.

Leo Karwejna: John, let's give it a test try here. I've tried to work through some connection issues.

John McNally: Okay, so we're up to Slide 10.

Slide 10: Municipal Advisor Exemptions

(20:17)

Leo Karwejna: We're going to talk next about working with banks and looking at whether or not the interaction with the bank may in some way, shape, or form differ. So they can provide advice and it could be looking at any investments that are held in a deposit account looking, feeling, acting like a bank. What you see in front of you or some of the particulars as it relates to acting on a CD or other type of debt instrument, deposit instrument issued by the bank, the extension of credit, working with you working with you on LOCs, direct loans, funds held in a sweep account, investments made by the bank acting in the capacity of your indenture trustee. These are all the things that you would typically

think of and look at as banking activity and the relationship you have as a municipal entity with the bank that you work with.

Marty Margolis: So to be very practical about it, a bank trust officer calls up and says you have cash in your trustee account and we recommend that you invest the cash as follows.

Leo Karwejna: That circumstance would fit.

Slide 11: Municipal Advisor Exemptions

(21:35)

Leo Karwejna: Next, let's talk about independent registered municipal advisors. So on the debt issuance side, perhaps you are already working with a financial advisor, and this is someone who you work with on a routine basis when it comes to debt issuance. Looking at this through the lens of the bond proceeds, it's also important to think about whether or not they may rightfully serve as your IRMA, your independent registered municipal advisor. It's more common for them to be on the debt issuance side. It's focused on primarily within the Rule, within the release, from that perspective as well. However, there is application potentially here should you be working with someone who, within the scope of their services, is providing you advice as an IRMA on the relation of bond proceeds and the investment of those bond proceeds and investment strategies.

There are a couple of Rules that are important to think about and understand in establishing the right elements for a service provider to act as your IRMA. First, they have to be independent. This is important to think about and it is measured both at the firm level as well as the individual level. So if someone were working at the broker that you may be interacting with within the past two years, for instance, that may then disqualify them from being independent and acting as the IRMA. Someone using this exemption needs to have a representation from you in writing that you are in fact represented by and will rely upon – and “rely upon” has been really focused in for us by the SEC – it's not that you must rely upon, it's must that you must at least consider the advice of that independent registered municipal advisor.

Marty Margolis: And again as a practical matter, I would say that the third matter is whether they are qualified and knowledgeable. So if they are acting on the debt side as fiduciaries, they have a responsibility not to act on the debt side if they are not qualified and knowledgeable, and you extend that to the investment side. And ultimately, the same set of issues arises. Are they qualified and knowledgeable?

Leo Karwejna: It may in fact limit the application here for many IRMAs given their focus and expertise primarily on the debt issuance side. Perhaps there are circumstances, but it may in fact limit the application of that IRMA exclusion.

Slide 12: Municipal Advisor Exemptions

(24:05)

Leo Karwejna: Let's turn our attention to the RFP/RFQ exemption.

Arto Becker: Leo, could I interrupt and ask you to follow up the question on the IRMA exemption? How will that impact your broker-dealers who are used to making business with public agencies? How is the scope of services established? How do you do business on a daily basis while engaging an independent agent?

Leo Karwejna: Arto, it's an excellent question. I'm going to actually table it just for a few more slides. We are going to get into the specifics of that particular question in much greater detail. There will be potentially some impact depending on the activities that you undertake. There may be little to no impact. If that's not a broad enough answer, we will get into more specifics as we go forward.

The RFP/RFQ exemption, this really focuses in and provides you an opportunity where if you are out seeking advice, seeking information, it can reasonably be relied upon by the other party that would provide you with that advice. However, it must be done in a response that is requested in writing or orally to requests for proposals or qualifications from you as an entity in connection with the product. So looking at this from a day-to-day perspective, one of the things that [it] would be helpful is to bring in some additional color from Jennifer's perspective on the issuer side and perhaps from Marty's as well from the investment advisory side. Jennifer, can you tell us your thoughts in regards to the use of the RFP exemption on a day-to-day basis?

Jennifer Christensen: Sure. Well, from an investment side versus when we're going to market on an issuance, but from an investment perspective, originally I didn't think there would be much ability to utilize this. My understanding now though is that from the perspective of some municipalities and the SEC in conversations that those parties are having, this RFP or mini-RFP exemptions can be used on a day to day basis and in fact maybe in a fairly generic way so that if the municipality that is perceived or is actually initiating this request for information, and it can be a pretty broad request that goes back to show me what you have that fits this criteria. And there is a model or a template that is available over at the GFOA website that I guess the municipalities and SEC seem to like for day-to-day requests for information that get initiated by the investor side or the municipality side. So there is some workability here that seems to be developing.

Marty Margolis: The comment I would make is, as an investment person, you want to be very thoughtful about whether what you are asking for is advice or recommendation which implicates this Rule or you're asking for an offering. So bond proceeds, I think you can say offer me, send me a list, offer me all of the A-rated corporate obligations that you have that mature between three years and 39 months. And I would suggest that the broker who does that is not giving you advice or recommendation. Or you could say I've got \$10 million to invest out three years. What would you recommend? I would say in the second case that the broker who responds to that is giving you a recommendation for advice. So picking up on Jennifer's commentary, in the first case I would say IRMA or a mini-RFP. In the second case, I would say – subject to other views of people on the phone – I would say business as usual.

Leo Karwejna: So as we draw near to the end of this portion of the discussion, I think as we look through the context John has provided in regards to the Rule itself overall, as we look at what some of

the exemptions are, the way the Rule has been fashioned provides an ability for you to have some level of control as well as some level of administrative burden potentially. But I think there is a discussion and a review that needs to be looked at that really starts with you the entity, you the issuer, and what your comfort level is and what your level of staffing and expertise is, and also at what you see is the relevant areas that this will affect you from a day-to-day perspective. I'm going to stop there and turn things back to John and ask him to talk to us a bit more about the bond proceeds themselves and define a bit further how that plays in.

Slide 13: Bond Proceeds

(29:40)

John McNally: Thanks, Leo. So once again, I keep coming back to the key step-thru definition of what is a municipal advisor and it's advice, and what we're discussing is advice to a municipal entity dealing with investing, at least in part, investing bond proceeds. And as we discussed, advice is not simply general information. It's not simply saying give us a quote on XYZ security. It's a recommendation. So we discussed that definition, that key component of being a municipal advisor. Now what we want to go into in a bit more detail: is the recommendation is investing bond proceeds, what are bond proceeds for purposes of this definition and what are the implications.

On Slide 13, we note that both the GFOA and NAST have recently issued some guidance on their recommendations on how to approach this question. Really just a footnote perhaps, but the NAST advice, at least one of the elements of the advice, is for a letter to run from the person handing the state treasurer account to the broker dealer by which they would say to the broker-dealer you're neither providing us with advice or investment strategies, nor recommending any action by us. I'm not sure that works. I think the purpose of the statute is to protect the municipal entities, the state entities, and I think it's going to be an objective question. Either the broker-dealer is providing advice or it's not. And I don't think the issuer can say you are not providing us advice and therefore there is no fiduciary duty. If it's advice, there is a fiduciary duty.

Slide 14: What Are "Proceeds"? (Rules)

(31:38)

John McNally: We also want to discuss how you determine whether or not what you have in your portfolio is bond proceeds. And the SEC gave us some guidance about how to handle that depending on whether the proceeds arose pre- or post-July 1, namely pre- or post- the effective date of the Rules. So what are proceeds? And these are, what we quoted here are guidelines from the Rules. And for those of you that are on the investment side, it may look very familiar. These are basically incorporating here federal tax law concepts as to what are proceeds. So it's not only what we would commonly think of as proceeds, namely the first item, those which arise from the bond issuance. It's also the investment income from such monies. Then in the third bullet, to the extent you are setting aside monies that's reasonably expected to be used as security or a source of payment, so that tax concept of whether or not it set aside and dedicated to that service, and then investment income from such monies. So all four of those are determined to be, or defined to be in the Rules, bond proceeds for purposes of determining whether or not you are getting advice on the investment of bond proceeds.

Slide 15: What Are “Proceeds”?**(32:53)**

John McNally: So looking to Slide 15, the first bullet is speaking to the fact that when the SEC was developing the Rules, some of the commentators came in and said well, once it's co-mingled with other funds and it is all in one portfolio, shouldn't they lose their characterization as bond proceeds? And the SEC said no. But they did incorporate in the Rules, once again, a tax concept that said once they are spent to carry out the authorized purpose, so in short, once you have spent them for an authorized purpose, there is no need to continue to trace whether or not they may constitute, or have as their source, bond proceeds. They did speak particularly to pension bonds and said to the extent you have proceeds of POBs and you put them into the portfolio that's going to pay for the pension that they lose their characterization. However, when you look to the FAQs, and once again all of these slides are simply summaries – you have to look to the exact language. But when you look to the exact language, they do say however if you are segregating the monies in a portion of the pension portfolio so that you can determine and identify them as bond proceeds, they will be treated as bond proceeds and therefore potentially picking up the municipal advisor concept. So I mentioned that there is a difference between pre- and post-July 1 and the concept of whether or not you have to track and if you do track, how do you track. And for that kind of detail back to Leo, if you please.

Slide 16: How to Track “Proceeds”**(34:35)**

Leo Karwejna: Thanks, John. So now we have led ourselves into the dilemma of, with the Rule in mind and understanding what impact and what effect it has on the partners we have from a brokerage perspective, what are some of the things that are unfortunate consequences and implications coming from a compliance officer's perspective, looking at the documentation that's necessary and thinking about what level of understanding and comfort you might have in providing information that allows for you as an entity to track whether or not how you are investing and what investments you are putting through a brokerage partner may in fact be proceeds. So as we speak today, I'm sure many folks have received various forms of notice, certification or representation that ultimately with legal colleagues and compliance colleagues at large have really resulted from trying to make sense out of how best to protect their entity and how best to continue to service working with yourselves as municipal entities and yet get comfort around whether or not they need to register as a municipal advisor in the first place, which I think generally speaking is something that unless it is core to your business you may wish to avoid.

The tracking of the proceeds themselves prior to May 19, when the more recent update to the SEC's frequently asked questions, really had you in a position where you need to know or reasonably should know that an account or existing investment in fact is connected to, contains the proceeds of, municipal securities. May 19 gave us a lot more information and really in sort inserted a reasonableness factor that allows for you as an entity, and perhaps more importantly for your financial partners or brokerage partners, to put in place a reasonable procedures that put in place day-to-day, whether or not there needs to be segmentation of your assets so if you so decide that if you want to receive advice, that they can make a decision on whether or not they need to be registered in the first place.

Slide 17: Post July 1, 2014**(36:40)**

Leo Karwejna: The tracking of the proceeds really stems from whether or not they lead from a prior issuance, and as they move through the various accounts, be it a pool-type investment, be it a direct investment account, or be it something other in terms of a municipal product, there is a necessity to continue to tie and register if you will whether or not they are from the bond issuance itself.

Post-July 1, this really now kicks into full effect from the SEC's perspective. Looking at this, investments of newly-arising proceeds after July 1 received from municipal securities that are issued on or after that date, market participants – this is primarily aimed at your brokerage partners – need to develop policies and procedures to reasonably determine whether or not the advice provided involves the investments of those proceeds in the first place. So what does this mean? This means that besides the forms that we may have been receiving as municipal entities, there now will also be some segment of reasonable policies and procedures that will allow for the discovery and a reasonable understanding as to what the nature of the investments are that are being placed, so that if a broker were to select or choose to continue to provide advice, they would now know and understand assets that are not in fact, dollars that are not in fact investments stemming from bond proceeds and other more general investments that may be operating funds or longer-term investments that are not fruit of an issuance in that sense.

Slide 18: Post July 1, 2014**(38:45)**

Leo Karwejna: So what are those policies and procedures? I suspect they will be in addition to the things we have talked about so far in regards to some of the exemptions that are available, these will now document an understanding of, just as now when you open a new account you have to answer certain questions as to the investment objective perhaps or the nature of your entity, who the primary contacts are. There will now be questions and answers for you to discover whether or not the monies coming into that account or flowing through that account for brokerage purposes are in fact bond proceeds. As a practical matter, there will likely be segmentation if there are bond proceeds going through those accounts. If there's not otherwise an exemption available or you have not otherwise instructed not to be in receipt of advice or recommendations from the broker.

Slide 19: Investment of Bond Proceeds**(39:47)**

Arto Becker: Thank you, Leo. The balance of the presentation revolves around a series of questions and answers we have set up in the PowerPoint presentation. CDIAC received several questions in advance of the presentation, some of which we have addressed. The following questions present some of the topics that merit particular emphasis. On Slide 20, we ask further about the advice standard.

Slide 20: Questions and Answers**(40:12)**

Arto Becker: One of the questions that we received this morning asked whether a broker-dealer receiving a request for investments responds with identifying one item out of a complete inventory holds, is that advice? Jennifer, John, would either one of you wish to respond to that?

John McNally: I think to the extent the municipality says we would like a bid or pricing information on X security, that's simply general market information and would not be a recommendation. But once you go beyond that and say we are interested in investing, we currently have \$10 million invested in securities X and Y, we are interested we are interesting in return, how can we restructure this? Once you get into something more than simply giving price information or general information, it becomes a recommendation. Now, I think Jennifer mentioned and I will let her speak to this, but to the extent that there is an RFQ or an RFP that says that same question, we are interested in how to restructure this portfolio, please send us your responses, the beauty of that is it then picks up the RFP exemption so that those that are responding to it would know they are not municipal advisors.

Jennifer Christensen: The one thing I would say is the more specific we as investors can be as to the structure that we are looking for, that gets my broker-dealers off the hook for providing advice. I can give them the strategies, I can give them the structures, and they can respond to those things with what they have that would fit within those options. But there is a slippery slope that you start to get down as a broker-dealer when the broker-dealer is providing the structure based on general requests coming from the municipality. So from my perspective, when I'm doing this, I'm going to be trying to be as specific as I can be in not only my request, but what structures I'm looking for and then again fitting that within my portfolio needs.

Leo Karwejna: And I would just add that I think some of this has to do with the nature of how your entity today is operating and structuring the use of professionals in the marketplace. So depending upon whether or not you may be a large organization with full-time staff focused from an investment perspective or a day-to-day perspective in terms of portfolio managers, perhaps traders or risk managers, all the way through to perhaps as an entity with a smaller budget, a smaller outstanding balance in terms of investments, I think there is a filter that needs to be applied as to how this impacts and how that affects you. In all instances, you can receive general information. I think you need to think about how best to set up the administrative aspect of this in order to be able to continue to control the flow of that information and put yourself into a position to either rely upon one of the exemptions we've talked about or perhaps set yourself up in the instance where you do not wish to receive advice or recommendation, to let the brokerage community know about that.

Slide 21: Questions and Answers**(43:59)**

Arto Becker: Thank you. Slides 21 and 22 review the exemptions for independent registered municipal advisors and registered investment advisors. Leo, we've touched upon this already. You've mentioned the letters and certifications that are being considered to document the practice under these exemptions,

in particular anything further on those letters, various forms are being suggested by various parties, anything unique to refer to the impact in dealing with obligated persons in connection with conduit bonds.

Marty Margolis: And we've spent a fair amount of time talking about whether the threshold issue of whether or not you're going to receive advice. If you decide you want to receive advice, the brokers are going to want to have an IRMA in place. And the set of operational questions of course is how does all of that work? Because the advice that you receive will have to be made available to the municipal advisor in a timely manner and a complete manner so the municipal advisor is able to provide recommendations to you, the municipal entity. You don't need to respect the recommendations, you can decide on your own, but you need to receive them. So the idea may be easy at first, the idea, well, I will just get an IRMA signed up and that will take care of things, from the perspective of the broker-dealer it is sort of, kind of might take care of things but as a practical matter from the perspective of a municipal investment official, it's a whole different world than the world that most of you are accustomed to being in. And so crossing the threshold from not receiving advice to receiving advice through an IRMA is something that you really have to think through and work through.

John McNally: As we discussed, there are couple of exemptions. One obviously is the IRMA. The other is the RFP. And to the extent that you, as I mentioned, said, we currently have the following investments, we're interested in restructuring along the following lines, we're interested in achieving some greater performance etc., whatever. To the extent that's put into an RFP approach, then those responding to the RFP would know by definition under the exemption that they are not a municipal advisor even if what they are doing is giving advice.

Arto Becker: Let me follow up with two questions we've received on this subject as we are talking. The first is who does [the] IRMA talk with, the broker-dealer or does the municipality talk with the IRMA? And related to that, someone asked the specific question, Can an issuer, a public agency investor, ask the broker for advice on "where is the sweet spot in the market so I can get my investment there?" Is that advice? Jennifer, John?

John McNally: I think so. I think anything that is in any way tailored. My tendency would be to be very cautious on where it crosses the line. And I think if you start saying "where is the sweet spot." Clearly if there is one objective answer that every broker-dealer would give you, it's not advice, but if you are asking it because you think different broker-dealers have different ideas on that and different options, once you start asking them for, in effect, a recommendation, it is advice.

Jennifer Christensen: I think you can work within the...I think sometimes it is how it is phrased in answer to a question like that, where is the sweet spot, but if you look at the examples for general information for the general information exclusion, there is some room here to navigate with the general market and financial information examples. But it is a place that I think the broker-dealer, not giving them advice, but I think this is where they need to navigate and proceed somewhat cautiously. And it really does get back to the two parties in the relationship, me as the investor and my broker-dealer, and figuring out how we are going to communicate with each other and never get into that advice spot. I,

myself, do not have an IRMA and do not imagine that I will be utilizing one at least here in the near future, as of July 1 anyway. So I'm going to have to live in this place, this general information exclusion and figure out how to continue to do business and maintain relationships with my broker-dealers, and it's going to be right here in these examples. I probably wouldn't phrase the question that way, "where is the sweet spot," but I will certainly be talking to them about yield curves and where the market is at and, generally, where we might think things are going.

John McNally: You know I think, if I can just follow up to that, Arto, I think what bears emphasis here – and we perhaps have not done it enough throughout this – this is not a municipality's problem, it's not a county's problem. The question is will you keep getting information that you want? But at the end of the day, were it to be advice, the problem is the person giving it to you becoming a municipal advisor on subject XYZ, these Rules do not apply to municipal entities. They apply to municipal advisors. So what we are doing is giving you information about how you can continue to receive the fill of information you want, but when we start talking but crossing the line, at the end of the day it's not your problem, it's the broker-dealers problem. That really is the focus of this – when does a person, in giving you advice, become a municipal advisor?

Leo Karwejna: Just from a compliance perspective, I think that's a very, very important point to take away here. It's something ultimately has an impact on you as a municipal entity but ultimately it is something that really impacts the focus on the brokerage community and what they need to do in order to decide what role they will play in continuing to provide the services that are being provided from an investment execution perspective.

Marty Margolis: And just following up on that, I think it's useful to try to avoid making their issue your issue, if you will. So the question of who you talk to if you have an IRMA is another illustration of that. If there's an IRMA, it seems to me it's not the broker who talks to the IRMA, but it's you who is required to keep the IRMA in the loop. Again, back to the question of whose issue it really is and who has to do the work to resolve the issue.

Arto Becker: A last question on the IRMA exemption before we move forward in the presentation. A participant asks, John, Does the Rule speak to how the IRMA is compensated? May it be paid out of bond proceeds? Monies under existing bond indentures? Must it be an hourly rate?

John McNally: It doesn't address it, to my knowledge.

Leo Karwejna: No, that's right. One thing that will address it will be the MSRB's proposed G-42 in some respect in terms of the adequacy of compensation, the competency of the service provider when acting as a municipal advisor, but today it's not in the SEC's final release.

Arto Becker: Let's go to the question on Slide 24. We had a specific question from participants about the municipal employee exclusion.

Slides 22 and 23 skipped.

Slide 24: Questions and Answers**(52:22)**

Arto Becker: The question asked for counties who run separately managed accounts containing bond proceeds. Would the county or its employees be considered a municipal advisor to the school district, and would that change if the county insisted the school district hire an advisor to perform the portfolio structuring work? John, from a legal perspective?

John McNally: On the first question... Once again going back to the statute, a municipal advisor is a person who is not a municipal entity or employee of a municipal entity. Now, there is some question as to whether that meant that you were an employee of municipal entity X giving advice to entity X. But what we have through the FAQs, where they use an example of a state employee giving advice to a county. So in short, they told us that if you are an employee of a municipal entity, municipal entity X, and giving advice to municipal entity Y, you will not be a municipal advisor. And to be clear when I say municipal entity, that is a statutory term. And that statutory term includes very broadly any state, political subdivision of a state, municipal corporate instrumentality, agency, authority, instrumentality of the state or political subdivision. So any concern you have about being an employee of a municipal entity, giving advice – let's just concede, it's advice – giving advice to another municipal entity, by statute you will not be a municipal advisor. As far as the second question on the slide, would it substantially change the county's role? It depends on how you structure it, but no, at the end of the day, you should be able to do what you have been doing in the same manner.

Slide 25: Questions and Answers**(54:30)**

Arto Becker: Our last Slide 25 I think covers matters we have covered, but I wanted to ask if any of the panelists wanted to speak any further to the changing rules on July 1 and how funds are to be tracked. I think that was covered. John, Leo, was there anything further that you wanted to share on that subject?

John McNally: I can start and Leo can perhaps respond as well. I think there's been some confusion in the marketplace because a lot of letters that were written by broker-dealers were written before the most recent FAQs, and as a result of that, there were letters by which the broker-dealers would say please advise us that investment we do on your behalf is not a municipal escrow investment, is not municipal bond proceeds etc. And then some were sending letters to the effect we are going to assume it's not municipal bonds proceeds unless you tell us otherwise. So there's a lot of confusion in the marketplace between, if you will, [with] the positive and the negative letters. But I think that has been largely clarified by the most recent FAQs, which do expressly bless the negative concept for pre-July 1 proceeds. So the SEC recognized that to the extent that you have bond proceeds in a portfolio, it was a bit unfair to expect those to have been traced in the past. So if you write a letter as a broker-dealer saying we're assuming unless you tell us otherwise there are no bond proceeds here, that's fine, except in the FAQs, if it's bond proceeds arriving after July 1 – that's where Leo got into the discussion – you will have to trace if you want to then give assurance to the broker-dealer community that it's not bond proceeds.

Leo Karwejna: Two things just from my perspective and then we can move on. One thing is from a practical matter if you haven't already set up procedure from the municipal entity perspective to be able to segment and track where your bond proceeds are, you should have that conversation here relevant to issuances after July 1. That's important and it's key, and I think for the most part folks may be able to do that in some relative fashion, but you definitely want to have some policy, some procedure around how you do that more concretely going forward. And the other thing is – and I think anyone else can speak up – but I don't think that come July 2 there will be a freeze in the marketplace. I think we've talked about a number of different opportunities or options to be able to continue to work with the brokerage community to be able to move forward with execution services and to be able to continue to manage your investment portfolios, including portfolios with investment of bond proceeds, with them in a meaningful manner. And so I think that this question has received a lot of help from the most recent FAQs and has put both broker-dealers and the overall community in a position where there are alternatives, there are other options, and there is a path forward in this respect.

Arto Becker: We are at the top of the hour when this session is expected to finish, but I will ask a few more questions and look for the folks at CDIAC to cut us off when we must.

Slide 26: Questions and Answers

(57:58)

We have a question from the audience about the RFP exemption. The SEC said the RFP could cover 6 months so the question assumes this would mean the RFP would not have to be sent out on a daily basis. How broad could that RFP be? Who wishes to touch that question?

John McNally: I think the way the RFP would apply....we know how it applies in the context of asking for ideas for a new bond issuance. As far as how it applies to investments, I think that is going to evolve. Clearly, if you were to send it out dealing with showing your existing portfolio and asking for new ideas on how you want to restructure it, that would be fine. I'm not sure that some kind of concept by which it's open for a period of time would necessarily work.

Arto Becker: I'm sorry I'm hearing some noise in the background, thank you, John.

Slide 27: Questions

(59:03)

Arto Becker: Anyone else want to respond to that? One or two last questions. Is there anything in the Rules that establish liability for the municipal entity for failure to report that funds are bond proceeds?

John McNally: No, once again these are Rules that apply to municipal advisers. What we are trying to do is give advice to cities and counties about how they can continue to receive advice and accommodate their broker-dealers, but there is nothing that would apply directly to the city. What we are doing is giving advice, how you can continue the best possible way, to continue to operate in the same way. Nothing directly applies to the city or county.

Arto Becker: Very good. Maybe a last question, which I think was covered during the course of the presentation, but it was asked and I want to make sure that person hears the response. The question is whether a bond trustee holding indentured funds is a municipal advisor.

John McNally: No, that is expressly answered in the banking exemption. There is a bank exemption in the Rules and says to the extent that you are a bond trustee, an indenture trustee, you will not be by definition a municipal advisor.

Arto Becker: Thank you, John. I think that covers many of the questions we have. I would turn it back to CDIAC to say goodbye. Thank you very much for everyone's attention. To the CDIAC folks.

Mark Campbell: Arto, thanks a lot. I want to thank all of the speakers, Jennifer, Leo, Marty and John for your contribution to this discussion and the timeliness with which you were able to coordinate this. If we've received any questions that we don't think were addressed during the course of the webinar, we will try to respond to those via our website. For those still listening, if you need to do that and you want to check the website in the future, we may have some questions that we post responses to. Again, thanks for participating and thank you again to all the speakers. Have a good day.