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Municipal Securities Rulemaking Board
Attention: Ronald Smith, Corporate Secretary
1300 Street NW
Washington, DC 20005

RE: MSRB 2016-11: Request for Comment on a Concept Proposal to Improve Disclosure of Direct Purchases and Bank Loans

Dear Board Members and Staff:

The Municipal Securities Rulemaking Board (“MSRB” or the “Board”) has requested comments on a concept proposal made in seeking to require registered municipal advisors be responsible to disclose certain information with respect to direct purchase transactions or bank loans obtained by municipal entity clients. Public Financial Management, Inc. (“PFM”) appreciates the opportunity to provide feedback on this initial concept and welcomes the occasion to be of further assistance to the MSRB and staff in respect to the matters raised in consideration of this topic.

PFM is a registered municipal advisor with the Securities and Exchange Commission (“SEC”) and the MSRB. In offering financial advisory services, PFM provides our clients with independent financial advice on capital formation, credit strategies, bond pricing and debt management, and capital and strategic planning.

Introduction

We have reviewed and given serious consideration to the basis of the concept proposal. We recognize the underpinning frustration in previous attempts by the MSRB to elicit voluntary additional disclosures by municipal entities upon financing their capital needs via a direct purchase with one or more investors or by obtaining a bank loan from a lending institution. PFM also recognizes that the MSRB has encouraged and supported issuers in the endeavor to voluntarily disclose information relating to direct purchases and bank loan financing on EMMA, yet it appears that voluntary submissions on such financings have been inconsistent in their content and frequency.

Traditionally, the general information regarding these type of financings are located in the issuer’s annual audit or CAFR in the same section as the publicly traded bond information. More recently, there have been requests by rating agencies for issuers to provide them with direct purchase transactions or bank loan information. In addition, information concerning direct purchases of bank loans becomes available during annual surveillance reviews by rating agencies or during a credit review for public issuance credit rating requests. Rating agencies have also incorporated interest rate and structure information of these types of financings within their rating reports.



As we believe that a lack of disclosure in material information can diminish the transparency, integrity and fairness of the municipal securities markets, PFM shares the MSRB's concerns, but cannot support the intended means for improvement as is currently proposed. While all municipal market participants, and their respective regulators, can support the benefits of increased transparency in supporting a robust marketplace for investors and municipal borrowers alike, there are inherent limitations to the concept proposal in effectively placing the responsibility for disclosures on the municipal advisor. PFM cannot be supportive of the currently proposed increased obligations, which are not well supported by the foundational elements of the registration and ensuing regulation for municipal advisors, nor can we support further indirect regulation of our municipal entity clients given the corresponding cost/benefit analysis. Rather, we believe that the means to accomplish this goal already exist without further extension of regulatory reach; however, it will require defining the 'materiality' of certain elements of continuing disclosure requirements to include direct purchases and bank loans under the provisions for modifications to the rights of existing security holders.

Regulatory Considerations

We continue to be supportive of the consistent objectives of the MSRB in seeking to facilitate market transparency and efficiency, but PFM also remains mindful of the respective role and obligations a municipal advisor owes each municipal entity or obligated person client in accordance with the requirements of Dodd-Frank, the SEC Municipal Advisor Rule, and the adoption of the Board's final rules. The MSRB has been making tangible progress in adopting and implementing the fundamental details of the regulatory regime for municipal advisors to follow since the SEC adopted final rules in implementing these legislative requirements in late 2013. This effort continues to evolve in these initial years of municipal advisory regulation; however, the duties and obligations of a municipal advisor have been and should continue to focus on the issuer.

We are fundamentally against the concept proposal seeming to provide for the extension of the obligations of a municipal advisor to directly incorporate the discrete interests of investors. Previous occasions have afforded Congress and the SEC multiple opportunities to enact provisions intended to have the municipal advisor also directly serve interests of investors and neither institution has done so to date. The Securities and Exchange Act ("Exchange Act") defines a municipal advisor to mean, in relevant part, a person that provides advice to or on behalf of a municipal entity or obligated person with respect to the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues. In adopting the rules to implement the statutory requirements for municipal advisors, the SEC further explained that with respect to the issuance of municipal securities, municipal advisors, "among other things, may assist municipal entities in developing a financing plan, assist municipal entities in evaluating different financing options and structures, assist in the selection of other parties to the financing (such as bond counsel and underwriters), coordinate the rating process, ensure adequate disclosure, and/or evaluate and negotiate the financing terms."¹ In all circumstances, these municipal advisory activities are defined, regulated, and directed towards the municipal entity.

The shift underlying the concept proposal will place municipal advisors in the tenuous position of serving dual interests, and this undermines the very core principles that led to the registration and

¹ *Registration of Municipal Advisors*, SEC Rel. No. 34-70462 (Sep. 20, 2013), 78 FR 67468, 67472 (Nov. 12, 2013) ("Adopting Release").



regulation of municipal advisors in the first place. While Exchange Act Section 15B(b)(2) provides broad rulemaking authority over municipal advisors, our view is that this authority is over the activities directed towards municipal issuers. The crossing of purposes inherent in the concept proposal reaches too far. If changes are to be made to these core precepts, we respectfully point to the need for Congressional and/or SEC action rather than Board or industry consensus in making such a change in the fabric of the municipal advisory regulatory regime.

Disclosure Dynamics for Direct Purchases and Bank Loans

Historically and today, municipal securities are largely held by individual or retail investors, however, banks or institutional investors are increasingly favoring municipal securities as compared to a number of other investment options. Commercial banks and large institutional investors may obtain municipal securities through both public and private offerings, although they have increasingly looked to obtain municipal securities through direct purchases, and banks have also increased providing conventional direct loans to municipal entities. In recent years, issuers have increasingly chosen to raise funds directly as an effective and efficient alternative to issuing publicly offered municipal securities, for a variety of reasons. In fact, the MSRB and the Financial Industry Regulatory Authority (“FINRA”) recently jointly observed that privately placing municipal securities with a single purchaser “can be beneficial for potential issuers of municipal securities” and the means of financing used is “the issuer’s choice.”²

From the issuer’s perspective the potential benefits and considerations include the following: lower true interest and transaction costs; greater flexibility with respect to the structuring and terms of the financing; and typically, a simpler execution process, because the issuer interacts directly with the providers/lenders, rather than with multiple bondholders through intermediaries. From the purchaser’s perspective, providing financing by means of a direct purchase or bank loan also has advantages, including: direct interaction with the issuer; direct communication with the issuer regarding the transaction structure; and confidence that the transaction will become part of the provider’s investment portfolio.

Rather than creating new regulation and compelling municipal advisors to perform certain disclosure distribution functions for documentation and information otherwise not generally available, municipal entities disclosures for pre-existing debt holders upon a direct purchase transaction or obtaining a bank loan could be supported by the long anticipated clarification of “materiality” and application of current continuing disclosure requirements under Rule 15c2-12 of the Exchange Act. It is also important to recognize that information pertaining to direct purchases or bank loans, in fact, is not made generally available by the investor or bank. There is not a clear path taken from the exercise of 15(B)(2) authority for the Board for such additional obligations to apply to municipal advisors, nor can we make the statutory leap necessary in implementing comparable requirements of Rule G-32 and G-34 to apply in the instance of direct purchases or bank loans, as there is insufficient support to do so without a newly found and generous interpretation to allow for it. In practicality, very often a municipal advisor may not be included in these issuer-provider transactions, may only be hired to perform certain administrative functions, or often only learns of a prior transaction when assisting with the issuance of a municipal entity’s next public offering of municipal securities.

² *Direct Purchases and Bank Loans as Alternatives to Public Financing in the Municipal Securities Market*, MSRB Regulatory Notice 2016-12 (Apr. 4, 2016).



Providing clarity and guidance to define the materiality factors supporting additional disclosure should be a key driver of the ongoing concept of achieving greater transparency for all market participants by making the disclosure a necessary element of investor communications and considerations for existing publicly held debt. This will be a shift from the current environment of somewhat cloudy materiality standards and voluntary disclosure requests surrounding this subject matter.

Final Considerations

We can agree that the additional disclosure of information materially affecting existing bond holders is reasonable and appropriate with the increased market transparency bringing additional benefits. However, the current concept of placing the obligation and economic burden on municipal advisors does not and will not sufficiently accomplish the stated transparency objectives in order to outweigh the associated costs in terms of digression from a municipal advisor's regulatory mission to the benefit of issuers; nor can it ultimately fully satisfy the outlined objective of providing investors with an ability to truly understand any and all related risks. In short, the concept proposal is a well-intended, but star-crossed attempt at compromise between the inability to directly require issuers to file disclosures and the objective to protect the interests of the municipal marketplace. Municipal advisors must not be put in a position to choose between the statutory fiduciary duty to the issuer and the proposal's newfound investor-driven regulatory disclosure requirements for non-publicly sold bond activities.

The statutory and associated regulatory environment does not lend itself to accomplish the concept proposal's objectives, and instead we recommend meaningful review and discussion of the guidance provided for continuing disclosure requirements for outstanding municipal entity debt to clearly define whether or not subsequent direct purchase or bank loan transactions meet criteria requiring additional continuing disclosure (i.e. modifications to rights of security holders, if material). We further suggest empowering a working group of industry participants and the MSRB staff (including technology representatives) with the objective of making definitive recommendations to unify the corresponding standards for the disclosure of direct purchases or bank loans, and also to improve the associated technology, including formatting, for compatibility in making such disclosures available more generally.

It is PFM's objective to be of assistance to the Board in respect to the matters raised in this submission, and, accordingly, we would welcome the opportunity to discuss this topic further.

Sincerely,

A handwritten signature in blue ink that reads "Leo Karwejna".

Leo Karwejna

Chief Compliance Officer

A handwritten signature in blue ink that reads "Cheryl Maddox".

Cheryl Maddox
General Counsel