MSRB
Municipal Securities Rulemaking Board

Remarks of Lynnette Kelly, Executive Director

"New Rules of Engagement for Municipal Finance"

at the

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- Good morning and thank you to NAST for the opportunity to participate in this symposium.
- I'm Lynnette Kelly, Executive Director of the Municipal Securities Rulemaking Board.
- During my public finance career and later at the MSRB, I have had the opportunity to work with many state treasurers and individuals responsible for state debt management.
- I deeply appreciate the work you do not only as stewards of state funds, but also as supervisors and mentors for the municipalities in your states that issue debt.
- You are the key individuals making the decision to borrow, assembling the deal team and understanding the different roles and responsibilities of each member of that team.
- Today I want to shed some light on new regulations that are changing the relationship between certain professionals on the deal team and you, their clients.
- I also want to address the important role state treasurers can play in helping ensure local governments also understand what they should expect from their municipal advisor professionals – and what is expected from the municipalities themselves when it comes to sound financial policies and good disclosure practices.

Municipal Advisor Regulation

- 2016 has proved to be a watershed year for the development of rules of the road for municipal advisors.
- Many state and local governments choose to add a municipal advisor to their deal team to provide financial advice about the structure, pricing, timing and distribution of their bonds to investors.
- While underwriters have long been subject to MSRB rules of fair play, there were no corresponding professional standards or regulations for individuals providing advice.
- That allowed unqualified and unscrupulous individuals to take advantage of their trusted positions for personal gain.

- And it allowed many underwriters to put themselves forward as advisors even though they did not have an obligation to provide disinterested advice.
- To protect the interests of state and local governments seeking unbiased advice, the Dodd-Frank Act established a federal fiduciary duty for municipal advisors working with municipal entities.
- At its core, that means a municipal advisor must act in the issuer's best interests without regard to their own financial or other interests.
- This fiduciary duty is a special relationship that goes beyond the obligations of an underwriter, which has an arm's length, transactional relationship with the issuer.
- The MSRB was charged with creating a comprehensive regulatory framework for municipal advisors to further define their relationship to their clients and the bounds of professional conduct.
- And this year, the foundational rules of that regulatory framework go into effect.
- These rules have implications for issuers, municipal advisors and the underwriters who used to be able to blur the line between underwriting and advisory services.
- Next week, the cornerstone of the MSRB's regulatory framework for municipal advisors takes effect.
- MSRB Rule G-42 establishes the core standards of conduct owed to clients of municipal advisors.
- It addresses disclosure of conflicts of interest, documentation of the advisory relationship, recommendations of transactions or products and specified prohibitions.
- For those of you interested in the nuts and bolts of this rule, an on-demand webinar is available on the MSRB's website.
- Also this year, the MSRB is extending two of its key rules promoting market integrity to also apply to municipal advisors.
- In May, municipal advisors became subject to the same standards as dealers limiting the size and nature of gifts to officials of state and local governments.

- This aims to curb conflicts of interest that may arise from gift-giving in connection with municipal advisory activities.
- Perhaps the most egregious form of conflict of interest occurs when financial firms use political contributions to gain business from state and local governments.
- As of August 17, 2016, municipal advisors will be subject to amendments to MSRB Rule G-37 on political contributions that extend the MSRB's well-established municipal securities dealer pay-to-play rule to municipal advisors.
- This important rule supports the integrity of the municipal market and will help ensure that municipal advisory business is awarded on the basis of merit.
- As with Rule G-42, anyone with a deeper interest in the MSRB's two pay-to-play rules can view on-demand webinars on our website.
- Last year, the MSRB implemented a supervision and compliance rule for municipal advisors to require firms to develop policies and procedures that can help ensure compliance with evolving regulations.
- And I can't neglect to mention two of the first actions the MSRB took when we were entrusted with oversight of municipal advisors.
- Among the most important protections in place for state and local governments that hire municipal advisors is the MSRB's golden rule, Rule G-17.
- This rule was amended in 2010 to require all MSRB-regulated professionals, including municipal advisors, to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest or unfair practice.
- Fair dealing is a central tenet of fair and efficient markets.
- Finally, one of the basic building blocks of a regulatory regime is registration.
- Municipal advisor firms must be registered with both the SEC and the MSRB in order to engage in municipal advisory activities.
- This may seem simple to you, but it may not be top of mind for individuals at the local level to check the registration of a municipal advisor before engaging them to provide advice.

- That brings me to my next topic: how you as state treasurers and debt managers can provide guidance and oversight to municipalities within your state that issue debt.

Local Oversight

- Keeping up with evolving regulations is a challenge for all market participants, but none more so than smaller and less frequent issuers who may only come to market once every 10 years or more.

- State treasurers are in a unique position to share knowledge and set the bar for what issuers in your states should be expecting from their municipal advisors.

- The MSRB's online Education Center includes several resources geared toward an issuer audience about the roles and responsibilities of the deal team, including the municipal advisor.

- I encourage you to make sure municipalities in your state are aware of this information and know that both you and the MSRB are a resource for them when navigating relationships with their financial professionals.

- Of course municipalities also need to understand their own responsibilities in a bond issuance.

- It's great to see several states taking proactive steps to aid municipalities with their debt issues.

- For instance, Florida, North Carolina, New York and other states have implemented systems to monitor the fiscal health of their localities.

- These kinds of early warning systems allow potential fiscal stress to be identified early enough to help right the course.

- As of 2012, nearly half of the states had implemented municipal debt supervision or restructuring mechanisms to help municipalities.

- This is in addition to municipal debt limitations in some of those states.

- GASB is doing its part as well.
- It is examining how to make improvements to going concern and debt disclosure guidance for state and local governments.
- GASB decided to initiate research on going concern disclosures, specifically the relevance of the "going concern" concept as it applies to governments.
- GASB's research is focusing on whether existing standards under US GAAP provide state and local government financial statement preparers with sufficient guidance about management's responsibilities for disclosing uncertainties associated with severe financial stress.
- The creation of oversight and control boards for municipal debt has also become a lynchpin the federal response to Puerto Rico's financial situation, which continues to be debated in Congress.
- Effective state intervention may not be warmly welcomed by all localities, but I'm sure even fewer would relish that kind of attention from Capitol Hill if their fiscal situation reaches crisis level.
- I applaud those of you who are actively engaged in local fiscal monitoring and oversight, and I hope you will share your experiences with your colleagues at states that have not yet implemented such programs.

Conclusion

- Thank you for the opportunity to update you on MSRB's progress on creating a regulatory regime for municipal advisors.
- The MSRB counts on your assistance with ensuring that all issuers in your states understand what to expect from their financial professionals.
- I truly value your contributions to ensuring public money is carefully managed and invested in projects that can benefit generations of taxpayers.

- I look forward to your questions.
- Thank you.