

# The Evolving Regulatory Landscape

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# Panelists

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# Securities - Regulation

- The SEC adopted the final municipal advisor rule in September 2013.
- The rule regulates “advice” (i.e., a recommendation) given to municipal entities and obligated persons regarding municipal financial products or the issuance of municipal securities.
- The rule provides exemptions that are activity-based, not status-based.
- Because of this approach, the rule, which many initially assumed would only regulate the conduct of financial advisors, may change how issuers and underwriters interact.
- A broker-dealer that intends to be an underwriter, but provides non-exempt advice, will be treated as a municipal advisor and be prohibited from serving as underwriter for the issuance for which they provided advice.

# Securities – Regulation (Cont'd)

- In communicating with issuers, broker-dealers who intend to serve as underwriters must either:
  - Not provide “advice,” i.e., provide only general information that does not involve a recommendation. General information includes information of a factual nature without subjective assumptions, opinions, or views and information that is not particularized to a specific municipal entity or type of entity.
  - Be responding to a request for proposals (“RFP”) or request for qualifications (“RFQ”) from the municipal entity or obligated person.
  - Be providing advice in circumstances in which a municipal entity or obligated person has an independent registered municipal advisor (“IRMA”) with respect to the same aspects of a municipal financial product or an issuance of municipal securities.

# Securities – Regulation (Cont'd)

- Questions:
  - How will the municipal advisor rule affect/alter the conduct and relationships of municipal market participants, including issuers, financial advisors, underwriters and bond counsel?
  - Will this rule result in greater use of financial advisors?
  - Will this rule restrict the flow of information to issuers?
  - Will this rule change the types of deals done in the municipal market?
  - Will this rule affect the volume of deals in the short run or long run?

# Securities – Enforcement

- While the SEC Office of Municipal Securities was focused on the municipal advisor rule in 2013, the SEC Enforcement Division's Municipal Securities and Public Pension Unit continued to push the envelope.
- Consider these three enforcement actions in 2013.

# Securities – Enforcement (Cont'd)

- **Greater Wenatchee Regional Events Center Public Facilities District (November 5, 2013)** - The SEC charged a municipal issuer in the State of Washington's Wenatchee Valley region with misleading investors in a bond offering that financed the construction of a regional events center and ice hockey arena.
- The Greater Wenatchee Regional Events Center Public Facilities District agreed to settle the SEC's charges by paying a \$20,000 penalty and undertaking remedial actions. It is the first time that the SEC has assessed a financial penalty against a municipal issuer.
- "Financial penalties against municipal issuers are appropriate for sanctioning and deterring misconduct when, as here, they can be paid from operating funds without directly impacting taxpayers," said Andrew Ceresney, co-director of the SEC's Division of Enforcement.

# Securities – Enforcement (Cont'd)

- **West Clark Community Schools (July 29, 2013)** - The SEC charged a school district in Indiana and its municipal bond underwriter with falsely stating to bond investors that the school district had been properly providing annual financial information and notices required as part of its prior bond offerings.
- “This is the first time the SEC has charged a municipal issuer with falsely claiming in a bond offering’s official statement that it was fully compliant with the annual disclosure obligations it agreed to in prior offerings, and an underwriter and its principal for not doing the necessary research to attest to the truthfulness of that claim,” said Andrew Ceresney, Co-Director of the Division of Enforcement.

# Securities – Enforcement (Cont'd)

- **City of Harrisburg (May 6, 2013)** - The SEC charged the City of Harrisburg, Pa., with securities fraud for its misleading public statements when its financial condition was deteriorating and financial information available to municipal bond investors was either incomplete or outdated. An SEC investigation found that the misleading statements were made in the city's budget report, annual and mid-year financial statements, and a State of the City address.
- This marks the first time that the SEC has charged a municipality for misleading statements made outside of its securities disclosure documents. Harrisburg agreed to settle the charges.
- The SEC found that Harrisburg failed to comply with requirements to provide certain ongoing financial information and audited financial statements for the benefit of investors holding hundreds of millions of dollars in bonds issued or guaranteed by the city.

# Securities - Enforcement (Cont'd)

- As a result of Harrisburg's non-compliance from 2009 to 2011, investors had to seek out Harrisburg's other public statements in order to obtain current information about the city's finances.
- "In an information vacuum caused by Harrisburg's failure to provide accurate information about its deteriorating financial condition, municipal investors had to rely on other public statements misrepresenting city finances," said George S. Canellos, Co-Director of the SEC's Division of Enforcement. "Statements that are reasonably expected to reach the securities markets, even if not prepared for that purpose, cannot be materially misleading."

# Securities – Voluntary Initiatives

- Efforts made by the buy side to identify information that is important is resulting in issuer groups recommending voluntary disclosure, motivated in part by a desire to avoid further federal regulation. Examples include:
  - Bank loan disclosure: White paper outlining voluntary disclosure considerations issued by a multi-association working group in May 2013. GFOA adopted a Best Practice recommending voluntary disclosure about bank loans in September 2013.
  - Interim financial reporting for State governments: In August 2013, the National Association of State Auditors, Comptrollers and Treasurers (“NASACT”) released its best practices for interim disclosure by States.

# Tax – Regulation

- Treasury published proposed arbitrage regulations in September 2013, which, among other things, would revise the definition of “issue price.”
- The proposed definition would replace the existing approach, which permits issue price for publicly-offered bonds to be determined on the basis of reasonable expectations as of the sale date, with an actual sales approach for all financings. Under the proposed definition:
  - Issue price of a maturity of bonds is the first price at which a “substantial amount” of the maturity is sold to the public.
  - “Substantial amount” is not defined, although a safe harbor is provided for the price at which 25% of a maturity is first sold to the public.

# Tax – Regulation (Cont'd)

- Why did Treasury propose this change?
  - To provide greater certainty in the determination of issue price in public offerings.
  - To address certain “concerns” about negotiated sales.
  - To attempt to make determination of “issue price” under Section 148(h) of the Code for arbitrage purposes more consistent with determination of “original issue discount” under Sections 1273 and 1274 of the Code.

# Tax – Regulation (Cont'd)

- NABL and other industry groups are concerned that the proposed definition of “issue price” would result in greater uncertainty and attempts to comply with this definition will impose substantial additional expense on issuers and alter longstanding practices in the municipal market.
  - If the proposed definition is adopted and municipal bonds continue to be marketed in ways that result in unsold (or undersold) maturities on the sale date, issuers will bear substantial additional expense attempting to determine issue price based on actual sales to the public. Under the proposed definition, issue price may not be able to be determined until after closing, if ever.
  - To eliminate unsold (or undersold) maturities on the sale date in negotiated underwritings, issuers would be forced to accept lower prices and higher yields.
  - Because issuers may not be able to eliminate the possibility of unsold (or undersold) maturities in competitively sold deals, the ability of issuers to sell bonds competitively may be limited.

# Tax – Regulation (Cont'd)

- Through the Voluntary Closing Agreement Program (“VCAP”) and enforcement efforts, the IRS continues to push for governmental issuers and conduit borrowers to adopt written post-issuance compliance procedures.
- GFOA and NABL are working on a post-issuance compliance policy considerations paper. Many issuers and borrowers have already adopted such policies.
- Questions:
  - Will adoption of these policies actually result in increased compliance?
  - Will the failure to comply with these policies result in worse outcomes in audits?

# Banking – Regulation

- The Federal Reserve, OCC and FDIC recently (November 29, 2013) proposed the U.S. rule implementing the global Basel III Liquidity Coverage Ratio (“LCR”). The proposed rule **excludes** municipal bonds from the definition of High Quality Liquid Assets (“HQLA”), while corporates, agencies, equities and other sovereign debt are all included. US depositories currently hold \$400B in municipal bonds, and \$300B of collateralized municipal deposits. The proposed rule could significantly constrain U.S. bank investment in municipals and acceptance of collateralized municipal deposits. The likely impact on U.S. municipalities would be two-fold: higher borrowing costs and lower interest rates on deposits.
- The final Volcker Rule (December 2013) expanded the scope of municipal bonds that are exempted from proprietary trading restrictions, but the risk-retention rules may limit TOB Programs.

# Questions?

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