CMTA 55th Annual Conference
Thursday April 17, 2014
4:00 p.m. - 5:30 p.m. Regulatory Panel Discussion

Topics: Basel III, Muni Advisor and Underwriter Rules, Volcker Rule, Money Market Reform, FINRA Rule 5141

Moderator: John Adams, Finance Director, City of Thousand Oaks
Christopher Mier, Managing Director, Analytical Services Division, Loop Capital Markets
Kerry Pope, CFA, Institutional Portfolio Manager, Fixed Income, Fidelity Investments
Joanne Medero, Managing Director, Government Relations, BlackRock
Richard Vest, Senior Vice President, Carolina Capital Markets
Ossie Spector, Senior Investment Officer, North America Liquidity Product Solutions, Bank of America Merrill Lynch
Overview

As public treasurers, we have experienced unprecedented financial changes over the past few years. Based on various financial concerns, many reforms have been proposed and/or implemented. We’re here today to discuss several of these regulatory changes affecting us.

With us today, we have a distinguished panel of financial professionals experienced with these changes and their impacts. I intend to ask our panelists a few questions on several topics and allow them to provide background. After we have touched on all the intended topics, we’ll take specific questions. Our panelists include:

**Ossie Spector**

Ossie Spector is a director and senior investment solutions specialist at Bank of America Merrill Lynch with more than 20 years experience working in the financial services industry. In her current role, she assists middle market and government entities manage liquidity and short-term investments.

**Joanne Medero**

Joanne Medero is a Managing Director for BlackRock with responsibilities for Government Relations. She has been in the financial services industry as a public policy advocate, a lawyer and as a regulator for over 30 years, having served as General Counsel of the Commodity Futures Trading Commission in the early 1990s.

**Christopher Mier**

Chris Mier is the Chief Strategist and director of the Loop Capital’s Analytical Services Division (ASD). In addition, he provides analytics and commentary on the economy, monetary policy, and a variety of public finance issues.

**Kerry Pope**

Kerry Pope is an institutional portfolio manager in the Fixed Income Division of Fidelity Asset Management with more than 25 years experience in the financial services industry.

**Richard Vest**

Richard is a Senior Vice President at Carolina Capital Markets, a fixed income broker dealer. He has more than 20 year experience in banking and investments and works with his clients to develop comprehensive investment plans and policies.
The Municipal Advisor Rule

Christopher Mier/Loop Capital

What is the Municipal Advisor rule?
In July 2010, Congress passed the Dodd-Frank Act, which included a provision to protect municipalities, taxpayers, and investors from conflicted advice and unregulated advisors. In particular, the Dodd-Frank Act requires the SEC to adopt a rule requiring these municipal advisors to register with the SEC and comply with a set of regulations that would be issued by the Municipal Securities Rulemaking Board (MSRB).

The Municipal Advisor Rule is part of the Dodd-Frank Act and deals with the regulation of the activity of individuals who offer municipal finance services (“advice” or “investment strategies”) to issuers of municipal debt.

“In the wake of the financial crisis, many municipalities suffered significant losses from complex derivatives and other financial transactions, and their investors were left largely unprotected from these risks,” said SEC Chair Mary Jo White. “These rules set forth clear, workable requirements and guidance for municipal advisors and other market participants, which will provide needed protections for investors in the municipal securities markets.”

What does the Rule do and why is it needed?

The Rule seeks to address a gap in the regulation of financial services and market activities where, unlike other market intermediaries, municipal advisors were not previously required to register with the SEC nor were they subject to a comprehensive regulatory regime. Therefore, municipal advisors did not have to adhere to standards for training, qualification, or conduct, including the treatment of conflicts of interest.

Conflicts of interest are an important area of concern for the SEC. The financial crisis exposed a number of problem transactions that municipalities had participated in where they were not fully aware of the incentives of the individuals involved, whether they were an underwriter, investment banker, advisor, or other municipal professional.

What the rule does is to:

(1) Clarify who is and isn't a “municipal advisor”;
(2) Offer guidance on when a person is providing “advice” for purposes of the municipal advisor definition; and

(3) Require that municipal advisors register with the SEC.

**What is the background for the regulation?**

State and local governments that issue municipal bonds frequently rely on advisors to help them decide how and when to issue the securities and how to invest proceeds from the sales. These advisors receive fees for the services they provide. Prior to passage of the Dodd-Frank Act, municipal advisors were not required to register with the SEC like other market intermediaries. This left many municipalities relying on advice from unregulated advisors, and they were often unaware of any conflicts of interest a municipal advisor may have had. An example is that the years leading up to the financial crisis, municipalities across the country invested in or purchased complex derivative products that resulted in substantial financial losses.

The new rule approved by the SEC requires a municipal advisor to permanently register with the SEC if it provides “advice” on the issuance of municipal securities or about certain “investment strategies” or municipal derivatives.

**Who is a municipal advisor and what does it mean to be “providing advice” or “investment strategies”?**

A person is providing “advice” to a municipal entity or an “obligated person” based on “all of the relevant facts and circumstances,” including whether the advice:

- Involves a “recommendation” to a municipal entity.
- Is particularized to the specific needs of a municipal entity.
- Relates to municipal financial products or the issuance of municipal securities.

Advice, however, does not include giving out certain general information.

An “obligated person” essentially means an entity such as a non-profit university or non-profit hospital that borrows the proceeds from a municipal securities offering and is obligated by contract or other arrangement to repay all or some portion of the amount borrowed.

With regard to “investment strategies”, a person providing advice to a municipal entity or an “obligated person” only has to register if such advice relates to:
• The investment of proceeds of municipal securities.
• The investment of municipal escrow funds.
• Municipal derivatives.

Are there exemptions from the Municipal Advisor Definition?...specifically, where do broker-dealers fall?

Yes. Certain professionals involved in municipal transactions, like attorneys, for example, and others, are exempted as more fully described elsewhere. More than 1,100 municipal advisors have since registered with the SEC.

What is the scope of a municipal advisor fiduciary duty?

When does the rule become effective?

The SEC Commission extended the date on which people need to begin complying with the final municipal advisor rules until July 1, 2014.

Why did the SEC grant an extension of the effective date?

The SEC wanted to be sure that investment banking firms, advisors, and others impacted by The Rule had time to adapting their policies and procedures, developing supervisory practices and internal controls, adapting their account and investment tracking systems, developing recordkeeping procedures, adapting their business models and practices, educating their personnel with respect to this regulatory regime, and developing training programs to establish effective compliance with the Rules.

What is the impact on public agencies?
Volcker Rule

Joanne Medero/BlackRock

What is Volcker Rule?

Why is it necessary?

When is it effective?

How will public agencies be affected?
FINRA Rule 5141

Richard Vest, Carolina Capital Markets

What is FIRNA Rule 5141?

FINRA Rule 5141 is a new, consolidated rule that protects the integrity of fixed price offerings by ensuring that securities in such offerings are sold to the public at the stated public offering price or prices. The rule prohibits the grant of certain preferences (e.g., selling concessions, discounts, other allowances or various economic equivalents) in connection with fixed price offerings of securities.

If Rule is new, what changed?

Is there a provision within the rule where a dealer can provide 3rd party research for a client?

FINRA Rule 5141.02 states that nothing in the new rule prohibits a member or person associated with a member that participates in a selling syndicate or selling group from selling securities in the offering to a person or account to which it has provided or will provide research, as long as the person or account pays the stated public offering price for the securities and the research is provided pursuant to the requirements of Section 28(e) of the Exchange Act. The rule provides that investment management or investment discretionary services are not research for purposes of the provision. The rule further requires that any product or service provided by a member or person associated with a member that does not qualify as research must not confer a reduced price as set forth under FINRA Rule 5141.01

What is the SECs definition of research?

From the SECs 2006 Release, the Commission indicates that Section 28(e) safe harbor "encompasses third-party research and proprietary research on equal terms." The eligibility criteria for research is advice, analyses, and reports concerning issuers, industries, securities, economic factors, trends, portfolio strategy, and performance of accounts. They go on to further recognize as third party research expenses for investment seminars, investment conferences, software or services for analyses of securities portfolios, and other products and services.

What are some examples of third party research?

Some examples are Bloomberg, SymPro, credit monitoring services, CMTA conference fees, GFOA and other association conference fees. Additional products and services are outlined in SEC Release 34-54165.
Does the SEC consider third party research a gift?

No, third party research is not viewed as a gift by the SEC. FINRA Rule 3220 addresses client gift rules, which revolves around personal gifts and entertainment type gifts. Additionally on July 30, 2013 the SEC staff issued a guidance letter regarding the distribution or 3rd party research and the appropriateness thereof.

Why is this important for public fund clients?

This is important because under FINRA Rule 5141 public fund clients may receive credit for third-party research services. Clients who purchase fixed price new issue offerings may receive back, in the form of research, a portion of the new issue sales concession or commission. This type of research would be beneficial to public fund clients who could use these services and products. The SEC wants institutional portfolio managers to have access to research without it having to be a budgeted expense.
**Basel III**

Ossie Spector/BAML

**What is Basel III? When is it effective?**

The BCBS is a committee made up of central banks and regulators from around the world. Their objective is to set global standards for the prudential regulation of banks and facilitate cooperation on banking supervision. Each jurisdiction that is part of the BCBS agrees to implement the BCBS standards domestically.

Basel III is a set of comprehensive reforms set forth by the BCBS in 2010 and updated in 2013. These reforms are designed to:

- Enhance the banking sector’s ability to withstand the impact of adverse economic and financial events, irrespective of the source;
- Strengthen risk management and governance; and
- Improve transparency and disclosures in the banking industry.

Basel III laid out enhanced minimum capital standards as well as increased liquidity requirements. The capital requirements place a greater emphasis on common equity and provide enhanced regulatory power in the event that a bank fails to maintain certain capital “buffers.” The liquidity standards require banks to maintain a portfolio of “high quality liquid assets” sufficient to cover their current obligations for the next 30 days, and also provide regulators with tools to assess a bank’s asset-liability mix in order to ensure adequate funding over a longer term.

The Liquidity Coverage Ratio (LCR) is a new global standard established by the Basel Committee on Banking Supervision (BCBS) to measure banks’ ability to access liquidity during a stress event. Parts of the LCR are expected to have an impact on how banks view and value certain types of deposits.

$LRC = \frac{\text{High Quality Liquid Assets}}{\text{Net cash outflows 30 days}} \geq 100\%$

Banks are now preparing for the LCR, which will be phased in beginning January 2015. Banks will be required to make assumptions about the stability of, as well as acceptable liquidity sources and levels for, each deposit type.

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What will be the effect on banks?

To be within LCR guidelines, banks must hold enough High Quality Liquid Assets (HQLA) to cover all statutorily defined cash outflows during a stress scenario over a 30-day period.

- LCR requirements based on asset size of banks (>\$250B full LCR, \$50B-$250B / 70% modified LCR, <\$50B exempt)

How will public agencies be affected?

Public sector deposit balance outflow rates vary by type of collateral backing the deposit.

Will it have an effect on the municipal bond market?

To be determined.
Money Market Reform

Kerry Pope, Fidelity Management & Research Company
Joanne Medero, BlackRock

Where do things currently stand with regard to the SEC’s final decision on 2a-7 reform?

Floating net asset value (NAV) for municipal and prime money market accounts, excluding Treasury and Government funds. In additional floating NAV applies to institutional investors, not retail (with single day withdrawals limited to $1 million).

Liquidity fees and redemption gates in time of stress.

What do you expect the final state to look like?

We remain optimistic that the SEC will put forth regulations that preserve the core features of money market funds that include the preservation of principal and liquidity. We can discuss the other features that we believe will be implemented.

What is the timing expectation in terms of decision making and implementation?

We would expect to have the SEC’s ruling the second half of this year. We believe that the SEC will recognize the effort and coordination required to implement reforms and will provide an implementation period long enough to ensure proper transition.

What should investors be thinking about as they prepare for potential reform? What are the risks they face?

What kind of impact will reform have on the money fund industry?...the broader market?...public agencies?

Do you believe the SEC will take into account the various stakeholders (issuers as well as investors) in its final reform rule?

If Prime Funds go to a floating NAV, do you expect to lose assets in that class of Funds?

Yes, the assets may migrate to Treasury or government funds that continue to maintain the stable NAV.

In anticipation of MMF, are there any new products being developed?

Even prior to the announcement, we have seen an increase in ultra-short funds that maintain very conservative structures.
Do you expect to see flow from financial intermediaries into 2A-7 funds due to Liquidity Coverage Ratio (LCR)?

LCR has greatly impacted bank’s desire to maintain wholesale funding and are starting to implement enhanced strategies to introduce alternative products

Will traditional broker dealers continue to face pressure to reduce their balance sheet for government repo collateral?

Yes, there has been a reduction of about $650 billion since the 2012 peak.

Given repo is a large percentage of 2a-7 funds liquidity assets, how will the availability of collateral impact 2a-7 funds ability to find liquid alternatives?

Alternatives are in limited supply and many MMF are having to participate more in the Fed’s reverse repo facility.