

MSRB Rule G-23: Who's Protecting Whom

Recently the MSRB's Executive Board reported that no action needed to be taken on Rule G-23 because the board found "no systemic problems that warranted change to the rule at this time." While it is not clear what level of independent research was done by the board to reach this conclusion, it is our hope that the MSRB will continue to keep on eye on market practices to ensure that Rule G-23 is not violated.

Though there has been much heated discussion on this issue, unfortunately, the G-23 debate did not seem to center on the issue that seems to be the problem — the business practices that continue to exist which call into question the effectiveness of Rule G-23. The questions must be asked — was the financial adviser planning to resign from day one, thus skirting their role as adviser to the issuer in order to underwrite the transaction, and what is the implication to issuers and investors if the G-23 shuffle occurs?

As the chair and vice chair of GFOA's Governmental Debt Management Committee we want to make issuers, the MSRB, and the public finance industry aware of the relevant GFOA Recommended Practices as related to principles of G-23 and the financial advisory relationship with an issuer.

GFOA has adopted a number of recommended practices for state and local government issuers of bonds. Several of these RPs relate to the situation in which the issuer's financial adviser resigns before the bond issue is completed and asks to be named the managing underwriter for a negotiated sale. Specifically, issuers should use competitive means to select financial advisers, bond counsel, underwriters, and other financing participants. Many factors should be considered when choosing professionals, in addition to the pricing of services. As covered in the following recommended practices: *Preparing RFPs to Select Financial Advisors and Underwriters*, 1997; *Selecting Bond Counsel*, 1998; and *Debt Management Policy*, 2003.

Issuers should consider a specific list of factors when making the decision to sell their bonds on a competitive or negotiated basis, as discussed in the recommended practice *Selecting and Managing the Method of Sale of State and Local Government Bonds*, 1994.

When a state or local government elects the negotiated sale method, a qualified financial adviser should be retained to advise on pricing terms, compensation of the underwriter, and other terms. As discussed in the recommended practice, *Selecting and Managing the method of Sale of State and Local Government Bonds*, 1994.

If state and local governments follow GFOA's recommended practices, situations where G-23 would apply should rarely, if ever, occur. If the initial financial adviser resigns, then another financial adviser should be retained using competitive means. Furthermore, the decision to use the negotiated sale should be carefully considered based on a number of factors, and if the negotiated sale method is selected then the managing underwriter should be selected only after receiving competitive proposals.

If G-23 events are frequent then issuers are probably not following GFOA's Recommended Practices. In transactions where the financial adviser resigns before the completion of the transaction, an issuer should wonder if the financial adviser is merely using this relationship as the means to become the managing underwriter in order to recommend the use of a negotiated sale and in turn earn higher fees. If certain dealers regularly have to apply G-23 as a means of securing negotiated sale business then we would suggest that the purpose of G-23 has been compromised.

As the debt committee works through the process of updating the recommended practices listed above and discusses possible new ones as well as public policy statements, we believe that the key elements that will be brought forward by the committee are: (i) the need for explicit fiduciary responsibility from the financial adviser to the issuer be included in a written contract; and (ii) the need for complete disclosure, of the varied interests all finance and legal professionals may have in a transaction, including model disclosure language. We are also aware that one of the most important aspects of this effort will be to educate the issuer community and provide them with the tools available to make the right decisions when hiring finance professionals.

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