

WHY USE A MUNICIPAL SECURITIES FINANCIAL ADVISOR?

Excerpt:

Unless the issuer has sufficient in-house expertise and access to market information, it should hire an outside financial advisor prior to undertaking a debt financing. *A financial advisor represents the issuer, and only the issuer*, in the sale of bonds. Issuers should assure themselves that the selected financial advisor has the necessary expertise to assist the issuer in selecting other finance professionals, planning the bond sale, and successfully selling and closing the bonds.

Government Finance Officers Association, Recommended Practice on Selecting Financial Advisors [Emphasis added.]

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Issuers must keep in mind that *the roles of the underwriter and the financial advisor are separate, adversarial roles and cannot be provided by the same party. Underwriters do not have a fiduciary responsibility to the issuer.* A financial advisor represents only the issuer and has a fiduciary responsibility to the issuer.

Government Finance Officers Association, Recommended Practice on Selecting Underwriters for Negotiated Bond Sales [Emphasis added.]

◆ **Fiduciary Relationship**

◆ **Impartial Advice**

◆ **Independence**

◆ **Experience**



American Governmental Financial Services Company is a private independent financial advisory firm bringing to its municipal securities issuer clients an important independent financial and business perspective. As a professional independent municipal securities financial advisor, AGFS does not seek to displace investment bankers or placement agents in the issuer's financing activities.

Unlike an underwriter, an independent financial advisor represents the interests of its issuer clients, acting as a financial and business agent in the analysis, negotiation and structuring of financial transactions and in long-term capital planning and budgeting. Independent financial advisors function best as extensions of their issuer-clients' staffs.

Excerpt:

The Underwriters' agreement to purchase the Securities from the Issuer is made in reliance upon the Issuer's representations The Issuer ... agrees that (i) the purchase and sale of the Securities ... is an arm's-length commercial transaction between the Issuer and the Underwriters, (ii) ... each Underwriter is acting solely as a principal and not as an agent or a fiduciary of the Issuer, (iii) the Underwriters have not assumed ... a fiduciary responsibility in favor of the Issuer with respect to the offering of the Securities or the process leading thereto ... and (iv) the Issuer has consulted with its own legal and financial advisors to the extent it deemed appropriate

Securities Industry & Financial Markets Association, Bond Purchase Agreement [Emphasis added.]

Investment bankers, in contrast, as underwriters, purchase the issuer's obligations, dealing with the issuers at arm's-length in the role of principals in buyer-seller commercial transactions. The bankers have important responsibilities to investors, which often differ sharply from the interests of issuers. *In other words, underwriters cannot represent issuers impartially because they are acting both for their own account and for the interests of investors.* When disputes arise, underwriters will deny they have fiduciary responsibilities to issuers, including responsibilities to inform or advise issuers.

Excerpt:

[The underwriter] had no relationship to either [issuer] that would impose the duty of disclosure [to issuers] posited by [the issuers]. [The underwriter] acted as a non-lead underwriter and commercial paper [seller to the issuers]. This was an arms'-length relationship and it did not give rise to the affirmative disclosure and monitoring obligations on which [the issuers'] claims are premised. *In fact, California law expressly states that a financial advisory relationship does not and cannot exist with a party that is also acting as an underwriter or commercial paper dealer. ... [The underwriter] had no relationship whatsoever with [the issuer].*

Orange County Transportation Authority, et al., v. Goldman, Sachs & Co., et al., Case No. BC 170207 (Los Angeles County, CA Sup. Ct.) [Tentative Ruling on Motion by Underwriter for Summary Judgment, March 26, 1998]. [Emphasis added.]

The California court quoted above effectively rejected the issuers' arguments that underwriters are bound by expansive representations and undertakings to issuers at the time of the selection process when the underwriters are employed. In contrast, another California court, by refusing to dismiss an issuer's complaint, recognized that a financial advisor could be considered to be a fiduciary, with a duty of disclosure to its issuer client, a duty to exercise care for its client, and a duty not to represent conflicting interests in a bond financing.

The following excerpt illustrates critical differences between underwriters, as described in the excerpt above, and independent financial advisors in terms of the fiduciary nature of the advice rendered by financial advisors to issuer-clients—

Excerpt:

Generally, a municipality's financial advisor owes fiduciary obligations to it in connection with bond financings by the municipality. In addition, under New Jersey state law, a fiduciary relationship arises when one person is under a duty to give advice for the benefit of another on matters within the scope of their relationship and the advisor occupies a dominant position over the other. [The issuer] had no expertise or experience in advance refundings or purchasing Treasury bonds and notes. Instead, [the issuer] relied on [the financial advisory firm], as its financial advisor, to serve its interests in all aspects of the refunding, including the purchase of escrow securities. Therefore, based on the facts and circumstances, [the financial advisory firm] had a fiduciary or similar relationship of trust and confidence with [the issuer].

Courts have imposed on a fiduciary affirmative duties of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading its client.

In the Matter of Lazard Freres & Co., LLC, SEC Rel. Nos. 33-7671, 34-41318 (Apr. 21, 1999). [Emphasis added; footnotes and citations omitted.]

Financial advisors and underwriters, of course, must work together to achieve issuer's objectives. A professional financial advisor develops sound working relationships with the investment banking community. A professional financial advisor does not, however, function as a competitor to investment bankers or placement agents, but rather as a helpful and independent financial and business advisor to the issuers. The underwriters then are better able to devote attention to their banking activities, informing issuers of their own sales capabilities and the interests of investors.

For example, much of the structuring of a financing for an issuer is best undertaken by a party working directly as an internal independent advisor to the issuer for a noncontingent fee, analyzing first whether the transaction should be undertaken at all, or if undertaken, with what approach. That way, the issuer's interests and its needs are more fully represented. The independent financial advisor is not a third party principal acting at arms'-length for its own interests or the interests of other parties, such as investors.

Indeed, a financial advisor, serving in an independent role with a noncontingent fee, is able to advise the issuer-client not to proceed with a transaction proposed by underwriters, developers or others when the transaction is not in the issuer-client's best interests. Such an independent financial advisor does not have conflicts of interest resulting from compensation concerns or from relationships with parties other than the issuer.

Stemming from this independence, the professional independent financial advisor does not automatically lead the issuer into competitive bids, but rather evaluates the circumstances on their merits. There are many conditions in which one or another sales approach may be preferable.

In structuring negotiated sales, the investment banker's point of view is an important element in providing information regarding the firm's capabilities to sell the issuer's securities as structured and as to investor response. The independent financial advisor works with the banker, just as with counsel, to prepare the issue and achieve a successful marketing.

When a competitive bid is the issuer's choice, the independent financial advisor assists the issuer in taking the issue to market, providing support in the bidding process, and aggressively utilizing the advisor's contacts with the investment banking community. In competitive sales, as a part of the process of educating the underwriting community about the issue, the professional independent financial advisor seeks comments from potential bidders about the issue and their views of market conditions bearing upon the structure.

In negotiated sales, the independent financial advisor assists the issuer-client in employing a qualified municipal securities team; works with the issuer, bond counsel and underwriters in structuring a sound municipal bond or other municipal securities transaction that meets the issuer's goals; and then monitors the underwriters' pricing of the securities sale.

The following highlights some of the reasons why issuers need independent municipal securities financial advisors at their side:

- An issuer gains the benefit of an independent professional finance and business representative on its side of the table, planning and negotiating for the issuer's interests from the earliest transactional stages.
- The independent financial advisor is able to function as an extension of the issuer's staff—an insider.
- The issuer obtains impartial, unbiased advice at the outset as to whether a market financing may be preferable or whether federal or state grants or loans, a pay-as-you-go approach or potentially less-costly project phasing alternatives may be less expensive or more effective.
- The independent advisor is able to translate and evaluate communications from investment bankers or placement agents and to shield the issuer from unnecessary intrusions.
- In negotiated issues, the issuer gains the independent financial advisor's professional judgment in the evaluation of proposals, the selection of the bankers for the financing team, the determination of the senior members of that team, and when desirable, the allocation of participations in the financing.
- In negotiated sales, the financial advisor and a professional proposal process can lead to greater competition in the spreads or discounts charged by underwriters and,

perhaps more importantly, in the securities structures and interest rates that underwriters offer.

- In competitive bids, the issuer gains an independent finance professional to assist in the bidding process. Aggressive bidding procedures can lead to the introduction to the issuer of new investment banking organizations. This can, and generally does, result in greater competition as to the prices paid for the securities.
- The independent financial advisor is, when employed for the purpose, able to assist the municipal securities issuer in the preparation of the issuer's official statements and continuing disclosure documents from the issuer's point of view, using information provided by the issuer and third parties. This is important for the issuer's protection and marketing optimization. Under prevailing positions expressed by the federal Securities and Exchange Commission, members of the issuer's governing body and its officers and staff must still review official statements carefully and conduct their own due diligence respecting disclosure information.
- An independent financial advisor, versed in the disclosure demands of the marketplace, is also able to advise the issuer on the creation of an effective disclosure program to attract municipal securities investors and, when required under the Securities and Exchange Commission's Rule 15c2-12, for the secondary market.
- The independent financial advisor is able to work at hourly or fixed rates. A noncontingent fee structure is more appropriate because it eliminates economic conflicts of interest, which can be very significant, and offers the issuer an impartial voice on the question of whether a financing should proceed at all. A contingent fee arrangement may be perceived by citizens and others as detracting from the financial advisor's independence because the advisor, like an underwriter, would receive compensation only if the transaction were completed (or if completed, there may be conflicts with reference to the amount borrowed or particular terms of the transaction). That may or may not be in the issuer's best interests.

In summary, the independent financial advisor offers issuers the important benefits of analyzing transactions with an independent perspective, and representing, and negotiating for, the issuers' best interests at the municipal bond or other municipal securities financing table, from the earliest planning stages to transactional closings. The issuers gain important advantages from the municipal securities financial advisor's independence, impartiality, experience and fiduciary responsibilities.

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