Recommended Practice

Selecting Financial Advisors (2008) (DEBT) (6/14/08)

Note: This Recommended Practice (RP) is one of a group of four relating to the sale of bonds. These four RP's should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The four RP's are:

Selecting and Managing the Method of Sale of State and Local Government Bonds
Selecting Financial Advisors
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

Background. State and local governments employ financial advisors to assist in the structuring and issuance of bonds whether through a competitive or a negotiated sale process. 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. In considering the roles of the financial advisor and underwriter, it is the intent of this RP to set a higher standard than is required under MSRB Rule G-23, because disclosure and consent are not sufficient to cure the inherent conflict of interest.

Recommendation. The Government Finance Officers Association (GFOA) recommends that issuers select financial advisors on the basis of merit using a competitive process and that issuers review those relationships periodically. A competitive process using a request for proposals or request for qualifications (hereafter, "RFP") process allows the issuer to compare the qualifications of proposers and to select the most qualified firm based on the scope of services and evaluation criteria outlined in the RFP.

Before starting the RFP process, issuers should decide whether the financial advisor will assist the issuer for a single bond sale, for a multi-year engagement or whether the issuer seeks to establish a qualified pool of financial advisors to choose from for future bond sales. The RFP can then be carefully written in order to result in the form of relationship desired by the issuer. Additionally, issuers should write the RFP to comply with applicable procurement requirements.

If an issuer is contemplating the possibility of selling bonds through a negotiated sale, the financial advisor should be retained prior to selecting the underwriter(s). This allows the issuer to have professional services available to advise on the appropriate method of sale, and if a negotiated sale is selected, to prepare the underwriter RFP and to assist in the evaluation of the underwriter responses.

No firm should be given an unfair advantage in the RFP process. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed, and determining when contacts with proposers will be restricted.

Due to potential conflicts of interest, the issuer should also enact a policy regarding whether, and under what circumstances, it will permit a firm to serve as an underwriter on one transaction and a financial advisor on another transaction. Additionally, it is recommended that any financial advisor contract with a firm that is also a broker-dealer have a lockout period from the termination of the contract to the time the broker-dealer can serve as a negotiated underwriter for the type of bond issue or program where they previously served as the financial advisor.

Request for Proposal Content. The RFP should include at least the following components:

1. A statement of the issuer stating that due to inherent conflicts of interest, the firm selected as financial advisor will not be allowed to resign in order to serve as underwriter for the proposed transaction (See GFOA Recommended Practice titled "Selecting and Managing the Method of Sale of State and Local Government Bonds).

2. A clear and concise description of the scope of work, specify the length of the contract and indicate whether joint proposals with other firms are acceptable.

3. In addition, the RFP should state whether the issuer reserves the right to select more than one financial advisor or to form financial advisory teams.

4. A description of the objective evaluation and selection criteria and explanation of how proposals will be evaluated.

5. A requirement that all fee structures be presented in a standard format and ask proposers to identify which fees are to be proposed on a "not-to-exceed" basis, describe any condition attached to their fee proposal, and explicitly state which costs are included in the fee proposal and which costs are to be reimbursed.

6. A requirement that the proposer provide at least three references from other public-sector clients; preferably providing services similar to those proposed to be undertaken as the result of the RFP.

Requested Proposer Responses. RFPs should request relevant information related to the areas listed below in order to distinguish each firm's qualifications and experience, including:

1. Relevant experience of the individuals to be assigned to the issuer, identification of the individual in charge of day-to-day management and the percentage of time committed for each individual on the account.

2. Relevant experience of the firm with financings of the issuer or comparable issuers, and financings of similar size, types and structures, including financings in same state.

3. Discussion of the firm's financial advisory experience necessary to assist issuers with either competitive or negotiated sales.

4. Demonstration of the firm's understanding of the issuer's financial situation, including ideas on how the issuer should approach financing issues such as bond structures, credit rating strategies and investor marketing strategies.

5. Demonstration of the firm's knowledge of local political, economic, legal or other issues that may affect the proposed financing.

6. Discussion of the firm's familiarity with GFOA Recommended Practices relating to the selling of bonds and the selection of finance professionals.

7. Disclosure of the firm's affiliation or relationship with any broker-dealer.

8. Analytic capability of the firm and assigned individuals and the availability of ongoing training and educational services that could be provided to the issuer.

9. Description of the firm's access to sources of current market information to assist in pricing of negotiated sales and information to assist in the issuer in planning and executing competitive sales.

10. Amounts and types of insurance carried, including the deductible amount, to cover errors and omissions, improper judgments, or negligence.

11. Disclosure of any finder's fees, fee splitting, payments to consultants, or other contractual arrangements of the firm that could present a real or perceived conflict of interest.

12. Disclosure of any pending investigation of the firm or enforcement or disciplinary actions taken within the past three years by the SEC or other regulatory bodies.

Additional Considerations. Issuers should also consider the following in conducting the financial advisor selection process**:**

1. Take steps to maximize the number of respondents by using mailing lists, media advertising, resources of the GFOA and applicable professional directories.

2. Allow adequate time for firms to develop their responses to the RFP. Two weeks should be appropriate for all but the most complicated RFPs.

3. Establish evaluation procedures and a systematic rating process, conduct interviews with proposers, and undertake reference checks. Where practical, one individual should check all references using a standard set of questions to promote consistency. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the selection team.

4. Document and retain the description of how the selection of the financial advisor was made and the rankings of each firm.

5. Consider whether to require disclosure of gifts, political contributions, or other financial arrangements in compliance with state and local government laws or other applicable policies.

Basis of Compensation. Fees paid to financial advisors should be on an hourly or retainer basis, reflecting the nature of the services to the issuer. Generally, financial advisory fees should not be paid on a contingent basis to remove the potential incentive for the financial advisor to provide advice that might unnecessarily lead to the issuance of bonds. GFOA recognizes, however, that this may be difficult given the financial constraints of many issuers. In the case of contingent compensation arrangements, issuers should undertake ongoing due diligence to ensure that the financing plan remains appropriate for the issuer's needs. Issuers should include a provision in the RFP prohibiting any firm from engaging in activities on behalf of the issuer that produce a direct or indirect financial gain for the financial advisor, other than the agreed-upon compensation, without the issuer's informed consent.

Form of Contract. As part of the RFP package, the issuer may also include a "Form of Contract" which incorporates elements and provisions conforming to prevailing law and procurement processes and require RFP respondents to comment on the acceptability of the Form of Contract. The comments on the acceptability of the Form of Contract should be part of the evaluation process. The contract development process should allow for reasonable negotiation over the final terms of the contract. A final negotiated contract should make clear those services that will be included within the basic financial advisor fee and any services or reimbursable expenses that might be billed separately.

References (NEED TO REVIEW)

- *Preparing Requests for Proposals*, Issue Brief No. 3, California Debt Advisory Commission, October 1994.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- *A Guide for Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia Tigue, GFOA, 1997.
- Method of Sale RP
- MSRB Rule G-23

Approved by the GFOA's Governmental Debt Management Committee, June 14, 2008. Pending approval by the GFOA's Executive Board.