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SEC Issues Proposed Rules Requiring Registration of Municipal Advisors

The Securities and Exchange Commission recently issued proposed rules (the Proposed Rules)* that define who must register as a “Municipal Advisor” under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), establish a permanent registration regime for Municipal Advisors and impose certain recordkeeping requirements on Municipal Advisors. Dodd-Frank also granted the Municipal Securities Rulemaking Board (MSRB) regulatory authority over Municipal Advisors and imposed upon Municipal Advisors a fiduciary duty when advising Municipal Entities (defined below). Registration requirements for the MSRB are in addition to registration requirements for the SEC.

The Proposed Rules broaden the definition of Municipal Advisor and the activities that constitute Municipal Advisory Activities (defined below). The Proposed Rules should be of particular interest to persons engaging in any activity with Municipal Entities because the broad definition of Municipal Advisory Activities may require registration with the SEC as a Municipal Advisor, both by entities currently registered with government regulators with respect to other activities (such as certain investment advisers that are registered with the SEC) and by entities currently not registered with any government regulators. Indeed, certain activities that previously were performed by registered investment advisers may now require such advisers to also register as Municipal Advisors.

Background

Before Dodd-Frank was adopted, the activities of Municipal Advisors were largely unregulated and most Municipal Advisors generally were not required to register with the SEC, the MSRB or other government entity with respect to their Municipal Advisory Activities. The Securities Act of 1933, as amended and the Securities Exchange Act of 1934, as amended (the Exchange Act) provide broad exemptions for municipal securities from their provisions except for the antifraud provisions. Indeed, some entities, such as brokers, dealers, municipal securities dealers, investment advisers and banks were subject to registration by other government regulators, but not with respect to their activities as Municipal Advisors. Under the Proposed Rules, these entities would have to register as Municipal Advisors with respect to their Municipal Advisory Activities.

* The Proposed Rules were published in the Federal Register, Volume 76, No. 4 (January 6, 2011) as Release No. 34-63576, and are available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2011_register&docid=%5bDOCID:fro6jan1-16%5d.pdf.

For more information or if you would like assistance in registering as a Municipal Advisor, please contact your Katten Muchin Rosenman LLP attorney or any of the following members of Katten's [Financial Services Practice](#).

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Title IX of Dodd-Frank amended Section 15B of the Exchange Act (which sets forth the registration requirements for Municipal Advisors) to (a) make it unlawful, absent certain exemptions, for Municipal Advisors to provide certain advice to, or solicit, Municipal Entities or certain other persons without registering with the SEC, and (b) require Municipal Advisors to register with the SEC effective October 1, 2010. To enable these advisors to fulfill Dodd-Frank's mandate, the SEC previously adopted an interim final temporary rule and form that provided a transitional step toward implementing a permanent registration regime for Municipal Advisors that will expire by December 31, 2011.

Statutory Proscription for Municipal Advisors

Section 15B(a)(1) of the Exchange Act, as amended by Dodd-Frank, makes it “unlawful for a municipal advisor to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person, unless the municipal advisor is registered.”

Proposed Rules Clarify Scope of Persons Included within the Definition of Municipal Advisor

Municipal Advisor

The statutory definition of “Municipal Advisor” is broad and includes persons that traditionally have not been considered municipal financial advisors, including financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders and swap advisors that engage in Municipal Advisory Activities. Unless one of the exclusions described below applies, the Proposed Rules state that these persons are included in the definition of Municipal Advisor if they provide advice to or on behalf of a Municipal Entity or Obligated Person (defined below) with respect to Municipal Financial Products (defined below), the issuance of municipal securities (including advice with respect to the structure, timing, terms and other similar matters) or undertake a solicitation of a Municipal Entity (“Municipal Advisory Activities”). Also included would be persons that provide advice with respect to plans, programs or pools of assets and investment funds held by, or on behalf of, a Municipal Entity, such as a 529 college plan or a public pension plan. The issue of whether a person is compensated for providing municipal advice is not determinative as to whether the person is a Municipal Advisor.

According to the Proposed Rules, there are three distinct categories of Municipal Advisors that offer different services:

- financial advisors (including broker-dealers already registered with the SEC) that provide advice to Municipal Entities with respect to their issuance of municipal securities and their use of Municipal Financial Products;
- investment advisers that advise municipal pension funds and other Municipal Entities on the investment of funds held by or on behalf of Municipal Entities (subject to certain exclusions); and
- third-party marketers and solicitors.

There are several exclusions from the definition of Municipal Advisor that are described below in the “Exclusions” section.

Municipal Entity/Obligated Person

In addition to a state, political subdivisions of a state and its instrumentalities and any agency of the state, “Municipal Entity” includes any plan, program or pool of assets sponsored by the state or its instrumentalities (including public pension funds and participant-directed investment programs or plans such as 529 plans) and any other issuer of municipal securities. “Obligated Person” means any person, including an issuer of municipal securities, who is committed by contract or other arrangement to support the payment of all or part of the obligation of the municipal securities to be sold in an offering of municipal securities. The Proposed Rules provide that Obligated Persons can include entities acting as conduit borrowers, such as private universities, nonprofit hospitals and private corporations, but would not include providers of municipal bond insurance, letters of credit or other liquidity facilities.

Municipal Financial Products/Investment Strategies

“Municipal Financial Products” means municipal derivatives, guaranteed investment contracts and “Investment Strategies.” The Proposed Rules interpret Investment Strategies to mean the investment of the proceeds of municipal securities and to include plans, programs or pools of assets that invest funds “held by or on behalf of a [M]unicipal [E]ntity.” Therefore, any person that provides advice with respect to plans, programs or pools of assets that invest funds held by, or on behalf of, a Municipal Entity must register as a Municipal Advisor unless it is covered by one of the exclusions discussed below.

In this regard, the Proposed Rules raise certain questions that require clarification. For example, every bank account of a Municipal Entity is comprised of funds “held by or on behalf of a [M]unicipal [E]ntity.” Under those circumstances, would a money manager providing advice to a Municipal Entity with respect to its bank accounts be deemed to be a Municipal Advisor and thus be required to register?

Of comfort to fund managers and investment advisers is the SEC’s statement in the Proposed Rules that to the extent a person is providing advice to a pooled investment vehicle in which a Municipal Entity has invested along with other non-municipal entities, the pooled investment vehicle would not be considered funds “held by or on behalf of a [M]unicipal [E]ntity,” and the person providing advice to the pooled investment vehicle would not be required to register as a Municipal Advisor. The SEC requested comments on whether this pooled investment vehicle interpretation should be limited to situations where the non-municipal investors are the primary investors or determined by the amount of investment by the Municipal Entity in the pooled investment vehicle. Of course, an investment adviser providing advice directly to a Municipal Entity (for example, a separately managed account) would have to register as a Municipal Advisor.

Solicitation of a Municipal Entity/Obligated Person

“Solicitation of Municipal Entity or Obligated Person” means a communication with a Municipal Entity or Obligated Person made for compensation on behalf of a broker, dealer, municipal securities dealer, Municipal Advisor or unaffiliated investment adviser for the purpose of obtaining or retaining an engagement by a Municipal Entity or Obligated Person of a broker, dealer, municipal securities dealer or Municipal Advisor in connection with Municipal Financial Products, the issuance of municipal securities or of an investment adviser to provide investment advisory services to or on behalf of a Municipal Entity.

According to the Proposed Rules, absent an exclusion, any third-party solicitor that seeks business on behalf of a broker, dealer, municipal securities dealer, Municipal Advisor or investment adviser from a Municipal Entity or Obligated Person must register as a Municipal Advisor. Accordingly, a third-party solicitor that seeks business on behalf of an investment adviser from a municipal pension fund or a government investment pool would be required to register as a Municipal Advisor. Neither the number nor the size of investments solicited is a factor in determining whether solicitation of a Municipal Entity requires registration as a Municipal Advisor. Indeed, the Proposed Rules provide that solicitation of even a single investment of any amount in a Municipal Entity or Obligated Person would require the person soliciting that entity to register as a Municipal Advisor.

Persons soliciting a Municipal Entity or Obligated Person on behalf of affiliated entities would not fall within the definition of Municipal Advisor and would not be required to register as such, although an affiliated person could voluntarily register as a Municipal Advisor (and subject itself to the regulatory regime for Municipal Advisors). Although the Proposed Rules do not elaborate, the reason an affiliated entity would not be required to register as a Municipal Advisor presumably is that the underlying entity on whose behalf it is soliciting would already be registered as a Municipal Advisor (or be excluded from that definition and would not be so registered). Similarly, the Proposed Rules also do not elaborate on whether a registered investment adviser would be required to register as a Municipal Advisor if it solicits a Municipal Entity on its own behalf (as opposed to providing advice to a Municipal Entity).

In this context, it should be noted that in its Proposed Rules Implementing Amendments to the Advisers Act (which is the subject of a previous [Katten Client Advisory](#)), the SEC is proposing to amend Rule 206(4) of the Investment Advisers Act of 1940, as amended (the Advisers Act) to permit investment advisers to pay a “regulated Municipal Advisor” to solicit government entities on its behalf.¹ Such solicitors may include entities affiliated with the investment adviser.

¹ A person that solicits investors to invest in securities also may need to consider whether it is acting as a broker and is required to register as such.

Exclusions from the Definition of Municipal Advisor

The Proposed Rules provide that the following would be excluded from the definition of Municipal Advisor:

- a) An investment adviser registered under the Advisers Act and its associated persons, to the extent that it provides investment advice that would subject such adviser to the Advisers Act. However, an SEC-registered investment adviser or its associated persons would have to register as a Municipal Advisor if the investment adviser or its associated persons engage in any Municipal Advisory Activities that would not be investment advice subject to the Advisers Act. For example, an SEC-registered investment adviser that provides advice with respect to how a Municipal Entity should issue municipal securities, or solicits a Municipal Entity on behalf of an unaffiliated Municipal Advisor, would be required to register as a Municipal Advisor. The Proposed Rules distinguish between advisory services performed by an SEC-registered investment adviser that fall within the purview of an investment adviser's traditional activities that are subject to the Advisers Act and those activities that fall outside that purview. Further, the Proposed Rules do not specifically exempt a state-registered investment adviser from registration as a Municipal Advisor, to the extent it is engaged in Municipal Advisory Activities. The SEC requested comments on whether these state-registered investment advisers should be exempt from the definition of Municipal Advisor to the extent (similar to SEC-registered investment advisers) they are providing advice that otherwise would be subject to the Advisers Act.
- b) A commodity trading advisor (CTA) registered under the Commodity Exchange Act and its associated persons, to the extent that it provides advice relating to swaps. However, the exclusion would not apply to a CTA to the extent it engages in municipal activities other than providing advice relating to swaps, in which case, it would have to register as a Municipal Advisor. For example, a CTA providing advice to a Municipal Entity with respect to engaging in a swap transaction and providing advice to the Municipal Entity with respect to the structure of a municipal securities offering would have to register as a Municipal Advisor.
- c) An employee of a Municipal Entity (although the exclusion would not apply to appointed members of the governing body of a Municipal Entity, as those persons are not directly accountable for their performance to the citizens of the Municipal Entity).
- d) A broker, dealer or municipal securities dealer serving as an underwriter on behalf of a Municipal Entity or Obligated Person in connection with the issuance of municipal securities (although the exclusion would not apply to a broker-dealer advising a Municipal Entity with respect to the investment of bond proceeds or acting as a placement agent for a private equity fund).
- e) Professionals, including lawyers, engineers and accountants, but only to the extent to which they are providing traditional advice not constituting Municipal Advisory Activities.

The SEC requested comments on whether an entity that as part of its ongoing ordinary communications provides to clients (including Municipal Entities) investment advice, such as research information and generic ideas or commentary, and that does not purport to meet the needs of specific clients, should be excluded from the definition of Municipal Advisor.

Application for Municipal Advisor Registration

Any person that falls within the definition of Municipal Advisor but does not fit into the exclusions discussed above would be required to register as a Municipal Advisor with the SEC and with the MSRB.

The Proposed Rules would establish procedures for Municipal Advisors to apply for registration with the SEC. The SEC would have 45 days either to (a) grant registration or (b) institute proceedings to determine whether registration should be denied. An application for registration as a Municipal Advisor would be filed electronically on proposed new Form MA (for Municipal Advisory firms) or Form MA-I (for natural person Municipal Advisors) and would be publicly available. The proposed forms are similar to Form ADV Part 1 and FINRA's Form U-4, with appropriate changes to reflect the activities of Municipal Advisors, and include a self-certification that the information is true and correct and that the Municipal Advisor is able to meet its regulatory obligations. The proposed forms would be required to be amended or recertified at least annually and more frequently if the information becomes inaccurate.

Recent Changes to MSRB Regulations and Requirements Applicable to Municipal Advisors Disciplinary Actions

The MSRB has amended Rule G-5 to provide that Municipal Advisors and their associated persons may not engage in Municipal Advisory Activities in violation of any restrictions imposed thereupon by the SEC.

Fair Dealing

The MSRB has amended Rule G-17 to provide that Municipal Advisors shall be required to deal fairly with all persons and not engage in any deceptive, dishonest or unfair practice.

Pay to Play

The MSRB has proposed the adoption of Rule G-42, modeled after Rule G-37, which would put into place certain “pay to play” restrictions on Municipal Advisors. The proposed rule would prohibit Municipal Advisors from engaging in Municipal Advisory Activities with a Municipal Entity for compensation, soliciting third-party business from a Municipal Entity for compensation or receiving compensation for the solicitation of third-party business from a Municipal Entity, within two years after any contribution to an official of such Municipal Entity. The compensation restrictions would begin on the date of the contribution and run for two years after the Municipal Advisor stops working for the Municipal Entity. For third-party solicitors, the compensation restrictions would run for the two-year period after they make a contribution.

The proposed rule would require Municipal Advisors to submit Board Form G-42 to the MSRB detailing contributions made by or on behalf of the Municipal Advisor in each quarter in which any applicable contributions were made.

The proposed rule would contain a two-year look-back period, but only for contributions made after the rule’s effective date. The proposed rule would also have an exception for contributions of up to \$250 to officials for whom the Municipal Advisor is entitled to vote.

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