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Board Members Beware - SEC Regulatory Authority May Cast Wide Net

Governmental board members and board members of nonprofit organizations may be "in the sights" of the Securities and Exchange Commission (SEC) if their organizations are involved in the issuance of municipal bonds, including tax-exempt bonds. Federal statutes known as the Dodd-Frank Wall Street Reform and Consumer Protection Act recently adopted by Congress (the Act) amended the Securities Exchange Act of 1934 (the 34 Act) to add a new requirement that "municipal advisors" register with the SEC. The definition of municipal advisor, as interpreted by the SEC, is potentially quite broad and could include appointed members of the governing body of an issuer of municipal bonds or the entity borrowing the proceeds thereof. For example, the Act could apply to the board members of a local industrial development authority or a private college.

In addition to the registration requirement, the Act amends the 34 Act to also subject municipal advisors to the regulatory authority of the Municipal Securities Rulemaking Board (the MSRB), impose a fiduciary duty on municipal advisors when advising municipal entities and impose certain record keeping requirements on municipal advisors. Therefore, just by being involved in a municipal bond transaction, these board members could be subjected to the expense of registration, the time requirements to comply with record keeping requirements and, potentially, have their ability to make political contributions limited.

These new requirements were implemented via temporary SEC rules in October 2010. The SEC issued proposed final rules in December 2010, which were published in the Federal Register on January 6, 2011, and invited public comment on the proposed final rules. The public comment period terminates in February 2011. The SEC's final rules on this topic are expected to be released later this year.

Who Are Municipal Advisors? Are Board Members Included?

The Act amendments to the 34 Act define "municipal advisor" as any person (that is not a municipal entity or an employee of a municipal entity) "that provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such financial products or issues or that undertakes a solicitation of a municipal entity" for such purposes. The statutory definition of "municipal advisor" and the SEC's interpretation thereof set forth in the proposed final rules released in December 2010 are broad enough to encompass not only those entities and individuals

traditionally thought of as “municipal advisors,” such as municipal financial advisors and underwriters acting as financial advisors, but could also apply to entities or individuals that traditionally have not been considered to be “municipal advisors,” including appointed board members of municipal entities or the entities borrowing the proceeds of municipal bonds.

In addition to the variety of boards formed by states and municipalities for the purpose of issuing bonds, the new rules could also impact boards formed by states and municipalities that are involved in the investment of governmental funds, including foundations and pension boards. The reach of the regulations could also ensnare the board members of nonprofit organizations, including hospitals, nursing homes, colleges and providers of nonprofit housing and social services. Despite often serving for little or no compensation, the members of all of these boards could be included within the definition of “municipal advisor.” The regulations could even extend to the board members of small manufacturing entities and other organizations that utilize municipal bonds to benefit from the lower interest rates available from tax-exempt borrowings.

The Act amendments to the 34 Act include express exclusions from the “municipal advisor” definition: brokers, dealers or municipal securities dealers serving as an underwriter, employees of a municipal entity, attorneys offering legal advice or providing services that are of a traditional legal nature, engineers providing engineering advice and investment advisers registered under the Investment Advisers Act of 1940 or persons associated with such investment advisers who are providing investment advice. The SEC’s proposed final rules address its views on application of the registration requirement to entities not traditionally considered to be “municipal advisors,” including commercial banks, bond insurers, accountants, elected and appointed members of the governing bodies of municipal entities and certain “obligated persons,” including chief financial officers, other employees and board members of non-municipal conduit borrowers, such as nonprofit hospitals and other nonprofit organizations.

In the release, the SEC makes clear its current position that employees of municipal entities, including *elected* or *ex officio* members of a governing body of a municipal entity, are excluded from the municipal advisor registration requirements. The SEC also makes clear in the release its current position that *appointed* members of a governing body of a municipal entity and board members or employees of nonprofit or other non-municipal conduit borrowers should not be excluded from the definition of “municipal advisor” and are, therefore, subject to the registration and other requirements contained in the Act. As previously noted, the SEC is seeking comments on the proposed rules and, therefore, may be persuaded to rethink its position on appointed board members. Even if the SEC maintains its current position in the final rules, the determination of whether such individuals are municipal advisors will also depend on whether they otherwise meet the definition – i.e., they provide “advice to or on behalf of” a municipal entity or conduit borrower with respect to “municipal financial products” or the issuance of municipal securities. The SEC release does not provide guidance with respect to what actions would constitute such advice, particularly by a member of a governing body.

Registration and Other Requirements Imposed on Municipal Advisors

Any entity or individual that falls within the "municipal advisor" definition must register on SEC-prescribed forms and update the registration on an annual basis or, with respect to individual municipal advisors, when the information provided in the original registration changes. The SEC forms require, among other things, information on work, residential and financial history, social security numbers for individual registrants, and an acknowledgment and certification that the registrant is able to meet his or her regulatory obligations. The proposed rules would require an individual to register even if the "municipal advisory firm" with whom the individual is employed is registered.

In addition to the registration requirements, all municipal advisory firms and sole proprietors (not individual municipal advisors) will be subject to certain record keeping requirements for at least five years. All municipal advisors will be subject to the MSRB's regulatory authority, including the MSRB's limitations on political contributions for certain entities. Municipal advisors will also have a fiduciary duty to municipal entities for which they are providing advice.

Next Steps

In the December 2010 release, the SEC solicited comments on the proposed rules. The SEC's position on certain of the proposed rules, including the entities and individuals that may be excluded from the "municipal advisor" definition, may change as a result of such comments. We will continue to monitor developments in this area. If you have further questions on the Act amendments regarding "municipal advisors," please contact one of the Thompson Coburn attorneys listed below:

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