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SEC Proposal May Require Municipal Entity Board Members and Conduit Borrower Board Members and Financial Officers to Register as Municipal Advisors

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On December 20, 2010, the Securities and Exchange Commission (SEC) released proposed rules (the "Proposed Rules") that would require appointed board members of a municipal bond issuer or other municipal entity that invests governmental funds to register as municipal advisors with the SEC and the Municipal Securities Rulemaking Board (MSRB) *if* they provide "advice" to the municipal entity as to the issuance of municipal securities, swap transactions, and/or investment strategy relating to state or municipal funds. Although not expressly addressed by the SEC's release, it appears that board members and even employees of conduit borrowers from municipal issuers also would need to register *if* they provide "advice" to such borrowers relating to the issuance of municipal securities, swap transactions, and/or investment strategy relating to municipal bond proceeds. The Proposed Rules do not address what constitutes "advice."

Proposed Rules 15Ba1-1 through 15Ba1-7 implement provisions of Section 15B of the Securities Exchange Act of 1934, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Section 15B"). The statutory provisions, requiring registration with the SEC and MSRB of "municipal advisors," became effective on October 1, 2010. The SEC adopted interim rule 15Ba2-6T on September 1, 2010, specifying temporary registration procedures for municipal advisors. Such temporary registrations expire on December 31, 2011. The Proposed Rules, when and as adopted, will replace the temporary registration procedures. The rules and registration form relating to the temporary registration procedures with the SEC can be found at http://www.sec.gov/info/municipal/form_ma-t.htm. The rules and registration form relating to the registration procedures with the MSRB can be found at <http://www.msrb.org/Rules-and-Interpretations/MSRB-Registration.aspx>.

Under Section 15B, a "municipal advisor" is defined to include a person (who is not a municipal entity or an employee of a municipal entity) who 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 municipal financial products or securities issuance. For this purpose, a "municipal entity" includes any state agency, authority, instrumentality, or political subdivision or municipal corporate instrumentality; any plan, program, or pool of assets sponsored or established by any such state or municipal entity; and any other issuer of municipal securities. An "obligated person" includes any entity that is contractually committed to support the payment of all or part of any issue of municipal securities, excluding, per the Proposed Rules, bond insurers and providers of letter of credit or liquidity facilities. "Municipal financial products" is defined to mean municipal derivatives, guaranteed investment contracts, and investment strategies. "Investment strategies" is defined to include plans or programs for the investment of the

proceeds of municipal securities, guaranteed investment contracts, and the recommendation of and brokerage of municipal escrow investments. Under the Proposed Rules, “investment strategies” also includes “plans, programs or pools of assets that invest funds held by or on behalf of a municipal entity,” whether or not such funds are proceeds of municipal securities, and would include pension funds, general funds, and other state or municipal investment pools.

As noted above, Section 15B excludes “an employee of a municipal entity” from the definition of “municipal advisor.” In the release accompanying the Proposed Rules (the “Release”), the SEC noted that a commenter on the interim rule for registration of municipal advisors had suggested that the SEC clarify that this “employee” exclusion covers any person serving as a member of the governing body of a municipal entity, such as a board member, commissioner, or city councilman. The SEC agreed that the “employee” exclusion should extend to *elected* members of a governing body of a municipal entity, and *ex officio* members who are on such governing body by virtue of holding an elective office. The SEC was not persuaded, however, that unpaid volunteers sitting on boards should be categorically exempted from the “municipal advisor” definition, and declined to exclude *appointed* members of a municipal entity’s governing body from the definition of “municipal advisor,” stating that “the Commission is concerned that appointed members, unlike elected officials and elected *ex officio* members, are not directly accountable for their performance to the citizens of the municipal entity.”

Neither Section 15B nor the Proposed Rules contain any exclusion from the definition of “municipal advisor” for a board member or employee of an “obligated person,” even though providing advice to an “obligated person” with respect to the issuance of municipal securities, related swap transactions, and/or investment of proceeds of municipal securities requires registration absent an applicable exclusion. Although the Release does not address the status of “obligated person” board members or employees, given the absence of a statutory or regulatory exclusion—and the SEC’s decision not to provide an exclusion for unelected board members of municipal entities—no express or implied exclusion to the municipal advisor registration requirements is apparent for, e.g., a hospital’s chief financial officer or other employees, or hospital board members, who provide “advice” to the hospital in connection with its tax-exempt borrowings through a state authority or in connection with “advice” to the hospital regarding related swap transactions or the investment of bond proceeds.

The fact that under the Proposed Rules appointed board members of a municipal entity, board members of a non-municipal conduit borrower, and employees of a non-municipal conduit borrower are not excluded from the definition of “municipal advisor” does not necessarily mean that they are or will be required to register as municipal advisors. Although the registration requirements of Section 15B are already in effect, the Proposed Rules are not, and expressions of concern by municipal issuers and conduit borrowers, or trade associations acting on their behalf, may persuade the SEC to change its mind when it finalizes the Proposed Rules and expressly exclude non-elected board members and employees. In the Release, the SEC states that “the Commission does not believe that whether a municipal advisor is compensated for providing municipal advice should factor into the determination regarding whether the municipal advisor must register with the Commission,” but solicits comment on whether there are any persons who engage in uncompensated municipal advisory activities who should be excluded. The Release also solicits comments on whether its distinction between appointed board members and elected board members is appropriate.

Even if comments on the Proposed Rules do not produce a change in the SEC’s position, the absence of an exclusion or exemption for non-elected board members or obligated person employees does not necessarily mean that a non-exempted board member or employee must register as a municipal advisor. It is possible that the SEC may clarify what constitutes “advice” in a manner that makes it clear that the mere offering by a board member of a view at a board meeting or in a report on how a bond issue should be structured or timed, on whether a swap should be used, and/or on how municipal funds or bond proceeds should be invested does not constitute “advice” to the entity served by such board member. Similarly, the omission of obligated person employees from Section 15B seems a glitch rather than an intended distinction from the exclusion for municipal employees, and the SEC could clarify that an obligated person employee is not providing “advice” to his or her employer when acting within the scope of his or her employment. Although a stampede of unelected board members and chief financial

officers registering as municipal advisors seems unlikely, it may nonetheless prove difficult, unless and until the SEC changes or clarifies its position, for non-elected board members or employees to participate in discussions or decisions regarding bond issues and investment policy without some concern that they may be in technical violation of federal securities laws.

Comments on the Proposed Rules are due 45 days after the date of publication of the Proposed Rules in the Federal Register, which has not yet occurred.

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