

Client Alert

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SEC's Final Municipal Advisor Registration Rules Will Take Effect on July 1, 2014

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The Securities and Exchange Commission's (SEC) temporary stay on its final municipal advisor rules under Section 15B of the Securities Exchange Act of 1934 (the "Exchange Act") expires July 1, 2014. Accordingly, municipal advisors will be required to register with the SEC on Form MA on a phased-in schedule beginning July 1, 2014, and ending October 31, 2014. Municipal advisors are also subject to registration with, and supervision by, the Municipal Securities Rulemaking Board (MSRB).

THE FINAL REGISTRATION RULES

Exchange Act Section 15B was amended by Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), to provide for a new class of regulated persons: municipal advisors. The municipal advisor provisions of Exchange Act Section 15B have been effective since October 1, 2010, and municipal advisors have been required since then to register under a temporary interim rule. The SEC's final registration regime replaces the interim rule.

In addition to imposing registration requirements, the SEC's final rules define a municipal advisor and provide certain exclusions and exemptions from the registration requirements.

KEY DEFINITIONS IN THE FINAL RULES

The SEC's final rules define a municipal advisor as a person (other than another municipal entity or employee of a municipal entity) who:

- provides advice to a "municipal entity" or an "obligated person" (both defined below) with respect to the issuance of municipal securities or municipal financial products (e.g., derivatives);
- provides advice on behalf of a municipal entity or obligated person with respect to the issuance of municipal securities or municipal financial products; or
- solicits a municipal entity or obligated person.¹

The rules define a municipal entity as "any state, political subdivision of a state or municipal corporate instrumentality of a state or political subdivision."² This includes any: "(1) agency, authority or instrumentality of a state, political subdivision or municipal corporate instrumentality; (2) plan, program or pool of assets sponsored or

¹ 17 C.F.R. § 240.15Ba1-1(d)(1)(i).

² 17 C.F.R. § 240.15Ba1-1(g).

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established by a state, political subdivision or municipal corporate instrumentality or (3) other issuer of municipal securities.”³

An obligated person is defined as any person who is “committed by contract or other arrangement to support the payment of all or part of an obligation on the municipal securities to be sold in an offering of municipal securities.”⁴ This can include conduit borrowers and issuers (such as hospitals, universities and private issuers of industrial development bonds) who use municipal platforms to issue tax-exempt securities. The rule expressly excludes, however, bond insurers, letter of credit issuers or other providers of liquidity or credit support in connection with municipal financial products or municipal securities.⁵

WHAT CONSTITUTES ADVICE?

Under the SEC’s final rules, there is a “facts and circumstances” test for what constitutes “advice.” The SEC stated that advice is “a recommendation that is particularized to the specific needs, objectives or circumstances of a municipal entity or obligated person.”⁶ General information, including information that is widely disseminated for use by the public and educational materials, does not constitute advice.⁷

There is a notable difference between the SEC’s approach to advice for purposes of registration as a municipal advisor versus the general definition of investment adviser under the Investment Advisers Act of 1940 (the “Advisers Act”): a person need not be compensated for its advice in order to have to register as a municipal advisor. In addition, there is no de minimis threshold or single transaction exception for advice given to a municipal entity. Thus, any advice given to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities will bring a person who does not qualify for an exclusion or exemption within the scope of the rules.

WHAT CONSTITUTES SOLICITATION?

A municipal advisor also can be a person who solicits a municipal entity or obligated person. Significantly, this prong of the definition does not apply if the solicitation is by a person on its own behalf. Rather, the solicitation of a representation or engagement of a municipal entity or obligated person must be made on behalf of a third party and must be in connection with a municipal financial product or an issuance of municipal securities.⁸

EXCLUSIONS AND EXEMPTIONS

The final rules provide some exclusions and exemptions from the requirement to register as a municipal advisor, even if a person is providing advice or soliciting within the meaning of the final rules. Thus, the following persons are excluded from the registration requirements of Section 15B:

³ 17 C.F.R. § 240.15Ba1-1(g).

⁴ 17 C.F.R. § 240.15Ba1-1(k); 15 U.S.C. 78o-4(e)(10).

⁵ 17 C.F.R. § 240.15Ba1-1(k).

⁶ Registration of Municipal Advisors, Securities and Exchange Act Release No. 34-70462 (September 20, 2013), 78 Fed. Reg. 67467, 67480 (November 12, 2013) (“Adopting Release”).

⁷ 17 C.F.R. § 240.15Ba1-1(d)(1)(ii); Adopting Release, 78 Fed. Reg. at 67479-80.

⁸ 15 U.S.C. 78o-4(e)(9); Adopting Release, 78 Fed. Reg. at 67499.

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- dealers acting in the capacity of an underwriter of a particular issuance of municipal securities, to the extent their activities are within the scope of an underwriting engagement with a municipal entity or obligated person;
- investment advisers registered under the Advisers Act (and their associated persons) if they are operating pursuant to an investment management agreement and within the scope of the Advisers Act, but they will be subject to registration if they are engaged in providing advice regarding the structure, timing and terms of an issuance of municipal securities or advice regarding municipal derivatives;
- registered commodity trading advisors, to the extent related to municipal derivatives; and
- attorneys, to the extent that they are offering traditional legal advice or services and are not holding themselves out as financial advisors regarding the issuance of municipal securities or municipal financial products.⁹

The SEC's final rules also exempt certain entities from the registration requirements to the extent they are involved in certain activities, including:

- banks, to the extent that their activities fall within traditional banking activities such as loans, investments held in a deposit or savings account, or investments made by the bank in its capacity as indenture trustee or a similar role;
- registered swap dealers, as long as they are not "acting as an advisor" (within the meaning of the Commodity Exchange Act and the Commodity Futures Trading Commission's rules) to a municipal entity or obligated person with respect to a municipal derivative or trading strategy;
- persons providing advice to a municipal entity or obligated person represented by an independent registered municipal advisor, subject to receipt of representations from, and provision of disclosures to, such municipal entity or obligated person; and
- persons responding to requests for proposals or qualifications, so long as such persons do not receive separate direct or indirect compensation for advice provided as part of such response.¹⁰

THE REGULATORY ROLE OF THE MSRB

Section 15B of the Exchange Act, as amended by the Dodd-Frank Act, imposes on municipal advisors a fiduciary duty to the municipal entities they advise, and a lesser duty of care to obligated persons. The MSRB is charged with drafting related rules, including business conduct standards, disclosure requirements, recordkeeping rules and pay-to-play rules, in addition to implementing such fiduciary duty.

⁹ 17 C.F.R. § 240.15Ba1-1(d)(2).

¹⁰ 17 C.F.R. § 240.15Ba1-1(d)(3).

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In early January, the MSRB proposed new Rule G-42, which is not yet final. The specifics of the final MSRB rule will be significant for a number of reasons, not least because Section 15B provides that the fiduciary duty applies to municipal advisors and to “any person affiliated with such municipal advisor.” Given the potentially broad application of this provision, it is hoped that the final MSRB rules clarify the statute in a way that does not impose too great a burden.

OUR TAKE

Those involved with the issuance of municipal securities, or with municipal financial products, and not yet registered with the MSRB as municipal advisors should evaluate their interactions with municipal entities and obligated persons and consult with counsel to determine whether they are providing advice or soliciting such persons for purposes of the SEC rule. It is possible that prompt registration will be necessary for them to continue some of their activities following July 1.

Entities that registered as municipal advisors under the interim rule and those that will be registering as municipal advisors when the final rule is effective should keep a close eye on the corresponding rules and guidance that are likely to be issued by the MSRB in the coming months. Moreover, entities that have already registered under the temporary municipal advisor registration regime will need to either re-register on the new forms or, if they are no longer actively providing advice to (or soliciting on behalf of third parties) municipal entities or obligated persons, may consider withdrawing their registration.

Some of the exemptions under the new SEC rules, particularly those based upon particular activities rather than an entity’s organizational structure, may be open for interpretation. In particular, open for interpretation are certain types of derivative financial products that may not fit neatly into a definition. In addition, a counterparty’s status under the new rules might not be clear. Banks, registered investment advisors and other market participants that are not registered as municipal advisors may therefore wish to seek representations from their counterparties regarding their status, and the characterization of the financial product, under the new rules. For example, such representations might include:

- that the counterparty is not a “municipal entity” or an “obligated person;”
- that the relevant financial product is not a “municipal security” or a “municipal financial product;”
- that no “advice” has been provided; or
- that no “solicitation” has occurred.

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