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Outlook 2015: Another Year of the Muni Advisor?

WASHINGTON — This year will bring more municipal advisor and secondary market transparency regulation, while a newly Republican-controlled Senate could lead Congress to scrutinize and possibly ease existing laws and rules.

“We expect 2015 to be again the year of municipal advisor regulation, said Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at the Securities Industry and Financial Markets Association. The Municipal Securities Rulemaking Board is still working on several rules governing MAs, including the crucial G-42 which spells out the core duties of non-solicitor advisors.

Dave Sanchez, a former Securities and Exchange Commission muni office lawyer who now runs his own firm in California, said MA regulation will be a major theme of the year as some market participants continue to adjust to the more than year-old SEC registration rule, which took effect July 1.

“On the regulatory front there will probably be a continued focus on implementing the municipal advisor regime,” Sanchez said. “It is clear to me that market participants are still legitimately struggling with how all of the various exemptions and exclusions work together and that the market needs more time to understand the rule. And that is fine.”

The final registration rule and subsequent MSRB proposals have caused some large issuer officials to complain that they feel directly regulated because they are essentially required to produce proof of exemptions to the rule that underwriters can rely on before providing advice. Federal law prohibits the SEC and the MSRB from requiring issuers to send them any documents prior to a bond offering.

SIFMA president and chief executive officer Kenneth Bentsen said earlier this month that SIFMA continues to be dissatisfied with the rule and believes it misinterpreted congressional intent in the Dodd-Frank Act provision authorizing creation of the MA regulatory regime. But most issuers and many individual underwriting firms have begun to make peace with it and operate more comfortably within the rule’s structure.

“I think many of the largest issuers increasingly understand that the important protections the rule provides for small and medium sized municipal entities are worth any small inconveniences they may endure in the way they do business,” Sanchez continued. “The rule is designed to put municipal issuers in control of their financing programs. And I do think that broker-dealers will continue to appreciate that the SEC provided important exclusions and exemptions for them that went beyond the narrow statutory exclusions articulated by Congress.”

MA Standards of Conduct

Leo Karwejna, chief compliance officer and managing director at Public Financial Management, said both the MSRB and the SEC will have the opportunity to fill in some of the remaining blanks on the

MA regime. The MSRB has proposed its Rule G-42 on the standards of conduct for non-solicitor municipal advisors, but has not sent it up to the SEC yet. It is not clear how similar the proposal the SEC receives will be to the very controversial one the MSRB floated earlier this year.

"That will introduce much of the practical detail that is necessary," Karwejna said.

He added that while most of the misunderstandings and apprehension about the SEC's MA rule are "under our belt" now, 2015 will be an important year for advisors and underwriters to continue to make sure that smaller and less frequent issuers understand the new regulatory regime. SEC muni office officials said this month they have no "concrete plans" to release further MA guidance, but could do so if they see a need. Karwejna said the chance could present itself in the coming year.

"I think there is ample opportunity for them to provide more guidance," he said.

Ernie Lanza, a shareholder at Greenberg Traurig in Washington who left the role of MSRB deputy executive director earlier this year, said he would be surprised if the SEC did not issue some more guidance in the coming year. Lanza said the board's development of a pilot qualification exam for MAs would also be a major development to watch in the coming year. He also said the MSRB could propose another core duties rule focusing on MAs who solicit business on behalf of other firms.

"They haven't yet hit the solicitors," Lanza said.

MSRB executive director Lynnette Kelly said the board remains very focused on MA rulemaking, but is also prioritizing secondary market initiatives. The board recently proposed, in conjunction with the Financial Industry Regulatory Authority, a rule that would require dealers acting as principals to disclose to customers on their confirmations a "reference price" of the same security traded that same day as well as the difference between that price and the customer's price.

Secondary market transparency and retail investor protection were major themes of the SEC's 2012 Report on the Municipal Securities Market, which recommended markup disclosure and other steps the SEC and MSRB could take to improve the market.

Mike Nicholas, chief executive officer of the Bond Dealers of America, said he expects the regulatory agenda to move more and more into secondary market issues in the common year.

"I think it's going to pivot," he said. The principal transactions proposal and implementation of the recently-adopted best execution rule, which would require muni dealers to seek the most favorable price possible when executing transactions for most investors, are top priorities for his group going forward.

"These are tough issues that will be focused on in 2015," Nicholas said.

Wildcard

A wildcard in the calculus for 2015's regulation outlook is the 114th Congress that will begin meeting on Jan. 6. Republicans seized control of the Senate and widened their lead in the House to historic levels, meaning that for the first time in years a single party may be able to move legislation through both chambers without much help from across the aisle. Sources said Republican leaders like incoming Senate Finance Committee chairman Sen. Orrin Hatch, R-Utah and Senate Banking Committee chairman Sen. Richard Shelby, R-Ala., could be interested in joining the House to roll back some Dodd-Frank provisions.

"I don't know that the Republicans have a clear sense of what they want to do," said a House staffer

who asked not to be identified. "You're going to have a more conservative Congress."

Bentsen said earlier this year that SIFMA would like to see Congress reexamine the MA rule to allow more freedom for investment bankers to contact issuers without having to become MAs and lose their ability to underwrite the resulting bonds. Michael Decker, a managing director and co-head of municipal securities at SIFMA, said Congress could use legislation previously introduced by Rep. Steve Stivers, R- Ohio, as the starting point. Stivers' bill would have defined MAs more narrowly by applying the fiduciary duty to advisors working for compensation and including an exception for dealers seeking to be underwriters.

"I think you can make a strong case for Congress taking another look at that issue," Decker said.

But the staffer said that the exemptions included in the final SEC rule, such as a broad exclusion that underwriters could rely on when giving advice to issuers who have their own MA, makes the idea of revisiting the MA rule a tough sell. Most larger, frequent issuers have their own MAs, so dealer groups would essentially be asking Congress to give them more leeway to pitch deals to less sophisticated issuers who might need more protection.

"If the issue is pitching, that's going to be hard," the staffer said.

Sanchez said Congress would be hasty if it does reopen that issue.

"I believe that any legislative change to the municipal advisor regime is premature and will only serve to prolong uncertainty in the market while potentially undermining valuable issuer protections that are supported by responsible broker-dealers and municipal advisors," he said.

Kelly said the MSRB will also have some educational priorities in 2015, such as ensuring that dealers understand and take seriously the requirement to sell securities only to retail investors during issuer-specified retail-only periods. The board is also concerned about the lack of transparency surrounding bank loans and private placements and will continue to encourage issuers to voluntarily disclose them. The board is also going to be continuing to review its current rulebook to find ways to harmonize its rules with FINRA's.

Lanza said it's also possible that the beginning of the 2016 presidential election cycle next year could spur a challenge to the MSRB's pay-to-play rule, which aims to prevent muni firms from peddling influence with donations to public officials who can influence the award of negotiated bond business. The SEC's investment advisor rule was the target of a lawsuit challenging its constitutionality earlier this year, but the suit was dismissed by a federal court in D.C. after the court determined it was not the proper venue to hear the case. That case is on appeal and observers say it could have implications for the MSRB's rule.

"It should be an interesting year," Lanza said.

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BY KYLE GLAZIER

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