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MSRB Issues First-of-a-Kind Compliance Advisory for MAs.

WASHINGTON — In a first-of-a-kind action, the Municipal Securities Rulemaking Board released a compliance advisory for municipal advisors on Thursday to help them understand and implement new regulations.

The MSRB said the advisory should serve as a tool for MAs to understand a number of compliance risks associated with the rules the MSRB has written in accordance with the Dodd-Frank Act.

“As the regulatory framework for municipal advisors takes shape, the MSRB believes it is important to assist [MAs] with evaluating their compliance programs in light of newly effective rules,” said MSRB executive director Lynnette Kelly.

Each of the five potential risk areas the MSRB identifies in the advisory are broken down into three sections: a summary of the rule or rules that apply, a list of potential violations, and a list of points MAs should consider when evaluating their compliance.

One section tackles MSRB Rule G-44 on supervisory and compliance obligations of municipal advisors. Under the rule, MAs are required to develop a supervisory system and compliance program, as well as to designate a chief compliance officer. The CCO can either be a part of the MA firm, or the firm can outsource the job. If the MA chooses to outsource, it still maintains ultimate responsibility for meeting its obligations under the rule.

The advisory warns MAs that they can violate the rule if they do not designate a CCO or have a CCO that does not have enough knowledge, experience, or training for the position. If a firm does not keep general business records, as mandated under MSRB Rules G-8 and G-9, or does not have a process to at least annually review, test, and modify its written compliance policies and procedures, it also could violate the rule. The MSRB included ten bullet points with questions MAs should ask themselves to determine if they are meeting the G-44 standards.

Another section addresses MSRB Rule A-12 and the need to properly register with the MSRB as an MA. The board reminds MAs that they must also register with the Securities and Exchange Commission, which requires completion of SEC Form MA, as a pre-requisite to MSRB registration. The advisory also includes information about supplying the MSRB contact information for key people, such as a master account administrator, a billing contact, and a compliance contact.

Possible violations, aside from not registering before acting as an MA, include the failure to update Form A-12 within 30 days of a change in material information, not paying applicable registration fees, and failing to affirm the registration information on Form A-12 during the affirmation period that starts on Jan. 1 of each year.

The advisory also discusses Rule G-3 on professional qualifications, on which MAs will be tested through a Series 50 Pilot Exam offered from Jan. 15 to Feb. 15. The board advised MAs and firms to make sure that any person engaged in MA activities meets the professional qualification requirements in G-3. A violation of the rule would include failing to identify each individual who is

directly engaged in the management, direction, or supervision of MA activities as well as not having a process that identifies those individuals.

The advisory also urged MAs to recognize if they are acting as a placement agent and may be engaging in brokerage activity in violation of several MSRB rules.

An MA that acts as a placement agent, engaging in a securities transaction with a possible investor and getting transaction-based compensation, may actually be a broker-dealer, the MSRB said. MAs could also cross over to broker-dealer activity when they help facilitate bank loans evidenced by notes and do not recognize the notes are municipal securities and the bank is actually an investor, the board added.

An MA that acts as a broker-dealer, without being registered as one, risks violations and also fails to follow other MSRB rules that are applicable to broker-dealers, the advisory warned. MAs should have controls in place that ensure that they are only conducting municipal advisor activities, the MSRB suggested. The advisory also encourages MAs to look at several MSRB notices on crossing over into broker-dealer activities, as well as the Supreme Court's "Reves test," which provides guidance for evaluating whether something is a security.

The advisory also covers MSRB Rule G-17 on fair dealing. When MAs consider fair dealing risks, they should avoid violative behavior like splitting municipal advisory fees with a third-party under a fee arrangement that is not disclosed to the client or falsely stating they are an independent registered MA (IRMA) for a municipal entity.

The MSRB's suggestions for complying with G-17 include developing a process to review advertising and other promotional materials, as well as statements found on the MA's website, to ensure the information is not false or misleading. An MA should also monitor whether everyone in the firm is fairly dealing with municipal entities and obligated persons.

The MSRB ended its advisory notice by encouraging MAs to explore past webinars and publications dealing with compliance that can be found on the MSRB's website.

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