

# **Bond Case Briefs**

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## **SEC Unanimously Adopts Final Muni Advisor Rules.**

The Securities and Exchange Commission unanimously adopted a registration rule for municipal advisors, establishing that they have a federal fiduciary duty to clients if they provide advice, compensated or not, that is related to bonds or other municipal financial products and involves recommendations based on the specific needs of a municipal entity.

The rule adopted Wednesday, which clarifies the requirement for registration with the SEC, is more narrowly-tailored than the securities regulator's initial December 2010 proposal. It includes exemptions that SEC muni chief John Cross said are based on the activities involved, rather than the status of the individuals or firms.

Members of governmental boards, whether elected or appointed, would not be subject to registration under the rule.

The 2010 SEC proposal to exempt only elected members generated significant controversy.

Market participants had been eagerly awaiting the definition since the passage of the Dodd-Frank Act in 2010, which mandated federal oversight and regulation of municipal advisors. But the SEC's initial proposed registration rule encountered resistance from lawmakers and market participants, who said it cast too wide a net by covering not only appointed board members, but also professionals already regulated under different statutes. Dodd-Frank imposes a federal fiduciary duty on municipal advisors that provide financial advice to state and local governments, meaning that the MAs must put their clients' interests ahead of their own.

"The final rules that the commission is considering today set forth clear, workable requirements and guidance for municipal advisors and other market participants, which will provide needed protections for this market," SEC chairman Mary Jo White said before the vote.

Dealer firms had looked to the SEC for clarification, complaining that non-dealer financial advisors have been operating without the same level of oversight as dealer-affiliated FAs. SEC commissioner Daniel Gallagher blamed delays in the rule on the rush to meet various "arbitrary" Dodd-Frank deadlines. A temporary registration rule has been in place since December 2010, and was extended last year to expire Sept. 30. The temporary rule will be extended again, as the final rule does not take effect until 60 days after its publication in the Federal Register, which could be in a few days. The SEC currently has about 1,100 firms registered, and expects the number to remain about the same with the final rule.

The new rule also contains exceptions for underwriters, registered swap dealers providing advice related to swaps, and all government officials acting within the scopes of their official duties. A person or firm providing advice on investment strategies will only have to register if that advice involves the proceeds of muni bond sales, the investment of municipal escrow funds, or municipal derivatives. Banks will only have to register if they provide advice that goes beyond the scope of traditional banking services, such as deposit accounts and extensions of credit. Accountants providing traditional accounting services and engineers providing engineering advice such as

feasibility studies would also be exempt.

Michael Decker, co-head of municipal securities at the Securities Industry and Financial Markets Association, said he was pleased to see the rule adopted and a new expansion of the underwriter exemption, which SIFMA had pushed for in comments submitted to the SEC. Under the rule, the underwriter exemption kicks in when a firm is engaged to underwrite a bond issue and covers advice on the structure, timing, and terms of the sale. Broker-dealers had harbored concerns that anything beyond negotiation of the agreement to underwrite could trigger the municipal advisor designation and impose a fiduciary duty on the firm.

Decker said the next question will be how dealers document engagement.

The SEC decision represents the first major muni move undertaken since two new commissioners, Kara Stein and Michael Piwowar, joined the commission. Piwowar protested that although he has been a commissioner for barely more than one month, he has already been forced to vote on hundreds of pages of complex rules without the time necessary to fully consider the proposals. He said he repeatedly asked White to have the meeting postponed, but that the chairman proved inflexible.

“My repeated requests were denied,” Piwowar said.

White said she understand his frustrations, but thought the commission should move forward in view of the years of staff work and Dodd-Frank mandates involved.

“I did not believe this should be delayed any further,” White said.

Stein said she was disappointed the rule does not contain an earlier provision that required firms to certify that MAs in their employ met certain standards. Gallagher said he looked forward to seeing an economic analysis of the rule, expressing some concern about its potential regulatory burden.

Reps. Steve Stivers, R-Ohio, and Gwen Moore, D-Wis., have sponsored legislation that would define MA’s even more broadly than the SEC’s new rule. That bill would define MAs as individuals paid by a muni issuer or borrower to provide advice on muni issuances or financial products. The SEC rule does not require compensation.

The SEC did incorporate Stivers’ and Moore’s exemption for many banking services. It is unclear if Stivers and Moore will still seek to have the bill brought to the floor. It is unlikely to gain traction in the Senate if passed in the House.

The Municipal Securities Rulemaking Board has proposed a series of rules that would govern the conduct and qualifications of municipal advisors, but those rules had been delayed pending the SEC’s final interpretation of the term. Now that the SEC has defined MA, the MSRB is poised to begin the process of moving toward getting those rules finalized.

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