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MSRB Floats Draft Municipal Advisory Conduct Rule.

WASHINGTON — The Municipal Securities Rulemaking Board on Thursday released a new draft rule that would govern the conduct of municipal advisors, and requested public comments on whether it should extend a fiduciary duty standard to cover all of an MA clients, including conduit borrowers as well as issuers.

Neither the Dodd-Frank Act nor the Securities and Exchange Commission's MA registration rule approved in September extends the full fiduciary duty to "obligated persons" such as conduit borrowers.

The draft Rule G-42, called "Duties of Non-Solicitor Municipal Advisors," codifies the language of the Dodd-Frank Act, which imposes a fiduciary duty on MA's to put their client's interest first before their own. The draft rule says MAs owe both a duty of loyalty and a duty of care to their municipal entity clients.

The MSRB said in its 36-page notice, that the goal of the draft standards is to promote "higher ethical and professional standards" for MAs.

The duty of loyalty is defined in the rule as requiring the MA to deal in the "utmost good faith" with municipal entities such as issuers and serve their best interests "without regard to the financial or other interests of the municipal advisor." MAs would owe the duty of care to all clients, and would also be bound by the MSRB's Rule G-17 on fair dealing.

The rule lays out the broad principles of MA duties to clients, but also includes many more specific conduct rules, some which have already been set by the SEC, such as those on recordkeeping.

MAs would be required to possess adequate expertise to assist their clients. They would need to disclose in writing all "material conflicts of interest" at the outset of their municipal advisory relationship. An MA would need to disclose whether and how much liability insurance it carries, which would pay out in the event of improper judgments or negligence, or must state that it carries no coverage. The MSRB asks for public comments on whether it should require MAs to have such insurance.

MAs also would have to disclose at the beginning of the relationship any legal or disciplinary event that might affect the client's evaluation of them.

The draft rule contains the equivalent of a suitability rule for MAs, providing that advisors must have a reasonable basis to believe their recommendations are suitable for their clients. In that vein, the rule includes a "know your client" obligation which would require MAs to use "reasonable diligence" to know essential information about their clients. However, the draft does not provide an exhaustive list of what that information might be, except to say that it includes information necessary to the advisory relationship and required in order to comply with laws and rules.

Fee-splitting arrangements between MAs and other providers of services to clients would have to be

disclosed at the outset of their relationships, but would be prohibited between MAs and underwriting firms. The rule would also bar MAs from engaging in any transaction in a principal capacity with a client, essentially barring any non-fiduciary business relationship running concurrent to the municipal advisory agreement.

There would be a presumption under G-42 that a municipal advisor would review the official statements of its issuer clients' bond offerings. But the MA would not be required to conduct such a review if both parties agree it is not necessary. Any agreement about an OS review would need to be included in the documents establishing the relationship, and those documents would have to be updated to reflect any change in the scope of services provided by the MA.

MAs would be required to review third party recommendations provided to their municipal clients, if this is within the scope of the advisory activities agreed upon at the outset of the relationship.

The MSRB also said it would amend its Rules G-8 on books and records and G-9 on preservation of records to reflect the SEC's requirement that MAs retain for at least five years records of all communications, policies and procedures, the names of associated persons, and any other material documents dealing with its clients. The records could be retained electronically.

The MSRB's notice requests many comments, including whether or not all fee-splitting arrangements should be prohibited, whether MAs should be required to obtain written acknowledgement that a client received the necessary disclosures, and whether MAs should have to disclose all legal or disciplinary actions related to individuals not working with clients.

The MSRB is providing an extended comment period of 60 days, with comments due by March 10.

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