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MSRB Proposes Revised MA Conduct Rule.

WASHINGTON — The Municipal Securities Rulemaking Board proposed a revised draft rule to establish the core duties of municipal advisors, tweaking some of the provisions that generated the most controversy in January's first draft.

The first draft's prohibition on principal transactions has been revised to apply only to transactions with municipal entity clients, not with obligated persons. Most market participants interpreted the first draft as barring MAs from engaging in any non-fiduciary business relationship running concurrent to the municipal advisory agreement. The revised draft released Wednesday defines the banned principal transactions as limited to those directly related to the subject of the municipal advisor's engagement with the municipal entity client.

It spells out that principal transactions are defined as "acting as a principal for one's own account, selling to or purchasing from the municipal entity client any security or entering into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client."

And it eliminates requirements that MAs review the official statement for a new bond issuance, disclose information about professional liability insurance, and estimate what they expect their total compensation to be. The new draft rule states that MAs don't have to disclose conflicts of interest or document the advisory relationship if they inadvertently provide advice that would be considered municipal advisory activity. It doesn't offer a "safe harbor" from potential violations of the requirement to register with the Securities and Exchange Commission and the MSRB.

The MSRB is seeking public comment on the revised G-42, and has set an Aug. 25 deadline for market participants to weigh in.

"As the foundation of the MSRB's regulatory framework for municipal advisors, MSRB Rule G-42 will play a central role in achieving the MSRB's mandate to protect municipal entities that engage the services of a municipal advisor," said MSRB executive director Lynnette Kelly. "It is important to us and to the market that we develop a rule that effectively and appropriately provides guidance on the core responsibilities of municipal advisors to their clients. The comments we received on the previous draft have informed a number of changes to the text of the draft, and the MSRB wants to provide an opportunity for market stakeholders to review and comment on these changes."

It wasn't initially clear whether the MSRB would repropose the rule or choose to submit a revised draft for SEC approval, but Kelly confirmed earlier this month that a re-proposal was coming. Chuck Samuels, an attorney at Mintz Levin and counsel to the National Association of Health & Higher Education Facilities Authorities, said the MSRB made the right choice, even though it would have been preferable to get G-42 done before the SEC's registration rule took effect July 1.

"Republishing the draft was inevitable and appropriate given the volume and quality of comments it received and the complexity of the issues," Samuels said. "It's unfortunate the process was not completed before the effective date of obligations, but better to get it right."

Jessica Giroux, senior counsel and senior vice president for federal regulatory policy at the Bond Dealers of America, said the MSRB addressed some of their first draft concerns.

“The BDA appreciates that the MSRB has revised Draft Rule G-42 and that they have incorporated some of the suggested changes made by the BDA and other market participants,” Giroux said. “We are also encouraged that the MSRB is releasing the revised draft rule for a second round of comments, allowing the industry yet another opportunity to work pro-actively with the MSRB to ensure the rule is in its strongest form before it becomes final.”

While the MSRB addressed the BDA’s concerns about an overbroad principal transaction ban and the requirement the inadvertent advice documentation, for example, it didn’t address points BDA raised about other issues. BDA favored a requirement to disclose liability coverage and wanted the proposed fiduciary standard to “more appropriately mirror existing fiduciary standards utilized in the legal profession.”

Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at the Securities Industry and Financial Markets Association, said SIFMA is initially pleased with several aspects of the revision.

“Upon first review, we are encouraged that the MSRB has clarified and narrowed the scope of the principal transaction prohibition,” Norwood said. “Further, we support the MSRB’s decision to limit the application of the fiduciary duty to municipal entities, and to exempt obligated parties, such as corporations, from this increased standard of protection. SIFMA will be reviewing the final rule in more detail with our members, and we look forward to commenting on the proposal.”

Nathan Howard, counsel to the National Association of Independent Public Finance Advisors, said the MSRB appeared to have taken public comments to heart, though the section on inadvertent advice needed closer scrutiny in the coming days.

The MSRB is in the midst of developing other MA regulations, including a competency exam. All of the board’s rule proposals are subject to SEC oversight.

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