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Ballard Spahr: MSRB Seeks Second Round of Comments on Municipal Advisor Conduct Rule.

The Municipal Securities Rulemaking Board (MSRB) recently released a revised draft of Rule G-42 (Draft Rule G-42) following receipt of more than 40 comments on its Initial Draft Rule in January 2014. Rule G-42 regulates standards of conduct and duties of municipal advisors in non-solicitor roles. The deadline for comments on the revised draft is August 25, 2014.

In response to commenters, the MSRB has scaled back or eliminated certain prohibitions and requirements, which should allay concerns expressed about potential heavy-handedness on the part of the MSRB. The proposed rule provides more clarity and guidance regarding conduct of municipal advisors, and allows many to operate in a manner similar to current practice.

The following portions of Rule G-42 and its Supplementary Material were revised or added:

- Duty of Care and Duty of Loyalty
- Disclosure of Conflicts of Interest and Other Information
- Documentation of the Municipal Advisory Relationship
- Recommendations and the Review of Recommendations of Others
- Principal Transactions
- Specified Prohibitions
- Inadvertent Advice

A more detailed explanation of the revisions follows.

Duty of Care and Duty of Loyalty

To allow clients to determine the scope of services and control the engagement with municipal advisors, the MSRB removed the duty of care requirement to undertake a thorough review of the official statement. Additionally, the duty of loyalty requirement to investigate or consider other reasonably feasible alternatives to any recommended municipal securities transaction or financial product has been likewise removed.

Disclosure of Conflicts of Interest and Other Information

Draft Rule G-42 regarding disclosure of conflicts has been revised to require disclosure of material conflicts of interest if such conflicts arise due to compensation being contingent on the size or closing of a transaction. Previously, the Initial Draft Rule required a broader compensation disclosure requirement that many commenters believed would confuse clients. An affirmative disclosure that there are “no known” conflicts is now required.

The requirement to disclose the amount and scope of professional liability insurance has been removed, but such disclosure may still be provided voluntarily or upon request. The municipal advisor must also now disclose any material legal or disciplinary event, including a description of the event, where the client may access the advisor’s most recent Securities and Exchange Commission

(SEC) forms on the event, and the date the last form was filed.

Documentation of the Municipal Advisory Relationship

A provision was added to detail the steps that may be taken if a party inadvertently engages in municipal advisory activities or enters into a municipal advisory relationship and does not intend to continue, but seeks a safe harbor to withdraw. See "Inadvertent Advice" below.

Revisions were made to simplify the documentation of compensation required under the Initial Draft Rule. Draft Rule G-42 requires that only the form and basis of any direct and indirect compensation be documented, but the parties may still agree to provide further information. The documentation of the advisory relationship must include any term relating to withdrawal from the relationship and can be amended only if there are material changes or additions.

Recommendations and the Review of Recommendations of Others

Draft Rule G-42 clarifies the provisions on recommendations by the municipal advisor and the municipal advisor's review of recommendations from other parties. This draft states that if a municipal advisor makes a recommendation of a municipal securities transaction or financial product, or if review of a recommendation of another party is requested by the municipal entity or obligated person client, then the municipal advisor, using reasonable due diligence, must determine whether such action is suitable for the client.

Principal Transactions

The Initial Draft Rule prohibited municipal advisors from engaging in any transaction in a principal role in which the municipal entity or obligated person client is a counterparty. Draft Rule G-42 eliminates the prohibition concerning obligated persons and limits the prohibited principal transactions between a municipal advisor or its affiliates and a municipal entity client to those transactions directly related to the same municipal transaction or financial product on which the municipal advisor is providing advice.

Inadvertent Advice

The MSRB added a provision to Draft Rule G-42 covering municipal advisors who unintentionally engage in municipal advisory activities. Such advisors are not subject to Draft Rule G-42's disclosure and documentation requirements if they promptly provide a disclaimer and other information to a municipal entity or obligated person following the provision of inadvertent advice. Draft Rule G-42 further requires a review of the municipal advisor's supervisory and compliance policies and procedures to ensure they are reasonably designed to prevent such inadvertent advice.

Specified Prohibitions

In response to numerous comments criticizing the excessive fee provisions in the Initial Draft Rule, the Draft Rule G-42 added a list of factors relevant to excessive compensation. Factors include municipal advisor expertise, transaction complexity, types of contingent fees, and time spent on the closing of the transaction or product.

Lastly, various Initial Draft Rule definitions were modified to match those found in the SEC Municipal Advisor Final Rule, and the definition of when the municipal advisory relationship begins and ends was also clarified to require written documentation.

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Ballard Spahr's Municipal Securities Regulation and Enforcement Group advises its clients on the latest securities issues in their public finance transactions, including regulatory and enforcement matters of the SEC. We advise issuers in a broad range of public offerings and private placements of municipal securities in the primary and trading activity in the secondary market.

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