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MSRB Files MA Core Conduct Rule With SEC For Approval.

WASHINGTON — The Municipal Securities Rulemaking Board has filed a proposed rule with the Securities and Exchange Commission that would govern the core conduct of municipal advisors, including their fiduciary duty to put the interests of state and local government clients ahead of their own.

The MSRB filed its proposed Rule G-42 on the conduct of non-solicitor municipal advisors in a 639-page release on Wednesday. Subject to SEC approval, the proposal is a key piece of the MSRB's efforts to regulate MAs under the Dodd-Frank Act's requirement that MAs act as fiduciaries to their issuer clients.

The rule is expected to affect roughly 740 firms and 3,800 individuals, the MSRB said.

"The MSRB believes this rule will further Congress' intent to build a framework of federal oversight for the advice state and local governments count on when considering municipal securities transactions and financial products," said MSRB executive director Lynnette Kelly. "The Dodd-Frank Wall Street Reform and Consumer Protection Act charged the MSRB with developing a comprehensive package of rules and professional qualification standards for municipal advisors, many of whom were previously unregulated at the federal level."

The proposed rule states that MAs owe a fiduciary duty of loyalty to their municipal issuer clients, requiring "without limitation … to deal honestly and with the utmost good faith with a municipal entity client and act in the client's best interests without regard to the financial or other interests of the municipal advisor."

It spells out a less stringent "duty of care" owed to all clients, including obligated persons such as conduit borrowers. The duty of care requires that an MA exercise "due care" in its work, be qualified to provide MA services, make a "reasonable inquiry" into the facts relevant to a client's request or a recommendation before deciding whether or not to proceed, and undertake a "reasonable investigation" to determine that its advice is not based on bad information.

The MSRB requested comment on the rule twice in 2014, initially in January and then again in July. The version filed with the SEC differs from the July version that was put out for comment in several ways.

The newest version states explicitly that, while an MA must document the municipal advisory relationship between the advisor and its client, that documentation does not have to take the form of a contract superseding existing agreements. The MA must, however, put into writing details such as the compensation structure to be used in the relationship, the scope of activities the MA will perform, any required disclosures, and any means for terminating the relationship.

The filed proposal adds that in addition to disclosing to a client any potential conflicts of interest that an MA might have it, the advisor must also disclose its disciplinary history. The MA could fulfill this requirement by directing a client to its Form MA filed with the SEC.

The filed proposal adds guidance to G-42's requirement that MAs not recommend a client enter into a transaction without determining through "reasonable diligence" that the transaction or product is suitable for the client. It states that the MA's suitability analysis can be client-specific, taking into account factors such as the client's financial situation and needs, objectives, tax status, risk tolerance, liquidity needs, experience with muni bond transactions, and more.

Another tweak to the filed version of G-42 concerns what happens when a firm inadvertently provides bond-related advice to a municipality. The previous draft introduced a provision allowing a firm to largely avoid the documentation and conflict of interest disclosure requirements of G-42 so long as it provided the municipality with a disclaimer stating that it did not mean to give that advice and had no intention of continuing an advisory relationship.

The filed version makes clear that the inadvertent advice provision "does not eliminate responsibility for compliance with the SEC's registration rule, other provisions of Rule G-42, other MSRB rules or any other applicable laws; rather, it offers narrow relief from specified requirements of Rule G-42 that are intended to apply to intentional advisory relationships."

The proposed rule would prohibit certain behavior that would be inconsistent with the fiduciary standard, including the MA acting as a principal in transactions with municipal issuer clients that are directly related to a transaction on which it is providing advice. The filed version of the rule makes clear that such prohibited transactions include bank loans of more than $1 million in size that are "economically equivalent to the purchase of one or more municipal securities."

The MSRB said it expects the SEC to publish the proposal in the Federal Register and ask for public comments. The commission could approve the proposal as is, or require changes. The MSRB is proposing that the rule become effective six months after SEC approval.

The MSRB plans to propose a separate rule governing the conduct of firms who solicit business on behalf of municipal advisors.

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