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Municipal Advisors Put Focus on Staying Clear of Dealer Activity.

NEW ORLEANS – Municipal advisors face growing concern that some activities they could pursue to help clients make private placements might land them in hot water with the Securities and Exchange Commission.

A panel discussion at National Association of Municipal Advisors' annual conference here focused on how MA firms' activities in private placements could lead the regulator so see them as unregistered broker-dealers, subject to a different set of regulations, and what they can do to avoid that trap.

The issue has received increased attention in past years as the popularity of bank loans and other private placements have increased in the municipal market, panelists and audience members said.

"We're all grappling with an approach we can go forward with to best serve our clients that still keeps us out of trouble with the SEC," said Alex Handlers, of Bartle Wells Associates, who moderated the panel. He said MA firms have changed their practices in recent years in various ways to address the concerns.

Private placements can be attractive for issuers because they are cheaper and less regulated than traditional issuances. They can also give issuers the ability to negotiate specific aspects of the deal like legal covenants.

MA involvement in such deals has raised legal issues over whether they are acting as unregistered brokerdealers. Advisors, who owe fiduciary duties to their clients, and broker-dealers, who act as intermediaries, operate in different regulatory regimes.

The legal question boils down into two areas of consideration: whether the private placement should be considered a security; and whether an advisor dealing with the private placement is acting only in the capacity of their advisory relationship with their client or whether the advisor is acting as a broker by entering into the business of effecting a transaction in the securities of others.

While SEC representatives have said in the past that there is no bright line test for determining whether something is a loan or a security, they point to the 1990 case *Reves v. Ernst & Young*, in which the Supreme Court found that notes were presumably securities, but allowed for that presumption to be overcome if the notes bore a strong resemblance to another note that is not a security.

If a private placement is not deemed a security, then the need to distinguish between MA and broker-dealer business is moot because the SEC and MSRB rules for broker-dealers only apply to municipal securities.

If a private placement is a security, though, MAs have to be more careful and can look to generally accepted key parts of a security transaction, including: solicitation; execution of the transaction,

conversations about the size of the transaction; and whether the MA handles the securities of others in connection with the transaction, as factors in determining whether they are acting as unlicensed dealers.

Handlers added that MAs seem to have found that some of the activities that they historically had taken on could be included in the definition of broker-dealer activity, such as identifying potential investors and doing the solicitation for the deal.

Handlers advised that when MAs are evaluating their activities, they take into account "the whole totality of things" the SEC could look for related to dealer activity, like whether the duty of soliciting for the deal falls to the MA or, as it should, a dealer acting as a placement agent.

"[An MA] could go over to the dark side on one of these things, [which does] not necessarily mean [it] is going to be deemed guilty, but it doesn't help" the MA's case with the SEC, Handlers said.

"The more we can keep ourselves on the right side of the line, the less chance there will be of any violation from the SEC's perspective," he said. "If we haven't changed our practices yet, it's time to do it now."

One MA in the audience who works for a larger firm shared with the panelists and attendees what steps his firm had taken to shield itself from possible violations. The main concern he addressed related to MAs having a list of possible lenders that they then reach out to asking about potential interest in a deal. The panelists and audience members agreed that such an action automatically limits the number of potential lenders and thus would move an MA into one part of the broker-dealer territory.

The MA's firm tries to combat that problem by making sure that its client supplies the list of potential lenders instead of the MA itself. That way, it's the issuer determining where the request for proposal (RFP) is going to go, the advisor said. The firm also sends out RFPs on the issuer's stationary instead of its own and will rely on its issuer client to take the lead on negotiating the terms of the private placement.

"We're trying to be pretty clear up front with everything we do because we don't know where we're going to … get trapped and be in the underwriter world," the advisor said.

SEC representatives have said that they are looking at the issues MAs can face when navigating the difference between allowable conduct with private placements and actions that can lead to violations. One solution could be providing for certain exemptions from broker-dealer rules for MAs conducting business. The SEC already provides other regulated entities like investment advisors and broker-dealers exemptions from its MA rule, but there are no parallel exemptions for MAs from broker-dealer or investment advisor rules.

Jeff Sharp, senior vice president and director of business development for Capital One Public Funding, which has a portfolio of muni private placements, encouraged the municipal advisors in the room to not shy away from having their issuer clients pursue private placements despite the regulatory concerns.

"I want to make a bit of an impassioned plea that you not just throw the baby out with the bathwater," he said. "These are a valuable tool for your clients at times. We really want to be an arrow in your quiver."

Sharp said the potential risk for MAs can be removed through the use of dealer placement agents as intermediaries.

“Placement agents are there to help you,” Sharp said. “It will cost your clients some money, but that’s just part of our new regulatory environment. They can keep you out of trouble and get your clients a good deal.”

The Bond Buyer

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October 11, 2016