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SEC Issues Temporary Order Exempting Municipal Advisors From Broker-Dealer Registration Requirements Under Certain Limited Conditions: Ballard Spahr

The U.S. Securities and Exchange Commission (SEC) on June 16, 2020, granted a [temporary conditional exemption](#) (Temporary Order) from broker registration under Section 15 of the Securities Exchange Act of 1934 (Exchange Act). The exemption allows registered municipal advisors to perform certain permitted activities for municipal issuers and obligors as defined in the Exchange Act (Municipal Issuers) in connection with direct placements of municipal securities.

Prior to the temporary order, registered municipal advisors were required to register under the Exchange Act as a broker to perform certain activities related to the placement of securities. Subject to the conditions described in the Temporary Order and summarized below, the Temporary Order exempts municipal advisors from the registration requirement by allowing them to solicit banks, their wholly-owned subsidiaries engaged in commercial lending and financing activities, and credit unions in connection with direct placements of securities issued by their Municipal Issuer clients.

The Temporary Order is narrower than the SEC's [proposed exemptive order](#) of October 2, 2019 (Proposed Order). The SEC stated that the Temporary Order is intended to address disruption in the municipal securities markets as a result of the COVID-19 pandemic. In its statements releasing the Temporary Order, the SEC stated that it decided not to move forward with the Proposed Order "at this time," and left open the possibility that it will be revived in some form in the future.

For municipal advisors to qualify for relief under the Temporary Order, the following conditions apply:

- Purchasers under the Temporary Order must be (i) a bank as defined in Section 3(a)(6) of the Exchange Act; (ii) a wholly owned subsidiary of a bank engaged in commercial lending and financing activities, such as an equipment lease financing corporation; or (iii) a federally or state-chartered credit union (each, a Qualified Provider). There appears to be no limitation on the number of Qualified Providers purchasing the securities in a given issuance.
- The municipal advisor must report to the SEC staff any instances of reliance on the Temporary Order within 30 calendar days of the sale date. The notification must identify the issuer or conduit, date of direct placement, principal amount of the placement, the purchaser(s), and the CUSIP number, if available.
- The municipal advisor must obtain written representations from the Qualified Provider that the Qualified Provider:
 - is a Qualified Provider as defined in the Temporary Order;
 - is capable of independently evaluating the investment risks of the transaction;
 - is not purchasing with a view to distribution; and
 - will not transfer any portion of the direct placement within one year of the date of issuance of the securities, except to another Qualified Provider.
- The municipal advisor must make a written representation to the Qualified Provider that the municipal advisor:

- represents solely the interests of the Municipal Issuer and not the Qualified Provider;
 - is soliciting the Qualified Provider in connection with the direct placement pursuant to the Temporary Order;
 - has not conducted due diligence on behalf of the Qualified Provider;
 - has not, as of the date of the written representation, engaged—nor has the Municipal Issuer engaged—a broker-dealer as a placement agent in connection with the direct placement; and
 - acknowledges that the Qualified Provider may nonetheless choose to engage the services of a broker-dealer to represent the Qualified Provider's interests.
- The municipal advisor must receive a written acknowledgement of receipt of the disclosures by the Qualified Provider.

Other Limitations:

- The Temporary Order is effective from June 16, 2020, until December 31, 2020.
- The aggregate amount of the direct placement may not exceed \$20 million. The Temporary Order does not state whether this aggregate limit applies for the duration of the Temporary Order or if more than one issuance of this size per Municipal Issuer is permissible.
- The minimum authorized denomination size for the securities being placed is \$100,000.
- The municipal advisor must make and keep the records required by the Exchange Act Rule 15Ba--8(a)(1)

The Temporary Order will not be available to dealer-affiliated municipal advisors since MSRB Rule G-23—which applies only to dealer-affiliated municipal advisors—prohibits a dealer municipal advisor from acting as placement agent and a municipal advisor on the same transaction. This disparity will be of great concern to many dealer-affiliated municipal advisors.

Additionally, the potential consequences to the municipal advisor are unclear if the conditions of the Temporary Order are not met. Municipal advisors may be reluctant to rely on the exemption in the absence of more guidance from the SEC on the timing of the disclosures and other ambiguities such as the application of the \$20 million limit.

The Temporary Order discusses that the now-permitted solicitation activity is in addition to the core advisory activities in which a municipal advisor might otherwise engage under the existing regulatory regime. These core activities include assisting municipal entity clients and or obligated person clients in (i) developing a financing plan; (ii) assisting in evaluating different financing options and structures; (iii) assisting in selecting other parties to the financing, such as bond counsel; (iv) coordinating the rating process, if applicable; (v) ensuring adequate disclosure; and/or (vi) evaluating and negotiating the financing terms with other parties to the financing including the provider of the direct placement. It is unclear to what extent these “core advisory activities” continue to be a condition to the now-permitted solicitation activities. Since municipal advisors are allowed to limit the scope of their activities (but not their core legal duties), we may see the emergence of municipal advisors set up solely to act as finders.

While the Temporary Order settles the question of whether soliciting investors is an activity subjecting people to broker-dealer registration, it leaves unaddressed the question of how to determine whether these direct placement instruments and the financing participants are subject to federal regulation as securities in the first place if they are unregulated loans and not securities. This ambiguity has been a critical, but as yet unresolved, issue for dealers and municipal advisors who need to know which laws to apply to their transactions.

by the Public Finance Group

June 23, 2020

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