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SEC 2021 Examination Priorities – Focus on Municipal Securities and Municipal Advisors - Ballard Spahr

The U.S. Securities and Exchange Commission's Division of Examination (Division) announced its 2021 examination priorities (the Report) on March 3, 2021. The Division's examination priorities reflect areas that present "heightened risks to investors or the integrity of U.S. Capital Markets."

This briefing discusses the following areas of the Division's 2021 focus:

- Respecting the importance of compliance departments
- Municipal advisors
- Environment, Social, and Governance (ESG) and how registrants are preparing for the expected discontinuation of the London Inter-Bank Offered Rate (LIBOR)

Looking back over 2020, the Division reported its satisfaction that firms delivered financial services "as they should have" in spite of the COVID-19 pandemic but noted their heightened and continuing concern about cybersecurity with the publication in 2020 of two cybersecurity risk alerts and a special report. The 2021 Report also discussed the completion of initial examinations of firms' implementation of Regulation Best Interest and the new Form CRS and provided guidance on successful implementation approaches.

Emphasis on the Critical Role Played by Compliance Departments

The Report included a strongly worded message about the critical importance of internal compliance programs at regulated entities, especially since an increasing number of staff of registered firms are working remotely. Based on "thousands of examinations of many different types of firms," the Report noted certain "hallmarks" of effective compliance programs including:

- a compliance department's active engagement in most facets of firm operations;
- early involvement by compliance in important business development, such as product innovation and new services;
  knowledgeable and empowered Chief Compliance Officers with full responsibility, authority, and resources to develop and enforce policies and procedures of the firm; and
- a commitment from C-level and similar executives to set a tone from the top that compliance is integral to the success of the firm and a continuous commitment to ensure adequate resources and tangible support for compliance at all levels of the firm.

Municipal Securities and Other Fixed Income Securities

In connection with a statement about the importance of timely and accurate municipal issuer disclosure as a result of the significant effects of the pandemic on the finances and operations of many municipal issuers, the Division stated it will examine the activities of broker-dealers and underwriters to assess whether they are meeting their respective obligations in relation to municipal issuer disclosure. This portends an examination of underwriter due diligence practices and SEC Rule 15c2-12 compliance in connection with municipal issuer offering documents. For a discussion of the

SEC's views on municipal disclosure practices in the light of the pandemic, see our Mid-Year 2020 Newsletter here. In addition, the Division will focus on an examination of broker-dealer trading activity in the areas of best execution, fairness of pricing, mark-ups and mark-downs, commissions, and confirmation disclosure requirements.

Municipal Advisor Examination Topics

Throughout 2021, the Division plans to examine the following areas:

- Whether municipal advisors "adjusted their practices" in the light of the impact of COVID-19 on the finances and operations of municipal issuers. In the Report, the Division draws a clear connection between "the importance of timely and accurate municipal disclosures" which is "critical to investors" and the duties of municipal advisors. This emphasis may portend a closer examination of the scope of services provided by municipal advisors to issuers in the context of disclosure. The Report also stated that the Division intends to examine whether municipal advisors documented the scope of their client engagements as required under MSRB Rule G-42.
- Whether municipal advisors relied on the Temporary Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Exchange Act of 1934 for Certain Activities of Registered Municipal Advisors (June 16, 2020).
  Whether municipal advisors have met their fiduciary duty obligations to municipal entity clients in regard to their disclosure of and management of conflicts of interest.
- Whether municipal advisors satisfied registration, qualification, CLE and supervisory requirements.

LIBOR Preparedness, Municipal Advisors: The Division stated its intent to engage with municipal advisors to assess their understanding of their own exposure to LIBOR, their preparations for the expected discontinuation of LIBOR and the transition to an alternative reference rate in connection with their financial matters related to LIBOR, and most relevant, those of their clients.

This follows the MSRB's publication *LIBOR Transition Information* available here and the SEC's Office of Municipal Securities Staff *Statement on LIBOR Transition in the Municipal Securities Market* available here. In both statements, municipal advisors were advised that under MSRB Rule G-42, if a municipal advisor makes a recommendation of a municipal securities transaction or product involving LIBOR (or is asked to review a recommendation of a third party), it must have a reasonable basis to believe the transaction or product is suitable for that client. In addition, with respect to a recommendation, the municipal advisor must inform the client of the risk, benefits, structure, and other characteristics as well as the suitability basis for any recommendation.

LIBOR Preparedness, Underwriters of Municipal Securities: The MSRB LIBOR publication described above reminded underwriters of their duty to make particularized disclosures for underwritings deemed complex municipal securities financings, in which LIBOR related financings are included. The Report portends the enhanced examination of municipal underwriters and their G-17 disclosure obligations respecting instruments using LIBOR.

Market Regulatory Infrastructure

Acting SEC Chair Allison Herren Lee stated that the Division will continue its oversight of the Financial Industry Regulatory Authority (FINRA) by "focusing on examinations on FINRA's operations and regulatory programs and the quality of FINRA's examinations of broker-dealers and municipal advisors." The Division will also examine the Municipal Securities Rulemaking Board (MSRB) to evaluate the effectiveness of its policies, procedures, and controls.

Our Municipal Securities Regulation and Enforcement Group and Public Finance Group continue to monitor any developments of the Division's exam priorities and findings as they relate to the municipal securities market.

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