

# The Securities and Exchange Commission Issues Municipal Advisor Final Rule

## Considerations for Municipal Authorities<sup>1</sup>

by Mark H. Vacha, Esq.  
Cozen O'Connor

### Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") was signed into law on July 21, 2010 in response to the financial crisis that occurred in 2008. In the two and a half years since passage, it has significantly impacted the municipal securities market.

The Dodd-Frank Act, among other things, requires the Securities and Exchange Commission (the "SEC") to establish a registration regime for municipal advisors. The SEC stated that the new registration requirements and regulatory standards are intended to respond to problems observed with the conduct of some municipal advisors, including "pay to play" practices, undisclosed conflicts of interest, advice rendered by financial advisors without adequate training or qualifications, and failure to place a duty of loyalty to clients ahead of the financial advisor's own interests.

The SEC in 2010 put a temporary registration regime in place. The SEC's

temporary regime and related guidance generated certain concerns among many municipal securities market participants notably with respect to the scope of who might be considered a municipal advisor. For example, there were concerns about whether unelected members of public authority boards might be treated as municipal advisors and thereby possibly become exposed to certain burdens and liabilities related to the registration requirements and fiduciary obligations imposed upon those who are deemed to be municipal advisors.

### Issuance of Municipal Advisor Rule, SEC Guidance and Effective Date

In the fall of 2013, the SEC issued a final rule<sup>2</sup> (the "Municipal Advisor Rule" or the "Rule") which, among other things, addresses the definition of "municipal advisor" and what may constitute "advice" and thereby implicate the municipal advisor rules. The Municipal Advisor Rule was to become effective on January 13, 2014. In response to concerns raised by invest-

ment banks and other market participants as well as trade groups, the SEC staff provided guidance about the Municipal Advisor Rule on January 10, 2014 in the format of frequently asked questions (the "FAQs") and then surprisingly, on January 13, 2014 postponed the effective date of the Municipal Advisor Rule until July 1, 2014 to allow market participants more time to implement procedures for compliance.

### Purpose

This article will address certain of the Rule's exemptions and exclusions from municipal advisor status with a particular focus on their impact on those who work for or on behalf of municipal authorities and upon the flow of information and financing proposals to municipal authorities.

### An Overview of Municipal Advisor Status for Various Officials and Professionals

#### Public Officials and Employees of Municipal Entities

In the Municipal Advisor Rule the SEC assuaged concerns related to the treat-



## AUS Consultants

*"Where Utilities find solutions to meet business objectives."*

RATE STUDIES - ACT 57 TAP FEE STUDIES - COST OF SERVICE - TARIFF RATE DESIGN,  
LITIGATION SUPPORT & EXPERT TESTIMONY - VALUATION & DEPRECIATION STUDIES

275 Grandview Avenue, Suite 100, Camp Hill, PA 17011

(717) 763-9890, FAX: (717) 763-9931

Contact: Gary D. Shambaugh, Principal & Director Email: [gshambaugh@ausinc.com](mailto:gshambaugh@ausinc.com)



ment of appointed board members and other officials. The SEC took a common sense approach, exempting from the municipal advisor requirements "any person serving as a member of a governing body, an advisory board, or a committee of, or acting in a similar official capacity with respect to, or as an official of, a municipal entity to the extent that such person is acting within the scope of such person's official capacity." Employees of municipal authorities would similarly be exempted from the municipal advisor requirements when acting within the scope of their employment.

### **Solicitors**

The Municipal Advisor Rule excludes from the municipal advisor definition attorneys offering legal advice "or providing services that are of a traditional legal nature". The SEC recognized that some financial advice is inherent in legal advice related to bond issues but indicated that the exclusion would not apply for advice that is primarily financial in nature (e.g., advice concerning the financial feasibility of a project or recommending a particular structure as being financially advantageous under prevailing market conditions).

### **Engineers**

Engineers are similarly excluded from the municipal advisor definition to the extent that they are "providing engineering advice". The SEC indicated that the activities within the scope of

this exclusion may include preparing feasibility studies, cash flow analyses and similar activities. The exclusion, among other things, would extend to providing information regarding a project schedule and anticipated funding requirements of a project. The exclusion would allow for an engineer to advise a municipal entity about whether a project could be safely or reliably completed with available funds and provide engineering advice about other alternative projects, cost estimates or funding schedules without engaging in municipal advisory activity.

### **Accountants**

Accountants have an exemption from the municipal advisor definition for the provision of audit and other attest services. The exemption would apply for the preparation of financial statements and the issuance of agreed-upon proce-

dures and similar letters for bond underwriters.

### **Exemptions of General Applicability**

Under the Municipal Advisor Rule, the determination of whether a person provides advice and thereby become subject to municipal advisor duties (subject to certain exceptions as discussed above and below) will depend upon whether a person makes a recommendation. A "recommendation" would be a communication that given its content, context and manner of presentation, would reasonably be viewed as a suggestion to a municipal entity to take or refrain from taking an action. Investment bankers, as emphasized in the FAQs, cannot switch roles from being a municipal advisor in the early stages of a bond transaction to being the underwriter

*continued on page 54*



*Specializing in Designing, Manufacturing, and Constructing*



- Water Tanks
- Anaerobic Digesters
- Sequencing Batch Reactors
- Turn-key Package Plants
- Oxidation Ditches
- Membrane Bioreactors
- Equalization Tanks
- Clarifiers



160 Rt. 41 • PO Box 549 • Gap, PA 17527 • (717) 442-8282 • [www.dutchlandinc.com](http://www.dutchlandinc.com)



*continued from page 11*

for the transaction. Once retained as the underwriter for a bond matter, the underwriter will be able to rely on a particular exemption from municipal advisor status. However, this creates an issue as to how municipal authorities and underwriters can communicate otherwise without the underwriter constituting a municipal advisor.

Certain general exemptions provide a means by which municipal authorities can receive information and proposals related to bond finance matters from bond underwriters. These rules will be most helpful during the time period between bond issues and during the period of time prior to an issuer's formal engagement of a bond underwriter.

### **General Information**

The Rule allows underwriters to provide municipal issuers with certain general types of information (e.g. information about general market developments and educational materials) without running afoul of the Rule.

This general information exemption would extend to information of a factual nature (i.e., without subjective assumptions, opinions or views); information that is not particularized to a specific municipal entity or type of municipal entity; information that is widely disseminated for use by the public, clients, or market participants other than municipal entities and educational materials.

Permitted educational material may not include past or projected performance figures from its provider and may not include a recommendation to purchase or sell any product or utilize any particular strategy.

In the FAQs, the SEC staff stated that a municipal issuer could be provided information about current market

prices and yields on its outstanding bonds. It could also receive hypothetical new issue pricing information containing a range of hypothetical interest rates or debt service requirements.

For a refunding, a municipal issuer can be provided information about hypothetical potential interest cost savings were it to issue refunding bonds to refinance its outstanding bonds based on current estimated market conditions. However, the hypothetical refunding information has to be based on the assumption that the refunding bonds have the same debt structure (e.g., level debt service for the hypothetical refunding bonds if the refunded bonds have level debt service) and same final maturity date as the bonds to be refunded.

### **Responding to an RFP**

Underwriters and others can provide proposals and recommendations to municipal authorities if the municipal authority has issued a request for proposals or request for qualifications. This exemption also applies to so-called "mini-RFPs" that might only be distributed to service providers that have been pre-screened or pre-qualified by the municipal authority.

A request can satisfy this exemption

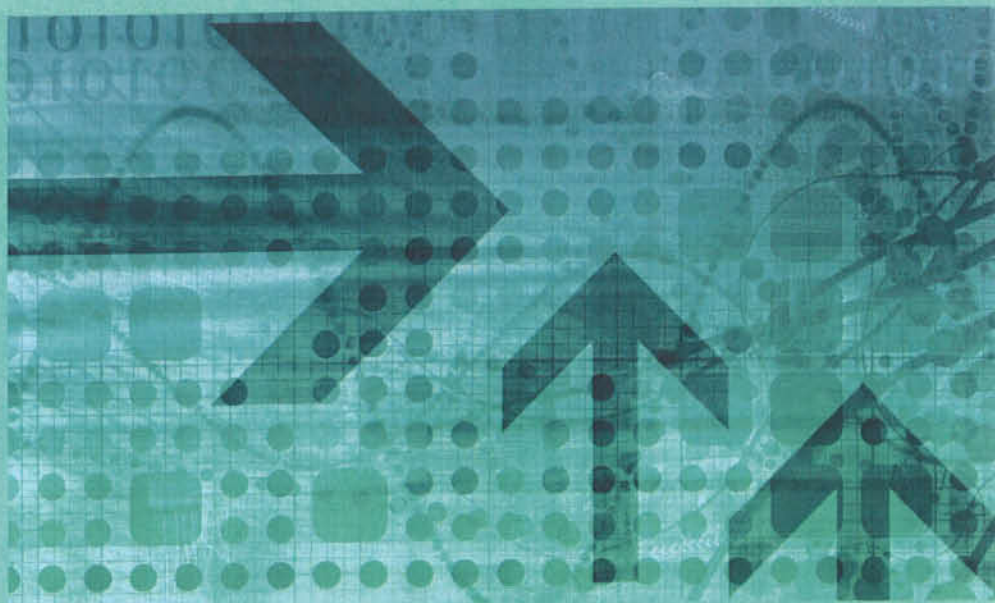
without necessarily having to meet particular state law formalities. The request cannot "evergreen" and would need to cover a specified time period. The SEC in its FAQs indicated that an open period of up to six months generally is considered reasonable. The RFP should be circulated to more than just one potential provider.

The SEC in its FAQs emphasized that the RFP needs to involve a competitive process under the facts and circumstances and should either be sent to at least three reasonably competitive market participants or publicly disseminated by posting on the issuer's official website.

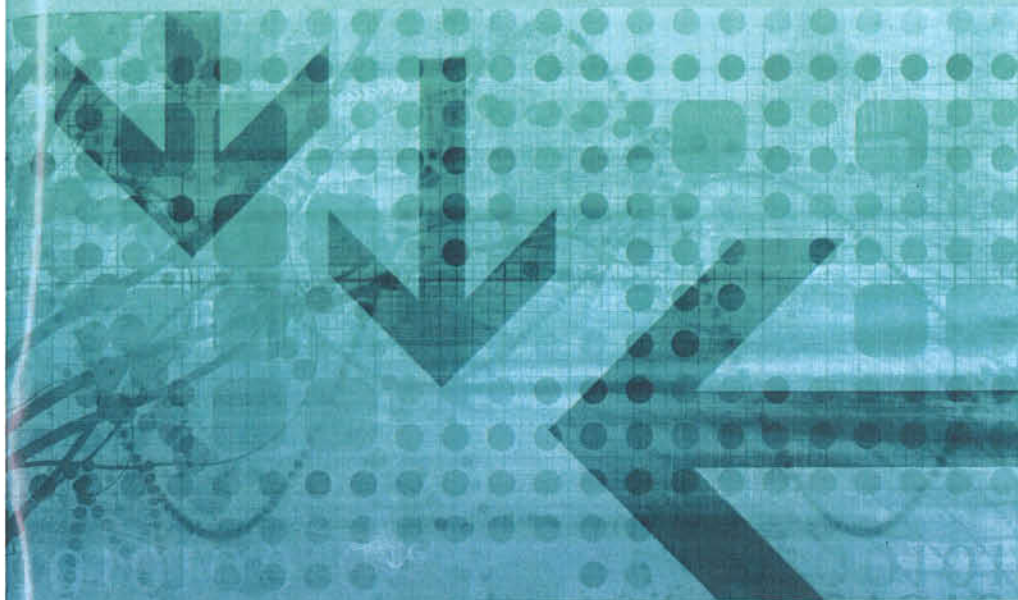
The RFP exemption is independent of the registered independent municipal advisor exemption discussed below and can be utilized by municipal authorities when they are not represented by a municipal advisor.

### **Representation by a Registered Independent Municipal Advisor**

Investment banks and others have an exemption from the municipal advisor definition and can make proposals and specific recommendations to municipal issuers in circumstances where the municipal issuer is represented by a registered independent municipal advisor







with respect to matters addressed by the recommendations.

This exemption is not self-executing but requires the municipal issuer to make certain representations to the party who will rely on the exemption. The issuer will need to represent that it will rely on its municipal advisor for advice with respect to recommendations about the issuance of municipal securities and/or municipal financial products.

The municipal advisor must be registered with the SEC and the Municipal Securities Rulemaking Board (the "MSRB"). In order for a particular investment bank to rely on this exemption, the municipal advisor cannot be "associated" (a term of art) with that investment bank for the prior two years.

The investment bank would also be required to make certain disclosures to the municipal issuer and the municipal advisor including a disclosure that the investment bank would not be subject to a fiduciary duty to the municipal issuer.

Municipal authorities should consider seeking legal advice prior to signing certifications and may need to obtain back-up representations from their

municipal advisors prior to providing written representations for purposes of the exemption.

#### **Bank Exemption**

The Municipal Advisor Rule provided a broad exemption for traditional banks and savings institutions. These institutions can provide advice with respect to certificates of deposits and other deposit instruments and the extension of credit including the issuance of a letter of credit, the making of a direct loan or the purchase of a municipal security by the bank for its own account.

#### **Continuing Developments to Monitor**

The SEC was very active in January of 2014 in response to feedback from market participants. It would not be surprising if more guidance is provided as lishing exemptions.

#### **Summary of Expected Practical Impact for Municipal Authorities**

Officers, employees and board members of municipal authorities acting within the scope of their duties should be exempt from municipal advisor status. Municipal authorities will be most impacted by the Municipal Advisor Rule in terms of the process for receiving financing proposals from investment banks.

As standard practices develop in the bond markets, municipal authorities should expect to be approached by investment banks to provide certifications to enable the investment banks to rely on the registered independent municipal advisor exemption.

Municipal authorities who do not have financial advisors may still be able to receive recommendations by conducting requests for proposals. In any event, certain general information about market conditions including hypothetical new money issues or plain vanilla refunding analyses of the issuer's bonds is likely to still be provided. However, such information would not be particularly customized to the municipal issuer's needs and would not extend to less traditional structures. Little or no disruption is expected in terms of receiving proposals from commercial banks and similar traditional banking institutions for loans or the direct purchase of bonds.

*<sup>1</sup>Copyright of Cozen O'Connor, 2014, all rights reserved. This article is for informational purposes only and is not intended to provide legal advice or establish any client-attorney relationship.*

*<sup>2</sup>Release No. 34-70462; File No. S7-45-10 (RIN 3235-AK86)*

Mark Vacha is a Member in the Public and Project Finance Group at Cozen O'Connor based in Philadelphia, Pennsylvania. He can be contacted at [mvacha@cozen.com](mailto:mvacha@cozen.com).

