

Client Alert

Current Issues Relevant to Our Clients

July 25, 2014

MSRB Revises Draft Rule G-42 on the Duties of Municipal Advisors

The Municipal Securities Rulemaking Board has released for public comment a revised draft of its proposed Rule G-42 on the duties of municipal advisors. The initial draft of Rule G-42 was released on January 9, 2014. The Rule as initially proposed was the subject of extensive comment, leading the MSRB to make various modifications and request additional comments.

Revised proposed Rule G-42 retains the duty of care and duty of loyalty components of a municipal advisor's fiduciary duty to its municipal entity clients, but does not extend the fiduciary duty or the duty of loyalty to obligated person clients, which remain subject to the duty of care. The Supplementary Material included with the revised proposed Rule generally retains most of the original guidance on the scope of the duties of care and loyalty with the modifications discussed below.

Key modifications to the initial proposed Rule G-42 include:

- A narrowing of the prohibition on a municipal advisor and its affiliates engaging in a principal transaction with a municipal entity client to those transactions directly related to the same transaction or product for which the municipal advisor is providing advice. "Engaging in a principal transaction" is defined as selling to or purchasing from the municipal entity client any security or entering into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client.
- Deletion of requirements that municipal advisors undertake a thorough review of the official statement in a new issue transaction, investigate or consider other reasonably feasible alternatives to any recommended transaction, disclose information about professional liability insurance and estimate their expected total dollar compensation, which elements the municipal entity may choose to address in the engagement documentation with the municipal advisor.
- Limiting the required disclosures to a municipal advisory client regarding legal or disciplinary matters to those that are material to the client's evaluation of the advisor or the integrity of its management or advisory personnel, but requiring disclosure of the types of information regarding legal and disciplinary matters that are included in the SEC's municipal advisor registration forms (Forms MA and MA-I), where the client may access these forms, and the date of the last material change to the legal or disciplinary event disclosures on these forms.
- The addition of a new provision specifically permitting withdrawal in the event a party inadvertently engages in municipal advisory activities and does not wish to continue or enter into a municipal advisory relationship.

The revised proposed Rule continues to require written documentation of all municipal advisory engagements, with specified minimum requirements which now include any terms relating to how the advisor may withdraw from the municipal advisory relationship.

The revised proposed Rule requires that a municipal advisor that makes a recommendation regarding a municipal securities transaction or a municipal financial product (or at the request of its client, reviews a recommendation made by another party) must determine through the exercise of reasonable diligence whether or not the transaction or product is suitable for the client. The advisor is also required to inform its client of (a) the material risks, benefits and characteristics of the transaction or product, (b) the basis for the advisor's suitability determination, and (c) whether the advisor investigated other reasonably feasible alternatives to the recommended transaction or product.

The Supplementary Material included with the revised proposed Rule retains the MSRB's original proposed guidance on an advisor's suitability determinations and "know your client" obligations. Proposed revisions to the record-keeping requirements of Rule G-8 would require the retention of any document created by a municipal advisor that memorializes the basis for its conclusions as to the suitability of a municipal securities transaction or a municipal financial product, or that was material to its review of a recommendation made by another party.

The MSRB's regulatory notice and request for comments (Regulatory Notice 2014-12, July 23, 2014) is available on the MSRB's website and can be found [here](#). Comments on the revised draft of proposed Rule G-42 must be submitted by August 25.

For a description of MSRB's initial proposed Rule G-42 as well as aspects of the initial proposal that were retained in the revised proposed Rule, see Chapman and Cutler's January 15, 2014 Client Alert which can be found [here](#).

[For More Information](#)

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