

# U.S. Securities and Exchange Commission Final Municipal Advisor Registration Rules

Guidance and Issues for Participants in  
Municipal Securities Transactions

October 2013

Chapman and Cutler LLP

---

Attorneys at Law • Focused on Finance®

**U.S. SECURITIES AND EXCHANGE COMMISSION  
FINAL MUNICIPAL ADVISOR REGISTRATION RULES:**

**Guidance and Issues for Participants in Municipal Securities Transactions**

---

**October 15, 2013**

## James C. Burr

This document has been prepared by Chapman and Cutler LLP attorneys for information purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material. The publication and receipt of this document do not constitute legal advice or establish an attorney-client relationship with any person. Attorney advertising material.

## Table of Contents

SECTION	PAGE
Background .....	1
Overview of the Final Rules and the Adopting Release .....	2
Who Is a Municipal Advisor? .....	2
Municipal Advisory Activities.....	3
What is Advice?.....	3
Municipal Entities and Obligated Persons.....	5
The Subject Matter of Advice .....	5
Exclusions and Exceptions from the Municipal Advisor Definition .....	6
Officers and Employees of Municipal Entities and Obligated Persons.....	6
Persons Responding to RFPs or RFQs.....	7
Represented by an Independent Municipal Advisor.....	7
Banks .....	8
Underwriters.....	9
Swap Advisors and Swap Dealers .....	12
Investment Advisers .....	13
Professionals.....	13
Vendors and Finance Companies .....	14
Municipal Advisors .....	15
In Conclusion.....	16
More Information .....	16

On September 18, 2013, the Securities and Exchange Commission unanimously approved final rules for the registration of municipal advisors under the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>1</sup> The final rules provide guidance on the persons who are required to register as municipal advisors and are subject to the fiduciary duty established in the Dodd-Frank Act. The final rules are more closely aligned with the municipal advisor provisions of the Dodd-Frank Act than the proposed rules issued in December 2010, and provide additional exemptions for various participants in municipal securities transactions. While the final rules incorporate a number of comments received from market participants on the proposed rules, they raise (or leave unresolved) a number of significant issues for participants in municipal securities transactions, including issuers, underwriters, attorneys and other professional service providers, as well as municipal advisors.

---

## Background

Under Section 975 of the Dodd-Frank Act, a person that provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities is a “municipal advisor” and is required to register with the SEC and the Municipal Securities Rulemaking Board. In addition to the requirement to register with the SEC and the MSRB, municipal advisors are:

- subject to substantially the same disciplinary rules of the SEC as municipal securities dealers, and substantially the same rules of the MSRB as municipal securities dealers, namely rules (to be adopted by the MSRB) imposing standards of training and competence, standards of conduct and practices, record-keeping requirements, and imposing fees and charges to defray the MSRB’s administrative and operating costs;
- prohibited from engaging in any fraudulent, deceptive or manipulative act or practice in connection with the issuance of municipal securities, municipal financial products or the solicitation of any municipal entity or obligated person; and
- deemed to have a fiduciary duty to their municipal entity clients and are prohibited from engaging in any act, practice, or course of business which is not consistent with a municipal advisor’s fiduciary duty or that is in contravention of any rule of the MSRB.

These provisions, as well as the SEC’s temporary registration regime for municipal advisors, became effective on October 1, 2010.<sup>2</sup>

---

<sup>1</sup> The adopting release is posted on the SEC’s website at <http://www.sec.gov/rules/final/2013/34-70462.pdf>.

<sup>2</sup> The temporary registration rule is posted on the SEC’s website at <http://www.sec.gov/rules/interim/2010/34-62824.pdf>.

---

## Overview of the Final Rules and the Adopting Release

The final rules issued by the SEC consist of nine new rules and four new forms that will apply to municipal advisors. The first of these rules and forms, Rule 15Ba1-1, defines “municipal advisor” and related terms, and provides status-based exclusions and activity-based exemptions to the municipal advisor definition, and constitutes the foundation of the final rules. The SEC’s adopting release includes over 200 pages of discussion regarding the provisions of Rule 15Ba1-1 and the comments received by the SEC on its proposed municipal advisor rules that were issued in late 2010. Despite the 777-page length of the SEC’s adopting release for the final rules, Rule 15Ba1-1 is slightly over 10 pages long.<sup>3</sup>

The remainder of the rules and forms cover the registration procedures, reporting requirements and related matters applicable to municipal advisors. These rules and forms are discussed briefly below, and will be covered in greater detail in a subsequent Chapman and Cutler Client Alert.

The final rules will become effective 60 days after they are published in the Federal Register. The final rules were not published before October 1 when the Federal Register reduced publication in response to the federal government shutdown, so the effective date of the final rules is not known as of the date of this article.

---

## Who Is a Municipal Advisor?

The final rules begin by adopting the definition of “municipal advisor” from the Dodd-Frank Act, which defined “municipal advisor” to include any person (who is not a municipal entity or an employee of a municipal entity) that:

- provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or
- undertakes the solicitation of a municipal entity or an obligated person.<sup>4</sup>

The Dodd-Frank Act definition of “municipal advisor” *specifically includes* financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents,<sup>5</sup> solicitors, finders and

---

<sup>3</sup> The text of the final rules begin at page 595 of the adopting release.

<sup>4</sup> This article does not include a discussion of the provisions of the final rules regarding solicitations of municipal entities and obligated persons. The SEC’s discussion of these provisions appears at pp. 113-129 of the adopting release.

<sup>5</sup> The reference to “placement agents” in the municipal advisor definition means persons engaged by investment advisers to obtain investment business from public pension plans and not to broker-dealers acting as placement agents for municipal securities. The adopting release includes separate discussions of (a) the designation of “placement agents” as municipal advisors with respect to their solicitation of investment business from public pension plans at pp. 114-115 and 125-126, and (b) the application of the underwriter exclusion from the municipal advisor definition to a broker-dealer acting as a placement agent for an issue of municipal securities at pp. 171-172.

swap advisors that provide advice or solicit business, *but excludes* underwriters of municipal securities, registered investment advisers providing investment advice, registered commodity trading advisors providing swap advice, attorneys offering legal advice or providing services that are of a traditional legal nature, and engineers providing engineering advice.

The final rules shape the Dodd-Frank definition of “municipal advisor” by:

- establishing an advice standard that includes guidance on what communications constitute “advice,” the definitions of “municipal entity” and “obligated person” and the municipal financial products and issuances of municipal securities that are the subject matter of such “advice,”
- refining the definitions of “guaranteed investment contracts” and “investment strategies” and providing a definition of “municipal derivatives,”
- providing interpretative guidance on the statutory exclusions from the municipal advisor definition (underwriters, registered investment advisers, registered commodity trading advisors, attorneys and engineers) under the Dodd-Frank Act,
- providing activity-based exemptions from the municipal advisor definition for officials, officers and employees of municipal entities and obligated persons, accountants and banks, and
- providing exemptions of general application for persons providing advice (a) in response to requests for proposals or requests for qualifications and (b) to a municipal entity or obligated person that is represented by an independent registered municipal advisor.

## Municipal Advisory Activities

The three elements of the municipal advisor definition—(a) advice, (b) to a municipal entity or an obligated person and (c) with respect to municipal financial products or the issuance of municipal securities—are embedded in the definition of “municipal advisory activities” in the final rules and are discussed at length in the SEC’s adopting release. A person engaged in municipal advisory activities must either register as a municipal advisor or avail itself of one of the exceptions and exclusions provided under the final rules. As detailed below, all of these exceptions and exclusions are subject to various qualifications and limitations, and to the extent that they may not be available in specific circumstances, persons may need to consider circumscribing their communications and activities with municipal entities and obligated persons to avoid being engaged in municipal advisory activities.

### What is Advice?

While the term “advice” is a key term in the definition of “municipal advisor,” it was not defined in the Dodd-Frank Act. The final rules provide that a *recommendation* with respect to the structure, timing, terms or similar matters concerning a municipal financial product or an issuance of municipal securities will constitute “advice.” In the adopting release, the SEC states its views that the term “advice”

(a) is not susceptible to a bright-line definition, (b) depends upon all relevant facts and circumstances, and (c) can be construed broadly. In addition, the SEC stated its view that “advice” includes “a recommendation that is *particularized* to the specific needs, objectives, or circumstances of a municipal entity or obligated person,” and information that is “*individually tailored* . . . to a particular municipal entity, obligated person, or targeted group of municipal entities or obligated persons that share common characteristics.” [emphasis added]

Whether a particular communication involves a “recommendation” is, in the SEC’s view, also based on all the facts and circumstances and includes consideration of its content, context and manner of presentation, as well as whether the communication “would be viewed as a suggestion that the municipal entity or obligated person take action or refrain from taking action regarding municipal financial products or the issuance of municipal securities.”

The final rules provide that, for purposes of the municipal advisor definition, “advice” excludes “the provision of general information that does not involve a recommendation regarding municipal financial products or the issuance of municipal securities.” In the adopting release, the SEC stated that this general information exception applies to:

- information of a factual nature 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 or obligated persons;
- general information in the nature of educational materials; and
- “efforts to win business,” as discussed below.

The “efforts to win business” component of the general information exception requires a person to identify himself or herself as seeking to obtain business from a municipal entity or obligated person, and to provide only general information. In the adopting release, the SEC indicated that a broker-dealer seeking an underwriting engagement could provide information regarding its underwriting capabilities and experience or general market or financial information that might indicate favorable conditions to issue or refinance debt.

Discussions of what constitutes “advice” appear throughout the adopting release, with multiple statements by the SEC that whether or not advice is given in a particular situation “depends upon all relevant facts and circumstances.” Based upon these discussions, persons seeking to avoid being deemed to be engaged in municipal advisory activities will need to take care in limiting their communications with municipal entities and obligated persons (a) to exclude recommendations regarding municipal securities or municipal financial products, and (b) to include only non-particularized, non-tailored information that falls within the general information exception.



## Municipal Entities and Obligated Persons

The final rules include a slightly-modified definition of “municipal entity” (“any State, political subdivision of a State, or municipal corporate instrumentality of a State or of a political subdivision of a State”), that also includes public employee retirement systems and benefit plans.

The final rules provide that “obligated person” has the same meaning as in Rule 15c2-12, which excludes providers of credit enhancement and liquidity facilities, as well as additional exclusions for (a) persons whose financial information or operating data is not material to a municipal securities offering and (b) the federal government.

## The Subject Matter of Advice

Advice given to a municipal entity or obligated person on the following subjects constitutes municipal advisory activity:

- the issuance of municipal securities, including advice with respect to the structure, timing and terms of municipal securities, and other similar matters; and
- municipal financial products, including advice with respect to the structure, timing and terms of municipal financial products, and other similar matters.

In the adopting release, the SEC stated that it would as a matter of policy construe broadly the phrase “issuance of municipal securities” to include “advice throughout the life of an issuance of municipal securities, from the pre-issuance planning stage for a debt transaction involving the issuance of municipal securities to the repayment stage for those municipal securities.” This conception-to-grave construction of “issuance of municipal securities” was not discussed in the proposed municipal advisor rules, and represents a significant expansion of covered municipal advisory activities to include not only advice with respect to new issuances of municipal securities, but also advice with respect to outstanding municipal securities.

“Municipal financial products” is defined in the Dodd-Frank Act to mean “guaranteed investment contracts” and “investment strategies” (each of which is separately defined in Dodd-Frank) and “municipal derivatives” (which is not defined in Dodd-Frank). In the final rules, the SEC:

- narrowed the definition of “guaranteed investment contract” so that it applies only to investments of the proceeds of municipal securities or municipal escrow investments, but with a broad interpretation of “proceeds” that includes sale proceeds, amounts in debt service funds, debt service reserve funds and sinking funds, and all investment proceeds;
- excluded from the definition of “municipal advisor” persons that provide advice with respect to “investment strategies” that are not (a) plans or programs for the investment of the proceeds of municipal securities or (b) the recommendation and brokerage of municipal escrow investments; and

- provided an expansive definition of “municipal derivatives” to include any “swap” or “security-based swap,” as these terms are defined in the U.S. Commodity Exchange Act, to which a municipal entity is a counterparty (including swaps unrelated to the issuance of, or an issue of, municipal securities) or to which an obligated person is a counterparty (but only with respect to swaps executed in connection with, or pledged as security or a source of payment for, an existing or proposed issue of municipal securities).

---

## Exclusions and Exceptions from the Municipal Advisor Definition

As noted above, the adopting release includes (a) interpretative guidance that shapes the statutory exclusions from the municipal advisor definition for underwriters, registered investment advisers, registered commodity trading advisers, attorneys and engineers, (b) activity-based exemptions from the municipal advisor definition for officials, officers and employees of municipal entities and obligated persons, accountants and banks, and (c) exemptions of general application for persons providing advice (i) in response to requests for proposals or requests for qualifications and (ii) to a municipal entity or obligated person that is represented by an independent registered municipal advisor. Each of the exclusions and exceptions from the municipal advisor definition is limited in various respects. Some of these limitations are significant, and will need to be considered carefully by persons relying on specific exclusions or exemptions.

### Officers and Employees of Municipal Entities and Obligated Persons

The Dodd-Frank Act definition of “municipal advisor” excludes municipal entities and their employees. The SEC’s proposed municipal advisor rules would also have excluded elected, but not appointed, members of the governing body of a municipal entity or an obligated person. In response to the over 600 comment letters that the SEC received on this proposal, the final rules exempt from the definition of “municipal advisor”:

- a member of a governing body, advisory board or committee of a municipal entity or obligated person, and an official of a municipal entity or obligated person, to the extent that such member or official is acting within the scope of his or her official capacity; and
- an employee of a municipal entity or obligated person, to the extent acting within the scope of his or her employment.

The adopting release did not include guidance on what activities would be considered to be outside the scope of a person’s official capacity or employment, although it should be assumed that unauthorized or illegal activities, particularly those involving pay-to-play schemes, would be considered to be outside the scope of a person’s official capacity or employment. The only circumstance cited by the SEC as requiring officials, officers or employees to register as a municipal advisor was if they are engaged by other municipal entities or obligated persons to provide compensated municipal advisory services. The SEC also stated that officers or employees of obligated persons that solicit, and engage in arm’s-length

negotiations of the terms of, conduit borrowings with municipal entities are not considered to be engaged in municipal advisory activities.

While the expanded exemption for officials, officers and employees is clearly a positive aspect of the final rules, municipal entities and obligated persons will need to consider carefully the other exclusions and exemptions from the municipal advisor definition discussed below. The scope of and limitations on these exclusions and exemptions will impact significantly future interactions between municipal entities and obligated persons and their advisors, professional consultants and underwriters.

#### Persons Responding to RFPs or RFQs

The final rules provide a general exemption from the definition of “municipal advisor” for any person responding (in writing or orally) to a request for proposals or a request for qualifications, including “mini-RFPs” issued to pre-qualified service providers, from a municipal entity or obligated person for services in connection with a municipal financial product or the issuance of municipal securities. This exemption is subject to the condition that such person does not receive separate direct or indirect compensation for advice provided as part of such response.

While this exemption for RFP or RFQ responses is broad, the SEC distinguished between responding to an RFP or RFQ, and assisting a municipal entity or obligated person with the preparation of an RFP or RFQ, or the evaluation proposals received. In the SEC’s view, such assistance could include advice with respect to the use of municipal financial products or the issuance of municipal securities that could constitute municipal advisory activities.

#### Represented by an Independent Municipal Advisor

The final rules provide a general exemption from the municipal advisor definition for any person providing advice with respect to municipal financial products or the issuance of municipal securities to a municipal entity or obligated person that is represented by an “independent” registered municipal advisor, subject to the following conditions:

- the registered municipal advisor must be providing advice with respect to the same aspects of a municipal financial product or an issuance of municipal securities;
- the registered municipal advisor is not, and for the past two years has not been, associated with the person relying on this exemption;
- the municipal entity or obligated person *represents in writing* that it is represented by, and *will rely* on the advice of, an independent registered municipal advisor;<sup>6</sup> and

---

<sup>6</sup> The person relying on this exemption is also required to have a reasonable basis for relying on the representation. The SEC stated in the adopting release that whether a person has a reasonable basis to rely on a written representation requires reasonable diligence, based on all the facts and circumstances, including review of the written representation and other reasonably-available relevant information, as well as information in the person’s possession that would cause it to know that the representation is inaccurate.

- the person relying on this exemption (a) discloses in writing to the municipal entity or obligated person that it is not a municipal advisor with respect to the municipal financial product or issuance of municipal securities, (b) discloses in writing to the municipal entity that it is not subject to the fiduciary duty imposed on municipal advisors, and (c) provides a copy of such disclosure to the independent registered municipal advisor.

The required disclosures must be made at a time and in a manner reasonably designed to allow the municipal entity or obligated person to assess the material incentives and conflicts of interest that the person relying on the exemption may have in connection with the municipal advisory activities. The SEC stated that the level and timing of the required disclosure should take into account the knowledge and experience of the municipal entity or obligated person, referencing the disclosures required by underwriters pursuant to MSRB Rule G-17.<sup>7</sup>

In the adopting release, the SEC stated that this exemption was intended to allow a municipal entity or obligated person to receive as much advice and information as possible from a variety of sources, so long as the municipal entity or obligated person is represented by and will rely on an independent registered municipal advisor that is subject to a fiduciary duty (in the case of an advisor to a municipal entity) or a duty of fair dealing (in the case of advisor to an obligated person). While this exemption is broad and applies to all persons in their communications with municipal entities and obligated persons, application of the exemption will require (a) municipal entities and obligated persons to retain registered municipal advisors and (b) delivery of the written representations and written disclosures described above. A significant number of municipal entities and obligated persons have not historically retained the services of municipal advisors, and whether they will be willing to bear the additional cost of paying a municipal advisor remains to be seen. While we expect that standardized forms of the required representations and disclosures will be developed, it is not clear that municipal entities and obligated persons will in all cases be willing to engage an independent registered municipal advisor or provide the required representations regarding their reliance on the advice of the advisor, particularly for those entities that have not previously engaged municipal advisors.

#### **Banks**

The Dodd-Frank Act did not exclude banks or bank activities from the municipal advisor definition. The final rules include a broad exemption from the municipal advisor definition for “banks” (*i.e.*, depository institutions described in Section 3(a)(6) of the Exchange Act) providing advice with respect to:

- any investments that are held in a deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank;

---

<sup>7</sup> See Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities (August 2, 2012), available at <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx?tab=2>.

- any extension of credit by a bank to a municipal entity or obligated person, 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;<sup>8</sup>
- any funds held in a sweep account; or
- any investment made by a bank acting in the capacity of an indenture trustee or similar capacity.

With regard to “direct purchase” transactions in which a bank purchases a municipal security for its own account, the SEC stated that, “banks providing municipal entities or obligated persons with the terms under which they would purchase securities for their own account are not engaging in municipal advisory activities,” though they may, depending on the facts and circumstances, be subject to regulation as municipal securities dealers.<sup>9</sup>

The SEC stated in the adopting release that the bank exemption was intended to permit “banks to continue to provide products and services to municipal entities and obligated persons that do not pose the types of risks that the Dodd-Frank Act was designed to address.” The SEC further noted that the products and services covered by the bank exemption “are transactions in which there should be no confusion as to the role of the bank or its employees.” However, the SEC emphasized in the adopting release that the bank exemption does not apply to banks engaged in municipal advisory activities, including particularly advice with respect to municipal derivatives.

For a bank engaged in municipal advisory activities, the final rules permit a separately-identifiable department or division of the bank, rather than the bank itself, to register as a municipal advisor. The separately-identifiable department or division must conduct all of the bank’s municipal advisory activities, and is subject to certain supervisory and record-keeping requirements set forth in the final rules.

#### Underwriters

The Dodd-Frank Act excluded a broker-dealer “serving as an underwriter” from the definition of “municipal advisor.” The scope of this statutory exclusion is limited by the final rules, which frame the underwriter exclusion as follows:

A broker, dealer, or municipal securities dealer serving as an underwriter of *a particular issuance of municipal securities* to the extent that the broker, dealer, or municipal securities dealer engages in activities that are *within the scope of an underwriting* of such issuance of municipal securities. [emphasis added]

---

8 A footnote in the adopting release states that the items listed as “extensions of credit” were not intended to be exhaustive, and that other extensions of credit by a bank would also be subject to the bank exemption, including “a banker’s acceptance or a participation in a loan which the bank or an affiliate of the bank (other than a broker or dealer) funds, participates in, or owns.” Adopting release, footnote 893 at p. 242.

9 Adopting release, footnote 894 at pp. 242-243.

The adopting release clarifies and limits the scope of the underwriter exclusion in several important respects. First, the SEC indicated that the underwriter exclusion applied regardless of the type of underwriting (firm or best efforts) or particular type of offering (public or private).<sup>10</sup>

Second, the SEC limited the period during which the underwriter exclusion applies by stating that (a) it is not available until such time as a broker-dealer has been engaged as underwriter with respect to a specific issue of municipal securities, and (b) it terminates at the “end of the underwriting period” under Rule 15c2-12.<sup>11</sup> A broker-dealer’s inclusion in a pool of pre-qualified underwriters that does not include an engagement for a specific issue of municipal securities is not sufficient to enable the broker-dealer to rely on the underwriter exclusion. Advice with respect to municipal financial products or the issuance of municipal securities that is given before a specific engagement or after the end of the underwriting period would, in the SEC’s view, constitute municipal advisory activities.

Third, the SEC limited the scope of the underwriter exclusion by stating that it applies to only those activities it considers to be (a) specific to a particular issue of municipal securities and (b) integral to fulfilling the role of an underwriter. The adopting release includes a list of nine activities that the SEC considers to be within the scope of the underwriting exception. These activities include, but only with respect to the municipal securities issue being underwritten:

- advice regarding the structure, timing, terms, and other similar matters;
- preparation of rating strategies and presentations and investor road shows and investor discussions;
- advice regarding retail order periods and institutional marketing;
- assistance in the preparation of the preliminary and final official statements, the negotiation of documents, certificates and opinions, assistance with closing and the preparation of post-sale reports; and
- structuring of refunding escrow cash flow requirements necessary to provide for the refunding and defeasance of an issue of municipal securities (provided, however, that the recommendation of and brokerage of particular municipal escrow investments is outside the scope of the underwriting exclusion).

---

10 The SEC also stated that it did not view the activities of remarketing agents to be municipal advisory activities “because the mere remarketing of bonds would not constitute an issuance of municipal securities,” but observed that a remarketing that constituted a “primary offering” within the meaning of the federal securities laws “is an issuance of municipal securities for purposes of the municipal advisor registration regime.”

11 “End of the underwriting period” is defined in Rule 15c2-12(f)(2) as “the later of such time as

- (i) The issuer of municipal securities delivers the securities to the Participating Underwriters or
- (ii) The Participating Underwriter does not retain, directly or as a member or an underwriting syndicate, an unsold balance of the securities for sale to the public.”

The SEC stated in the adopting release that it considers the performance of underwriter obligations under the antifraud provisions of federal securities law and MSRB rules as activities that are integral to fulfilling the role of an underwriter.

The adopting release listed a dozen activities that, in the SEC's view, are *outside* the scope of the underwriter exclusion, including the following:

- advice on investment strategies and municipal derivatives (including derivative valuation services);
- advice on the method of sale for municipal securities (competitive or negotiated), assistance with competitive sales, and advice regarding the selection of underwriters and other finance professionals;
- advice on whether a governing body of a municipal entity or obligated person should approve or authorize an issuance of municipal securities, and advice on bond election campaigns;
- advice that is not specific to a particular issuance of municipal securities on which the underwriter is serving, and advice that involves analysis or strategic services with respect to overall financing options, debt capacity constraints, debt portfolio impacts, analysis of effects of debt or expenditures under various economic assumptions, or other impacts of funding or financing capital projects or working capital;
- preparation of financial feasibility analyses, and budget planning and analyses and budget implementation issues with respect to debt issuance and collateral budgetary impacts; and
- advice on an overall rating strategy that is not related to a particular issuance of municipal securities, including advice and actions taken on behalf of a municipal entity or obligated person between financing transactions.

In order for an underwriter to provide advice on the foregoing matters, the advice would need to (a) be given in response to an RFP or an RFQ, (b) be given to a municipal entity or obligated person that had engaged an independent registered municipal advisor or (c) otherwise be unrelated to a municipal financial product or the issuance of municipal securities. The SEC's determination to exclude advice on investment strategies and municipal derivatives from the scope of the underwriter exclusion, including advice that is incidental to the issuance of municipal securities, will present challenges for the structuring and execution of municipal securities issues that include these elements, and may have the effect of requiring the municipal entity or obligated person to engage an independent registered municipal advisor.

The intersection between the SEC's limitations on the scope of the underwriter exclusion and provisions of MSRB Rule G-23 present additional challenges for prospective underwriters. Rule G-23 was amended in 2011 to generally prohibit a broker-dealer serving as a financial advisor for an issue of municipal securities from switching roles and underwriting the same issue. While Rule G-23 requires

that financial advisory relationships be evidenced by written agreements, the MSRB's guidance under Rule G-23 provides that "a financial advisory relationship will be deemed to exist . . . regardless of a written agreement" whenever a dealer renders advice with respect to the structure, timing, terms, and other similar matters concerning an issuance of municipal securities.<sup>12</sup> The MSRB's 2011 guidance goes on to provide that a broker-dealer will be considered to be "acting as an underwriter" and not as a financial advisor with respect to a particular issue of municipal securities issue if it "clearly identifies itself in writing as an underwriter and not as a financial advisor from the earliest stages of its relationship with the issuer with respect to that issue." Although the MSRB's guidance under Rule G-23 is aligned with its subsequent guidance on underwriter disclosures under Rule G-17,<sup>13</sup> it is not so closely aligned with the limitations on the underwriter exclusion under the final municipal advisor registration rules, which do not enable a broker-dealer to provide covered advice merely by identifying itself as an underwriter or a prospective underwriter.

In order to avoid being engaged in municipal advisory activities with respect to a particular issue of municipal securities and thereby being precluded from serving as underwriter with respect to that issue, broker-dealers will need to do one or more of the following: (a) obtain an underwriting engagement for that issue at the earliest stages of its contact with the municipal entity or obligated person, and provide the disclosures required by MSRB Rule G-17; (b) if applicable, rely on the general exemptions for RFP responses or the engagement by the municipal entity or obligated person of an independent registered municipal advisor for the subject transaction; or (c) carefully circumscribe the information it provides to the municipal entity or obligated person so that it does not constitute covered advice.

#### Swap Advisors and Swap Dealers

The Dodd-Frank Act excluded from the definition of "municipal advisor" any "commodity trading advisor registered under the Commodity Exchange Act or persons associated with a commodity trading advisor who are providing advice related to swaps." The final rules adopt this exclusion with minor modifications. In the adopting release, the SEC stated that the exclusion would not apply, and a commodity trading advisor would be required to register as a municipal advisor, if (a) the commodity trading advisor engages in municipal advisory activities unrelated to swaps, or (b) the commodity trading advisor is not registered with the Commodity Futures Trading Commission, including advisors exempt from registration under the Commodity Exchange Act or CFTC no-action letters.

The final rules exempt from the municipal advisor definition registered swap dealers providing advice with respect to municipal derivatives or trading strategies that involve municipal derivatives, as long as the dealer is not "acting as an advisor" to a municipal entity or obligated person within the

---

<sup>12</sup> MSRB Notice 2011-65 (November 18, 2011), available at [http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-23.aspx?tab=2#\\_B79A2C2C-796A-4152-BEEB-93E0C5944753](http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-23.aspx?tab=2#_B79A2C2C-796A-4152-BEEB-93E0C5944753)

<sup>13</sup> See "Interpretive Notice Concerning The Application Of MSRB Rule G-17 To Underwriters of Municipal Securities" (August 2, 2012) ("The disclosure concerning the arm's-length nature of the underwriter-issuer relationship must be made in the earliest stages of the underwriter's relationship with the issuer with respect to an issue (e.g., in a response to a request for proposals or in promotional materials provided to an issuer."), available at [http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx?tab=2#\\_D54ECA7-2CE6-4ED9-BB05-3C9B32FB7BF4](http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-17.aspx?tab=2#_D54ECA7-2CE6-4ED9-BB05-3C9B32FB7BF4).



meaning of the CFTC’s business conduct standards for swap dealers.<sup>14</sup> The CFTC’s business conduct standards include enhanced provisions for swap dealers acting as counterparties to “special entities” (which, in general, include municipal entities but do not include non-governmental obligated persons), including a requirement that the special entity has retained and will rely on the advice of a qualified independent representative.

#### Investment Advisers

The Dodd-Frank Act excluded from the definition of “municipal advisor” any “investment adviser registered under the Investment Advisers Act of 1940.” The final rules provide that (a) this exclusion applies “to the extent that such registered investment adviser . . . is providing investment advice in such capacity” and (b) “investment advice does not include advice concerning whether and how to issue municipal securities, advice concerning the structure, timing and terms of an issuance of municipal securities and other similar matters, advice concerning municipal derivatives, or a solicitation of a municipal entity or obligated person.”

#### Professionals

The adopting release includes guidance on the statutory exclusions applicable to, and additional exemptions for, certain professionals providing advice to municipal entities and obligated persons.

*Accountants.* The Dodd-Frank Act did not exclude accountants from the municipal advisor definition. The final rules exempt accountants from the municipal advisor definition to the extent that an accountant is providing audit or attest services, preparing financial statements or issuing letters for underwriters for a municipal entity or obligated person. The SEC did not extend this exemption to non-attest services provided by accountants, such as tax advice and arbitrage rebate services.

*Attorneys.* The Dodd-Frank Act exempted attorneys offering legal advice or providing services that are of a traditional legal nature. The SEC noted in the adopting release that “legal advice and services of a traditional legal nature in the area of municipal finance inherently involves a financial advice component.” The final rules modify the attorney exemption by adding that the advice with respect to the issuance of municipal securities or municipal financial products be given to a client of such attorney that is a municipal entity, obligated person, or other participant in a municipal securities transaction. The SEC stated, however, that the exemption does not apply if an attorney “represents himself or herself as a financial advisor or financial expert regarding the issuance of municipal securities or municipal financial products.”

*Engineers.* The Dodd-Frank Act excludes engineers providing engineering advice from the municipal advisor definition. In its 2010 proposing release, the SEC proposed a narrow interpretation of this exclusion that would not apply to any activities of an engineer that amounted to municipal advisory activities, citing cash flow modeling or providing information relating to, or feasibility studies that included analyses of, municipal securities or municipal financial products and feasibility studies as

---

<sup>14</sup> *Business Conduct Standards for Swap Dealers and Major Swap Participants*, 77 Fed. Reg. 9734 (Feb. 17, 2012), available at <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2012-1244a.pdf>

activities that would require an engineer to register as a municipal advisor. In the adopting release, the SEC modified its proposed interpretation of the engineering exemption so that providing cash flow analyses or feasibility studies do not *per se* cause an engineer to become a municipal advisor.

The SEC listed the following activities as within the scope of the engineering exception:

- providing advice on the engineering aspects of a project, including estimates of the cost of construction;
- providing feasibility studies that include projections that are based on considerations involving the engineering aspects of a project, such as projections of output capacity, utility project rates, project market demand and project revenues;
- providing funding schedules and cash flow models that anticipate the need for funding at certain junctures; and
- providing information regarding potential tax savings, rebates or discounts on supplies.

However, the SEC also restated its view that certain activities performed by engineers will constitute municipal advisory activities if they involve advice regarding the structure, timing, terms or similar matters concerning municipal financial products or the issuance of municipal securities. The SEC viewed the preparation of “revenue projections to support the structure of an issuance of municipal securities” as municipal advisory activities, and that a feasibility study that included “revenue projections and debt service coverage calculations . . . may suggest municipal advisory activity.” An engineer that provides information discussing financing alternatives may be considered to be making a recommendation that would constitute municipal advisory activity.

#### Vendors and Finance Companies

The SEC stated in the adopting release that it viewed the activities of vendors in advertising, promoting and selling their products to be generally outside the scope of municipal advisory activities. The SEC went on, however, to indicate that:

the provision of advice and recommendations by vendors (or any other person including, for example, lease financing companies affiliated with vendors) to municipal entity or obligated person clients regarding specific financing options for the purchase of products could, depending on the facts and circumstances, be a municipal advisory activity.

The SEC went on to state that certain equipment or lease financings could involve the issuance of a municipal security, and that the provision of advice and recommendations regarding such an issuance could constitute municipal advisory activity.

Unless an exclusion or exemption from the municipal advisor definition is available (*e.g.*, a municipal entity or obligated person represented by an independent registered municipal advisor), vendors and finance companies should consider framing their communications with, and the information

they provide to, municipal entities and obligated persons to provide factual information with regard to their products and services, while avoiding advice or recommendations with respect to the issuance of municipal securities that could be considered to be municipal advisory activities. In addition, vendors and finance companies should also consider providing appropriate written disclosures to their municipal entity and obligated person customers (a) regarding the commercial, arm's-length nature of the proposed transaction, (b) with a disclaimer that the vendor or finance company is not providing any advice or recommendations with respect to the proposed transaction, and (c) that the customer is free to retain its own advisor with respect to the transaction.

## Municipal Advisors

For municipal advisors subject to the final rules, the next several months will present a number of challenges. The SEC's current temporary registration regime for municipal advisors has been extended through December 31, 2014. The permanent registration system for municipal advisors will become effective on July 1, 2014, with a staggered phase-in period for registration based on the registration numbers assigned to municipal advisors when they registered under the temporary registration rules. The first set of municipal advisors are required to be registered under the final rules by July 31, 2014, and all previously-registered advisors are required to be registered under the final rules by October 31, 2014.

The final rules exempt from municipal advisor registration natural persons who are associated persons of a registered municipal advisor who engage in municipal advisory activities solely on behalf of a registered municipal advisor. Municipal advisory firms registering under the final rules will be required to submit detailed information regarding their municipal advisory business and the natural persons engaged in municipal advisory activities on behalf of the firm.

We expect to issue an additional Client Alert on the registration requirements and mechanics under the final rules. Municipal advisors may also want to refer to the MSRB's recently-published registration guide for municipal advisors.<sup>15</sup>

With the SEC's issuance of the final rules, it is expected that the MSRB will re-initiate the municipal advisor rule-making process that began in early 2011 and was subsequently suspended. While municipal advisors have been subject to MSRB G-17, the fair dealing rule, since December 2010,<sup>16</sup> the upcoming MSRB rulemaking is expected to establish a rigorous code of conduct for municipal advisors, including detailed guidance of the scope of their fiduciary duties, as well as prohibitions on certain gifts and gratuities and certain political contributions.<sup>17</sup> We expect to issue additional Client Alerts as the MSRB's rule-makings proceed.

15 *Preparing for Regulation: A Guide for Municipal Advisors*, available at [http://www.msrb.org/msrb1/pdfs/Municipal-Advisor\\_Preparing-for-Regulation.pdf](http://www.msrb.org/msrb1/pdfs/Municipal-Advisor_Preparing-for-Regulation.pdf)

16 See MSRB Notice 2010-59 (December 23, 2010), available at <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-59.aspx>.

17 Information on the MSRB's upcoming municipal advisor rulemaking is available at <http://www.msrb.org/MSRB-For/Municipal-Advisors/MSRB-Draft-Rules.aspx>.

---

## In Conclusion

The SEC's final municipal advisor registration rules are likely to have significant impacts on both the overall landscape of the public finance market and the conduct of issuers, advisors, underwriters and other professionals engaged in specific municipal securities transactions. While the SEC's adopting release provides significant guidance on a range of topics under the final rules, there are a number of areas where additional guidance will be necessary or desirable. We encourage our clients to engage with their industry organizations to promote continuing discussion and dialogue with the SEC and its Office of Municipal Securities to clarify and improve the application of the final rules.

---

## More Information

For additional information regarding the final rules, please call your regular contact at Chapman and Cutler.

# Chapman and Cutler LLP

Attorneys at Law • Focused on Finance®

## Chicago

111 West Monroe Street  
Chicago, IL 60603-4080  
312.845.3000

## Salt Lake City

215 South State Street, Suite 800  
Salt Lake City, UT 84111-2339  
801.533.0066

## Washington, DC

1717 Rhode Island Avenue NW  
Washington, DC 20036-3026  
202.478.6444

## New York

1270 Avenue of the Americas, 30th Floor  
New York, NY 10020-1708  
212.655.6000

## San Francisco

595 Market Street, 26th Floor  
San Francisco, CA 94105-2839  
415.541.0500

[chapman.com](http://chapman.com)

