

Client Alert

Current Issues Relevant to Our Clients

January 15, 2014

SEC Releases Interpretive Guidance on Municipal Advisor Rules

On January 10, 2014, the Staff of the Office of Municipal Securities of the Securities and Exchange Commission released additional guidance on the SEC's registration rules for municipal advisors in the form of responses to Frequently Asked Questions. While the FAQs generally adhere to the positions set out in the SEC's adopting release for the registration rules, the FAQs provide helpful guidance on the "advice" standard, pre-engagement communications by prospective underwriters, certain exemptions and other matters.

Below is a summary of the FAQs by topic. The FAQs can be found [here](#).

Background

Under the SEC's municipal advisor registration rules, 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, under the municipal securities provisions of the Dodd-Frank Act, a municipal advisor is subject to a fiduciary duty to its municipal entity clients. The MSRB has recently issued its proposed Rule G-42 on the fiduciary duty and the other responsibilities of municipal advisors. Our Client Alert on proposed MSRB Rule G-42 can be found [here](#).

The Advice Standard

For the purpose of determining who is a municipal advisor under the registration rules, the SEC has noted that the concept of "advice" is to be construed broadly, and whether a particular communications includes "advice" is an objective determination that is based upon all relevant facts and circumstances. In the adopting release, the SEC stated that "advice" includes, among other things, a *recommendation* tailored to the specific needs, objectives or circumstances of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities. Whether a recommendation has been given is an objective inquiry that takes into account whether, *considering the content, context and manner of presentation*, the information given to a municipal entity or obligated person reasonably would be viewed as a suggestion that the recipient take or refrain from taking action in connection with municipal financial products or the issuance of municipal securities.

The FAQs address some of the circumstances where providing certain types of information would not constitute "advice" under the registration rules.

General Information Exclusion. In the adopting release, the SEC provided that "advice" does not include general information that does not involve a recommendation regarding municipal financial products or the issuance of municipal securities. The FAQs expand this general information exclusion to cover the following types of information:

- information regarding professional qualifications and prior experience involving municipal financial products or issuances of municipal securities, including lists, descriptions, terms and other information regarding prior transactions;
- general market and financial information, including markets statistics regarding issuance activity and current interest rate information for different types of bonds and credits;
- information regarding a financial institution's currently-available investments, including terms, maturities and interest rates, and market prices or price quotes for investments that meet criteria specified by a municipal entity or obligated person;
- factual information describing various types of debt financing structures (*e.g.*, fixed and variable rate debt; tax-backed, revenue-backed and credit-enhanced debt), including a comparison of the general characteristics, risks, advantages and disadvantages of various financing structures; and

- factual and educational information regarding various government financing programs and incentives.

The general information exclusion applies only to factual information that does not include an express recommendation, opinion or view regarding an issuance of municipal securities, a municipal financial product or what alternative may be in the best interest of a municipal entity or obligated person.

Disclosures and Disclaimers. The FAQs provide that the inclusion of the following disclosures and disclaimers in communications with municipal entities or obligated persons would be factors in determining that a communication does not constitute advice for purposes of the registration rules:

- the person providing the information is not recommending an action to the municipal entity or obligated person;
- the person is not acting as an advisor to the municipal entity or the obligated person and does not owe a fiduciary duty pursuant to the registration rules;
- the person is acting for its own interests; and
- the municipal entity or obligated person should discuss any information received with its own internal and external advisors.

The disclosures and disclaimers must be conspicuously stated in written materials that accompany communications to municipal entities and obligated persons. While the disclosures and disclaimers do not create a safe harbor that will prevent information from being considered to constitute a recommendation, the FAQs state that they will weigh against the treatment of the information as a recommendation.

Business Promotional Material Provided by Potential Underwriter. In addition to the general information described above, the FAQs provide that a potential underwriter can provide the following types of information without such information constituting a recommendation or advice:

- an indication of a hypothetical pricing range for a new issue of municipal securities that takes into consideration current market conditions and information particularized to the municipal entity, such as the entity's credit rating, geographic location and market sector;
- information regarding a municipal entity's outstanding securities, such as current market prices and yields;

- information regarding a range of hypothetical interest rates or debt service requirements for a new money debt issuance based on the factors outlined above;
- public information regarding the terms and a range of interest rates for the special U.S. Treasury Securities of the State and Local Government Series for use as refunding escrow investments; and
- mathematical calculations of a municipal entity's potential interest cost savings if it were to refund outstanding debt, provided that the calculations assume the same debt structure as the debt to be refunded.

The FAQs cautioned that care must be taken to ensure that information particularized to a municipal entity or obligated person does not constitute a recommendation. Specifically, the FAQs noted that information regarding a debt refunding must be based on the existing debt structure with the same final maturity of the debt to be refunded to avoid violating the general advice exception. In other words, prospective underwriters (not yet engaged and not operating under the RFP or IRMA exemptions) may provide a "plain vanilla" refunding analysis to a municipal entity or obligated person, but may not provide a refunding analysis that restructures the existing debt.

Additional Disclosures and Disclaimers by Potential Underwriter. The FAQs provide that the inclusion of the following disclosures and disclaimers in business promotional materials provided by a potential underwriter, in addition to the general disclosures and disclaimers discussed above, would be factors weighing against the treatment of promotional materials as a recommendation:

- a statement that the potential underwriter seeks to serve as an underwriter on a future transaction and not as a financial advisor or municipal advisor, consistent with MSRB Rule G-23;
- a description of the arm's length nature of the underwriter's role; and
- a statement that the information provided is for discussion purposes only in anticipation of being engaged to serve as an underwriter.

RFP Exemption

Information, ideas, advice and recommendations that are provided pursuant to a request for proposals or a request for qualifications (either, an "RFP") are exempt from the municipal advisory provisions under the registration rules. The FAQs provide that an RFP process conducted pursuant to the following parameters would generally be consistent with the RFP exemption:

- a municipal entity or obligated person (or municipal advisor acting on such party's behalf) conducts the RFP;
- a particular objective is identified in the RFP;
- the RFP is open for a reasonable, specified period of time (up to six months was suggested as a reasonable period); and
- the RFP involves a competitive process, which can be demonstrated by sending the RFP to at least three reasonably competitive market participants or by posting it on the website of a municipal entity or obligated person.

The use of a more targeted process by a municipal entity is permitted to solicit specific ideas from a smaller group of market participants. The FAQs indicate that a municipal entity may identify specific questions or ideas on which information is requested, and distribute a "mini-RFP" to at least three members of a pre-screened or pre-qualified pool of market participants. A shorter response period not exceeding three months is considered reasonable.

Independent Registered Municipal Advisor Exemption

The FAQs provide the following guidance with respect to the independent registered municipal advisor exemption:

- A person can rely on the independent registered municipal advisor exemption in instances where the municipal advisor serves in a *general* capacity, provided that the scope of the municipal advisor's representation of the municipal entity or obligated person covers advice with respect to the same aspects of the issuance of municipal securities or municipal financial products as the person who is seeking to rely on the exemption and all other requirements of the exemption are met.
- A municipal entity may provide its required representations regarding its representation by and reliance on an independent registered municipal advisor in any reasonable manner, including a single written disclosure to multiple transaction participants. The FAQs state that the disclosure could be posted to a municipal entity's website, but in such case the municipal entity must include an additional statement that it intends for market participants to receive and rely on the disclosure for purposes of the IRMA exemption.
- Transaction participants that have taken the steps necessary to activate the IRMA exemption

may communicate freely with a municipal entity on a planned issuance of municipal securities, even though the entity's registered municipal advisor is not present. In the SEC's view, the municipal entity would subsequently have the opportunity to discuss any issues with its independent registered municipal advisor.

Registered Investment Adviser Exclusion

The FAQs provide that an investment adviser registered under the Investment Advisers Act of 1940 may provide advice on municipal derivatives in an investment portfolio for clients that are municipal entities or obligated persons without registering with the SEC as a municipal advisor. This exclusion does not apply to advice given by a registered investment adviser with respect to a municipal derivative used in connection with an issuance of municipal securities (*e.g.*, an interest rate swap).

Underwriter Exclusion

The FAQs provide helpful guidance on how an underwriter can demonstrate that it meets the underwriter exclusion under the registration rules. The FAQs provide that an engagement of an underwriter may be demonstrated by a preliminary engagement letter or letter of intent between an underwriter and a municipal entity or obligated person, with the following features:

- the engagement letter is executed, approved or acknowledged by the governing body or an authorized officer of the municipal entity or obligated person,
- the engagement letter clearly relates to providing underwriting services, and clearly states the role of the underwriter in the transaction,
- the engagement letter relates to a particular issuance of municipal securities and is not a general engagement for underwriting services that does not relate to a particular transaction, and
- either the engagement letter or a concurrent communication to the municipal entity or obligated person provides all disclosures required under MSRB G-17 regarding the underwriter's role, interests and conflicts.

In the case of conduit issuances, the FAQs provide that the engagement letter may be executed, approved or acknowledged by an authorized officer of the obligated person responsible for municipal finance, even though the selection of the underwriter may be subject to the final approval of the conduit issuer.

The FAQs further provide that an underwriter engagement letter that includes the features described above may also include reasonable conditions or limitations, such as:

- a statement that the engagement is preliminary in nature and that the issuer intends or reasonably expects to engage the broker-dealer as the underwriter for an identified issue of municipal securities,
- a statement specifying that the engagement is subject to conditions, such as formal approval of the selection of the underwriter by the governing body or finalizing the structure of the issue of municipal securities;
- a statement that the engagement is nonbinding and that it can be terminated by either party; or
- a term that limits liability of a party to the engagement letter.

The FAQs also provide that a municipal entity or obligated person may furnish engagement letters to more than one underwriter, provided that it reasonably expects to engage each such underwriter to serve as an underwriter on the identified issue of municipal securities.

Lastly, the FAQs provide that a broker-dealer may establish its engagement as an underwriter by means other than an engagement letter, including an oral or written acknowledgement of engagement from an authorized issuer official. The Staff again emphasized its view that broker-dealers should provide their Rule G-17 disclosures at *or before* the time of engagement.

[Advisor's Fiduciary Duty Precludes Underwriting](#)

The FAQs state that if a broker-dealer "acts as" a municipal advisor to a municipal entity with respect to an issuance of municipal securities, it owes a fiduciary duty to the municipal entity with respect to that issue and must not take any action inconsistent with its fiduciary duty. Accordingly, the fiduciary duty itself would preclude such a broker-dealer from serving as an underwriter for the same issuance of municipal securities, in addition to the prohibitions on role-switching contained in MSRB Rule G-23.

[Post-Issuance Advice by Underwriters](#)

The FAQs provide that an underwriter for an issuance of municipal securities would be permitted to advise a municipal entity that the offering document for such municipal securities should be supplemented to correct a material omission, even if such advice is provided after the end of the underwriting period. The Staff considers such

advice to be an integral part of an underwriter's responsibility in connection with an issuance of municipal securities, and further promotes compliance with the anti-fraud provisions of the federal securities laws. Similarly, an underwriter, while performing due diligence with respect to a new issuance of municipal securities, may advise a municipal entity to take corrective actions in connection with a missed filing under a continuing disclosure undertaking for a previous issuance of municipal securities.

Additionally, an underwriter is permitted to assist a municipal entity with its continuing disclosure obligations so long as the underwriter adheres to the general advice standard. Underwriters may provide specific factual information required to complete an annual disclosure filing, but may not provide subjective assumptions, opinions or views, and may not advise a municipal entity as to whether a particular event is a "material event" that requires disclosure under SEC Rule 15c2-12.

[Remarketing Agents](#)

The FAQs confirm the SEC's view in the adopting release that actions taken by remarketing agents such as setting the interest rates and remarketing tendered bonds are not municipal advisory activity. While a remarketing agent may provide factual information regarding market conditions and how the interest rate would be impacted by a change in interest rate modes or a change in the liquidity facility provider, it may not provide advice recommendations or opinions regarding changes in interest rate mode or other matters relating to an issuance of municipal securities or a municipal financial product. Specifically, the FAQs state that the underwriter exemption does *not* apply to remarketing agents.

[Opinions by Citizens in Public Discourse](#)

The FAQs confirm that the registration rules are not intended to impede public discourse. Concerned citizens, business owners and community leaders may publish opinions or make public comments supporting or opposing the issuance of municipal securities without triggering the municipal advisor rule's registration requirement.

[Effective Date of the Registration Rules and Compliance Period for Using the Final Registration Forms](#)

The municipal advisor registration rules were scheduled to become effective on January 13, 2014. On that date, the SEC stayed the registration rules until July 1, meaning that market participants are not required to comply with the registration rules until July 1, 2014. From and after that date, the registration rules will apply to any person interacting with a municipal entity or obligated person in a

manner and with regard to transactions that are considered to be municipal advisory activity. We encourage market participants to implement their compliance procedures prior to July 1, 2014 in order to be positioned to comply with the registration rules on July 1, particularly with regard to transactions that will be in process on July 1.

Municipal advisors, unless already registered, must register with the SEC using the temporary registration forms. Phased-in registration under the final registration rules and forms begins on July 1, 2014.

Takeaways

The SEC will focus its determination of what constitutes “advice” on whether or not a “recommendation” was made to the municipal entity or obligated person. Persons providing information specifically tailored to a municipal entity or obligated person must use due care to avoid providing a recommendation and should also provide appropriate disclaimers.

Underwriters seeking to use the underwriter exclusion from the registration rules should strongly consider using the underwriting engagement letter described in the FAQs. The engagement letter should clearly outline the underwriter’s engagement with respect to a particular issuance of municipal securities.

The SEC seemingly will grant substantial leeway to underwriters advising municipal entities and obligated persons with respect to the accurate documentation of continuing disclosure violations. Underwriters are permitted to advise municipal entities or obligated persons of these violations even if such advice is provided after the end of the underwriting period or pertains to a previous issuance of municipal securities. However, underwriters should adhere to the general information standard when assisting municipal entities or obligated persons with their continuing disclosure obligations in the normal course of business.

Our whitepaper on the municipal advisor registration rules can be found [here](#).

For More Information

Please contact your primary attorney at Chapman and Cutler if you have any questions on the municipal advisor registration rules or the FAQs.

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