

The Securities and Exchange Commission (SEC) unanimously approved the regulatory regime for municipal advisors on September 18, 2013 and allayed concerns raised in the proposed rule regarding the treatment of appointed issuer officials. The release announcing the revised rule (the "Release"), posted on the SEC's website two days later, is nearly 800 pages long. The rule will take effect 60 days after official publication in the Federal Register (which has not yet occurred).

The final rule replaces the proposed rule, published in late December 2010, which was met with a firestorm of criticism from municipal issuer groups and their advocates over the treatment of appointed board members of municipal and other public bond-issuing authorities. The proposed rule garnered more than 1,000 comment letters, the majority of which addressed the issue of appointed board members. After considering the comments, the SEC decided to exempt from the definition of municipal advisor "all members of a municipal entity's governing body, its advisory boards and its committees, as well as persons serving in a similar official capacity with respect to the municipal entity, to the extent they are acting within the scope of their official capacity, regardless of whether such members or officials are employees of the municipal entity."

The Securities Exchange Act of 1934, as amended by the Dodd Frank Act, defines "municipal advisor" as "a person (who is not a municipal entity or an employee of a municipal entity) that (i) 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, or (ii) undertakes a solicitation of a municipal entity or obligated person." The commentary contained in the Release provides guidance and interpretation as to the extent and coverage of the rule and, in some circumstances, specific exemptions under the authority granted to the SEC by the Dodd Frank Act.

For example, the Release includes commentary on the definitions of the terms "municipal entity," "advice," and "municipal financial products." A charter school created as a corporate instrumentality of a political subdivision would be a "municipal entity" under the rule. The term "Municipal Financial Products" includes "guaranteed investment contracts" and "investment strategies" which, in the proposed rule, were defined very broadly to include virtually any investment by a municipal entity (including pension plans). The final rule limits these terms to products relating to investment of municipal bond proceeds.

Although the SEC clearly reviewed and understood the concerns raised in the comment letters submitted following release of the proposed rule, there remains uncertainty regarding the extent of the rule and its application to certain activities commonly performed by attorneys and underwriters including the following:

- Unsolicited pitches by underwriters to municipal issuers may be limited (or eliminated) which may impede the ability of municipal issuers to receive, review and respond to refunding and/or restructuring opportunities.
- Frank analysis and discussion by attorneys regarding financial aspects of a transaction may be chilled, thereby denying municipal issuers the opinions and observations of their counsel who already has a fiduciary duty to the municipal issuer.

These and other questions raised may only be resolved through additional guidance from the SEC. It is expected that several interested groups will be seeking such guidance from the SEC on the application of the rule to specific circumstances. If you have questions about the rule please contact the Squire Sanders attorney with whom you work.

Some of the highlights of the Release are summarized below.

Advice Standard

Although some commenters urged the SEC to clarify and, in some cases, narrow what it means to "provide advice," the SEC stated the term "advice" is not susceptible to a "bright-line definition." Rather, the SEC provided clarification and interpretation of what it believes is not advice. Under the rule and the SEC's interpretation, the following would be considered "general information" and not "advice" for purposes of the rule.

- 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; and
- General information in the nature of educational materials.

Exemption of Public Officials and Employees of Municipal Entities and Obligated Persons

After considering the avalanche of comments on this particular topic, the SEC utilized its exemption authority under the Dodd Frank Act to exempt from the definition of municipal advisor all members of a municipal entity's governing body, its advisory boards and its committees, as well as persons serving in a similar official capacity with respect to the municipal entity, to the extent they are acting within the scope of their official capacity, regardless of whether such members or officials are employees of the municipal entity.

Specifically, Rule 15Ba1-1(d)(3)(ii) exempts from the definition of municipal advisor “[a]ny 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 or obligated person to the extent that such person is acting within the scope of such person’s official capacity” and “any employee of a municipal entity or obligated person to the extent that such person is acting within the scope of such person’s employment.”

The exemption extends to advice given by an employee of a municipal entity or obligated person to another municipal entity provided the provision of such advice is within the scope of his or her official duties or employment.

The exemption extends to all designees of public officials or members of a municipal entity’s governing body, “to the extent such designation is made pursuant to existing rules of the municipal entity for designating or delegating authority.”

The SEC also delivered support for public comment forums provided by municipal entities and responses by former board members relating to past debt issuances, determining that such activities should not be construed as “advice.”

Responses to RFPs and RFQs

The rule specifically exempts any person providing responses to RFPs and RFQs from the definition of “municipal advisor” so long as that person is not compensated, directly or indirectly for advice provided as part of the response. According to the SEC, this includes “mini-RFPs” among a select group. Interestingly, the SEC states that assisting a municipal entity with preparing an RFP or evaluating responses and participating in the selection of a broker-dealer, investment advisor or financial advisor “could” constitute municipal advisory activities for which registration or another exemption would be required.

Municipal Entity Represented by an Independent Municipal Advisor

The regulation exempts from the rule any person providing advice if the municipal entity is otherwise represented by an independent registered municipal advisor, provided certain disclosures are made and written acknowledgement is provided. Some have interpreted this as an indirect mandate for municipal entities to employ a municipal advisor. However, SEC staff has stated publicly no such mandate was intended.

Broker Dealer serving as Underwriter

The underwriter exception excludes 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.”

A few points on this exemption:

- The broker-deal must be engaged for a specific transaction. Simply being in the “underwriting pool” is not sufficient.
- The exemption does not cover advice on investment strategies, advice on municipal derivatives or advice otherwise identified by the SEC to be outside the scope of an underwriting.

- Activities that “are integral to the purchase and distribution of a particular issuance of municipal securities on which a broker, dealer, or municipal securities dealer is engaged to serve in the capacity as underwriter” will be considered by the SEC as within the scope of an underwriting, as well as activities that are integral to fulfilling the role of an underwriter, such as the obligations of underwriters under the antifraud provisions of the federal securities laws and obligations of underwriters under Municipal Securities Rulemaking Board rules.
- The following activities were specifically mentioned in the Release to be within the scope of the underwriting exclusion: “(1) advice regarding the structure, timing, terms, and other similar matters concerning a particular issuance of municipal securities (except as otherwise provided [herein] with respect to advice on investment strategies, municipal derivatives, or other activities identified by the Commission as outside the scope of an underwriting); (2) preparation of rating strategies and presentations related to the issuance being underwritten; (3) preparations for and assistance with investor ‘road shows’ and investor discussions related to the issuance being underwritten; (4) advice regarding retail order periods and institutional marketing if the municipal entity has determined to engage in a negotiated sale; (5) assistance in the preparation of the preliminary and final official statements for the municipal securities; (6) assistance with the closing of the issuance of municipal securities, including negotiation and discussion with respect to all documents, certificates, and opinions needed for such closing; (7) coordination with respect to obtaining CUSIP numbers and the registration of the issue of municipal securities with the book-entry only system of the Depository Trust Company; (8) preparation of post-sale reports for such municipal securities; and (9) 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).”
- The following activities are considered by the SEC to be outside the scope of the underwriter exclusion: “(1) advice on investment strategies; (2) advice on municipal derivatives (including derivative valuation services); (3) advice on what method of sale (competitive sale or negotiated sale) a municipal entity should use for an issuance of municipal securities; (4) advice on whether a governing body of a municipal entity or obligated person should approve or authorize an issuance of municipal securities; (5) advice on a bond election campaign; (6) advice that is not specific to a particular issuance of municipal securities on which a person is serving as underwriter and 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; (7) assisting issuers with competitive sales, including bid verification, true interest cost (TIC) calculations and reconciliations, verifications of bidding platform calculations, and preparation of notices of sale; (8) preparation of financial feasibility analyses with respect to new projects; (9) budget planning and analyses and budget implementation issues with respect to debt issuance and collateral budgetary impacts; (10) advice on an overall rating strategy that is not related to a particular issuance of municipal securities on which a person is serving as an underwriter, including advice and actions taken on behalf of a municipal entity or obligated person between financing transactions;

(11) advice on overall financial controls that are not related to a particular issuance of municipal securities on which a person is serving as an underwriter; or (12) advice regarding the terms of requests for proposals or requests for qualification for the selection of underwriters or other professionals for a project financing and advice regarding review of responses to such requests, including matters regarding compensation of such underwriters or other professionals.”

Registered Investment Advisors

Investment advisors registered under the Investment Company Act of 1940 providing investment advice are excluded. Some commenters wanted state registered advisors also exempt, however, the SEC declined to extend the exemption.

Registered Commodity Trading Advisors; Swap Dealers

Commodity trading advisors registered under the Commodity Trading Act are exempt with respect to advice given regarding interest rate swaps. Note that commodity trading advisors who are exempt from registration under the Commodity Trading Act are not exempt under the municipal advisor rules.

Additionally, although not specifically exempted in the original proposal, the SEC has provided an exemption to swap dealers registered under the Commodity Exchange Act, so long as they are not acting as an advisor (determined by treating the municipal entity or obligated person as a “special entity” under the Commodity Exchange Act).

Accountants and Engineers

Accountants are exempt from the rule to the extent that the accountant is providing audit or other attest services, preparing financial statements, or issuing letters for underwriters for, or on behalf of, a municipal entity or obligated person.

Engineers are excluded from the definition to the extent that the engineer is providing engineering advice which, according to the Release, includes preparation of project feasibility reports, however, revenue projections (including debt service coverage projections) may be considered outside the scope of “engineering advice” and would need to fall under another exemption such as the presence of a registered municipal advisor.

Attorneys

Attorneys are excluded from the definition to the extent that the attorney is “offering legal advice or providing services that are of a traditional legal nature with respect to the issuance of municipal securities or municipal financial products to a client of such attorney that is a municipal entity, obligated person, or other participant in the transaction.” However, representing oneself as a financial advisor or financial expert regarding the issuance of municipal securities or municipal financial products is outside the exclusion.

The SEC cites the following activities as primarily financial in nature: “(1) the financial feasibility of a project or financing; (2) advice estimating or comparing the relative cost to maturity of an issuance of municipal securities depending on various interest rate assumptions; (3) advice recommending a particular structure as being financially advantageous under prevailing market conditions; (4) advice regarding the financial aspects of pursuing a competitive sale versus a negotiated sale; and (5) other types of financial advice that are not related to the attorney’s provision of legal advice and services of a traditional legal nature.”

The SEC’s guidance on what activity would be included within the attorney exception includes (1) analysis, discussion, negotiation, and advice regarding the legal ramifications of the structure, timing, terms, and other provisions of a financial transaction; (2) the preparation of various documents including basic legal documents, disclosure documents, various closing certificates and legal opinions with respect to the transaction; (3) advice and documentation with respect to post-closing policies and procedures and (4) advice and related legal services regarding federal tax requirements for issues of municipal securities, including advice and services relating to arbitrage rebate.

Until additional guidance is provided from the SEC on the scope of the attorney exclusion or unless another exemption or exclusion applies, frank analysis and discussion by attorneys regarding financial aspects of a transaction may be chilled, thereby denying municipal issuers the opinions and observations of their counsel, who already has a fiduciary duty to the municipal issuer.

Banks

Any bank, as defined in section 3(a)(6) of the Securities Exchange Act, is excluded to the extent the bank provides advice with respect to the following: (1) Any investments that are held in a deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank; (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; (3) Any funds held in a sweep account that meets the requirements of section 3(a)(4)(B)(v) of the Securities Exchange Act; or (4) Any investment made by a bank acting in the capacity of an indenture trustee or similar capacity.