

## **Background and Overview**

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Who Bears Risk of Non-Compliance?

What Kind of Advice Requires Registration?

What General Information Does Not Require Registration?

### **I. Background**

- A. Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Securities Exchange Act of 1934 to add a new requirement that “municipal advisors” register with the SEC effective October 1, 2010
- B. Response to the 2008 economic crisis
- C. Imposes a fiduciary duty on municipal advisors when advising municipal entities

### **II. Effective Dates**

- A. On September 20, 2013, the SEC adopted final rules (the “Final Rules”) for municipal advisor registration to interpret the statutory definition of the term “municipal advisor”.
- B. The Final Rules were effective on January 13, 2014; however on January 13, 2014, the SEC temporarily stayed the Final Rules until July 1, 2014.
- C. FAQs issued by SEC on January 16, 2014 and updated on May 19, 2014.
- D. Compliance with the Final Rules begins on July 1, 2014 with a phased-in compliance period beginning on July 1, 2014 and ending on October 31, 2014 for municipal advisors to comply with the requirement to register as municipal advisors.

### **III. Who is a “Municipal Advisor”?**

- A. Exchange Act Section 15B(e)(4) defines the term “municipal advisor” to mean, in part,

1. a person (who is not a municipal entity or an employee of a municipal entity ) that<sup>1</sup>
  - a. 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
  - b. undertakes a **solicitation** of a municipal entity or obligated person;
  - c. unless exempted or excluded (see below), a municipal advisor must register with the SEC.

**IV. Who is a “Municipal Entity”?**

- A. Any State, political subdivision of a State, or municipal corporate instrumentality of a State, including:
  1. any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality;
  2. any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and
  3. any other Issuer of municipal securities.

**V. What are Municipal financial products?**

1. municipal derivatives,
  2. guaranteed investment contracts and
  3. investment strategies.
- A. What is Advice related to the **issuance of municipal securities** includes advice with respect to the structure, timing, terms and other similar matters concerning such financial products or issues.
  - B. **Specific exclusions and exemptions** to the definition include:
    1. municipal entity or all employees of a municipal entity, governing body members and officials
    2. underwriters

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<sup>1</sup> This includes all employees, governing body members and other officials of municipal entities and obligated persons to the extent that they act within the scope of their employment or official capacity.

3. registered investment advisers
  4. registered commodity trading advisors
  5. attorneys
  6. engineers
  7. accountants
  8. banks
  9. swap dealers
- C. What Kind of Advice Requires Registration and What General Information Does Not
1. The Advice Standard:
    - a. “advice” is not susceptible to a bright-line definition and can be construed broadly.
    - b. for purposes of the municipal advisor definition, advice includes, without limitation, a **recommendation** that is particularized to the specific needs, objectives, or circumstance of a municipal entity or obligated person with respect to **municipal financial products** or the **issuance of municipal securities**, including with respect to the structure, timing, terms and other similar matters concerning such financial products or issues, based on all facts and circumstances.
    - c. “Advice” excludes, among other things, the provision of general information that does not involve a recommendation regarding municipal financial products or the issuance of municipal securities.
  2. Examples of general information:
    - a. information of a factual nature
    - b. information that is not particularized to a specific municipal entity or type of municipal entity
    - c. information that is widely disseminated
    - d. general information in the nature of educational materials

- D. Certain **key elements** to consider in determining if a “**recommendation**” has occurred:
1. The determination is objective rather than subjective.
  2. Consider the content, context and manner of presentation, the information communicated to the municipal entity or obligated person reasonably 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.
  3. The more individually tailored and specific the information is to an entity or a targeted group of entities that share common characteristics (e.g. school districts or counties), the more likely it will be a recommendation that constitutes advice
- E. Who Bears Risk of Non-Compliance
1. Issuers are not responsible for non-compliance with registration by municipal advisors.
  2. Registration of entities and individuals or natural persons are exempted if associated with a registered municipal advisor and engage in activities solely on behalf of the registered municipal advisor.
- F. Examples
1. The SEC FAQs provide that a person could rely on the general information exclusion from advice under the Final Rules when providing a municipal entity or obligated person with information that does not involve a recommendation, such as factual information that does not contain subjective assumptions, opinions or views. Examples of this type include:
    - a. How will the advice standard affect how you work with underwriters and municipal advisors? What will underwriters be looking for to determine whether an Issuer has engaged a municipal advisor? What would be most beneficial, a deal specific engagement or a general engagement of a municipal advisor? How will underwriters

Absent any other exemption or exclusion:

    - i. If an entity provides advice to a municipal entity with respect to an interest rate swap, it will be required to register.

- ii. If an entity provides advice with respect to the investment or brokerage of escrow refunding securities, it will be required to register.

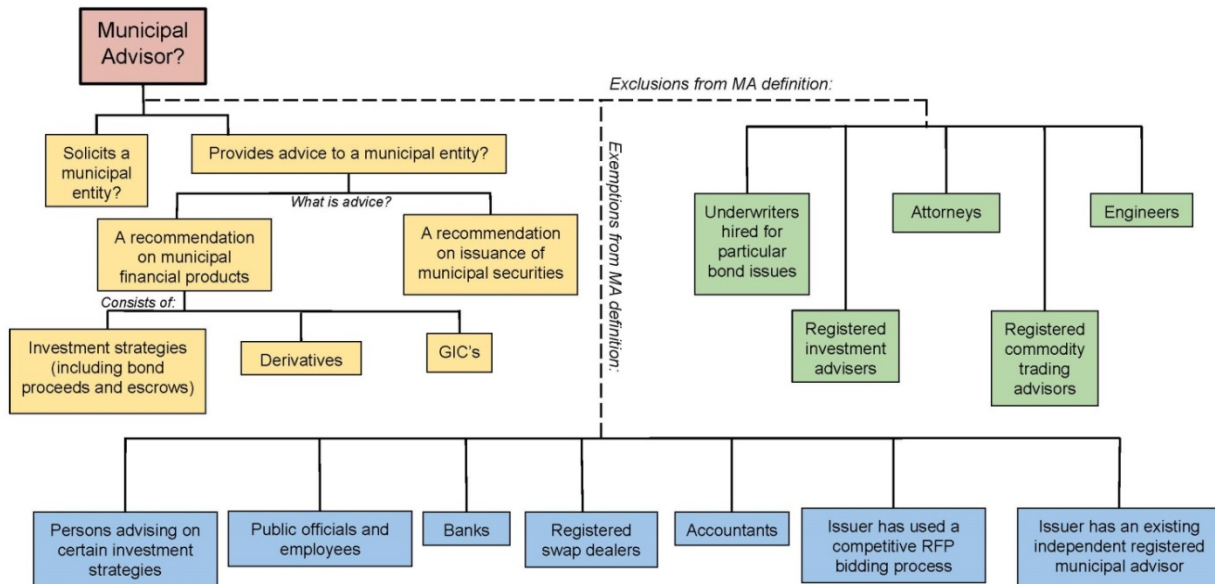
**Exemptions and Exclusions from the MA Rule**

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**IMPORTANT:** This chart is an oversimplification of the Municipal Advisor rule. In particular, numerous additional requirements must be met in order for the exclusions and exemptions described above to apply. Please consult the text of the rule and your legal advisor.

**I. The MA Rule contains about a dozen exceptions (called “exemptions” or “exclusions”). The exceptions likely to be the most commonly used are described below.**

**A. Exemption for Responses to RFPs:**

1. “Any person providing a response in writing or orally to a request for proposals or qualifications from a municipal entity or obligated person for services in connection with a municipal financial product or the issuance of municipal securities; provided however, that such person does not receive separate direct or indirect compensation for advice provided as part of such response.”
2. Rationale:
  - a. RFP’s are a competitive process

- b. Winning bidder will need to register as MA unless another exemption applies
    - c. RFP responders are likely to be regulated in other ways
  - 3. Communications covered by this exemption include:
    - a. The RFP response itself
    - b. Communications between the bidder and the Issuer or the Issuer's registered MA prior to and after the RFP response is made.
  - 4. Requirements for normal RFP:
    - a. RFP responder may not be compensated for responding to the RFP
    - b. RFP must be conducted by municipal entity or a registered MA on its behalf
    - c. RFP must identify a particular objective (e.g., how to structure an issuance for an identified capital project)
    - d. RFP must be a competitive process (at least 3 competitive market participants)
  - 5. Requirements for "mini-RFP:"
    - a. A mini-RFP is distributed only to a pre-selected pool of underwriters.
    - b. Requirements are the same as a normal RFP, except that it must be sent to the entire pool, or at least 3 members of the pool.
  - 6. Duties of Issuers under this exemption:
    - a. Issuers should inform anyone wanting to use this exemption that it sent bids to at least 3 bidders.
    - b. Issuer appears to have no duty to determine whether those bidders are "reasonably competitive."
- B. Exclusion if Registered Municipal Advisor Already Retained
  - 1. A person is not a municipal advisor if they are "engaging in municipal advisory activities in a circumstance in which a municipal entity or obligated person is otherwise represented by an independent registered

municipal advisor with respect to the same aspects of a municipal financial product or an issuance of municipal securities.”

2. Rationale:
  - a. The municipal entity is already being advised by a registered MA, so other parties do not need to so register.
3. Communications covered by this exemption include:
  - a. The underwriter may discuss the planned financing without the independent registered MA present if the municipal entity does not object.
  - b. This exclusion is broad since the issuer already has a registered MA upon which to rely for advice.
    - i. Requirements:
      - (1) The existing MA must be registered and must not have been associated with the person using this exemption for at least 2 years. Detailed guidance has been issued defining what it means to be “associated” with a party.
      - (2) The existing MA may be “on retainer” in a general capacity, or may be hired for a specific bond issue.
      - (3) The person using this exemption must receive a written representation from the municipal entity that it’s represented by, and will rely on the advice of, the independent registered MA.
        - (a) One representation can be relied upon by multiple parties, and the municipal entity can post the representation on its website.
        - (b) Other methods should be permissible, e.g., including the representation in a Notice of Sale for a competitive issue.
        - (c) “Rely on” means that the municipal entity will seek and consider the advice, analysis and perspective of the independent registered MA. But it is not required to

follow the advice of the independent registered MA.

(4) The person using this exemption must provide written disclosures to the municipal entity stating:

- (a) It is not a MA
- (b) It is not subject to the MA fiduciary duty
- (c) Disclosure must be made at a time and in a manner to allow the municipal entity to assess incentives and conflicts of interest

ii. Duties of Issuers under this exemption:

(1) Make the written representation to the market participant described above.

c. Exemptions or Exclusions for Certain Persons

i. Underwriter Exclusion:

(1) “Municipal advisor” shall not include 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.”

(2) Rationale: underwriters should be allowed to provide advice, but only pertaining to a certain issue and only for underwriting activities. One purpose of Dodd-Frank was to prevent underwriters from giving derivatives advice.

(3) Application to broker-dealers acting in other roles:

- (a) Applies to broker-dealers acting as placement agents.
- (b) Broker-dealers acting as remarketing agents are not municipal advisors if the activity is truly a remarketing and no advice is given except the new price for the bonds.



- (4) Requirements:
  - (a) Underwriter must be engaged by the Issuer. This can be oral or by email so long as the underwriter has provided the MSRB G-17 disclosures to the Issuer.
  - (b) Best way to prove an engagement is with a written agreement, engagement letter or letter of intent.
  - (c) The agreement should contain the following features:
    - (i) Governing body has acknowledged or signed the agreement (can be obligated person for a conduit issuance).
    - (ii) Must relate to underwriting services
    - (iii) Must clearly state role of the broker-dealer
    - (iv) Must relate to a particular issuance of securities; cannot be a general engagement for underwriting services.
    - (v) Must contain MSRB Rule G-17 disclosures regarding compensation and conflicts of interest
  - (d) The agreement may contain limitations:
    - (i) May be preliminary in nature
    - (ii) May be subject to conditions
    - (iii) May be nonbinding and terminable
    - (iv) May limit the liability of a party
- (5) Underwriters *may* do the following:
  - (a) Provide advice with respect to the structure, timing, terms, and other similar matters

- concerning that issuance of municipal securities.
  - (b) Prepare rating agency presentations.
  - (c) Prepare investor “road shows” and discuss the issuance with investors.
  - (d) Provide advice for retail sales and institutional sales for negotiated offerings.
  - (e) Assist with closings and closing documents.
  - (f) Arrange for CUSIP numbers and DTC book entry.
  - (g) Prepare post-sale reports.
  - (h) Structure refunding escrows (excluding the provision of securities for the escrow).
  - (i) Includes activities integral to the underwriter role.
  - (j) Includes fulfillment by the underwriter of its anti-fraud responsibilities.
  - (k) Solicit Issuers for new business, so long as the solicitation is limited to the underwriter’s overall experience and abilities, and is limited to general market conditions.
- (6) Underwriters *may not* provide the following advice under this exemption in the following areas:
- (a) Investment strategies.
  - (b) Derivatives.
  - (c) Competitive sale versus negotiated sale.
  - (d) Whether the governing body should approve the bonds
  - (e) Bond election campaigns

- (f) 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
  - (g) Assisting Issuers with competitive sales
  - (h) Preparation of feasibility studies
  - (i) Assisting Issuers with budgets or budget impacts
  - (j) Ratings strategy not related to the particular bond issue
  - (k) Financial controls of the Issuer not related to the particular bond issue
  - (l) Assisting Issuers with RFPs
- (7) Post-issuance activities:
- (a) If the bond issue has closed and the underwriting period has ended, the underwriting exemption has also ended.
  - (b) Continuing disclosure assistance: Post-issuance advice on continuing disclosure is generally outside of the exemption, but assisting the Issuer with preparing objective, factual information for annual filings is not an MA activity. Underwriters may (i) remind Issuers of continuing disclosure obligations, (ii) assist with EMMA filings and (iii) notify Issuers whether their filings appear on EMMA.
  - (c) Activities integrally related to the issuance (such as updating an error in the Official Statement discovered after the close of the underwriting period) would still fall within the exemption.

- (8) If an underwriting firm has already served as MA to the Issuer in the early stages of a financing, it may not use the underwriter exemption.
- ii. Investment Adviser exclusion:
  - (1) Must be registered under the Investment Adviser Act of 1940
  - (2) Investment advice does not include advice on structuring bonds and does not include advice on derivatives
- iii. Public officials and employees exemption
- iv. Banks exemption:
  - (1) Banks are exempt from the MA rule with regard to traditional bank lending activities. These include providing advice with respect to the following activities:
    - (a) Investments in deposit accounts
    - (b) Loans, letters of credit and purchases of bonds for the bank's own account (including advice to the Issuer regarding the structure, timing and terms of that particular loan or bond issue, but not others)
      - (i) Is a bank which participates some of its exposure on the loan to another bank buying for its own account? Or does the loan exception prevail?
    - (c) Sweep accounts
    - (d) Investments made by the bank in its role as indenture trustee
  - (2) This exemption does not include advice by banks on derivatives
  - (3) Banks which offer MA services may register as an MA only in the name of the "separately identifiable division" of the bank.

- v. Registered Commodity Trading Advisor exclusion
- vi. Registered Swap Dealers exemption
- vii. Attorney exclusion (covers services of a “traditional legal nature”)
- viii. Accountants exclusion
- ix. Engineer exclusion

## **Documenting Compliance**

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The Independent Registered Municipal Advisor Exemption permits free flow of information between market participants and municipalities when the municipality is represented by an independent registered municipal advisor.

### **I. What kinds of new behaviors will Issuers see from underwriters?**

#### **A. Clarification of Roles of Players**

1. Municipal Advisor - A person is required to register as a municipal advisor if the person provides advice on:
  - a. issuance of municipal securities, including structure, timing, terms, and other similar matters with respect to such issuance (interpreted broadly time-wise, from early planning to bond redemption);
  - b. investments of proceeds of municipal securities and the recommendation of and brokerage of municipal escrow investments under “investment strategies” definition; and
  - c. municipal derivatives (swaps and security-based swaps).
2. Market Participants/Underwriters - Underwriters may communicate with issuers about general market issues, facts and ideas.
  - a. Unless an exemption is met, underwriters cannot provide advice with respect to the structure, timing, terms and other similar transaction related matters or advise a government to take a specific action such as whether to pursue a negotiated or

competitive sale. In order to give such advice, the underwriter must be engaged by the Issuer. This engagement may be oral or written.

- b. In the past, underwriters often gave general advice to issuers related to the issuance of bonds and other financial matters, whether or not related to a particular series of bonds. Now, the underwriter's role is limited to providing advice relating to the underwriting of a particular transaction.

- B. Underwriter Engagement Letter/Letter of Intent ("Letter"):
  1. proves that the Underwriter is engaged by the Issuer and insures that the underwriter exemption applies.
  2. should be entered into at preliminary stage of transaction.
  3. provides that the underwriter is not acting as municipal advisor, does not owe a fiduciary duty to the issuer with respect to the advice it provides and discloses any potential conflicts of interest.
  4. The underwriter is required to provide a copy of the Letter to the issuer and the issuer's municipal advisor.

## **II. What will Issuers be asked to do?**

- A. Sign Underwriter Engagement Letter/Letter of Intent.
- B. Provide written representation that the municipality is represented by a municipal advisor prior to receiving certain types of advice or recommendations from an underwriter or other professional.
  1. For example, the Letter may state that: "The purpose of this letter is to advise you that the Issuer is being represented by, and will rely on the advice of \_\_\_\_\_ (the 'Independent Municipal Advisor') with respect to the issuance of the Bonds. The Issuer understands that the Independent Municipal Advisor is a municipal advisor registered pursuant to Section 15B of the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder."
  2. An issuer may post this representation on their web site as long as the posting states that the representation is intended to establish the independent municipal advisor exemption.
- C. Consider rule in drafting RFPs or RFQs for Underwriters (including mini RFPs)

1. Response to Request for Proposals Exemption: “This RFP is being conducted by the Issuer and is intended to meet the requirements for the Rules ‘request for proposals’ exemption.”
  2. Represented by an Independent Registered Municipal Advisor Exemption: “The Issuer has engaged, is represented by and will rely on the advice of an independent registered municipal advisor to advise it on the issuance of the Bonds and the RFP. The Issuer intends that (i) this statement constitutes the ‘required representation’ for purposes of the ‘represented by an independent registered municipal advisor’ exemption set forth in the Rule and (ii) persons responding or considering responding to this RFP and all other market participants may rely on this written statement and receive and use it for purposes of that exemption.”
  3. Disclaimer: “Each RFP participant should consult with its own advisors in determining (i) whether one or more of the above exemptions are available to that RFP participant and (ii) other requirements for the applicable exemption(s) to be available to that RFP participant.”
- D. Upon request, represent to brokers in writing that the monies regarding which they are providing investment advice are not bond proceeds or in escrows to pay for bonds.

**III. Will this increase costs and the number of professionals to be retained by Issuers?**

- A. Municipal Securities Transactions
1. The SEC recommends that issuers engage a municipal advisor prior to undertaking a debt financing unless the issuer has sufficient in-house expertise.
  2. Many issuers have financial advisors that are registered municipal advisors.
  3. State and local government employees, board and committee members, and others are exempted from the rule when acting in their official capacities.
- B. Investments or Brokerage of Refunding Securities and Interest Rate SWAPs
1. Advisors investing the proceeds of municipal securities and escrows must register with the SEC as municipal advisors.
  2. Advisors and brokers providing investment advice relating to monies which are not bond proceeds or in escrows to pay for bonds do not need to register with the SEC as municipal advisors.

**IV. Application of MA rule to public sales**

- A. Negotiated Sale Transaction - Bond Purchase Agreement (BPA) language:
1. Issuer is free to engage a municipal advisor: “If the Issuer would like a municipal advisor in this transaction that has legal fiduciaries duties to the Issuer, then the Issuer is free to engage a municipal advisor to serve in that capacity.”
  2. Acknowledging receipt of Letters of Intent/Engagement Letters: “The Issuer has received and acknowledged the Letter of Intent dated \_\_\_\_\_ and delivered by the underwriter.”
- B. Competitive Sale Transaction - Notice of Sale (NOS) language:
1. Issuer is Represented by Independent Registered Municipal Advisor. “The Issuer has engaged, is represented by and will rely on the advice of \_\_\_\_\_, an independent registered municipal advisor, to advise it on the issuance of the Bonds offered for sale in this Notice, and other aspects of the financing for which the Bonds are being issued. The Issuer intends that (i) this statement constitutes the ‘required representation’ for purposes of the independent registered municipal advisor exemption set forth in SEC Rule 15Ba1-1(d)(3) and (ii) prospective bidders and other market participants may rely on this written statement and receive and use it for purposes of that exemption.”
- C. Investment of Bond Proceeds
1. Issuers should separate bond from other investment proceeds.
  2. A municipal advisor must advise issuers on the investment of bond proceeds unless an exception or exemption applies.

**The SEC’s Municipalities Continuing Disclosure Cooperation Initiative**

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**I. Introduction**

- A. Description of Prisoner’s Dilemma
- B. Tension between Issuers and Underwriters was intentionally created by SEC



**II. Background Regarding Continuing Disclosure in the Municipal Market**

- A. Municipal Exemption from the Securities Act
- B. Rule 15c2-12 (brief description including required filings and disclosure obligation)
- C. NRMSR Issues
- D. EMMA launch
- E. SEC's 2012 Report on the Municipal Securities Market
- F. West Clark and City Securities Settlements
- G. MCDC Initiative (allow Issuers and underwriters to "clean up" past compliance lapses and "reset" into good compliance)

**III. What is the Initiative?**

- A. Offer by SEC's Division of Enforcement to recommend settlement terms to Issuers and underwriters arising out of materially inaccurate statements in official statements relating to compliance with Rule 15c2-12 continuing disclosure obligations if such potential violations are self-reported prior to September 10, 2014
- B. Settlement terms include consent to cease and desist proceeding in which self-reporting entity neither admits or denies the SEC findings
- C. Harsher settlement terms after September 10, 2014 are likely

**IV. What the Initiative Isn't**

- A. Protection for Individual Issuer officials or employees of the Underwriter
- B. Protection from other agencies
- C. Protection from an SEC enforcement action relating to any other misstatement or omission
- D. Protection against being asked to testify under oath in SEC investigation against other deal participants

**V. Issuer Must Also Agree to:**

- A. Establish appropriate policies, procedures and training regarding continuing disclosure within 180 days

- B. Update past delinquent filings within 180 days
- C. Cooperate with any subsequent SEC investigation including roles of other deal participants
- D. Disclose settlement terms in any official statement for next 5 years
- E. Provide SEC with a compliance certification on one-year anniversary

**VI. Underwriter Must Also Agree to:**

- A. Retain an independent consultant to conduct compliance review and provide due diligence recommendations within 180 days
- B. Take reasonable steps to enact such recommendations within 90 days
- C. Cooperate with any subsequent SEC investigation including roles of other deal participants
- D. Provide SEC with a compliance certification on one-year anniversary

**VII. Civil Penalties**

- A. No payment of civil penalty by Issuer
- B. Payment of \$20,000 civil penalty by Underwriter for offerings of \$30 million or less
- C. Payment of \$60,000 civil penalty by Underwriter for offerings of more than \$30 million
- D. Underwriter's aggregate civil penalties under Initiative capped at \$500,000

**VIII. Determining Whether There is Potential Need to Self-Report Under Initiative**

- A. Do any statements made in official statement materially misstate the Issuer's or obligor's compliance with continuing disclosure agreements in the five years preceding the date of the official statement
- B. Did the underwriter demonstrate it formed a reasonable basis for belief in the continuing disclosure representation prior to underwriting
- C. Look at continuing disclosure representations made in official statements published after September 10, 2009 (5 year statute of limitations)
- D. Review continuing disclosure filings for five year period prior to such official statements

- E. Continuing disclosure non-compliance after most recent official statement is not relevant
- F. Don't assume language in all continuing disclosure obligations is the same
- G. Not clear what SEC might consider material inaccurate statement regarding 15c2-12 compliance
- H. SEC Guidance: "Whatever you would be concerned about after the reporting deadline should our enforcement lawyers question you regarding omissions from your report."
- I. May want to engage counsel for both assistance in determining materiality and possibly making conversations privileged
- J. Evaluating likelihood of SEC bringing enforcement action--considerations

**IX. What Information Must an Issuer or Underwriter Self-Report**

- A. Information Regarding the potentially inaccurate statements
- B. Identities of lead underwriter, municipal advisor, bond counsel, underwriters' counsel and disclosure counsel
- C. A statement that the self-reporting entity intends to consent to the applicable settlement terms under the MCDC

**X. Modified Prisoner's Dilemma**

- A. If Underwriters Avail Themselves of \$500,000 cap, incentive to over report
- B. Communications between Issuers and Underwriters Prior to September 10, 2014