



Municipal Securities Rulemaking Board Issues Draft Rule To Regulate Duties And Responsibilities Of Municipal Advisors

03.31.2014 | By [Stanley S. Taylor](#)

In a previous e-alert, dated February 5, 2014, we informed our clients that a range of municipal financial advisors, including banks, are now required to register with the Securities and Exchange Commission (the "Commission") as a result of amendments to the Securities Exchange Act of 1934 (the "Exchange Act") by the Dodd Frank Act. The Commission has issued final municipal advisor rules (the "Rules"), *which are effective as of July 1, 2014*, that lay out in detail activities that may give rise to a requirement to register with and become subject to regulation by the Commission.

With the adoption of the Commission's Rules, the Municipal Securities Rulemaking Board ("MSRB") has also engaged in development of regulatory framework for municipal advisors. In that regard, it has proposed a draft Rule G-42 ("Draft Rule") "on standards of conduct and duties of municipal advisors when engaging in municipal advisory activities other than the undertaking of solicitation." On March 10, 2014, the MSRB closed its comment period on the Draft Rule.

The primary duties and responsibilities for municipal advisors under the Draft Rule follow.

Duty of Care and Loyalty as a Fiduciary

The Draft Rule requires that a municipal advisor carry out his or her duties with due care and loyalty. In that regard, the Draft Rule requires that each advisor:

1. exercise due care in performing his or her municipal advisory activities;
2. possess the degree of knowledge and expertise needed to provide the client with informed advice;

3. make a reasonable inquiry as to the facts that are relevant to a client's determination as to whether to proceed with a course of action or that form the basis for any advice provided to the client; and
4. undertake a reasonable investigation to determine that the municipal advisor is not basing any recommendation on materially inaccurate or incomplete information.

The duty of loyalty requires a municipal advisor to transact with honesty, utmost good faith, and with the client's best interest in mind, without regard for the municipal advisor's financial or other interests.

The Draft Rule also makes clear that the above list is not exhaustive.

Disclosure of Conflicts of Interest and Other Related Information

The Draft Rule requires that a municipal advisor fully and fairly disclose to his or her clients in writing all material conflicts of interest prior to forming an advisory relationship. This requires disclosure of any actual or potential conflict of interest that might impair the advisor's ability to render unbiased and competent advice or to fulfill his or her fiduciary duty. Municipal advisors must also disclose legal and disciplinary events that are material to a client's evaluation of the advisor or that are disclosed on municipal advisor registration forms.

The Draft rule includes a non-exhaustive list of specific items requiring disclosure.

Documentation of Municipal Advisory Relationship

The Draft Rule requires a municipal advisor to document a municipal advisory relationship in writing prior to, upon or promptly after the beginning of the relationship. The documentation must include items relating to compensation, the scope of municipal advisory activities to be performed and certain terms relating to the termination of the municipal advisory relationship.

Review of Official Statements

The Draft Rule does not prescribe specific responsibilities to be undertaken with regard to the preparation and issuance of official statements, other than a requirement under the duty of care that municipal advisors are required to thoroughly review official statements where the municipal advisor's role includes participation in the preparation of the document. The MSRB sees the client as the one to determine the scope of the municipal advisor's activities. The client and advisor may also agree upon other roles and responsibilities of the advisor with respect to an official statement, which would have to be set forth in the writing. A municipal advisor's obligation with respect to an official statement arises where the engagement includes that activity but not otherwise.

Disclosure to Investors

The Draft Rule requires that a municipal advisor must disclose to an investor if he or she or his or her affiliate prepares a document that is included in an official statement. The affiliation and the advice, service or product provided by the affiliate must all be disclosed in writing to investors.

Recommendations and Suitability

A municipal advisor may not recommend to a client a municipal securities transaction or municipal financial product unless he or she has a reasonable basis for believing that the transaction or product is suitable for

the client and in the client's best interest. The municipal advisor must consider certain factors before making a recommendation including: the client's financial situation and needs; its objectives; its tax status; its risk tolerance; its liquidity needs; its experience with municipal securities transactions or municipal financial products; its financial capacity to withstand changes in market conditions; and should consider any other material information known by the municipal advisor about the client and the municipal securities transaction or municipal financial product, after reasonable inquiry, before making the recommendation.

Review of Third-Party Recommendations

The Draft Rule requires that when a municipal advisor is asked to review a third-party's recommendation regarding a municipal securities transaction or municipal financial product, the municipal advisor must make a "thorough review" of the recommendation. The municipal advisor is further obligated to discuss with the client his or her evaluation of the material risks, potential benefits, structure and other characteristics of the recommended transaction.

Specified Prohibitions

The Draft Rule specifically prohibits certain types of activities by a municipal advisor including: receiving excessive compensation; delivering an invoice for fees or expenses that does not accurately reflect the municipal advisory activities actually performed or the personnel that actually performed those services; misrepresenting his or her capacity, resources and knowledge in response to requests for proposals or qualifications or in oral presentations to a client or prospective client; making or participating in any fee-splitting arrangements with underwriters; and making or participating in any undisclosed fee-splitting arrangements with providers of investments or services to a client of the municipal advisor.