



Securities and Exchange Commission's New Municipal Advisor Rules Clarify Requirements for Banks

02.05.2014 | By [Stanley S. Taylor](#)

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. These amendments resulted from the major losses that the \$3 trillion municipal securities market suffered during the 2008 financial crisis caused by investments in complex derivative products, marketed by unregulated financial intermediaries.

After an extensive rulemaking and comment process, the Commission has issued final municipal advisor rules (the "Rules"), *which are effective as of July 1, 2014*, that lay out in detail requirements for registration with and regulation by the Commission.

This e-alert discusses the registration requirements for banks under the Rules.

Limited Exception for Banks' Traditional Products and Services

The Rules define the term "municipal advisor" to include a person, other than a municipal entity or 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, or undertakes a solicitation of a municipal entity or obligated person.

Even though the Rules do not provide a blanket exception for banks, in response to concerns expressed by the industry, the Commission adopted a limited exemption from the definition of municipal advisor for any bank to the extent that it provides advice with respect to:

1. Investments by municipal entities in a deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank;
2. Extensions 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. Funds held in certain sweep accounts; or
4. Investments made by a bank acting as an indenture trustee or in a similar capacity.

These exemptions to the definition of "municipal advisor" generally cover banks that provide traditional banking products and services. The Commission does not consider advice on such products and services by the banks to municipal entities and obligated persons to present the kind of risk that the municipal advisor registration regime intended to mitigate.

The Rule defines "obligated person" as a person that is committed to support payments of the obligations underlying municipal securities sold in an offering. However, the Rules exclude the following from the definition of obligated person:

1. A person who provides municipal bond insurance, letters of credit or other liquidity facilities;
2. A person whose financial information or operating data is not material to a municipal securities offering, without reference to any municipal bond insurance, letter of credit, liquidity facility or other credit enhancement (for consistency with Rule 15c2-12 disclosure obligations for municipal securities); or
3. The federal government.

No Exception for Bank's Municipal Advisory Activities

Banks are *not* exempt when they provide advice to municipal entities or obligated persons.

The statute does not define exactly what constitutes "advice." According to the Rules it includes information "that involves a recommendation regarding municipal financial products or the issuance of municipal securities."

The Rules state that "the Commission is not exempting from registration [as a municipal advisor] banks that engage in municipal advisory activities, including without limitation banks that provide advice to municipal entities or obligated persons with respect to the issuance of municipal securities, or banks that provide advice with respect to municipal derivatives, unless the bank qualifies for another exclusion or exemption."

The Commission also emphasized that the bank exemption does not apply to advice on the issuance of municipal securities or municipal derivatives – a major problem area that resulted in municipal entities suffering significant losses during the financial crisis. Thus, any bank that provides advice to a municipal entity or obligated person with respect to interest rate swaps or investment of proceeds or to a government pension plan funded in whole or in part by proceeds, will be required to register as a municipal advisor.

Registration of Separately Identifiable Departments or Divisions

The Rules provide that if a bank's Separately Identifiable Division ("SID"), as defined by Municipal Securities Rulemaking Board ("MSRB"), provides advice with respect to municipal derivatives or engages in any other non-exempt municipal advisory activities, then the SID, rather than the bank itself, shall be deemed to be the municipal advisor. A SID is that unit of the bank that conducts all of the municipal advisory activities of the bank, provided that the following requirements are met:

1. Such unit is under the direct supervision of an officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, including the supervision of all bank employees engaged in the performance of such activities; and
2. Records relating to the Bank's municipal advisory activities are maintained in or separately extractable from such unit's own facilities or the facilities of the bank, and are so maintained or otherwise accessible as to permit independent examination thereof and enforcement of applicable provisions of the Exchange Act, the Commission's rules and regulations under the Exchange Act and the rules of the MSRB.