

New SEC Regulations of Municipal Advisors and Underwriters Take Effect in July

March 3, 2014

Last fall, the federal Securities Exchange Commission (SEC) issued new rules (Rule) regulating municipal advisors and underwriters, now scheduled to become effective July 1, 2014.

In 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, the most sweeping financial industry reform since the Great Depression. Four years later, federal agencies are still developing rules to implement the new law. Dodd-Frank amended the Exchange Act to make it unlawful for a “municipal advisor” to advise a state or local governmental entity regarding municipal financial products or securities or solicit work from a governmental entity unless it is registered with the SEC. The Rule defines and regulates activities of municipal advisors, including underwriters who provide advice or recommendations to state and local governmental issuers.

The Dodd-Frank Act defines “municipal advisor” to include any person who provides advice to governmental entities regarding municipal financial products or the issuance of municipal securities including advice with respect to the structure, timing, terms and other similar matters concerning these financial products or who undertakes a solicitation of a municipal entity. Neither elected nor appointed public sector board members are municipal advisors. Lawyers, feasibility consultants, engineers or accountants performing services for municipal clients in the ordinary course of their profession are also excluded from the definition.

The Rule represents the latest in a series of regulatory changes affecting municipal market participants, including particularly the relationship between public sector borrowers and underwriters and financial advisors. In 2012, the Municipal Securities Rulemaking Board (MSRB) issued new guidance for financial advisors and underwriters, including broker dealers under Rules G-17 and G-23, that underwriters and financial advisors may no longer serve in both capacities in the same transaction. Underwriters retained for municipal transactions have begun to send to tax-exempt issuers a required communication confirming the scope of their responsibilities in connection with the transaction, primarily confirming that the underwriter has a duty of fair dealing to the issuer, but is not the issuer’s agent in the transaction.

The goal of the new SEC Rule is to protect borrowers and the market from unscrupulous market participants by assuring fair dealing, and that recommendations are appropriate for the issuer, commensurate with the sophistication and financial needs of the issuer, and that the issuer has a full understanding of the transaction and its financial ramifications and risks.

What the Rule Means for Governmental Borrowers

Any person who solicits a public sector entity on behalf of a municipal advisor or underwriter must be registered with the MSRB as a municipal advisor or exempt from registration. Government officials who wish to receive recommendations from underwriters will need to confirm that preference in writing. In the absence of such a representation underwriters may not offer customized or tailored recommendations to the potential borrower[1].

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Beginning July 1, 2014, underwriters may not pitch financing ideas or products to a public sector issuer outside of a formal RFP process or underwriting engagement unless (i) the issuer has retained an independent registered municipal advisor, (ii) the issuer has, in writing, invited the underwriter to submit recommendations to the issuer, and (iii) the underwriter also submits the recommendations to the issuer's municipal advisor for review.

Some underwriters and financial advisors are taking steps to comply with the Rule before the new effective date. We will be pleased to assist in the preparation of a letter which meets the requirements of the Rule. While there is no penalty imposed on issuers for violation of the Rule by underwriters or financial advisors, issuers should be sufficiently mindful of the Rule to be able to spot violations.

>> *See also our separate Alert regarding a proposed new MSRB Rule on the Standards of Conduct for Municipal Advisors.*

Please contact us for further information relevant to your needs.

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[1]SEC guidance suggests that underwriters may continue to provide (i) general factual information regarding the market, types of financing structures and government financing programs and incentives, not particularized for the needs and objectives of a governmental entity, and (ii) factual information regarding an issuer's existing debt with no overlay of subjective assumptions or opinions about rates relevant to the issuer. This may include refunding savings projections if the information does not include restructuring the existing debt by extending maturities or otherwise changing the debt structure.