# Regulatory Considerations for SEC Registered Municipal Advisors

*By Matthew C. Boba*

After four years of discussion following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"), the Securities Exchange Commission (the "SEC"), the Municipal Securities Rulemaking Board (the "MSRB") and the Financial Industry Regulatory Authority ("FINRA") began to roll out, and continue to roll out, implementing rules and regulations. A summary of the rules and regulations was published in the MarchApril 2015 edition of this publication. Now, following the implementation of the rules and regulations and the initial wave of SEC examinations of municipal advisors, management and compliance personnel are navigating through the rules while continuing to run their business and service clients.

## Fiduciary Standard

For newly registered municipal advisors and representatives who were not previously registered as an investment adviser or representative under the Investment Advisers Act of 1940 or a broker-dealer with discretionary account authority or ERISA accounts, you and your representatives are now charged with the highest standard of care in the securities industry, a fiduciary duty to clients. Specifically,

> A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the Board.[1]

Well, what does that mean? Basically, a municipal advisor and its representatives must act in the best interests of clients and place the interests of clients before their own at all times. The duty goes beyond good faith and non-negligent dealings with clients. It originates

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from the common law duties of an agent, the municipal advisor, to its principal, the client. Two significant concepts imbedded in the fiduciary standard of the agent are the duties of care and loyalty. The duties are now codified in MSRB Rule G42(a).[2]

The duty of care establishes a reasonableness standard on the municipal advisor based upon industry norms and practices. The standard of care is meant to be objective, measured by reference to the actions of a reasonable (or prudent) person in like circumstances. However, in the event that the agent has specialized skills relevant to the client's retention of the agent, as is the case in most every municipal advisory relationship, then the applicable standard of care for the advisor is that of a prudent person in possession of the specialized skills.[3]

The second requirement, the duty of loyalty, generally prohibits self-dealing and conflicts of interest by the agent, or if not prohibitive, requires the affirmative consent by the client, following full and fair disclosure by the municipal advisor. The obligation is meant to deter the municipal advisor from self-dealing and avoid conflicts of interest, or to disclose the material facts of the conflict to the client so that the client can make an informed decision whether to give consent.[4]

MSRB Rule G42 sets forth the core standards of conduct and duties of municipal advisors when engaging in municipal advisory activities. The Rule draws on aspects of existing agency law and regulation from the investment adviser, broker-dealer, ERISA and corporate law areas. In summary, Rule G42:

- Establishes certain standards of conduct consistent with the fiduciary duty owed by a municipal advisor to its clients;
- Requires a municipal advisor to exercise due care when performing its municipal advisory activities for its clients;
- Provides for the full and fair disclosure, *in writing*, of all material conflicts of interest and all legal or disciplinary events that are material to a client's evaluation of a municipal advisor;
- Requires documentation of the municipal advisory relationship, specifying certain aspects of the relationship that must be included in the documentation; and
- Requires, when making a recommendation, that a municipal advisor have a reasonable basis to believe that the recommendation is suitable and, if appropriate, requires a municipal advisor to determine the suitability of recommendations made by third parties.[5]

As described above, municipal advisors now see words, phrases and concepts that previously existed in the other areas of the financial services industry such as "due care", "full and fair disclosure", "recommendation" and "suitability." Dealing with, and documenting adherence to, these concepts are of vital importance to implementing a successful compliance program and culture for your firm.

Rule G42 also specifically prohibits a municipal advisor from engaging in certain activities, including:

- Receiving excessive compensation;
- Delivering inaccurate invoices for fees or expenses;
- Making false or misleading representations about the municipal advisor's resources, capacity or knowledge;
- Participating in certain fee-splitting arrangements with underwriters or in any undisclosed fee-splitting arrangements with providers of investment services to a client;
- Making payments for the purpose of obtaining or retaining an engagement to perform municipal advisory activities, with limited exceptions; and
- Engaging in certain principal transactions with its clients, subject to a narrow exception for fixed income securities transactions.

These concepts are far more straightforward, at least on paper. How the duties and the prohibited activities play out in a municipal advisor's policies, procedures, practices and SEC examinations is discussed below.

## Registration and Professional Qualifications

Before we get to the standards for providing municipal advice,[6] we have to deal with the registration itself. By now, most of the subscribers to this publication have made it through the Form MA process, the filing of Form MAIs for your representatives and payment of the applicable registration fees. Your firm is a registered municipal advisor with the SEC. However, the obligations do not end here; a municipal advisor must promptly amend Form MA and each Form MAI upon the occurrence of certain material events, and update the Form MA at least annually, within 90 days of the end of the municipal advisor's fiscal year.[7] Easy pickings for the SEC staff during an examination if your filings haven't taken place on a timely basis.

Another easy to detect violation involves the representatives' Form MAIs. At the end of the Form MAI there is a consent to service provision which reads:

> The *municipal advisory firm* has obtained and retained written consent from the individual that service of any civil action brought by, or notice of any *proceeding* before, the *SEC* or any *self-regulatory organization* in connection with the individual's *municipal advisory activities* may be given by registered or certified mail to the individual's address given in Item 1.[8]

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A municipal advisory firm must obtain an executed written consent to service of process from each of its representatives and maintain the consent in its compliance or personnel files for each representative. This requirement may be overlooked due to the electronic nature of the filing system or the signature line leadin language which addresses perjury for false statements, not consent to service. The SEC likely will ask to see the actual consents when they arrive for your firm's first examination, therefore you need to have them drafted, executed by each representative and available for inspection. A consent should be included as part of each new hire package along with the MA-I, Form W-2 and other personnel records.

As part of Dodd-Frank, the MSRB has implemented the first qualifying examination for municipal advisors, the Series 50 exam. If your representative(s) took and passed the Series 50 pilot exam, he or she is qualified as a municipal advisor representative and will not be required to take the permanent Series 50 exam. On May 31, 2016, the MSRB announced that the permanent exam will be available on September 12, 2016 and representatives will have one year from that date to complete the examination and obtain the Series 50 license.

Two important issues to keep in mind regarding the qualification examination: (1) no employee or independent contractor of a municipal advisor may conduct any municipal advisory activity which is beyond the scope of his or her licenses; and (2) do not cheat during the exam (*i.e.,* no papers hidden in the restroom of the testing center, no notes on your forearm, subordinates showing up to the testing center in your place, iPhones in accessible places). These may sound obvious, but it isn't to some. The punishments vary but none of them is particularly good.[9]

## Policies and Procedures

MSRB Rule G44 requires a municipal advisor to establish, maintain and enforce written supervisory procedures. In addition, the Rule also requires municipal advisors to review the adequacy of those procedures and designate a Chief Compliance Officer (the "CCO") to review and implement the procedures.

As Dodd-Frank's implementation continues with the adoption or modification of MSRB Rules, a good policies and procedures manual will address each of the relevant rules and the firm's standard practices with respect to its municipal advisory business. At a minimum, your policies and procedures should address the following administrative areas: (a) hiring and licensing of representatives; (b) customer complaints; (c) communications, advertising and sales literature; (d) use of electronic communication mediums; (e) ongoing education and annual compliance programs; and (f) a whistleblower policy.

Depending on the scope of your firm's municipal advice, policies and procedures for municipal advisory services should include the following (with corresponding MSRB Rules):

- Fiduciary Duties (Rule G42(a));
- Advisory Agreements and Compensation (Rule G42(c) and (e));
- Recordkeeping (Rules G8(h) and G9);
- Recommendations to Clients and the Review of Recommendations of Others (Rules G17 and G42(d));
- Know Your Clients and Suitability (Rule G42(d));
- Conflicts of Interest (Rules G17 and G42(b));
- Inadvertent Advice (Rule G42, Supplemented Material .07);
- Gifts and Gratuities (Rule G20);[10]
- Political Contributions and Pay-to-Play Practices (Rule G37);[11] and
- Insider Trading Prohibition (Rule G17).

The policies need to be tailored to the municipal advisor's activities and abilities. Greater detail should be afforded areas that constitute the majority of the municipal advisor's business activities or revenues. One of the few things worse than no policy is a policy that is ignored by the representatives, supervisors and compliance personnel. That is the danger of "off the shelf" policy manuals; what a 40-person municipal advisory firm can accomplish with multiple principals and a three person firm with its president serving as the CCO and primary business originator often are materially different. Although policies must reflect your firm's resources, being small is not a defense to a rules violation. There are no small firm exceptions to the MSRB Rules.

## Advisory Activity and Common Practices

In setting forth the fiduciary standards and resulting responsibilities of a municipal advisor, we included a list of prohibitions provided by the MSRB. We just covered the types of policies and procedures that a municipal advisor should put in place to comply with its duties and obligation under MSRB Rules. However, many municipal advisors have been in business for years, possessing longterm clients and solid relationships with third parties such as bond counsel, underwriters, investment product providers and trustees, each of which have historically served your client well. How do the new duties and prohibitions effect these long-term relationships and the municipal advisor's dealings with its client and the other professionals on the financing team?

### Advisory Agreements

It is time to review your standard contract. Does the contract clearly set forth the scope of your duties and responsibilities as well as specify the matters which your firm will not undertake on behalf of the client? Some of the common undertakings of a municipal advisor in representing an issuer in a municipal bond transaction include:

- Establishment of a budget for a bond transaction's costs and expenses;
- Assist in the selection of transaction professionals;
- Assist in establishing the method of sale (*e.g.,* competitive bid, negotiated sale, private placement or bank placement);
- Providing financial data for the issue, including debt service schedules, interest costs, costs of issuance, tax levies, refunding savings, etc.;
- Attendance at issuer meetings, both public and private, where the transaction is discussed;
- Vetting investment products;
- Assistance with the drafting of the official statement;
- Reviewing underwriter, placement agent or bank bids or pricing; and/or
- Closing assistance.

Fairly standard advisory activities; but now the municipal advisor's duties are of a fiduciary nature. Where may an advisor find trouble during the course of implementing the new MSRB Rules and enduring its initial SEC examination?

First, if you take on the responsibility, not only do you need to perform, but you need to document your performance under MSRB Rule G9. The documentation must be maintained, in paper or electronic form, for the requisite time periods and available for review by the SEC staff. MSRB Rule G9(d) begins:

> All books and records required to be preserved pursuant to this rule shall be available for ready inspection by each regulatory authority having jurisdiction under the Act to inspect such records, shall be maintained and

preserved in an easily accessible place for a period of at least two years….

A brief discussion of accessibility and the SEC examination process is below.

Second, take an inventory of your existing contracts and municipal client relationships.

- Has your contract expired and so requires renegotiation or a simple extension?
- Are there legal or disciplinary disclosures about your firm or your representatives that require written disclosure to the client under MSRB G42(c)?
- Has your scope of services changed over the years?

A municipal advisor has to have current, written contracts with the clients; if you find a deficiency, it needs to be addressed promptly.

Third, examine the prohibitions listed in MSRB Rule G42(e) in relation to the scope of your services actually rendered to your client. Again, it is not what's necessarily in your contract, but what your files demonstrate actually took place during a transaction. Is your fee typically tied to the size of the transaction? If so, should your fee be tied to the size of the deal as a fiduciary to the client? Does the fee reflect the value of the activity and services rendered? Make sure your contract contains a description of any potential conflicts of interest arising from the municipal advisory activities to be performed that is contingent on the size or closing of any transaction as to which your firm is providing advice.

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Be mindful of your invoicing and expense reimbursement requests. How explicit is your contract with respect to expenses? How many representatives of your firm attended the closing and related festivities? Did spouses attend? If the transaction closed in New York on a Tuesday, did your representatives travel on Friday or Saturday? If so, where did they stay, what did they eat and is your firm seeking reimbursement from the municipal client for these costs? Were client officials present for some or all of the activities? Remember, you are a fiduciary to the municipal client with duties of care and loyalty attributed to all of your interactions with the client, not just the advice being rendered. Also be mindful of state ethics laws and lobbying requirements when incurring any expenses for municipal client personnel.

### Dealings with Bond Counsel

For bond issuer clients, many have a preferred bond counsel or counsel which have been awarded an issuer's transaction through an RFP process. Bond counsel will typically render an opinion that the bonds have been validly issued and, if tax exemption is intended, that the bonds are exempt from federal, state or local taxes. The opinion also may address related matters, such as the enforceability of certain security provisions. Typically, bond counsel may prepare or review and advise the issuer regarding its authorizing resolution, trust indenture, bond purchase agreement and official statement.

If asked by a municipal client to deal with bond counsel, either in the selection of counsel or with respect to the negotiation of counsel fees, the municipal advisor must first determine that it, through its representatives, is equipped with the necessary knowledge of bond counsel functions and the legal issues for a particular transaction to render a useful recommendation. The requisite knowledge will be different for evaluating counsel for a general obligation bond versus, for instance, a tax increment financing or a conduit transaction. Clearly, an advisor can gather information regarding the extent of bond counsel's experience, tax expertise and availability to assist the issuer, in making a selection; but to make a recommendation, maybe not.

The first issue which gives rise to the duties of the municipal advisor is the negotiation of bond counsel's fee and cost of issuance for the bond transaction. Remember, effective June

23, 2016, a municipal advisor now owes a fiduciary duty to the municipal client. Should the advisor be involved with the fee negotiations with counsel? Is it truly a negotiation or more of a cost of issuance inquiry from counsel along the lines of "what do you have us in for"?

Has the municipal advisor taken on the responsibility of interacting with and coordinating the other deal professionals as part of the written contract or have your representatives morphed into this role as a "full service" provider? If your representative discloses the preliminary cost of issuance allocated by the municipal client to bond counsel, has the municipal advisor breached a duty of loyalty and confidentiality to the client? Was there authority for your representative to make the disclosures as part of the contract? What does your email chain with bond counsel regarding fees look like to an independent examiner who may not understand, or care, about familiarity or the long-term relationships involved?

Frequently, longterm bond counsel will work on a small bond issuance for your client at a very low cost. What if the upcoming transaction is ten times the size but roughly the same amount of work; resolutions, indentures, purchase agreements, official statement, closing documents and opinions, all with an extra zero in the principal amount. Can you, a municipal advisor with fiduciary duties, recommend a "make-up" payment for bond counsel to your client for this new deal due to the increased cost of issuance cap if the scope of professional services did not materially change?[12] Were the bids from bond counsel for the two transactions accepted as one bid by the client? In considering these questions, you should bear in mind that bond counsel fees typically include a component to compensate the issuer of the opinion for market exposure, which increases with bond issue size. Also, the willingness to do a small issue for a small fee may be part of a long-standing relationship between the municipal client and bond counsel and you should be cognizant of that dynamic.

The responsibilities likely require that the municipal advisor recommend to the client a bond counsel fee that is fair and reasonable based on the work to be performed on the new, distinct transaction without regard to the relationship history with counsel unless the transactions were grouped together by the issuer and priced accordingly by counsel. With fiduciary duties, a municipal advisor may be better served getting out of the way of counsel fee negotiations and weigh in as to the reasonableness after the fee is negotiated between counsel and the client. Guidance should be limited to obtaining market data on fees and expenses incurred in similar transactions in order to support any costs of issuance recommendation.

### Underwriters, Product Providers and the Review of the Recommendations of Others

The review of the recommendations of others is a cornerstone of the municipal advisory-client relationship. Depending on the size of the municipality and the knowledge of its personnel, the municipal advisor brings skills and experience to allow the client's staff to sit at the table with investment product providers, underwriters and rating agencies, negotiate the terms of the transaction and get a favorable result. After Dodd-Frank and the recent implementation of MSRB Rule G42, the law requires that the advisor serve as a fiduciary, placing the client's interests ahead of its own and elevating the standard of care.

With respect to investment products, whether GICs, hedges or other sophisticated financial instruments, the municipal advisor has a suitability obligation when making a recommendation to the client. MSRB Rule G42(d) begins:

> If a municipal advisor makes a recommendation of a municipal securities transaction or municipal financial product to a municipal entity or obligated person client, it must have a reasonable basis to believe that the recommended municipal securities transaction or municipal financial product is suitable for the client…

In July 2012, FINRA revised its "suitability" and "know your customer" rules.[13] Although the MSRB has not adopted the same rules as currently apply to broker-dealers, the concept is similar and guidance is provided in the Supplementary Materials .09 and .10 to Rule G42. In a nutshell, the responsibilities of the municipal advisor, when recommending an investment product or reviewing recommendation of another professional, are to, after reasonable inquiry:

- Know and retain the essential facts concerning the client;
- Understand the authority of each person acting on behalf of the client;
- Understand the client's financial situation and needs, objectives, tax status, risk tolerance, liquidity needs, experience;
- Be knowledgeable of any state or local restrictions on the types of financial instruments that the client may purchase or agreements that it may execute; and

- Understand the client's financial capacity to withstand changes in market conditions during the life of the product.

Again, be mindful of the documentation responsibilities pursuant to MSRB Rules G8(i) and G9. Like broker-dealers and registered investment advisers, your client's files must contain evidence that your representatives conducted a "reasonable inquiry" of the municipal client's situation and the diligence on the product being offered to fulfill the client's financial needs.

However, unlike those other licensed parties, municipal advisors do not typically provide clients with a new account form or investor questionnaire that gathers relevant financial information such as tax status, risk tolerance, financial capacity or investment experience, at the commencement of a client relationship. The municipal advisor will have to rely on other sources such as biographies of the key decision makers at the municipal client, the client's history with similar transactions and investment products and the client's budget to gather the required information.

As to assessing risk tolerance, be mindful of its two components: risk capacity and risk willingness. Risk capacity looks at the municipal client's ability to absorb a loss in investing in an investment product. Risk willingness measures the municipal client's representatives' attitude toward risk. The trick for the municipal advisor is made more difficult if the elected official's willingness, due to the nature of the financing or the individual's tolerance, exceeds the municipal client's capacity.

This article has touched on a number of issues that a municipal advisor needs to be aware of in serving its clients following the MSRB's implementation of Dodd-Frank. Most of these issues can be satisfied by diligence, recordkeeping and sound business practices. The final issue is that of bond pricing; a municipal advisor's responsibilities to its client in its review of the underwriters' performance, both at the time of pricing and following issuance to determine whether the client's bond transaction was priced fairly or that an investment product performed as advertised. If the client did not receive the best or market equivalent pricing, did the municipal advisor breach its fiduciary duties? Did the advisor violate the fair dealing provisions of MSRB Rule G17? Are the advisor's supervisory policies and procedures adequate in describing its pricing review activities and recommendation as required by MSRB Rule G44?

In a competitive bid situation, the analysis at the time of pricing is a bit easier so long as a number of reputable firms are bidding for the client's bond transaction. Market forces are at work so the best bid will be compared to transactions that are priced elsewhere in the marketplace with comparable information available through a number of sources, including the MSRB's Electronic Municipal Market Access (EMMA). As current practice, a municipal advisor will compare the winning bid against recently priced transactions of similar ratings, terms, security and redemption features in recommending whether the client should accept the winning bid and close the transaction.

Evidence of the review, including comparable transactions and industry indices, must be maintained in the deal file. SEC Rule 15Ba18(a)(4) and MSRB Rule G8(h)(i) require municipal advisors to maintain a copy of *any* document created by the municipal advisor that was material to making a recommendation to a municipal entity or that memorializes the basis for that recommendation. An advisor representative can no longer look at the information, compile it in a spreadsheet, provide advice and throw it all out with the bond document drafts post-closing. Remember, MSRB Rule G9 is titled "Preservation of Records."

In a negotiated sale to the underwriters, the municipal advisor does not have the same market forces at work, and is bidding down the yield in order to win the client's business. The lack of this dynamic puts additional focus on obtaining current data on comparable transactions, industry indices, market trends and economic conditions, both locally and through the U.S. economy to best advise the client in its negotiations as to the structure, pricing and overall yield of the issue. Again, the review and analysis need to be documented and available for review by the SEC staff during the course of an examination.

Another issue that may arise in determining whether the municipal advisor fulfilled its fiduciary obligations in the pricing of a transaction pertains to the idea of a retail order period.[14] The SEC staff may take the position that a retail order period is something a municipal client is entitled to receive from its underwriter. Whether or not you believe that to be true, a municipal advisor, at a minimum, needs to be aware of the concept of a retail order period in rendering pricing advice or in assisting its client in the underwriter RFP process.

In discussing the concept with its clients, all municipal advisors should note however, that (a) retail order periods are not typically offered by underwriters to smaller, less frequent issuers, (b) a client insisting on a retail order period may incur

additional underwriting cost or expense due to the additional work, and, (c) depending on the length of the retail order period, in volatile markets an extended period may put an issuer at risk of losing favorable overall pricing metrics, especially in refunding issues where many items must fall into place to gain the savings that the issue may afford. Nonetheless, the costs and benefits of including a retail order period for a client's a bond transaction should be discussed at the outset of a transaction if better pricing would likely result.

Assuming your municipal client accepted the underwriters' pricing and closed the bond transaction, it is best practice for the municipal advisor to conduct a post-pricing review. Some advisors do it as common practice in both evaluating its own pricing analysis and client recommendations and the performance of the underwriters and their dealers and may be helpful in the client lining up the next transaction team. Whether your firm or representatives conduct a postpricing review, I can almost assure you that the SEC will conduct such a review prior to, or during the course of, your examination in trying to determine whether you fulfilled your fiduciary duties in reviewing the recommendation of others under MSRB Rule G42(d).

For example, if your client sold a bond maturity at par on Day 1 and a few bonds of that maturity trade at 102% on Day 2, the suggestion may be that your client's bonds were mispriced. How do you combat such an examination finding? First, as we have discussed earlier, a robust review of comparable transactions, documented for the client and maintained in your files, is always the best defense during the course of any review or examination. Post-closing market movement cannot be your problem, but what if the market moved days prior to pricing and your representatives missed it as your files only contained market information of the previous week? What if a similar deal priced to yield 25 basis points lower the day before your client's pricing? You will be asked to make a distinction between the issues which justify your recommendation to accept the underwriter's more expensive bid.

Is the pricing "problem" only with one maturity of a multiple series issue? Can you distinguish that series from the others and show that the overall yield and cost to the issuer remained constant post-pricing due to below par trading of another series or maturity? Is the price a product of a small denomination of a series or maturity trading at a premium? Numerous market factors can be involved that do not indicate a mispriced transaction or breach of duty: (a) the trade at issue represented only a small portion of the maturity, with an incremental trade not necessarily indicative that the entire maturity, let alone the series, could have been priced at the more favorable yield to the client; (b) the sale at 102% was the only trade in the maturity in excess of par in the days following pricing which may be more indicative of a large markup by the dealer to its customer than a mispriced maturity; and (c) at or around the open on the day following the trade in question, the same maturity of bonds was sold at par or at a price with a significant reduction in the previous premium.

Also a contributing factor in determining whether the municipal advisor can show it fulfilled its fiduciary duties is the existence, or preferably, non-existence, of conflicts of interests between the municipal advisor and the underwriter. The duty of loyalty requires that the advisor not engage in municipal advisory activities if it cannot manage or mitigate its conflicts of interest in a manner that will permit it to act in the client's best interest. If a potential conflict may exist due to the relationship or prior dealings between the municipal advisor or one or more of its representatives and the underwriter, has the potential conflict been disclosed, in writing, to the client? The existence of an undisclosed conflict of interest, coupled with bonds selling at a substantial premium shortly after pricing, is a difficult set of facts to rebut when making your case to the client or the SEC that you fulfilled your responsibilities in placing the client's interests ahead of your own.

In all situations, it is best for a municipal advisor to document its review of the pricing of a bond transaction within a few weeks following the execution of the bond purchase agreement. Not only does the review educate your representatives as to (a) the aftermarket trading in the securities, (b) the knowledge and capabilities of the municipality's staff in fulfilling the "Know Your Customer" requirement and (c) the performance of an underwriter, the costs of conducting the review in real time pale in comparison to trying to conduct the review months or years later, following an adverse finding during an SEC examination.

## SEC Examinations

As a registered municipal advisor, the firm and its representatives fall within the purview of the SEC; that means periodic examinations by its staff. It can be a bit intimidating

to receive your first notice from the SEC that its staff is coming to visit, but the examination process is manageable and has become commonplace for broker-dealers and registered investment advisors. The manner in which a firm deals with the SEC staff and its own employees during the course of the examination process can go a long way in obtaining a favorite result. A few items to consider when your examination notice arrives are:

- Free up your CCO to prepare for the examination. This may mean, depending on the size of your firm, that the CEO or other supervisors take on a little more administrative responsibility for a week or two as the CCO assembles documents and responds to pre-examination inquiries from the SEC. The preparation is not debilitating, but, if there is some flexibility, it is a good idea to move a few things around.
- Meet the deadlines for producing documents and information, especially if it is your firm's first dealing with the SEC. The ability to meet the standard timetable suggests that your firm maintains its records in an orderly fashion. If your CCO is unable to meet the initial deadline, it is not the end of the world, extensions are often granted. Just don't wait until 4:30 p.m. on the deadline date to request for more time.
- Let your representatives and other employees know that the SEC staff will be on site and that any "clean desk" policies must be adhered to. Ask them to be respectful, be mindful of their conversations in the hallways, elevators and restrooms. Provide the staff with reasonable amenities during their visit (a private office or conference room, access to water and coffee, vending machines or other essentials as well as a phone and a room temperature that does not require a parka or swim trunks).
- Establish a contact person or persons for inquiries during the course of the examination, both on site and after the conclusion of the onsite portion examination. Typically, this person is the CCO. The staff should be provided with the CCO's phone extension but if they request an in person conversation, the CCO should come to them to limit any wandering through your office.
- If documents are requested, be mindful of Rules G8(h) and G9(d). A CCO informing the staff that he or she will need a week or so to obtain the records will not serve the advisor well either in getting the staff out of its office on a timely basis or illustrating compliance with the MSRB's document maintenance or preservation rules. If certain documents are kept offsite, retrieve them before the onsite examination begins.
- If the SEC staff requests an introductory meeting at the commencement of the examination, the CEO should be in attendance and if not, the CCO should have a really good explanation why that was not possible. This conference is a great opportunity for the CEO to explain the municipal advisor's business model, the types of clients, the services provided and revenue generated from those services. A thoughtful presentation often aids in streamlining the onsite portion of examination, allowing the staff to focus on the material aspects of the advisor's business.
- If the staff asks to speak, informally, with representatives and other employees of the advisor during the course of the examination, consult with your counsel. Depending on the situation, it may be in everybody's best interest to have the representative conduct the interview; remember it's the SEC, they will speak with the representative at some time during the course of the examination. A firm is often better off keeping it friendly but your licensed representative may have a different viewpoint. If after consultation with counsel, the firm and the representative agree to speak with the staff, always answer the questions truthfully.
- The staff will typically ask to conduct an exit interview during its last day in your office. Accept the invitation. They will go over some areas of possible deficiencies and provide your CCO with a list of additional materials to be delivered to complete the review. Once the final document exchange takes place, at some point in the following few months, the municipal advisor will receive an examination findings letter from the SEC.

The advisor is then afforded the opportunity to provide a written response to the findings letter. When making the response, check your information carefully to ensure that your representations are accurate. If violations of federal securities laws or MSRB rules are alleged to have taken place, consult with your counsel prior to submitting your response. If additional documentation is required to explain or illustrate the firm's position, attach the documents to your response.

Once your response has been received, the SEC will issue a letter which may (a) conclude the examination process with

a few policy and procedure adjustments, (b) continue the examination process, requesting additional information or testimony or (c) refer the matter to enforcement, depending upon the alleged severity of the conduct or violations. If the matter is referred to enforcement, consult with counsel prior to initiating correspondence with the staff.[15]

## Conclusion

For newly registered municipal advisors going through SEC registration, formal compliance programs and, now, the examination process, this may be a time full of anxiety. Fiduciary duties are no longer on the horizon; they are here. So are some prohibited activities, conflicts disclosures and recordkeeping requirements. Getting a handle on the scope of your responsibilities in light of your firm's municipal advisory activities will take time, effort and resources. For firms with long-term relationships and histories of providing advice to municipal entities, it is time to review the client relationships and the underlying contracts for compliance with the recent, and still expanding, MSRB Rules. Most municipal advisors have received, or will receive, an examination notice from the SEC. With a combination of diligence and common sense, you will survive the examination, making additional adjustments to your policies and practices to comply with your expanded duties to the clients.

ENDNOTES

1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 975.

2 MSRB Rule G42, Duties of NonSolicitor Municipal Advisors, became effective on June 23, 2016.

3 Robert H. Sitkoff, "The Fiduciary Obligations of Financial Advisers under the Law of Agency" Harvard Law School, May 15, 2013.

4 Guidance on the "Duty of Care" is provided by the MSRB in the Supplemental Information .01 to Rule G42 and guidance on "Duty of Loyalty" is provided by the MSRB in the Supplemental Information .02 to Rule G42.

5 See MSRB Regulatory Notice 201603.

6 For purposes of this article, the assumption is that your firm is providing advice. Pursuant to the SEC's Registration of Municipal Advisors FAQ, "Advice" is not susceptible to a bright-line definition and can be construed broadly. The determination of whether a person provides "advice" to or on behalf of a municipal entity regarding municipal financial products or the issuance of municipal securities depends on all of the relevant facts and circumstances.

7 Instructions for Form MA and MAI can be found at https://www.sec.gov/about/forms/formmadata.pdf.

8 SEC Form MAI which can be found at https://www.sec.gov/about/forms/formma-i.pdf.

9 FINRA's Sanction Guidelines provides for fines between $5,000 and $25,000 and a range from a two-year suspension and a permanent bar from servicing as a registered representative for cheating on a license examination.

10 Amendments to MSRB Rules G20 affecting municipal advisors became effective on May 6, 2016.

11 Amendments to MSRB Rules G37 affecting municipal advisors become effective on August 17, 2016.

12 By no means do we intend to oversimplify the duties and responsibilities of bond counsel or the diligence, risk and nuances involved in taking on a new bond transaction, but the relationships among municipal entities, municipal advisors and bond counsel is a new area for the SEC staff in applying the new fiduciary standards. Please note, if a municipal advisor negotiates and recommends, and a municipality chooses to pay, bond counsel $15,000 for the $5 million tax-exempt transaction in March and $100,000 for a $50 million transaction in May based upon the same set of documents, you may receive an inquiry as to the fulfillment of your fiduciary duty to the client in the event the engagement did not result from an RFP process for, or the client's direct negotiation with, bond counsel.

13 See FINRA Rules 2090 and 2111.

14 MSRB Rule G11 discusses primary offering practices and provides for a retail order period, meaning "an order period during which orders that meet the issuer's designated eligibility criteria for retail orders and for which the customer is already conditionally committed will be either (i) the only orders solicited or (ii) given priority over other orders."

15 A detailed description of the SEC and FINRA examination process for broker-dealers is provided in the MayJune 2012 edition of this publication. Many of the author's recommendations are onpoint and provide relevant guidance for newly registered municipal advisors.