

## **The Municipal Advisor Rule: Receiving Advice from Your Broker-Dealer Regarding Investments**

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This paper is intended to assist state and local governments in understanding the impact that the Municipal Advisor Rule<sup>1</sup> of the United States Securities and Exchange Commission (“SEC”), effective July 1, 2014, has on their sales and purchases of securities through broker-dealers. Brokers are impacted by the Municipal Advisor Rule if they provide any “advice” to a municipal entity or obligated person<sup>2</sup> in connection with the investment of the proceeds of the issuance of municipal securities or escrow investments.

### **1. Why does the Municipal Advisor Rule cause my broker to ask if we are investing funds that are proceeds from the issuance of municipal securities or escrow investments?**

Under the Municipal Advisor Rule, any person who provides advice to any municipal entity or obligated person concerning the investment of proceeds of the issuance of municipal securities or escrow investments is a “municipal advisor,” unless that person is eligible for an exclusion or exemption from the Rule. In the context of a broker selling or purchasing securities, a broker could become a municipal advisor to a municipal entity or obligated person if it provides advice that is incidental to the sale or purchase, if the funds that the municipal entity or obligated person are investing are proceeds from the issuance of municipal securities or escrow investments, and the broker did not bother to inquire as to the nature of the funds. This could be the result even if the broker never identifies itself as an advisor or uses the words “advise” or “recommend” in its communications with the municipal entity or obligated persons. Accordingly, it will be very important for brokers to inquire whether any transaction or conversation entered into with a municipal entity or obligated person involves the investment of

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<sup>1</sup> Securities Exchange Act Release No. 34-70462 (Registration of Municipal Advisors) (September 2013).

<sup>2</sup> The Municipal Advisor Rule uses the terms “municipal entity,” which, in general, refers to state and local governments, and “obligated person,” which, in general refers to conduit borrowers in municipal securities transactions.

the proceeds from the issuance of municipal securities or escrow investments before having any discussions concerning the transaction.

**2. Why is my broker concerned about being a municipal advisor?**

Brokers will generally not choose to be characterized as municipal advisors because being a municipal advisor will carry additional duties that will complicate its role as broker. A municipal advisor to a municipal entity will have a fiduciary duty to that municipal entity. If a broker has this duty, it will complicate its role of purchasing and selling securities to municipal entities at an arm's length. In addition, being a municipal advisor will impose other duties and responsibilities in addition to the duties imposed on them as brokers.

**3. Why is my broker asking for me to provide an acknowledgement that the amounts we want to invest are not proceeds from the issuance of municipal securities or escrow investments?**

Under the Municipal Advisor Rule, in order to avoid accidentally advising a municipal entity or obligated person with proceeds from the issuance of municipal securities or escrow investments, a broker is allowed to rely on a written representation from a knowledgeable official of the municipal entity or obligated person. If the broker obtains that written representation, it allows the broker to proceed without being concerned that it might be later characterized as a municipal advisor. If you provide this written representation, it should resolve any concerns your broker has about possibly being a municipal advisor and therefore becoming limited in the services it can provide.

**4. How do I know if the amounts we want to invest are proceeds from the issuance of municipal securities or escrow investments?**

In general, proceeds from the issuance of municipal securities are held in construction funds or debt service reserve funds related to the issuance. In addition, proceeds from the issuance of municipal securities include any monies of a municipal entity or obligated person held in funds under legal documents for the municipal securities that are reasonably expected to be used as security or a source of payment for the payment of the debt service on the municipal securities, including reserves, sinking funds, and pledged funds created for such purpose. Other times, however, funds can remain proceeds even if they are not in a fund specifically designated as a bond fund and even if they are comingled with other funds. If you have any question concerning whether funds constitute proceeds from the issuance of municipal securities, you should contact the bond counsel for the issuance.

**5. Can my broker become a municipal advisor if it provides advice concerning investments that do not constitute proceeds from the issuance of municipal securities or escrow investments?**

No. Under the Municipal Advisor Rule, the only funds that can make a broker's advice trigger a characterization as a municipal advisor are proceeds from the issuance of municipal

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securities or escrow investments. Other funds of a municipal entity or obligated persons are not affected by the Municipal Advisor Rule.

**6. If I want investment advice from my broker concerning the investment of the proceeds of municipal securities or escrow investments, what can I do?**

The Municipal Advisor Rule affords municipal entities and obligated persons with two options that would allow them to obtain advice from brokers concerning the investment of proceeds of municipal securities or escrow investments without making the brokers municipal advisors. The first is the Request for Proposal (“RFP”) exemption. Under the RFP exemption, if a municipal entity or obligated person asks multiple brokers for investment advice in a competitive process, then the brokers may provide advice in their response without becoming municipal advisors. We provide more detail about the RFP exemption below. The second is the Independent Registered Municipal Advisor (“IRMA”) exemption. Under the IRMA exemption, if a municipal entity or obligated person has retained a municipal advisor to provide advice concerning the investments with respect to which the broker would provide advice, then, as long as the conditions set forth in the Municipal Advisor Rule are satisfied, the broker may provide advice concerning those investments without becoming a municipal advisor. We provide more detail about the IRMA exemption below.

**7. What would I need to do to solicit advice from brokers using the RFP exemption?**

The Municipal Advisor Rule provides an exemption for advice that is provided in response to an RFP. If a municipal entity or obligated person wants to solicit the advice of brokers as to what securities it should purchase or sell using proceeds from the issuance of proceeds of municipal securities, it could issue an RFP to solicit advice on the topic. Any advice that the brokers offered in response to that RFP would **not** cause the broker-dealer to become a municipal advisor.

In order for a broker to be eligible for this exemption from the Municipal Advisor Rule, the broker would need to ensure that the RFP met the following requirements:

- The municipal entity or obligated person, or a registered municipal advisor acting on its behalf, would need to conduct the RFP;
- A particular objective needs to be identified in the RFP (that is, in this context, the municipal entity or obligated person would need to be clear about what advice it is seeking concerning investments);
- The RFP would need to be open only for a specified period that is reasonable under the circumstances and no longer than six months); and
- The RFP would need to involve a reasonably competitive process, including being sent to at least three reasonably competitive market participants or publicly disseminated.

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Sample RFPs are attached to this paper as **Exhibit A**.

**8. When would it make sense for a municipal entity or obligated person to use the IRMA exemption to receive advice from brokers?**

Under the Municipal Advisor Rule, if a municipal entity or obligated person has retained a municipal advisor to provide advice concerning the investment of proceeds of municipal securities or escrow investments and the requirements of the Municipal Advisor Rule are met, then a broker may provide advice concerning those matters and not become a municipal advisor. We encourage municipal entities and obligated persons to review their contracts with municipal advisors to be sure that they have been retained to provide advice concerning the same scope for which advice may be provided by brokers. To avail itself of this option, the following requirements need to be met:

- The municipal entity or obligated person must retain a registered municipal advisor to provide it advice concerning the investments for which it will seek advice from brokers;
- The municipal advisor needs to be “independent,” which means that the municipal advisor may not have been affiliated or employed by any of the brokers from which the municipal advisor or obligated person will seek advice;
- The municipal entity or obligated person must represent to the broker that it will rely on the municipal advisor; and
- The broker must provide certain disclosures to the municipal advisor or obligated person.

If a municipal entity or obligated person has retained a registered municipal advisor and the other requirements of the IRMA exemption are satisfied, then there is no requirement that the municipal advisor participate or be included in any conversations or communications between a broker and the municipal entity or obligated person.

**9. If a broker cannot provide advice without becoming a municipal advisor, what information can the broker provide?**

Under the Municipal Advisor Rule, a broker may provide any “general information” without providing advice. In general, general information is defined under the Municipal Advisor Rule to mean any information that is factual in nature or information that is not particularized to the needs of the municipal entity or obligated person. In ordinary circumstances, this should include general market information, lists of inventories of securities and offered prices or yields of securities that may be available to purchase (so long as the broker does not exercise any discretion in sorting the list), portfolio reports, and research reports (so long as they are general in nature).

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## EXHIBIT A

### SAMPLE RFPs

#### Sample #1

Subject: RFP for Investment Advice for [Municipal Entity/Obligated Person]

[Municipal Entity/Obligated Person] is anticipating investing \$[AMOUNT] (the “Investment”) representing proceeds from the issuance of municipal securities under the following parameters (the “Investment Limitations”):

- [SPECIFY ANY LIMITATIONS IN INVESTMENTS]; and
- [SPECIFY MATURITY or ANY OTHER IMPORTANT CHARACTERISTICS].

The [Municipal Entity/Obligated Person] is requesting [DESCRIBE RECIPIENTS] to provide advice concerning the Investment. Any and all such advice must comply with the Investment Limitations. All such proposals must be delivered in [DESCRIBE FORM OF DELIVERY] no later than [SPECIFY DATE AND TIME] to [SPECIFY CONTACT INFORMATION WHERE PROPOSALS SHOULD BE SENT].

The [Municipal Entity/Obligated Person] is aware of the “Municipal Advisor Rule” of the Securities and Exchange Commission. The [Municipal Entity/Obligated Person] intends this RFP to qualify for the exemption from the definition of “municipal advisor” for a person providing “advice” in response to an RFP. The [Municipal Entity/Obligated Person] has [publicly disseminated this RFP by posting it on our website] [sent this RFP to at least three qualified and competitive firms].

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## *Sample #2*

Subject: RFP for Investment Advice for [Municipal Entity/Obligated Person]

The [Municipal Entity/Obligated Person] is considering revising its Investment Policy with respect to [DESCRIBE KIND OF INVESTMENTS], which include proceeds of the issuance of municipal securities. The [Municipal Entity/Obligated Person] is requesting advice from multiple firms with respect to suggested changes to the Investment Policy. The Investment Policy is subject to the following parameters:

- [DESCRIBE ANY STATUTORY PARAMETERS]; and
- [DESCRIBE ANY INDENTURE OR OTHER PARAMETERS].

Any and all such recommendations must comply with these parameters. All such proposals must be delivered in [DESCRIBE FORM OF DELIVERY] no later than [SPECIFY DATE AND TIME] to [SPECIFY CONTACT INFORMATION WHERE PROPOSALS SHOULD BE SENT].

The [Municipal Entity/Obligated Person] is aware of the “Municipal Advisor Rule” of the Securities and Exchange Commission. The [Municipal Entity/Obligated Person] intends this RFP to qualify for the exemption from the definition of “municipal advisor” for a person providing “advice” in response to an RFP. The [Municipal Entity/Obligated Person] has [publicly disseminated this RFP by posting it on our website] [sent this RFP to at least three qualified and competitive firms].

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