Rule G-23 finalized

May 31, 2011

Late Friday, May 27, the SEC approved changes to Rule G-23 to prohibit a financial advisor from switching roles and serving as an underwriter in negotiated and competitive transactions. *The changes are effective in six months, for new issues for which the Time of Formal Award (as defined in Rule G-34(a)(ii)(C)(1)(a)) occurs after November 27, 2011.* The prohibition would apply on an issue by issue basis, so that a firm can be a financial advisor to an issuer for one issue and, at the same time, an underwriter for the same issuer on a different issue. The prohibition applies to any firm controlling, controlled by, or under common control with the financial advisor.

There are several exceptions to the general prohibition, including for advice provided by an underwriter. The SEC also approved an interpretive guidance on when a firm would be considered to be an underwriter and not a financial advisor. The MSRB Notice is available here and the SEC Release is available here. The BDA has prepared suggested language for firms to use to be considered an underwriter and we will be updating that language in light of the SEC and MSRB actions.

The SEC and MSRB Notices describing the new rule make clear that this is only a conflict of interest rule. The new Rule does not establish substantive rules of conduct and the Notices make a point of distinguishing between "financial advisor" under this rule and "municipal advisor" under Dodd-Frank. A firm might not be considered a financial advisor, and thus could underwrite an issue, but it could at the same time be considered a municipal advisor – depending on how the SEC ends up defining that term - requiring registration as such and imposing a fiduciary duty on the firm. Dodd-Frank also may impose specific requirements for swap "advisors" under the CFTC. A firm that is considered an underwriter for the purposes of Rule G-23 may nevertheless be considered to be a municipal advisor by the SEC or a swap advisor by the CFTC and as a result have the associated substantive obligations.

General Rule: No broker, dealer, or municipal securities dealer that has a "financial advisory relationship" with respect to the issuance of municipal securities shall acquire as principal either alone or as a participant in a syndicate, directly or indirectly, from the issuer all or any portion of the issue, or act as agent for the issuer in arranging the placement of such issue. A "financial advisory relationship" shall be deemed to exist when a firm renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters. A firm need not be paid to be considered a financial advisor and, although a written agreement to be a financial advisor must be entered into at some point, it may be entered into *after* some financial advice is given.

However, an underwriter may give advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters or advice with respect to the investment of the proceeds of the issue, municipal derivatives integrally related to the issue, or other similar matters concerning the issue. In addition, a financial advisor may purchase securities from an underwriter, either for its own trading account or for the account of its customers, except to the extent that such purchase is made to contravene the purpose and intent of the rule.

When is a firm an underwriter? : Under the Rule and the Interpretive Guidance accompanying the Rule, a firm giving advice about the structure, timing, terms and other similar matters would be considered to be a financial advisor (and thus prohibited from being an underwriter) ***unless*** it clearly identifies itself *in writing* as an underwriter and not as a financial advisor *from the earliest stages of its relationship with the issuer* with respect to that issue (*e.g.*, in a response to a request for proposals or in promotional materials provided to an issuer). The writing must make clear that the primary role of an underwriter is to purchase, or arrange for the placement of, securities in an arm's-length commercial transaction between the issuer and the underwriter and that the underwriter has financial and other interests that differ from those of the issuer. In addition to this written disclaimer, the dealer must not act in a manner that is inconsistent with this arm's-length arrangement.

Placement with a governmental entity: A financial advisor may act as agent for the issuer in arranging the placement of the entire issue with any state, local or federal governmental entity, such as a bond bank, as part of a plan of financing by such entity for or on behalf of the issuer, but only if such broker, dealer or municipal securities dealer does not receive compensation from any person other than with respect to financial advisory services related to such placement and does not receive compensation from any person for underwriting any contemporaneous financing transaction directly or indirectly related to such issue undertaken by the state, local, or federal governmental entity with which such issue was placed.

Remarketing: No firm that has a financial advisory relationship with an issuer with respect an issue may act as the remarketing agent for that issue until at least one year after the termination of the financial advisor relationship with respect to that issue.