

The House Cracks the Ice. Will the SEC Sail Through with Municipal Advisor Rules?

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Just who is and is not regulated under changes made to federal securities law by the Dodd Frank Act as a "municipal advisor" and consequently a fiduciary to their clients has concerned many since the Securities and Exchange Commission released proposed rules employing an aggressively broad interpretation in December 2010. For those frozen in this grey zone of regulatory ambiguity, the ice may finally be cracking. Last night the House of Representatives passed H.R. 2827, a bill amending provisions of the Securities Exchange Act of 1934 to clarify the regulation of municipal advisors. Earlier last week the House Committee on Financial Services passed the same bill with bi-partisan unanimity in a 60-0 vote. Likelihood that the bill will become law in the brief time before the current Congress ends is slim, but not out of the question. Much more likely, the bipartisan nature of the House vote may encourage the Securities and Exchange Commission to move forward with its long-delayed final rules on municipal advisors.

Key features of H.R. 2827:

- narrow the definition of municipal advisors to parties engaged for compensation;
- restrict application of the existing fiduciary duty to activities pursuant to the engagement; and
- clarify covered activity by exempting certain activities of nine different categories of professionals.

The current deadline for final rulemaking is September 30, just a few days away. Unless the SEC adopts final rules in the short time remaining, the regulatory can will be kicked further down the road. The bipartisan nature of the House vote provides the SEC with a clear signal that its earlier proposals broadly misread Congressional intent and it should show little hesitation in trimming its proposals to a scope more in harmony with existing law and regulation. Whether the SEC responds remains to be seen.

In the interim, municipal advisers owe a fiduciary duty to their clients under current law resulting from Dodd-Frank and must comply with Municipal Securities Rulemaking Board (MSRB) Rule G-17 by dealing fairly with all persons.

Dodd Frank created "municipal advisor" as a new category of parties regulated by the SEC. Municipal advisors must register with both the SEC and the MSRB. Significantly, since October 1, 2010, municipal advisors have owed a fiduciary duty to their clients imposed by the statute itself, even if the SEC has not issued final rules clarifying whether or not the duty does, indeed, apply to them.

The SEC's draft rules released in late December 2010 cast an extraordinarily wide net, proposing to include many parties already regulated under the securities laws as well as many who never envisioned their activities with state and local governments as possibly coming within the scope of financial markets regulation of any sort. Objections from a large number of state and local officials as well as many members of Congress followed. The original deadline of December 31, 2011 was kicked forward nine months and is likely to be extended again. After this clear signal from the House, the SEC may have little excuse for not moving forward and finalizing its rules.

Key features of H.R. 2827 begin with a straightforward definition of the term "municipal advisor" as a person who "is engaged, for compensation, by a municipal entity or obligated person." This addition brings the definition in line with other definitions of financial service professionals under the federal securities laws such as "broker," "dealer," and "investment advisor," all of which include some form of the phrase "in the business of" as part of their definition which facilitates the SEC's exclusion of categories of actors from their scope by rulemaking.

The definition of municipal advisor is further clarified by new language stating that it does not include nine different categories of actors solely as a result of engaging in the respective activities described under their category, as shown in the redline below.

The definition "solicitation of a municipal entity or obligated person" is limited and the newly defined terms "municipal derivative" and the term to provide advice "on behalf of a municipal entity or obligated person" are added.

The definition of "investment strategies" is narrowed by both limiting language and specific exclusion.

Finally, the fiduciary duty specified under Section 15B(c)(1) is limited to municipal advisors "acting pursuant to an engagement" as described by the modified definition of municipal advisor and the MSRB is instructed in its rulemaking to apply the fiduciary duty only in connection with specific activities involving a municipal client in the context of its engagement with the client and specify when such duty begins and ends.

A redline of the affected subsections of Section 15B can be seen [here](#).