

PREPARE | PARTICIPATE | PUTTING INTO PRACTICE

2016 Compliance Advisory for Municipal Advisors

A GUIDE FOR
MUNICIPAL ADVISORS



Produced by the
Municipal Securities Rulemaking Board

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Introduction

The Municipal Securities Rulemaking Board (MSRB) is publishing the 2016 Compliance Advisory (Advisory) as part of the MSRB's ongoing effort to assist municipal advisors with understanding and implementing the new regulatory framework being developed by the MSRB in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).¹ The MSRB has prepared this Advisory to highlight some of the key compliance risks for municipal advisors that, if not properly addressed, could adversely affect municipal entities, obligated persons, investors and public confidence in the municipal securities market.² This Advisory also provides examples of conduct that could result from the absence of adequate controls (identified below as "Potential Violative Conduct") and a list of factors a firm may consider when evaluating its compliance controls and implementing measures to mitigate its exposure to these compliance risks (identified below as "Considerations"). The MSRB intends for municipal advisors to use this Advisory as a tool to supplement their assessment of the adequacy of their compliance programs.³

¹ Pub. Law No. 111-203, 124 Stat. 1376 (2010).

² This Advisory is not intended to address all the requirements of each MSRB rule or other federal securities laws and is not meant to be exhaustive or tailored to any one firm's business activities. This Advisory is not legal advice and does not create a safe harbor with respect to potential deficiencies in a municipal advisor's compliance processes or supervisory system.

³ The MSRB also identifies key compliance risks to assist the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) in the development of regulatory examination programs for municipal advisors consistent with Section 15B(b)(4) of the Securities Exchange Act of 1934.

Compliance Risks

Failure to Properly Register with the MSRB (MSRB Rule A-12)

A pre-requisite to registration with the MSRB is registration with the Securities and Exchange Commission (SEC), including the completion of SEC Form MA. A firm that has not registered with the SEC under the SEC's final municipal advisor registration rule⁴ may not engage in municipal advisory activities even if the firm previously registered with the MSRB while being registered with the SEC under its temporary rules.

MSRB Rule A-12, the MSRB's registration rule, requires municipal advisors to provide contact information (name, title, telephone number, address, and email address) for key contact persons to the MSRB on the electronic MSRB Form A-12.⁵ This information ensures that the municipal advisor will receive timely communications from the MSRB and assists the MSRB in communicating regarding regulatory matters and making requests directly to the relevant contact person tasked with handling such matters at each regulated entity. In addition to a primary regulatory contact, registrants are required to identify on Form A-12 a master account administrator, billing contact, compliance contact and primary data quality contact. Under MSRB rules, these contact persons are required to have certain competencies so that they can respond effectively to MSRB communications. For information about these contacts, and for additional information concerning completing, updating, amending or withdrawing registration via Form A-12, municipal advisors should consult the MSRB Registration Manual (available at www.msrb.org).

⁴ See Registration of Municipal Advisors, Exchange Act Release No. 70462 (Sept. 20, 2013), 78 FR 67467 (Nov. 12, 2013) ("SEC Final Rule on MA Registration").

⁵ See MSRB Regulatory Notice 2014-10 (May 12, 2014) "Guidance on the MSRB Municipal Advisor Registration Process" <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2014-10.ashx?n=1> and listen to the podcast "Being a Regulated Municipal Advisory" <http://www.msrb.org/EducationCenter/library/podcasts.aspx>.



MSRB RULE A-12

POTENTIAL VIOLATIVE CONDUCT:

- Failure to properly register prior to engaging in municipal advisory activities.
- Failure to update Form A-12 within 30 days of a change in material information.
- Failure to affirm the registration information disclosed on Form A-12 during the annual affirmation period that commences on January 1 of each calendar year and ends 17 business days thereafter.
- Failure to pay the applicable registration fees for both the firm pursuant to Rule A-12 and its associated persons pursuant to [Rule A-11](#).
- Failure to effectively withdraw registration with the MSRB.



MSRB RULE A-12

CONSIDERATIONS:

- Whether the firm is properly registered with the SEC and the MSRB and, as applicable, notified the appropriate regulatory agency of its intent to engage in municipal advisory activities.
- Whether the firm has controls in place to ensure that all of the appropriate contact persons are listed on Form A-12.
- If the firm, on a periodic basis throughout the year, reviews its Form A-12 to ensure the firm's filing contains current and accurate information.
- If the firm has controls in place to ensure that the applicable registration and professional fees are paid annually.

Failure to Ensure Associated Persons of the Municipal Advisor are Properly Qualified (MSRB Rule G-3)

MSRB Rule G-3, on professional qualifications requirements, provides for two municipal advisor classifications: (a) municipal advisor representative and (b) municipal advisor principal.⁶ Rule G-3 defines a “municipal advisor representative” as a natural person associated with a municipal advisor who engages in municipal advisory activities on the municipal advisor’s behalf, other than a person performing only clerical, administrative, support or similar functions. Rule G-3 defines a “municipal advisor principal” as a natural person associated with a municipal advisor who is qualified as a municipal advisor representative and is directly engaged in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons. Rule G-3 also requires that municipal advisors appoint at least one municipal advisor principal to be responsible for supervising the municipal advisory activities of the municipal advisor firm.

To act in the capacity of a municipal advisor representative or a municipal advisor principal, an individual will need to qualify by passing the Municipal Advisor Representative Qualification Examination (Series 50). Once the Series 50 examination becomes operational, municipal advisor professionals will have one year to pass the exam in order to satisfy the qualification requirements outlined in G-3. While municipal advisor professionals may continue to engage in or supervise municipal advisory activities during the one-year grace period, after the Series 50 examination has been operational for one year, municipal advisor professionals can not engage in municipal advisory activities on behalf of a municipal advisor without first passing the Series 50 examination.⁷

⁶ See Exchange Act Release No. 74384 (Feb. 26, 2015), 80 FR 11706 (March 4, 2015), File No. SR-MSRB-2014-08 (Nov. 18, 2014).

⁷ See MSRB Regulatory Notice 2015-04 (March 2, 2015) “MSRB to Amend Rules to Create Professional Qualification Standards for Municipal Advisors.”



MSRB RULE G-3

POTENTIAL VIOLATIVE CONDUCT:

- Failure to identify the individual(s) engaged in municipal advisory activities that are, by definition, municipal advisor representatives and must be qualified as such.
- Failure to identify each individual who is directly engaged in the management, direction or supervision of the municipal advisory activities of the municipal advisor and its associated persons and must be qualified as a municipal advisor principal.
- Failure to have an adequate process to identify individuals who perform municipal advisory activities and the management, directing or supervisory role(s) they may perform.



MSRB RULE G-3

CONSIDERATIONS:

- How the firm evidences that each of its associated persons engaged in municipal advisory activities is properly designated as either a municipal advisor representative or a municipal advisor principal.
- How the firm ensures that, once the Series 50 is implemented, each individual engaged in municipal advisory activities passes the Series 50 examination before the grace period ends or, at such time, ceases to engage in municipal advisory activities.
- How the firm evidences that it has appointed at least one municipal advisor principal to supervise the firm’s municipal advisory activities and that such person(s) is properly qualified.

Failure to Implement an Appropriate Compliance Program (MSRB Rule G-44)

MSRB Rule G-44 establishes supervisory and compliance obligations of municipal advisors when engaging in municipal advisory activities, setting forth basic requirements for municipal advisors to establish a supervisory system and compliance program.⁸ For purposes of the rule, a municipal advisor is defined as a person registered or required to be registered as a municipal advisor under Section 15B of the Securities Exchange Act of 1934. Rule G-44 follows a widely-accepted model in the securities industry, consisting of a reasonably designed supervisory system complemented by the designation of a chief compliance officer (CCO). The CCO can be a firm employee or a person external to the firm. While the municipal advisor retains ultimate responsibility for its compliance obligations, the option to outsource the CCO role provides flexibility, particularly for small municipal advisors, including those with only one associated person.⁹

⁸ See MSRB Regulatory Notice 2014-19 (October 24, 2014) “SEC Approves MSRB Rules G-44 on Supervisory and Compliance Obligations of Municipal Advisors, and Amendments to MSRB Rules G-8 and G-9.” See also, “Considerations for Developing a Municipal Advisory Supervisory System and Compliance Program” <http://www.msrb.org/msrb1/pdfs/MSRB-Rule-G-44-Considerations.pdf>.

⁹ This approach is consistent with the approach applicable to investment advisers under the Investment Advisers Act. See Section 202(25) of the Advisers Act, 15 U.S.C. 80b-2(25), and Rule 206(4)-7, 17 CFR § 275.206(4)-7. See also *In the Matter of Parallax Investments, LLC, John P. Bott, II, & F. Robert Falkenberg, Respondents*, Investment Advisers Act Release No. 4159 (Aug. 6, 2015) (An investment adviser that failed to tailor an “off the shelf” compliance manual to its business and ensure that its CCO adequately administered the investment adviser’s compliance program was found to have willfully violated its obligations under Rule 206(4)-7.)



MSRB RULE G-44

POTENTIAL VIOLATIVE CONDUCT:

- Failure to properly designate one or more municipal advisor principals vested with the authority to carry out the supervision of the municipal advisor for which they are responsible and have sufficient knowledge, experience and training to understand and effectively discharge their responsibilities.
- Failure to develop and implement written supervisory procedures and compliance policies reasonably designed to achieve compliance with all applicable securities laws and regulations.
- Failure to maintain general business records required by the SEC and under MSRB Rules [G-8](#) and [G-9](#) including, but not limited to, a general ledger reflecting asset, liability, reserve, capital, income and expense accounts and a written consent to service of process from each person associated with the municipal advisor that engages in municipal advisory activities on behalf of such municipal advisor.¹⁰
- Failure to maintain records concerning compliance with MSRB Rule G-44 as required by MSRB Rules G-8 and G-9.
- Failure to implement an effective compliance program due to the lack of operational resources.
- Failure to implement a process to, at least annually, review, test and modify the firm’s written compliance policies or supervisory procedures required to maintain a comprehensive compliance program.

¹⁰ See SEC Final Rule on MA Registration, *supra* note 4.

**MSRB RULE G-44****CONSIDERATIONS:**

- Whether the firm has appointed at least one municipal advisor principal who is responsible for reviewing the municipal advisory activities of all associated persons for compliance with the policies and procedures and how the firm evidences that supervisory review.
- Whether the firm has appointed a CCO who has the requisite competence to, among other things, understand the municipal advisory services and activities and to identify the applicable rules and standards of conduct pertaining to such services and activities.
- Whether the firm has identified who is charged with the obligation to develop written policies and procedures and, if it is not the CCO, how coordination with the CCO is evidenced.
- Recognizing that the municipal advisor retains ultimate responsibility for its compliance obligations, whether the firm has a process to ensure that the CCO devotes sufficient time and effort to effectively develop the firm's comprehensive compliance program.
- Whether senior management of the municipal advisor has a practice of regular and significant interaction with the CCO regarding the firm's compliance program as intended by Rule G-44.
- How the firm monitors regulatory developments, including applicable rule changes that might suggest a need to modify its supervisory system and how the firm communicates any modifications to its associated persons.¹¹
- How the firm evidences that, at least annually, the supervisory procedures and compliance policies are reviewed to ensure they are reasonably designed to achieve compliance with applicable rules and make any changes as a result of the review.
- What process the firm will develop to ensure that the Chief Executive Officer (CEO) or equivalent officer certifies on an annual basis, beginning April 23, 2016, that the municipal advisor has in place processes to establish, maintain, review, test and modify written compliance policies and supervisory procedures reasonably designed to achieve compliance.
- How the firm maintains originals or copies of all written communications, received or sent by the municipal advisor (including inter-office memoranda and communications) relating to municipal advisory activities, as required by SEC rules, regardless of the medium of the communications.
- Whether the firm has considered reasonable safeguards and technical controls to protect its data and technology systems from cyber threats to ensure its records are maintained and preserved consistent with SEC Rule 15Ba1-8(a)(1)-(8) and MSRB Rule G-9.¹²

¹¹ For more information on the MSRB's rulemaking process, as well as the structure and format of MSRB rules, see "The Municipal Advisor's Introduction to MSRB Rules," <http://www.msrb.org/MSRB-For/Municipal-Advisors/News-and-Resources.aspx>.

¹² See, e.g., "OCIE Cybersecurity Initiative" (April 15, 2014) available at: <http://www.sec.gov/ocie/announcement/Cybersecurity-Risk-Alert--Appendix--4.15.14.pdf>.

Failure to Recognize when Placement Agent Activity may be Brokerage Activity (MSRB Rules [A-12](#), [G-3](#), [G-32](#) and [G-34](#))

A municipal advisor may be acting as a broker-dealer when, for example, it acts as a placement agent effecting a securities transaction with a potential investor coupled with the receipt of transaction-based compensation. In some cases municipal advisors that play a role in facilitating bank loans evidenced by notes may fail to recognize that the instrument being issued is a municipal security and that the bank is not a lender, but an investor. In other cases, a direct purchase of a variable rate demand obligation (VRDO) by a bank, followed by a significant restructuring of the terms of the security, may amount to a primary offering of municipal securities. In addition to the activities potentially requiring registration as a broker-dealer, such activities may trigger the application of MSRB rules beyond those that apply to municipal advisors engaging in activities in their capacity as municipal advisors.



MSRB RULES [A-12](#), [G-3](#), [G-32](#) AND [G-34](#)

POTENTIAL VIOLATIVE CONDUCT:

- Conducting business as an unregistered broker-dealer.
- Failure to comply with MSRB rules applicable to brokers, dealers and municipal securities dealers, including rules requiring registration, disclosures and trade reporting.



MSRB RULES [A-12](#), [G-3](#), [G-32](#) AND [G-34](#)

CONSIDERATIONS:

- Whether the firm has reviewed MSRB Notice 2011-37 (August 3, 2011), MSRB Notice 2011-52 (September 12, 2011) and MSRB Notice 2015-03 (January 29, 2015) regarding private placements and bank loans.
- Whether the firm has a process to evaluate whether a particular financial instrument is not a security under the Supreme Court's "Reves test"¹³ and to document that analysis.
- Does the firm have controls in place to ensure that the activities it engages in are within the scope of the definition of "municipal advisory activities" as provided under [MSRB Rule D-13](#) and do not trigger registration as a broker-dealer.¹⁴

¹³ See *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

¹⁴ See, e.g., SEC Division of Trading and Markets, "Guide to Broker-Dealer Registration" (April 2008), available at www.sec.gov/divisions/marketreg/bdguide.htm.

Failure to Deal Fairly with all Persons in the Conduct of Municipal Advisory Activities (MSRB Rule G-17)

In the conduct of its municipal advisory activities, each municipal advisor firm and its associated persons shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. This rule is designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade and, in general, to protect investors, municipal entities, obligated persons and the public interest.



MSRB RULE G-17

POTENTIAL VIOLATIVE CONDUCT:

- Splitting municipal advisory fees with a third-party under a fee arrangement that is not disclosed to the client.
- Providing a specific suggestion or recommendation to a municipal entity to either act or refrain from acting with regard to municipal financial products or the issuance of municipal securities and providing a disclaimer that such suggestion or recommendation is not advice.
- Falsely holding the firm out as the independent registered municipal advisor for a municipal entity.



MSRB RULE G-17

CONSIDERATIONS:

- Whether the firm has a process to review advertising and other promotional materials, including its website, with a view to ensure that they do not contain false or misleading information.
- How the firm monitors whether it is dealing fairly with all persons, including municipal entities and obligated persons.

Conclusion

This Advisory is designed to support municipal advisors in the development of effective policies and procedures for supervision, compliance and the assessment of their compliance programs. In addition to this Advisory, municipal advisors may wish to reference other information regarding MSRB rules and regulations on the MSRB's website at www.msrb.org.

The MSRB engages in an ongoing dialog with municipal market participants through outreach events and education activities and encourages municipal advisors to visit the MSRB's website to review past webinars and publications, including the MSRB's quarterly newsletter for municipal advisors.¹⁵

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¹⁵ Municipal advisors can also subscribe to the MSRB email updates on the MSRB's website to ensure they receive information from the MSRB on upcoming events, educational resources and news in a convenient electronic format.



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