MSRB NOTICE 2011-37 (AUGUST 3, 2011)

FINANCIAL ADVISORS, PRIVATE PLACEMENTS, AND BANK LOANS

Introduction

The Municipal Securities Rulemaking Board ("MSRB") wishes to bring an important issue to the attention of all financial advisors, both those that are not currently registered with the Securities and Exchange Commission ("SEC") as "brokers" within the meaning of Section 3(a)(4) of the Securities Exchange Act of 1934 (the "Exchange Act") and those that are already registered with the SEC as brokers, dealers, or municipal securities dealers ("broker-dealers"). Under principles described by the SEC in no-action letters, if financial advisors engage in certain activities with respect to placements of municipal securities by issuers, they may be considered to be acting as a "broker" and, depending on the nature of such activities, could be viewed as placement agents. Activities of particular concern are introductions of potential investors to an issuer or negotiation with potential investors, in either case coupled with the receipt of transaction-based compensation. If a financial advisor, by virtue of its activities, would be viewed as a placement agent for a new issue of municipal securities, its activities in connection with such placement would be subject to all MSRB rules normally applicable in connection with private placements, as described below.
Given the growing use of placements as an alternative to traditional public offerings of municipal securities, it is particularly important that all financial advisors, including financial advisors that are also broker-dealers, understand the principles for treatment as a "broker" set forth by the SEC so that they can tailor their conduct accordingly. It is also important for financial advisors to be aware that what are referred to as "bank loans" may, depending on the specific terms and conditions, be placements of municipal securities.

Repeal of "Dominion Resources" No-Action Letter

In 1985, the Office of Chief Counsel in the SEC's Division of Market Regulation issued a no-action letter in response to a request from Dominion Resources, Inc. ("Dominion Resources").[1] The letter said that staff of the Division of Market Regulation would not recommend that the SEC initiate enforcement action under Section 15(a) of the Exchange Act if Dominion Resources failed to register with the SEC as a broker-dealer pursuant to Section 15(b) of the Exchange Act. The no-action letter said that it was based on the letter submitted by Dominion Resources, in which Dominion Resources described certain activities concerning placements of municipal securities in which it planned to engage. Those activities included advice on the structuring of municipal securities; recommendations of other transaction participants (e.g., bond lawyers and underwriters); introduction of issuers to commercial banks that might act as the initial purchaser of the securities and/or as a standby purchaser if the securities could not be readily remarketed by the broker-dealer; preparation of official statements; and participation in meetings with transaction participants, including commercial bank standby purchasers, during which it might articulate, explain or defend negotiating proposals or positions that had been adopted by its client. Dominion Resources told the SEC that it would neither bid on any issues of securities nor underwrite, trade, or hold funds or securities of the

[1] Letter re: Dominion Resources, Inc. (July 23, 1985). At the same time, Dominion Resources was issued a companion no-action letter by the staff of the SEC's Division of Investment Management. That no-action letter is not the subject of this notice.

issuer. It also said that the only contact that it would have with any potential purchaser was the possible introduction of the issuer to a commercial bank for which it said it would not receive any commissions or other transaction-based compensation. Fees charged by Dominion Resources for its consultative and coordinating services would, it said, be negotiated with the issuer, be related to the overall size of the financing that the client wished to arrange, and generally not be payable unless the financing closed successfully, although such fees would not be based upon successful issuance of securities to the public or be affected by secondary trades thereafter.

In 2000, the SEC revoked the Dominion Resources no-action letter, stating that the staff no longer believed that an entity conducting the activities described in that letter would not have to register as a broker-dealer under Section 15 of the Exchange Act. In its letter revoking the no-action letter, the SEC said that, since issuing the Dominion Resources no-action letter, the staff had frequently considered the question of when a person is a broker that must register as a broker under Section 15 of the Exchange Act, and when the person is merely a "finder" that is not subject to registration. It said that, "in the intervening years, technological advances, including the advent of the Internet, as well as other developments in the securities markets, have allowed more and different types of persons to become involved in the provision of securities-related services." It noted that, more recently, the staff had denied no-action requests in situations that it characterized as somewhat similar to the arrangements described in the Dominion Resources no-action letter. The no-action letters cited by the SEC[2] all involved situations in which various parties had introduced the issuers of securities to investors and/or participated in negotiations with those investors, and received transaction-based compensation -- all activities in which Dominion Resources had represented that it would engage.

Applicability of MSRB Rules

If financial advisors are engaged in activities that require them to register with the SEC as "brokers," such activities will be subject to all of the federal securities laws that normally apply to broker-dealers when they act as placement agents for issuers, including rules of the MSRB.[3] The applicability of MSRB rules relating to activities of a placement agent is equally true under circumstances where financial advisors that are already registered as broker-dealers engage in the activities that are viewed as placements of municipal securities. Importantly, financial advisors that have not traditionally viewed themselves as brokers could unintentionally become subject to MSRB Rule G-23, which, effective November 27, 2011, generally precludes financial advisors that are broker-dealers from becoming underwriters or placement agents for issues of municipal securities for which they have been serving as financial advisors.[4] Therefore it is crucial

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[2] Letters re: John Wirthlin (Jan. 19, 1999); Davenport Management, Inc. (Apr. 13, 1993); and C&W Portfolio Management, Inc. (July 20, 1989).

[3] MSRB rules applicable to brokers acting as placement agents would apply in addition to any MSRB rules applicable to municipal advisors engaging in municipal advisory activities. The MSRB notes that rules applicable to placement agent activities would apply regardless of whether a firm acting in such capacity that is required to register with the SEC as a broker has in fact so registered.

[4] A limited placement agent exception to Rule G-23's ban is found in Rule G-23(d)(ii), which provides:

> Notwithstanding subsection (d)(i), a broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to the issuance of municipal securities shall not be prohibited from acting as agent for the issuer in arranging the placement of the entire issue with any state, local or federal governmental entity

that financial advisors are aware of the SEC rules that can result in their being viewed as placement agents as a result of their activities.

Financial advisor placement agents would be required to register with the MSRB as broker-dealers if they have not previously done so, even if they were already registered as municipal advisors. Among the other MSRB rules to which they would be subject are: Rule A-13 (requiring broker-dealers to pay assessments on underwritings and placements of municipal securities), Rule G-3 (requiring broker-dealers engaged in municipal securities activities to pass qualifying examinations), Rule G-14 (requiring broker-dealers to report purchases and sales of municipal securities, including agency trades), Rule G-17 (imposing a duty of fair dealing on broker-dealers in the conduct of the municipal securities and municipal advisory activities), Rule G-32 (requiring submissions of official statements and related new issue information), Rule G-34 (requiring broker-dealers to obtain CUSIP numbers for municipal securities issues), and Rule G-37 (banning broker-dealers from engaging in municipal securities business for two years following non-de minimis political contributions to certain "issuer officials"). If they were functioning as municipal advisors, such financial advisors would also be subject to a federal fiduciary duty under Section 15B(c)(1) of the Securities Exchange Act of 1934.

Review of Potential Status as Financial Advisor or Placement Agent

The repeal of the Dominion Resources no-action letter and the reasons given by the SEC for the repeal should be considered by all financial advisors when they choose to engage in certain activities with regard to the placement of municipal securities, particularly if they will introduce potential investors to an issuer or negotiate with potential investors, in either case coupled with the receipt of transaction-based compensation. Financial advisors should consult with their counsel for advice on whether such activities may require them to register with the SEC as "brokers" and subject them to MSRB rules applicable to broker-dealers, as well as those applicable to municipal advisors. All financial advisors, including those that are already registered as broker-dealers, should also consult with their counsel on whether engaging in such activities could trigger the application of MSRB rules that apply to placement agents. All financial advisors may also find an SEC publication called "Guide to Broker-Dealer Registration" helpful. It contains answers to frequently asked questions, including "Who is required to register?" and contains a phone number to contact the SEC for questions.

Distinguishing a Bank Loan from a Municipal Security

A key threshold determination that must be made is whether a financial advisor is assisting in the placement of a security or a loan. If the financial instrument that is the subject of the placement is a loan, the financial advisor's activities in connection with the loan will probably not cause it to have to register as a broker. As

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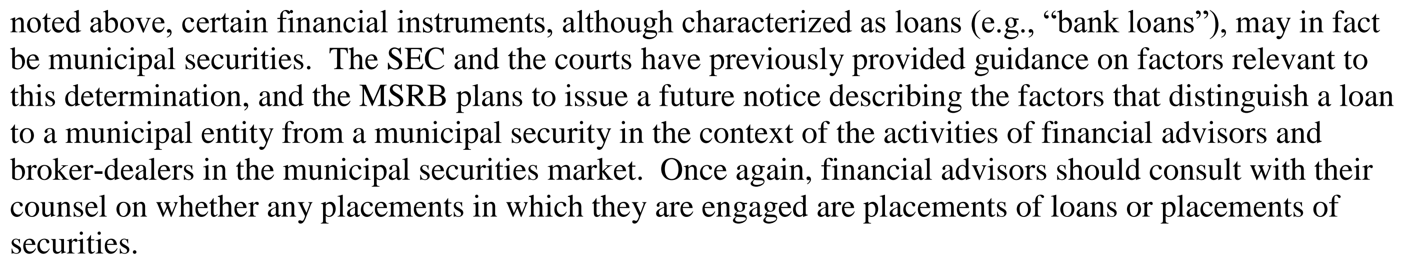
> as part of a plan of financing by such entity for or on behalf of the issuer, but only if such broker, dealer or municipal securities dealer does not receive compensation from any person other than with respect to financial advisory services related to such placement and does not receive compensation 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.

This exception may have applicability, for example, to borrowings from bond banks and state revolving funds created to finance clean water and drinking water expenditures, if such borrowings are evidenced by bonds or other securities.



noted above, certain financial instruments, although characterized as loans (e.g., "bank loans"), may in fact be municipal securities. The SEC and the courts have previously provided guidance on factors relevant to this determination, and the MSRB plans to issue a future notice describing the factors that distinguish a loan to a municipal entity from a municipal security in the context of the activities of financial advisors and broker-dealers in the municipal securities market. Once again, financial advisors should consult with their counsel on whether any placements in which they are engaged are placements of loans or placements of securities.

August 3, 2011