

Overview

To protect the interests of state and local governments that engage the services of municipal advisors, the Dodd-Frank Wall Street Reform and Consumer Protection Act charged the Municipal Securities Rulemaking Board (MSRB) with creating rules of conduct and standards of qualification for municipal advisors. As part of that mandate, the MSRB developed proposed Rule G-42,¹ which, if approved by the Securities and Exchange Commission (SEC), would establish the core duties of municipal advisors when providing municipal advisory services to state and local governments and other clients. The rule does not address the duties of municipal advisors acting as solicitors.

The key provisions of the proposed rule address:

- The fiduciary duty owed by a municipal advisor to its municipal entity clients;
- The duty of care owed by a municipal advisor to its municipal entity and obligated person clients;
- Full and fair disclosure of conflicts of interest;
- Documentation of the municipal advisory relationship;
- Suitability of recommendations; and
- Specific prohibitions against certain activities, such as those related to principal transactions, compensation and fees.

Key Provisions

Duties of Municipal Advisors

Municipal advisors are required to exercise due care when advising all clients, including state and local governments, other municipal entities and non-municipal entities obligated to repay the bonds. This “duty of care” entails a responsibility to possess the requisite knowledge and conduct appropriate research to provide informed advice and make suitability determinations for recommendations to their clients. Further, when dealing with municipal entities, municipal advisors owe a duty of loyalty and must act with utmost good faith and put their clients’ interests ahead of their own under the federal fiduciary duty established by the Dodd-Frank Act.

Disclosure of Conflicts of Interest

Prior to or upon beginning services for a client, municipal advisors must provide full and fair disclosure, in writing, of all material actual or potential conflicts of interest. These generally include

¹ This document provides only a high-level summary of proposed MSRB Rule G-42 as filed with the Securities and Exchange Commission on April 15, 2015. [Refer to the rule filing](#) on the MSRB website at MSRB.org for the full text of the proposed rule.

conflicts arising from financial arrangements or relationships with third parties that may affect the advice provided to the client. Municipal advisors are also required to disclose other information relevant to a client's assessment of the municipal advisor's integrity, such as legal or disciplinary actions against the municipal advisor. Disclosure of this particular information may be fulfilled by directing clients to the relevant portions of the municipal advisor's most recent Forms MA and MA-I on file with the SEC.

Documentation of the Relationship

At least promptly after beginning a municipal advisory relationship with a client, municipal advisors must put into writing the details of the relationship, including compensation structure, scope of activities, required disclosures and any means for terminating the relationship. This documentation need not take the form of a contract, and the required updates may be made in separate writings.

Suitability of Recommendations

If a municipal advisor recommends a municipal securities transaction or municipal financial product, or is asked by the client to review a recommendation of a third party, the municipal advisor must use reasonable diligence to determine whether the transaction or product is suitable for the client. This suitability determination requires the municipal advisor to "know your client" and consider a variety of factors such as the client's risk tolerance, financial situation and experience with municipal securities transactions or municipal financial products. The municipal advisor must inform the client about the risks, potential benefits, structure and other characteristics of the transaction or product. Additionally, the municipal advisor must disclose the basis for reasonably believing that the transaction or product is, or is not, suitable for the client, as well as whether the municipal advisor investigated other reasonably feasible alternatives to the recommended transaction or product.

Prohibited Activities

Municipal advisors are prohibited from certain unfair practices or activities, including, but not limited to, receiving excessive compensation, misrepresenting the extent of the municipal advisor's knowledge or qualifications, participating in fee-splitting arrangements with underwriters, making payments to secure municipal advisory business (with limited exceptions), and engaging in principal transactions with their municipal entity clients that are directly related to the transaction for which the municipal advisor is providing advice.

Inadvertent Advice

In the event that a municipal advisor inadvertently provides advice, the municipal advisor may be relieved from the conflict disclosure and relationship documentation requirements if it ceases immediately and documents the error in writing for the client. Doing so does not eliminate responsibility for compliance with the SEC's registration rule, other provisions of Rule G-42, other MSRB rules or any other applicable laws; rather, it offers narrow relief from specified requirements of Rule G-42 that are intended to apply to intentional advisory relationships.