



August 1, 2014
2014 Edition, Issue XIV

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MSRB Actions Regarding Municipal Advisors: Release of Revised Draft Rule G-42 for Comment, and Submission of Proposed Rule G-44 to SEC for Approval

This mailing is to inform you of the Municipal Securities Rulemaking Board (MSRB) releasing Revised Draft Rule G-42 (setting forth duties of non-solicitor municipal advisors) for public comment, and submitting Proposed Rule G-44 (setting forth the supervisory obligations of municipal advisors) to the Securities and Exchange Commission (SEC) for approval.

Revisions to Draft Rule G-42

On July 23, 2014, the MSRB issued Regulatory Notice 2014-12 (the Notice) seeking comment on revised Draft Rule G-42, with conforming changes to MSRB Rules G-8 and G-9 (required records and preservation requirements, respectively) (the Revised Draft Rule). The prior version of Draft Rule G-42 was released on January 9, 2014 (the Initial Draft Rule). See our [mailing](#) dated January 22, 2014, on notable provisions in the Initial Draft Rule.

The Revised Draft Rule contains various changes in response to the large number of comments received by the MSRB on the Initial Draft Rule.

Comments on the Revised Draft Rule are due to the MSRB by August 25, 2014. The Notice is available here: <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2014-12.ashx?n=1>

The more notable revisions in the Revised Draft Rule are summarized below.

Duty of Care and Fiduciary Duty

The MSRB has proposed changing the language of Supplementary Material .01, addressing a municipal advisor’s Duty of Care to obligated person and municipal entity clients, and Supplementary Material .02, addressing a municipal advisor’s Duty of Loyalty to municipal entity clients (that is, the fiduciary duty owed to municipal entity clients). Under the Revised Draft Rule, the requirement for a municipal advisor to undertake a thorough review of the official statement is eliminated from the Duty of Care. With respect to the Duty of Loyalty, a municipal advisor is no longer required to investigate or consider other reasonably feasible alternatives to any recommended municipal securities transaction or municipal financial product that might also or alternatively serve the client’s objectives. These changes reflect the MSRB’s position that clients should determine the scope of services required to be provided by municipal advisors.

Additionally, revised Supplementary Material .02 prohibits a municipal advisor from engaging in municipal advisory activities with a municipal entity client if it cannot manage or mitigate its conflicts such that it may act in such client’s best interests.

Principal Transactions

In response to numerous comments concerning the broad scope of the Initial Draft Rule’s prohibition on principal transactions, the MSRB significantly narrowed its application in the

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Revised Draft Rule. Rather than prohibiting a municipal advisor and its affiliates from engaging in any principal transaction with a municipal entity or obligated person client of the municipal advisor, the Revised Draft Rule prohibits a municipal advisor and its affiliates from engaging in a principal transaction with a municipal entity if that transaction is directly related to the same municipal securities transaction or municipal financial product regarding which the municipal advisor is providing advice. Additionally, the Revised Draft Rule defines a principal transaction as selling to or purchasing from one's municipal entity client any security or entering into any derivative, guaranteed investment contract, or other similar financial product with one's municipal entity client, in each case when acting as principal for one's own account. The MSRB states in the Notice that the goal of such changes is to address the concerns of some commenters that transactions such as taking cash deposits or accepting payments for solely professional services were covered by the prohibition in the Initial Draft Rule.

Disclosure of Conflicts of Interest

The Revised Draft Rule made a number of changes to the required disclosures regarding conflicts of interest, including:

- Revising the requirement to disclose conflicts arising from the form of compensation to require only disclosure of conflicts arising from compensation for municipal advisory activities to be performed that is contingent on the size or closing of any transaction as to which the municipal advisor is providing advice.
- Revising the requirement that a municipal advisor concluding it has no material conflicts provide a written statement to that effect by adding a knowledge qualifier such that the municipal advisor in such a position must provide a written statement that it has no known conflicts.
- Eliminating the requirement to disclose the amount and scope of professional liability insurance carried by the municipal advisor.
- Eliminating the requirement to disclose all legal and disciplinary events disclosed on Form MA and applicable Forms MA-I, leaving only the requirement to disclose such events that are material to a client's evaluation of the municipal advisor and its personnel. Please note legal and disciplinary events disclosed on Forms MA and MA-I must be maintained as part of the documentation requirement. See Documentation of Municipal Advisory Relationship below.

Documentation of Municipal Advisory Relationship

The Revised Draft Rule made a number of changes to the documentation that must be maintained by the municipal advisor, including:

- Eliminating the requirement to document the reasonably expected amount of compensation, to the extent it can be quantified. The Revised Draft Rule only requires municipal advisors to document the form and basis of the compensation.
- Revising the requirement to amend the documentation. The Revised Draft Rule requires municipal advisors to amend the documentation only to reflect material changes or additions.
- Eliminating the requirement that, with respect to a new issue or reoffering of municipal securities, the documentation must detail the specific undertakings requested by the client relating to preparing and finalizing an official statement or similar disclosure document.
- Adding a requirement that the documentation must include any terms relating to the municipal advisor's withdrawal from the relationship.

- Adding a requirement that the documentation must include a description of the type of information regarding legal events and disciplinary history requested by the SEC on Forms MA and MA-I, and information identifying where the client may electronically access the advisor's most recently filed Forms MA and MA-I. The documentation must also include the date of the municipal advisor's last material change to such disclosures.

Suitability of Recommendations

The Revised Draft Rule does not materially change the Initial Draft Rule's factors taken into account for determining whether a municipal financial product or transaction is suitable for a client. However, the section merges into one the standards for making a recommendation to a client and those for reviewing the recommendations of others. In addition, the Revised Draft Rule eliminates the requirement that the municipal advisor discuss with the client the municipal advisor's basis upon which it reasonably believes its recommendation is reasonable. The Revised Draft Rule only requires that the municipal advisor inform the client of such basis.

Specified Prohibitions

The Initial Draft Rule contained a prohibition on a municipal advisor receiving excessive compensation in relation to services rendered. The Revised Draft Rule keeps this prohibition, and adds guidance on factors that may be relevant when determining whether compensation is "excessive," that is, whether it is so disproportionate to the nature of the municipal advisory services performed as to constitute an unfair practice in violation of G-17, including:

- The municipal advisor's expertise;
- the complexity of the municipal securities transaction or the financial product;
- whether the fee is contingent upon the closing of the transaction or financial product;
- the length of time spent on the engagement; and
- whether the advisor is paying other relevant costs related to the transaction or product.

New Provision for Inadvertent Advice

The Revised Draft Rule contains a new safe harbor provision under which a municipal advisor that inadvertently provides advice to a municipal entity or obligated person may be exempt from the Revised Draft Rule's requirements on conflict disclosure and documentation of a municipal advisory relationship, provided certain requirements are satisfied. The Notice explains that this provision is in response to comments that the Initial Draft Rule did not take into account situations where a firm provides advice to a company that is not identified as an obligated person, or where the firm provides advice to a municipal entity or obligated person but subsequently does not enter into a client relationship with that entity or person.

In the safe harbor provision, a municipal advisor must, as promptly as possible, provide a document to the municipal entity or obligated person that is dated and includes:

- A disclaimer that the advisor did not intend to provide advice and that, effective immediately it has ceased engaging in municipal advisory activities;
- A notification that the disclosure of conflicts of interest has not been provided;
- A representation by the advisor that it, in good faith, has undertaken reasonable efforts to identify the advice that was inadvertently provided; and
- A request that the municipal entity or obligated person acknowledge receipt.

In addition, municipal advisors using this safe harbor must promptly conduct a review of their written supervisory and compliance policies and procedures to ensure they are reasonably designed to prevent the provision of inadvertent advice to municipal entities and obligated persons.

Proposed Rule G-44

On July 24, 2014, the MSRB submitted Proposed Rule G-44 (the Proposed Rule), with conforming changes to Rules G-8 and G-9, to the SEC for approval. See our prior [mailing](#) dated March 3, 2014, which summarized Draft Rule G-44.

The MSRB's press release announcing the submission, which contains a link to the filing with the SEC, is available here: <http://www.msrb.org/News-and-Events/Press-Releases/2014/MSRB-Seeks-Approval-to-Implement-Supervision-Rule-for-Municipal-Advisors.aspx>

The Proposed Rule made some additions to Draft Rule G-44, but few other changes. The more notable additions are summarized below.

Annual Certification Requirement

The Proposed Rule requires that a municipal advisor shall have its chief executive officer or equivalent officer certify in writing annually that the municipal advisor has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable rules.

The requirement does not apply to municipal advisors that are subject to a substantially similar certification requirement of the Financial Industry Regulatory Authority with respect to all applicable rules.

Effect of Annual Certification on Business Line Responsibility

The Proposed Rule provides that the person signing the certification described above is certifying only as to having processes in place to establish, maintain, review, test and modify the municipal advisor's written compliance and supervisory policies and procedures and the execution of this certification and any consultation rendered in connection with such certification does not by itself establish business line responsibility.

Exemption for Federally Registered Banks

To the extent it engages in municipal advisory activities in the exercise of any fiduciary powers authorized by the Comptroller of the Currency pursuant to 12 C.F.R. 9.2(g), a municipal advisor that is a bank or separately identifiable department or division of a bank as defined in Securities Exchange Act Rule 15Ba1-1(d)(4) is exempt from G-44 and certain books and records requirements in G-8 if such municipal advisor certifies in writing annually that it is, with respect to such activities, subject to federal supervisory and compliance obligations and books and records requirements that are substantially equivalent to the supervisory and compliance obligations of this rule and the books and records requirements of Rule G-8(h)(iii).

Please contact us with questions.