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The following materials have been prepared by the Orrick, Herrington & Sutcliffe public finance department to provide an outline for purposes of discussing the issues that arise under the SEC Municipal Advisor Rule as they relate to underwriters. The materials are to generate discussion and do not represent legal advice.

Summary of Selected Issues of the SEC Municipal Advisor Rule that Affect Broker-Dealers Intending to be Underwriters

Dodd Frank Act Definition of "Municipal Advisor"

A "municipal advisor" is a person (including a firm or an associated person) (but not including a municipal entity or an employee of a municipal entity) who (1) provides "advice" to "municipal entities" or "obligated persons" on the "issuance of municipal securities" or "municipal financial products," or (2) undertakes a "solicitation of a municipal entity."

On September 18, 2013, the SEC unanimously approved Release No. 34-70462 (Sept. 20, 2013)(Adopting Release), which contains final rules on the registration of municipal advisors (SEC Municipal Advisor Rule or Final Rule). The Final Rule includes eight rules under section 15B of the Securities Exchange Act of 1934 (Rule 15Ba1-1 through Rule 15Ba1-8) and a series of Forms for registration as a municipal advisor. Definitions are in Rule 15Ba1-1.

The Importance of the Term "Advice"

Each of the statutory terms in quotation marks in the first paragraph above is defined or amplified in the Dodd Frank Act, except the term "advice," and while staff of the SEC in speeches has emphasized the importance of the term, it was not formally described until the Final Rule. After the definition of municipal advisor (15Ba1-1(d)(1)(i)), subparagraph (ii) is entitled "Advice

standard." The subparagraph is written in the negative, and states "advice excludes, among other things, the provision of general information that does not involve a recommendation regarding municipal financial products or the issuance of municipal securities (including with respect to the structure, timing terms and other similar matters concerning such financial products or issues)." (emphasis added)

Turning the negative around, the Adopting Release states that "advice" includes a recommendation that is particularized to the specific needs, objectives, or circumstances of a "municipal entity" or "obligated person" with respect to municipal financial products or the issuance of municipal securities, including with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, based on all the facts and circumstances. (p. 46) (emphasis added)

"Advice" does not include provision of the following "general information:"

- Information of a factual nature without subjective assumptions, opinions, or views.
- Information that is not particularized to a specific municipal entity or type of municipal entity.
- Information that is widely disseminated for use by the public, clients, or market participants other than municipal entities or obligated persons.
- General information in the nature of educational materials.

A key term in the advice standard is a "recommendation." The term has long been used by FINRA in its suitability rule to define when a broker-dealer has an obligation to make a suitability determination. FINRA Regulatory Notice 11-02 (Jan., 2011), which describes the FINRA "Know Your Customer" and "Suitability" rules, states that the inquiry is "whether – given its content, context and manner of presentation – a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy." (p.46)

The Adopting Release cites favorably both FINRA Rules 2111(suitability) and 2090(know your customer) and MSRB Rule G-19(suitability) since both provide comparable suitability standards. In addition, the SEC cites case law to the effect that a suitability recommendation involves a "call to action." Note that both the FINRA and MSRB suitability rules now include a recommendation to refrain from taking action, and the Adopting Release picks up this idea by stating that advice would include a suggestion that the municipal entity or obligated person "refrain" from taking action regarding municipal financial products or the issuance of municipal securities.

Advice on the "issuance of municipal securities" includes advice throughout the life of an issue of municipal securities, from the pre-issuance planning stage for a debt transaction involving the issue of municipal securities to the repayment stage for those municipal securities.

Hypothetical. In the pre-RFP exemption period, at the request of a municipal entity, a broker-dealer prepares a refunding analysis of certain outstanding bonds selected by the municipal entity. The broker-dealer delivers the mathematical analysis without comment. (1) Under the Final Rule, is the analysis a call to action because the refunding analysis is particularized to a specific municipal entity and specific outstanding bonds? (2) Does the suitability recommendation standard have a reasonable inference principle when a broker-dealer provides information? (3) *Suppose the refunding analysis contains a bold disclosure at the top stating: "This refunding analysis is for information only and does not constitute a recommendation by ABC broker-dealer firm to take any action."*

Municipal Advisory Activities

The SEC emphasizes that the municipal advisor definition and registration requirement are determined by reference to activities engaged in by a person and not the status of a person. Thus an engineering firm may be excluded from the definition of a municipal advisor, not because it is an engineering firm, but because it is not engaging in any municipal advisory activities. Rule 15Ba1-1(d) defines a municipal advisor and enumerates the exclusions and exemptions. Rule 15Ba1-1(e) defines municipal advisory activities to mean the activities specified in (d)(1), which are not excluded under (d)(2) or exempted under (d)(3), that would cause a person to be a municipal advisor. The activities are the statutory activities of providing advice to a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, or the solicitation of a municipal entity or obligated person.

Hypothetical. In the planning period before the RFP process, the CFO of a municipal entity calls a broker-dealer, who will later respond to the underwriter RFP, and describes the upcoming issuance of bonds for which there will later be a RFP. During the course of the conversation, the CFO asks for the broker-dealer's advice on whether the municipal entity should sell certain assets that are unrelated to the upcoming offering. Is the broker-dealer a municipal advisor?

The MSRB Rule G-17 Underwriter Notice to the Issuer and the Existence of a Municipal Advisor

On August 2, 2012, the MSRB released an interpretive notice concerning the application of Rule G-17 on fair dealing by a broker-dealer acting in the capacity of underwriter for an issuer's negotiated sale. The notice requires the underwriter to make certain disclosures to the issuer to clarify its arm's-length role and to describe specified conflicts of interest. The G-17 Notice provides the underwriter with a tool for assessing the conflicts of interest that are present in a financing to determine whether they are manageable.

Question. If the underwriter delivers the G-17 Notice to an issuer at the earliest stage of a transaction, and before the issuer sends out a RFP, can a case be made that a broker-dealer, who provides the issuer with recommendations on the structure of a transaction, is not a municipal advisor because the issuer does not view the broker-dealer as a municipal advisor? Note, this conclusion is difficult to reach if the information meets the "advice standard" of the Final Rule because it is a recommendation on the structure of the financing. Can an argument be made that not allowing the recommendation would prevent an issuer from receiving useful information when (i) the issuer is the intended beneficiary of the Final Rule, and (ii) the issuer has received adequate notice of the underwriter's role? Suppose the advice comes from the underwriter's trading desk and relates to certain market activity that would not ordinarily be within the expertise of an independent municipal advisor? The G-17 management of conflicts may be more useful in determining whether an underwriter is acting within the allowable scope of advice for an underwriter under Rule G-23. See discussion of Rule G-23 below.

Fiduciary Duty

A municipal advisor has a fiduciary duty to its "municipal entity" clients. Section 15B provides that a municipal advisor and any associated person with a municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom it acts as municipal advisor, and the statute directs the MSRB to "prescribe means reasonably designed to prevent acts, practices, and

courses of business as are not consistent with a municipal advisor's fiduciary duty to its client." (emphasis added). Note this prophylactic wording, which is similar to the prophylactic authorization in section 15(c) for Rule 15c2-12. Therefore, MSRB rules are not confined to defining a fiduciary duty, but may also address acts or practices that may lead a municipal advisor to violate its fiduciary duty. Note that the fiduciary duty standard applies to advice to municipal entities, but not obligated persons. Advice to an obligated person is likely to be covered by MSRB fair dealing rules.

"Fiduciary duty" is generally understood to encompass a duty of loyalty and a duty of care. Although the MSRB has not yet issued guidance on the "fiduciary duty" of municipal advisors, it is generally recognized that:

- Under the duty of loyalty, a fiduciary is required to act in its client's best interests without regard to its own financial or other interests. The fiduciary is also required to disclose conflicts of interest that might impair its ability to fulfill its duty of loyalty and not to undertake engagements if it cannot manage those conflicts.

- Under the duty of care, a fiduciary must be qualified to undertake its engagement and consider alternatives to those presented to the client that might better serve its client's interests.

The Underwriter Exclusion

Subparagraph (2) of Rule 15Ba1-1(d) contains definitional language for the five statutory exclusions (underwriters, investment advisers, commodity trading advisors, attorneys and engineers), but most of the explanation of the exclusions is in the text of the Adopting Release. A broker-dealer serving as an underwriter is excluded from the municipal advisor definition to the extent the broker-dealer engages in activities that are within the scope of an underwriting.

The underwriter exclusion applies when a dealer has been engaged to underwrite a particular issue of municipal securities and continues until the end of the underwriting period for that issue. A broker-dealer firm that is selected to be a part of a pool of potential underwriters, without being selected for a specific deal, does not constitute serving as an underwriter on a particular issuance of municipal securities. If the broker-dealer is selected for a particular issuance, the exclusion does not extend to related issues or tranches on which it is not engaged.

In furtherance of the underlying policy of the SEC Municipal Advisor Rule, certain advice is considered outside the scope of the underwriting for purposes of the exclusion, including (1) advice on investment strategies, (2) advice on municipal derivatives, and (3) advice otherwise identified by the SEC to be outside the scope of an underwriting.

Broker-dealers may argue that, for example, they can't responsibly recommend a variable rate financing without making recommendations about derivatives, but the SEC commentary indicates that the Dodd Frank Act municipal advisor provisions were enacted, in part, because "municipal entities suffered significant losses in the financial crisis related to advice on complex derivatives, and advice on investments, such as refunding escrow investments provided by underwriters and investments involving fraud in investment bidding procedures." (p. 160) Implicit in this statement is a policy that these types of advice to municipal entities should be subject to a fiduciary standard of care.

The underwriter exclusion includes:

- Advice regarding the structure, timing, terms, and other similar matters concerning a particular issue of municipal securities (except as otherwise provided below).
- Preparation of rating strategies and presentations related to the issue being underwritten.
- Preparations for and assistance with investor "road shows" and investor discussions related to the issue being underwritten.
- Advice regarding retail order periods and institutional marketing if the issuer has decided to engage in a negotiated sale.
- Assistance in the preparation of the POS and OS.
- Assistance with the closing of the issue, including negotiation and discussion with respect to all documents, certificates, and opinions needed for the closing.
- Coordination with respect to obtaining CUSIP numbers and the registration of the issue with DTC.

- Preparation of post-sale reports for the issue.

- Structuring of refunding escrow cash flow requirements, but not the recommendation of and brokerage of particular municipal escrow investments.

The SEC repeatedly emphasizes that the underwriter exclusion does not include (1) advice on investment strategies, (2) advice on municipal derivatives, and (3) advice otherwise identified by the SEC. In this third category, the underwriter exclusion does not cover:

- Pre-selection activities (e.g., RFP responses or other business solicitation activities).

- "Advice" to an issuer as part of an underwriting pool when the firm has not been selected to be the underwriter on a specific issue.

- Advice to an issuer when the firm has been selected as underwriter for a period of time but not for a specific issue.

- Advice on "municipal financial products." as defined in the Final Rule.

- Advice on what method of sale (competitive sale or negotiated sale) an issuer should use for an issue of municipal securities.

- Advice on whether a governing body of an issuer should approve or authorize an issue of municipal securities.

- Advice on a bond election campaign.

- Advice that is not specific to a particular issue of municipal securities for which a firm is serving as underwriter and that involves analysis or strategic services with respect to overall financing options, debt capacity constraints, debt portfolio impacts, analysis of effects of debt or expenditures under

various economic assumptions, or other impacts of funding or financing capital projects or working capital.

- Assisting issuers with competitive sales, including bid verification, true interest cost (TIC) calculations and reconciliations, verifications of bidding platform calculations, and preparation of notices of sale.

- Preparation of financial feasibility analyses with respect to new projects.

- Budget planning and analyses and budget implementation issues with respect to debt issuance and collateral budgetary impacts.

- Advice on an overall rating strategy that is not related to a particular issue of municipal securities for which a firm is serving as an underwriter, including advice and actions taken on behalf of an issuer between financing transactions.

- Advice on overall financial controls that are not related to a particular issue of municipal securities for which a firm is serving as an underwriter.

- Advice regarding the terms of RFPs or RFQs for underwriters or other professionals for a project financing and advice regarding review of responses to such requests, including matters regarding compensation of such underwriters or other professionals.

Hypothetical. If a broker-dealer is selected as an underwriter on a refunding issue, can the underwriter recommend the refunding of an additional series of bonds other than the series of bonds to be refunded for which the underwriter was selected, or is the underwriter a municipal advisor as to the other series? Similarly can the underwriter selected for a new money issue recommend a refunding of certain outstanding bonds to improve the cash flow for the new money bonds, if the recommendation for the refunding is made after the selection for the new money issue? (See eighth bullet above).

Hypothetical. Can a broker-dealer be engaged "on all future bond issues until given notice of termination," in order to obtain post-underwriting period advice, or to attend periodic rating agency maintenance presentations? (See third bullet above).

Engagement. The underwriter exclusion commences when the broker-dealer has been engaged (sometimes the word is "selected") to serve as underwriter on a particular transaction. The staff of the SEC informally has recognized that the traditional methods by which municipal governments select and contract with an underwriter vary. The Adopting Release does state: "For example, a contractual engagement by a municipal entity of a broker-dealer to serve as an underwriter on a specific planned transaction would constitute the requisite engagement." (pp. 160-161). Staff has also commented that they expect the municipal tradition to gravitate toward engagement letters. Such letters would be useful (dated the date of selection) to document the commencement of the exclusion.

Hypothetical. The issuer calls the broker-dealer and tells the broker-dealer, "Congratulations, we have selected you to be the underwriter. Your appointment will officially be made tomorrow night when the board meets. Meanwhile, let's start talking about the structure of the deal." Is an engagement contractual or can it be a verbal communication before there is a written contract? The word "selected" suggests a verbal notification, but the term in the Final Rule under the underwriter exclusion is "serving as an underwriter," which suggest the broker-dealer is under contract. Can an engagement letter be written to cover discussions before the selection was actually made?

Pitches versus Advice. The Adopting Release recognizes that broker-dealer pitches for new business, like general information, often are not within the meaning of advice. Many situations may be easily addressed by asking whether a communication is advice, and, if it is, is it municipal advisory activity? The SEC responds to numerous comment letters by using this approach to show there is no issue. Referring to the provision of general information, the Adopting Release states that, "the Commission believes that a broker-dealer who provides information to a municipal entity regarding its underwriting capabilities and experience or general market or financial information that might indicate favorable conditions to issue or refinance debt likely would not be treated as engaging in municipal advisory activities." (p. 169).

Remarketing Agents. Ordinarily, a remarketing agent is performing ministerial functions pursuant to the terms of a remarketing agreement. Problems can arise, however, (1) if a remarketing constitutes a primary offering, or (2) if the remarketing agent gives advice on whether to remarket or hold tendered bonds. The Adopting Release cautions that a primary offering raises issues, and notes that a primary offering would be the issuance of municipal securities for purposes of the definition of municipal advisory activity. Attention should be given to the interpretation of a primary offering in the various contexts the term is used. On the second point, the Adopting Release states: "… if the activities of a remarketing agent include providing advice (such as advice with respect to the investment of proceeds) beyond merely determining a remarketing price for bonds that have already been issued and that are not being reoffered, the remarketing agent would need to evaluate its activities to determine if an exception to [municipal advisor] registration (such as the investment adviser exclusion) apples." (p. 174).

Placement Agents. The Adopting Release provides that the underwriter exclusion applies whether the underwriter is acting in a principal or agency capacity. "The Commission does not believe that the underwriter exclusion should be limited to a particular type of underwriting or particular type of offering." (p. 172). The broker-dealer should exercise care to be certain any advice is within the scope of the offering engagement because an agent can easily be drawn into a wide range of advisory activities.

Managers of Tender Offers. In the Adopting Release, the SEC determined that "a broker-dealer acting as a dealer-manager for a tender offer without more, would not be a municipal advisory activity because tender offers typically involve only the purchase of municipal securities and the purchase is not itself an advisory activity." (p. 172, emphasis added). This relief should be used with caution because it is not based on the underwriter exclusion (tender agents often try not to be underwriters), but is based on the absence of advisory activity. Thus the underwriter exclusion for advice on structure and terms may not apply if the broker-dealer is advising the issuer on matters related to a tender offer or secondary market purchase program.

Communications during Due Diligence. During the drafting of an official statement, or in due diligence sessions, the underwriter is likely to explore issues that do not relate directly to the structure or terms of the municipal securities being issued. Communications pursuant to due diligence responsibilities should ordinarily be considered part of an underwriting. The Adopting Release states: "The Commission also considers activities that are integral to fulfilling the role of an underwriter, such as the obligations of underwriters under the antifraud provisions of the federal securities laws and

obligations of underwriters under MSRB rules, to be within the scope of an underwriting." (p. 165).

Hypothetical. As part of its due diligence, an underwriter of XYZ bonds begins questioning the issuer about the issuer's compliance with its obligation to file annual and event information on EMMA during the previous five years. The underwriter discovers that the issuer has not made the requisite filings with respect to its ABC bonds. The underwriter advises the issuer to establish policies and procedures in connection with all its outstanding bonds to assure compliance with its continuing disclosure agreements. Is the underwriter a municipal advisor?

RFP Exemption

In addition to the subparagraph (d)(2) exclusions, subparagraph (d)(3) provides several exemptions from the definition of a municipal advisor, including an exemption for responses to a RFP or RFQ. The exemption states that the definition of a municipal advisor does not include any "person providing a response in writing or orally to a request for proposals or qualifications from a municipal entity or obligated person for services in connection with a municipal financial product or the issuance of municipal securities; provided however, that such person does not receive separate direct or indirect compensation or advice provided as part of such response."

Informally, the staff has suggested that the exemption can be used to avoid problems with one or two investment bankers providing advice in the pre-RFP period. For example, if an issuer is not prepared to proceed with its formal RFP, but needs preliminary advice from broker-dealers on its proposed financing structure, the issuer could conduct mini- RFPs, even orally, with the potential recipients of the formal RFP.

Reconciling the SEC Municipal Advisor Rule and MSRB Rule G-23

The big question is, what are the consequences of a broker-dealer giving advice in the period before the RFP process when the broker-dealer intends to act as an underwriter and not as a municipal advisor? Assume that the broker-dealer has delivered a Rule G-17 Underwriter Notice to the issuer at an early stage before any advice is given; the G-17 Notice makes clear that the broker-dealer's intention is to act as an underwriter, and the broker-dealer has also delivered to the issuer a Rule G-23 Notice at an early stage before any advice is given.

- As a consequence of the SEC Municipal Advisor Rule, or the fiduciary duty obligation of the 1934 Act, is a broker-dealer, who is found to be a municipal advisor in the pre-RFP period, precluded from acting as the underwriter with respect to the particular transaction?

- Alternatively, is the broker-dealer held to a fiduciary duty standard with respect to a municipal entity for the period before the RFP, and then an arm's-length standard when selected as underwriter?

- If a broker-dealer, who has served as underwriter for a transaction, engages in municipal advisory activities after the end of the underwriting period, what are the consequences?

We understand that the staff of the SEC has informally (at conferences, webinars etc.) taken the position that a broker-dealer, who acts in the role of a municipal advisor in the pre-RFP period by making a communication to an issuer, which is determined to be municipal advisory activity (because, for example, it is advice on the structure of an upcoming issuance of bonds), cannot then act as underwriter for the issuance of the bonds.

Below are three possible bases for this conclusion.

1. First, there is an inherent policy in the SEC Municipal Advisor Rule that precludes a broker-dealer firm from being both a municipal advisor and, subsequently, an underwriter on the same transaction. Therefore, crossing from municipal advisor to underwriter (without some exemption) is a violation of the SEC Municipal Advisor Rule.

2. A second possibility is that when a broker-dealer, who has engaged in municipal advisory activities, attempts to change its role to an underwriter, the broker-dealer is likely (depending on facts and circumstances) to have unmanageable conflicts of interest that constitute a breach of its fiduciary duty under section 15B(c)(1) of the 1934 Act (if the issuer is a municipal entity).

3. The third argument requires reference to MSRB Rule G-23. If a broker-dealer is a municipal advisor in the pre-RFP period, an attempted cross-over is the very conflict that MSRB Rule G-23 was designed to prevent. Rule G-23 requires that the advice that is permitted under the rule must be consistent with the arm's-length relationship of an underwriter. If the broker-dealer has been determined to be a municipal advisor, by definition, it is not in an arm's-length relationship, and Rule G-23 prevents the cross-over.

The first argument is suggested by informal SEC staff statements that the SEC Municipal Advisor Rule and Rule G-23 are two separate regimes. The problem with a literal application of a two regime approach is that the SEC Municipal Advisor Rule does not specifically state that the cross-over is illegal under the rule. A way to circumvent the lack of a specific prohibition against a change of roles is to combine the second argument with the first to find a rule violation under the section 15B(c)(1) fiduciary duty rule.

The third argument requires a review of MSRB Rule G-23. Rule G-23 is a conflict of interest rule that provides, in general, that no broker-dealer, who has a financial advisory relationship with respect to the issuance of municipal securities, shall act as underwriter for the same transaction. Assume in a given situation the broker-dealer activities before the RFP period constitute both municipal advisory activities for the SEC Municipal Advisor Rule and a financial advisory relationship under Rule G-23, but that the broker-dealer has not entered into an agreement evidencing a financial advisory relationship; instead, by filing both the G-17 Notice and the G-23 Notice, the broker-dealer has evidenced its intention to be an underwriter.

There are several aspects of Rule G-23 that suggest G-23, read by itself, may not preclude a broker-dealer from acting as underwriter on an issue where the broker-dealer has rendered financial advice in the period before the RFP exemption period.

- Rule G-23 is structured differently than the SEC Municipal Advisor Rule. Rule G-23(b) provides, "For purposes of this rule (note the emphasis), a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter and not as a financial advisor, a [broker-dealer] renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities." The question then is what is the scope of acting as an underwriter for purposes of Rule G-23, not for purposes of the SEC Municipal Advisor Rule? This analysis is necessary if Rule G-23 is given as the reason the broker-dealer cannot act as underwriter.

- The period of time a broker-dealer is an underwriter is different under Rule G-23 than under the SEC Municipal Advisor Rule. The November 27, 2011 Interpretive Guidance released by the MSRB with the adoption of Rule G-23 (and approved by the SEC) states: "… a dealer that clearly identifies itself in writing as an underwriter and not as a financial advisor from the earliest stages of its relationship with the issuer with respect to that issue (e.g., in response to a request for proposal or in promotional material provided to an issuer) will be considered "acting as an

underwriter" under Rule 23(b) with respect to that issue." (emphasis added) If the broker-dealer follows the underwriter procedures within G-23, it is not a financial advisor at any point of time, but, throughout, is an underwriter. There is no "change of role" concept in Rule G-23 if the procedures and limitations are followed.

- The scope of activities included in underwriting, for purposes of Rule G-23, are different than under the SEC Municipal Advisor Rule. The November 27, 2011 Guidance provides, "… a dealer providing advice to an issuer with respect to the issuance of municipal securities (including the structure, timing, and terms of the issue and other similar matters when integrally related to the issue being underwritten) will not be viewed as a financial advisor for purposes of Rule G-23, if such advice is rendered in its capacity as underwriter for such issue. In addition to engaging in underwriting activities, it shall not be a violation of Rule G-23(d) for a dealer that states that it is acting as an underwriter with respect to the issuance of municipal securities to provide advice with respect to the investment of the proceeds of the issue, municipal derivatives integrally related to the issue, or other similar matters concerning the issue." (emphasis added)

- The November 27, 2011 Guidance further states: "Rule G-23 is solely a conflicts rule. Accordingly, this notice does not address whether provision of advice permitted by G-23 would cause the dealer to be considered a 'municipal advisor' under the Exchange Act and the rules promulgated thereunder." The Guidance thus contemplates the possibility of two different results under Rule G-23 and the SEC Municipal Advisor Rule.

- However, the November 27, 2011 Guidance contains an important limitation. "The dealer must not engage in a course of conduct that is inconsistent with an arm's-length relationship with the issuer in connection with such issue of municipal securities or the dealer will be deemed to be a financial advisor with respect to that issue and precluded from underwriting that issue by Rule G-23(d)." Thus, the filing of a G-23 Notice at the earliest stages does not give the underwriter free reign to provide advice that is outside the scope of underwriter advice under Rule G-23. Likewise, there may be conflicts of interest revealed by the Rule G-17 Underwriter Notice to Issuers that preclude a broker-dealer from acting as an underwriter.

- Does this cautionary language suggest a possible reconciliation of the SEC Municipal Advisor Rule and Rule G-23 as follows? If a broker-dealer

fully complies with Rule G-23, the broker-dealer will be deemed not to have engaged in municipal advisory activities under the Final Rule, solely with respect to advice that is within the scope of advice that is permitted of an underwriter under Rule G-23. A broker-dealer that renders advice that is beyond the scope of underwriter advice permitted by Rule G-23 will not be permitted to act as underwriter under Rule G-23 because it is in violation of Rule G-23.

- The advice permitted by an underwriter under Rule G-23 is broader than the communications permitted under the SEC Municipal Advisor Rule underwriter exclusion because the Rule G-23 Notice makes clear to the issuer that the broker-dealer is giving advice in an arm's-length principal to principal relationship and not in an agency fiduciary relationship of a financial advisor.

The third argument could prevent this reconciliation as follows. The determination whether the underwriter's advice is consistent with an arm's-length relationship should not be made solely by reference to the four corners of Rule G-23. If, during the pre-RFP period, the underwriter engages in advice that constitutes municipal advisory activity under the SEC Municipal Advisor Rule, the SEC may conclude that the municipal advisory activity causes a violation of Rule G-23. A broker-dealer, who engages in municipal advisory activity is not acting within the Rule G-23 arm's length limitation. Thus, the SEC Municipal Advisor Rule is used to interpret Rule G-23 rather than Rule G-23 being a basis for an underwriter, who has delivered the G-23 Notice and the G-17 Notice, arguing that it is not a municipal advisor. If this analysis is applied, it is likely to raise more questions than it answers. Does it imply that a person in a principal to principal arm's length relationship cannot provide advice? Rule G-23 itself indicates that an underwriter, in a principal to principal relationship, can provide "advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities." If this third argument is used to find a rule that is violated by an underwriter who gives advice in the pre-RFP period, is the SEC amending Rule G-23, contrary to the two regime theory, solely to find a rule that is not within the SEC Municipal Advisor Rule?

Representation by an Independent Municipal Advisor

The Final Rule provides an exemption from the definition of a municipal advisor for any person engaging in municipal advisory activities in a circumstance in which a municipal entity or obligated person is otherwise represented by an independent registered municipal advisor with respect to the same aspects of a municipal financial product or the issuance of municipal

securities A municipal advisor is "independent" of the proposed underwriter if it has not been an "associated person" of the proposed underwriter within the last 2 years.

For a broker-dealer to rely on the independent municipal advisor exemption in order to engage in advising the issuer before the RFP period, the broker-dealer must:

1. Obtain a written representation from the municipal entity or obligated person that it is represented by, and will rely on the advice of, an independent registered municipal advisor.

2. With respect to a municipal entity, the broker-dealer must provide written disclosure to the municipal entity (with a copy to the independent municipal advisor) that, by obtaining such representation from the municipal entity, the broker-dealer is not a municipal advisor and is not subject to the fiduciary duty established in Section 15B(c)(1) of the Exchange Act with respect to the municipal financial product or issuance of municipal securities.

3. With respect to an obligated person, the broker-dealer must provide written disclosure to the obligated person (with a copy to the independent municipal advisor) that, by obtaining such representation from the obligated person, the broker-dealer is not a municipal advisor with respect to the municipal financial product or issuance of municipal securities.

4. Such disclosure must be made at a time and in a manner reasonably designed to allow the municipal entity or obligated person to assess the material incentives and conflicts of interest that such person may have in connection with the municipal advisory activities. The level and timing of disclosure required may vary according to the issuer's knowledge or experience.

This exemption has been analogized to the disclosures that underwriters are required to make under MSRB Rule G-17 and to the difficulty of obtaining an acknowledgement of receipt from the issuer. However, the required disclosures under the SEC Municipal Advisor Rule may be more analogous to those under the CFTC's "business conduct rule" for swap dealers. That is because MSRB Rule G-17 requires only that underwriters use reasonable efforts to obtain the issuer's acknowledgement of the required disclosures. The CFTC rules prohibit a swap dealer from having tailored communications with

state or local governments until the government has provided the required representations.

Hypothetical. A municipal entity does not ordinarily have a municipal advisor, and does not believe it is necessary to have a municipal advisor. In order to encourage potential underwriters to bring ideas to the issuer, and to limit the cost of a municipal advisor, the municipal entity retains a municipal advisor for the period beginning when the issuer first seeks ideas from potential underwriters and ending when an underwriter is selected and the underwriter exclusion begins. Is there a rule violation if the municipal advisor serves only during this period?

[The following sections on the investment adviser and the commodity trading adviser exclusions, and on the swap dealer and bank exemptions do not relate directly to the issues raised in the preceding outline for underwriters, but they are appended because they may relate to broker-dealer underwriting activities.}

Investment Advisers

Paragraph (d)(2)(ii) of the Final Rule excludes from the definition of a municipal advisor: "Any investment adviser registered under the Investment Advisers Act of 1940 … or any person associated with such registered investment adviser to the extent that such registered investment adviser or such person is providing investment advice in such capacity. Solely for purposes of this paragraph (d)(2)(ii), investment advice does not include advice concerning whether and how to issue municipal securities, advice concerning the structure, timing, and terms of an issuance of municipal securities and other similar matters, advice concerning municipal derivatives, or a solicitation of a municipal entity or obligated person"

Hypothetical. A registered investment adviser has a non-profit university as a regular client. The client is routinely an obligated person on tax exempt financings. Discussions are had with the university on the advisability of entering into swap transactions. Is the investment adviser subject to registration as a municipal advisor? Two additional pieces of information are needed.

1. *The Final Rule defines a municipal derivative to include a swap in which an obligated person is a counterparty when the obligated person is "acting in such capacity."*

2. *To determine whether the university is an obligated person at the time the investment adviser gives the swap advice, the Final Rule defines obligated person by reference to the definition under Rule 15c2-12. There, an obligated person is a person who is committed*

> *by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the offering. Arguably, an investment adviser should not be considered a municipal advisor to an obligated person until the obligated person has begun the process of applying to, or negotiating with, a municipal entity to issue conduit bonds on behalf of the obligated person.*

An investment adviser who is registered under state law, and not the 1940 Advisers Act, does not have the benefit of the exclusion. A state law investment adviser will thus have to determine whether the advice is municipal advisory activity, probably by reference to the term "investment strategies" under the concept of municipal financial products. The Final Rule defines investment strategies as advice on the investment of the proceeds of municipal securities and the recommendation and brokerage of municipal escrows. The Final Rule adopts a similar definition of "proceeds" as that in the IRS arbitrage rebate rules (i.e.): (i) monies derived by a municipal entity from the sale of municipal securities, (ii) investment income derived from the investment or reinvestment of such monies, (iii) any money of a municipal entity or obligated person held in funds under legal documents for the municipal securities that are reasonably expected to be used as security or a source of payment for the payment of the debt service on the municipal securities, including reserves, sinking funds, and pledged funds created for such purpose, and (iv) the investment income derived from the investment or reinvestment of monies in such funds.

Commodity Trading Advisors and Swap Dealers

Following the Dodd Frank Act, the Final Rule contains an exclusion from the definition of municipal advisor for commodity trading advisors, and, separately, adds a limited exemption for swap dealers.

A commodity trading advisor is defined under the Commodity Exchange Act (CEA) as any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value or advisability of trading in any swap (or other CEA products). Commodity trading advisors are required to be registered with the CFTC and are subject to the rules of the CFTC and the National Futures Association. The Final Rule contains an exclusion from the definition of a municipal advisor for a CEA registered commodity trading advisor, or person associated with a registered commodity trading advisor, to the extent that the commodity trading advisor is providing advice that is related to swaps, as defined in the CEA.

A broker-dealer that is not a registered commodity trading advisor would have to register as a municipal advisor if it provides advice with respect to swaps to a municipal entity or obligated person.

A swap dealer is defined similarly to a broker-dealer with respect to securities. A swap dealer is any person who holds itself out as a dealer in swaps, makes a market in swaps, regularly enters into swaps as an ordinary course of business, or engages in activity that causes it to be commonly known in the trade as a swap dealer. The Final Rule provides an exemption for a swap dealer registered under the CEA, or associated person to a swap dealer recommending a municipal derivative or a trading strategy that involves a municipal derivative, so long as the registered swap dealer is not acting as an advisor to the municipal entity or obligated person with respect to the municipal derivative or trading strategy pursuant to the CEA and rules and regulations thereunder.

The CFTC has a comprehensive regulatory scheme for commodity trading advisors and swap dealers, including rules for the independent representatives for special entities. The CFTC has determined that the independent representatives are commodity trading advisors and subject to registration as such.

MSRB jurisdiction, under the scheme of the SEC Municipal Advisor Rule, would come into play if the commodity trading advisor or swap dealer acts outside its exclusion or exemption under the Final Rule and engages in municipal advisory activity. Like others engaging in municipal advisory activies outside an exclusion or exemption, the person would be within the definition of a municipal advisor and subject to MSRB municipal advisor rules. If the person is also within the CEA definition of a commodity trading advisor or swap dealer, the person would be subject to registration with the CFTC, and, as a municipal advisor, would be subject to registration with the SEC and MSRB.

Bank Direct Loans

A bank may have a separately identifiable municipal securities department that is registered with, and subject to the rules of the MSRB as a "municipal securities dealer." If the bank municipal securities dealer engages in underwriting activities, including private placements, it is analyzed under the SEC Municipal Advisor Rule comparably to an ordinary broker-dealer. If the bank elects to serve as a municipal advisor, Final Rule 15Ba1-1(d)(4) allows the separately identifiable department to register without the entire bank being treated as a municipal advisor.

Final Rule 15Ba1-1(d)(3)(iii) includes a bank exemption for any bank, to the extent the bank provides advice with respect to "… (B) Any extension of credit by a bank to a municipal entity or obligated person, including the issuance of a letter of credit, the making of a direct loan, or the purchase of a municipal security by the bank for its own account." Informally, the staff of the SEC has recognized that when a bank presents loan terms to the municipal entity or obligated person, it will ordinarily be acting in the capacity of a counterparty and not as an advisor.

However, if the bank is not purchasing a municipal security for its own account (or is making a loan that is actually a municipal security), and the municipal security, or loan that is actually a municipal security, is sold to others in a private placement or public distribution, the bank may need to rely on the underwriter exclusion and take care not to provide municipal advice before the engagement.