

## INSIGHTS

## New Municipal Advisor Supervision Requirements Adopted

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Rule G-44, proposed earlier this year by the Municipal Securities Regulation Board (MSRB) and approved by the Securities and Exchange Commission (SEC) this month, requires that municipal advisors develop internal supervisory and compliance systems. The new rule will go into effect on April 23, 2015, and is the first MSRB rule specific to municipal advisors.<sup>1</sup>

### Background

Following the 2008 financial crisis, the 2010 Dodd-Frank Act amended the Securities Exchange Act of 1934 (the “Exchange Act”) to regulate municipal advisors, requiring them to register with the SEC and the MSRB, and requiring the MSRB to adopt rules regulating this new class of regulated persons.

Under the Exchange Act, persons who provide advice to or solicit a municipal entity regarding municipal financial products or issuance of municipal securities are deemed “municipal advisors.” Significantly, a person or entity cannot simultaneously serve as both a municipal advisor and an underwriter to the same client on an issue of municipal financial products or securities, and owes fiduciary duties to the municipality to whom they are acting as an advisor.

### Rule G-44

As part of the MSRB’s efforts to develop a regulatory framework for municipal advisors, MSRB Rule G-44 delineates supervisory and compliance requirements for municipal advisors.

Given that municipal advisors include a wide array of business types and activities, Rule G-44 is intended to be a “principles based approach to supervision and compliance” that accommodates “the diversity of the municipal advisor population, including small and single-person entities.”<sup>2</sup>

#### *Supervisory requirements*

Specifically, Rule G-44(a) requires that municipal advisors develop, use, and maintain a supervisory system reasonably capable of ensuring that their advisory activities comply with applicable securities laws and regulations. These supervisory systems may be tailored to the needs of each municipal advisor, accounting for factors such as size and business model.<sup>3</sup>

#### *Compliance requirements*

Additionally, Rule G-44(b) requires that municipal advisors perform at least annual compliance reviews of their supervisory systems and written policies. Depending on the size and complexity of the municipal advisor, it may want to consider more frequent compliance reviews.<sup>4</sup>

*Chief Compliance Officer*

To oversee and implement Rule G-44 supervisory and compliance requirements, section (c) of the Rule requires that municipal advisors designate a Chief Compliance Officer (CCO). This individual may simultaneously hold any other position in the municipal advisor's business, including management positions, or may be external to the business.<sup>5</sup>

*Annual certification*

Rule G-44(d) requires that a municipal advisor's CEO annually certify in writing that it has implemented and monitored systems and processes to ensure compliance with applicable securities laws and regulations. FINRA member businesses subject to FINRA Rule 3130, which requires similar certification, are excepted from Rule G-44(d).<sup>6</sup>

*Federally-regulated bank exemption*

Federally-regulated banks which engage in municipal advisor activities are exempt from Rule G-44, provided that they annually certify in writing that they are subject to parallel federal regulations regarding supervisory systems and compliance requirements.<sup>7</sup>

**Amended Rule G-8 and Rule G-9 record-keeping requirements**

To facilitate Rule G-44 enforcement, Rules G-8 and G-9 have also been amended. Rule G-8 delineates recordkeeping requirements for brokers, dealers, and municipal securities dealers, and Rule G-9 specifies record preservation requirements.

Specifically, Rule G-8 now includes section (h)(i), which requires municipal advisors to keep the same business records required under Exchange Act Rule 15Ba1-8(a)(1)-(8). Additionally, Rule G-9 now requires that municipal advisors preserve records required under Rule G-8(h), including those related to supervisory and compliance systems, for at least five years.<sup>8</sup>

**Impact**

To the extent that Rule G-44 was crafted to account for the diverse pool of individuals and businesses considered municipal advisors, it appears that the MSRB sought to adopt a flexible approach to supervision and compliance. It remains to be seen, however, whether this flexibility will ease or confuse implementation of the new rule.

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<sup>1</sup> MSRB Regulatory Notice 2014-19 (Oct. 24, 2014), SEC Approves MSRB Rule G-44 on Supervisory and Compliance Obligations of Municipal Advisors, and Amendments to MSRB Rules G-8 and G-9, available at <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2014-19.ashx?n=1>.

<sup>2</sup> *Id.* at 1.

<sup>3</sup> *Id.* at 2.

<sup>4</sup> *Id.* at 3.

<sup>5</sup> *Id.* at 4.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 5.

<sup>8</sup> *Id.* at 6.