

## **Securities and Exchange Commission’s Proposed Registration of Municipal Advisors Rule**

On December 20, 2010, the Securities and Exchange Commission (“SEC”) released its proposed rules for registration of municipal advisors.<sup>1</sup> The proposed rules could potentially require the appointed board members of the public retirement systems that invest money to register with the SEC. The proposed rules were issued to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) that amended Section 15B of the Securities and Exchange Act of 1934, which, among other things, makes it unlawful for municipal advisors to provide advice to or on behalf of municipal entities with respect to municipal financial products or the issuance of municipal securities without registering with the SEC. *SEC Release at 18*. The Dodd-Frank Act also grants the Municipal Securities Rulemaking Board (“MSRB”) regulatory authority over municipal advisors, and imposes a fiduciary duty on municipal advisors when advising municipal entities. *SEC Release at 16*. The proposed rules are not yet final, and the **SEC was soliciting public comments regarding the rules with a due date of February 22, 2011. However, it appears that the SEC is still accepting public comments on the proposed rules.**

### **Potential Impact on Public Retirement Systems**

In order to understand the impact of the proposed rules on public retirement systems’ appointed board members, it is important to understand the definitions provided by the Dodd-Frank Act and their related interpretation by the SEC in the proposed rule release.

### **Proposed Rule – Key Questions**

- **Who is a Municipal Advisor?** The Dodd-Frank Act broadly defines the term “municipal advisor” to mean a person (who is not a municipal entity or an employee of a municipal entity) that:
  - i. provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, or
  - ii. that undertakes a solicitation of a municipal entity.

The Dodd-Frank Act also imposes fiduciary duty on municipal advisors when advising municipal entities.

- **What is a Municipal Entity?** Under the Dodd-Frank Act the term “municipal entity” means any state, political subdivision of a state, or municipal corporate instrumentality of a state, including agencies or authorities, or any “plan, program, or pool of assets

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<sup>1</sup> SEC Release No. 34-63576; File No. S7-45-10 (Dec. 20, 2010), *available at* <http://www.sec.gov/rules/proposed/2010/34-63576.pdf>

sponsored or established by the state, political subdivision, or municipal corporate instrumentality or any agency, authority or instrumentality thereof;” and any other issuer of municipal securities. *SEC Release at 22.*

The SEC provided additional clarification to this definition in its proposed rule release by noting that the definition of a “municipal entity” includes, but is not limited to, public pension funds, local government investment pools and other state and local governmental entities or funds, as well as participant-directed investment programs or self-directed pension funds like 403(b), and 457 plans.

- **Who is an Employee of a Municipal Entity?** The Dodd-Frank Act’s definition of a “municipal advisor” excludes “employees of a municipal entity.” The SEC states that “employees of a municipal entity” include elected members of a governing body of a municipal entity and appointed members who are ex officio members of the governing body by virtue of holding an elective office. However, the SEC believes that the appointed members of a governing body of a municipal entity (other than elected ex officio members) are not employees and should be included in the definition of a “municipal advisor.” *See Release at 40-41.* This could mean that the appointed members of a governing board of a public retirement system that provides financial advice or makes financial decisions should register with the SEC.
- **What is a Municipal financial product?** Under the Dodd-Frank Act, the term “municipal financial products” means municipal derivatives, guaranteed investment contracts and investment strategies. The term “investment strategies” includes plans or programs for the investment of the proceeds of municipal securities that are not municipal derivatives and guaranteed investment contracts. Further, the SEC in the release interprets “investment strategies” to include plans, programs, or pools of assets that invest funds held by or on behalf of a municipal entity, and, therefore, any person that provides advice with respect to such funds must register as a municipal advisor, unless it is covered by one of the exclusions provided under the Dodd-Frank Act. Based on these definitions, the SEC goes on to state that it believes “*it was Congress's intent to include in the definition of ‘municipal advisor’ persons that provide advice with respect to plans, programs or pools of assets that invest funds held by, or on behalf of, a municipal entity, such as a 529 college savings plan, or public pension plan. Such plans, programs, and pools of assets are generally funded from sources other than proceeds of municipal securities, such as pension contributions from employees and state and local government employers.*” **See Release at 26.**

**SEC's interpretation, particularly the distinction between elected and appointed members of governing boards**

Based on the SEC's interpretation of the amendments made by the Dodd-Frank Act as stated in the SEC proposed rule release, appointed members of governing boards of municipal entities, including public pension funds, are not excluded from the registration requirement for municipal advisors. The impact on public pension funds' board members is covered in the proposed rule's interpretation of the definition of "municipal advisor" and the related exclusions.

The proposed rule unequivocally excludes from the definition of "municipal advisor" (1) municipal entities; and (2) municipal entity employees. The SEC further addresses the second exclusion to include elected members of governing bodies of municipal entities and appointed members of a governing body to the extent such appointed members are ex officio members of the governing body by virtue of holding an elective office. The SEC does not believe that appointed members of a governing body of a municipal entity that are not elected ex officio members should be excluded from the definition of a "municipal advisor." The SEC explains:

*"The commission believes that this interpretation is appropriate because employees and elected members are accountable to the municipal entity for their actions. In addition, the Commission is concerned that appointed members, unlike elected officials and elected ex officio members, are not directly accountable for their performance to the citizens of the municipal entity." See **Release at 41.***

Additionally, the SEC in its release addressed the question of whether someone who offered free or voluntary advice was subject to the rule. The SEC concluded that the rule applied:

*"In defining the term "municipal advisor" in Exchange Act Section 15B(e)(4), Congress did not distinguish between those municipal advisors who are compensated for providing advice and those who are not compensated for providing advice. Thus, consistent with Congress's definition of the term 'municipal advisor,' the Commission does not believe the issue of whether a municipal advisor is compensated for providing municipal advice should factor into the determination of whether the municipal advisor must register with the Commission." See **Release at 48.***

**Agency Action**

In the interest of keeping its constituents informed regarding the potential impact of the proposed rules and to make them aware of the opportunity to participate in the SEC's comment process, the PRB sent out an informational e-mail with a summary of the proposed rules in January of 2011 and also published the summary on its website.

## **Public Comments**

The SEC started receiving public comments on the proposed rules from January 1, 2011. To date, the SEC has received thousands of comments denouncing the rule's far-reaching implications. Governmental entities, including public retirement systems from all across the U.S. participated in the comment process.<sup>2</sup> Some of the Texas public retirement systems, including the Teacher Retirement System of Texas and Employees Retirement System of Texas also partook in the comment process. Due to the potential impact of the proposed rules on members of appointed board of state agencies, university systems, commissions, and other state and local municipal entities, the Office of the Attorney General submitted comments on behalf of the State of Texas, including the Office of the Governor, the Texas Comptroller of Public Accounts and the various agencies who also joined the Attorney General's Office in submitting the comments. Comments provided by the Attorney General's Office have been enclosed with this report for easy reference.

## **Proposed Legislation**

On August 26, 2011, H.R. 2827<sup>3</sup> was introduced in the House of Representatives by Rep. Bob Dold (IL). The proposed bill has been referred to the House Financial Services Committee and seeks to amend the Securities Exchange Act of 1934 to clarify provisions relating to the regulation of municipal advisors, and for other purposes.

The legislation, among other things, would narrow the definition of municipal advisor, clarify the definition of an investment strategy and eliminate the federal fiduciary standard for municipal advisors.

## **Definition of Municipal Advisor**

Section 1 of the bill relates to the definition of a municipal advisor and proposes to amend Section 15B (e) (4) of the Securities Exchange Act of 1934 which defines the term municipal advisor. The proposed amendment, among other things, explicitly states that the term 'municipal advisor' does not include any elected or appointed member of a governing body of a municipal entity, with respect to such member's role on the governing body.

A copy of the proposed bill has been enclosed with this report for easy reference.

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<sup>2</sup> Available at <http://www.sec.gov/comments/s7-45-10/s74510.shtml#comments>

<sup>3</sup> Available at <http://www.govtrack.us/congress/bill.xpd?bill=h112-2827>