

Memorandum

DATE: May 16, 2011

TO: Municipal Advisor File

RE: **Legislative History of the Engineering Exclusion**

The history of the municipal advisor registration requirement in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) is limited, and information about the history of the engineering exclusion from the definition of “municipal advisor” in that section of the Dodd Frank Act is even more limited.

In brief, as discussed below, the concept of municipal advisor registration and regulation originated with a free standing bill introduced in 2009. We have found no background information about the source of the engineering exclusion that was incorporated into the definition of “municipal advisor” in the first Senate draft of the Dodd-Frank Act. We also have found no record of Committee or Floor colloquies regarding the potential impact of the municipal advisor registration regime on the activities of engineers. In addition, informal inquiries by government affairs representatives of Honeywell and Chevron did not result in any recollection by House of Representative or Senate staff members as to the origins of the exclusion for engineers.

Municipal advisor registration was initially introduced in 2009 as The Municipal Advisers Regulation Act (“Municipal Advisers Act”).¹ The Municipal Advisers Act was introduced by Steven Driehaus, a Democrat, of Cincinnati, Ohio. Al Green of Texas, Barney Frank of Massachusetts, Joe Baca of California, Emanuel Cleaver of Missouri, Jim Moran of Virginia, Robert Andrews of New Jersey and Gerry Connolly of Virginia cosponsored the bill.² While the Municipal Advisers Act outlined the basis for the municipal advisor registration requirements that ultimately were incorporated in the Dodd Frank Act, there was no mention of an engineering exclusion.

The legislative history of the Municipal Advisers Act provides some insight into the original reasoning behind including a municipal advisor registration requirement in the Dodd-Frank Act. The impetus behind establishing a municipal

¹ H.R. 2550, 111th Cong. (2009).

² *Id.*

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advisor registration regime stemmed from a concern expressed by Chairman Frank, Chairman Bachus and the Securities and Exchange Commission (“SEC”) that the municipal bond market was on the verge of failure.¹ A hearing on “Legislative Proposals to Improve the Efficiency and Oversight of Municipal Finance” (Municipal Finance Hearing) was held on May 21, 2009 that addressed the merits of and need for “The Municipal Advisers Regulation Act.”⁴ This hearing addressed the motivation behind crafting a new law that would require municipal advisors to register with the SEC.

Chairman Bachus and Chairman Frank explained at the Municipal Finance Hearing that they were supportive of a municipal advisor registration regime in order to grant the SEC authority over the municipal securities market. Chairman Frank clarified that his support of the bill stemmed from his concerns over the increased interest rates that municipal entities were being forced to pay to their insurers, which were ultimately being passed on to those who invested in municipal bonds.² Chairman Frank attributed some of the problems in the municipal securities market to the unregulated municipal advisor industry.⁶ Implementing a municipal advisor registration regime, Chairman Frank believed, would protect both investors in municipal bonds and municipalities from abuses.⁷

Chairman Bachus traced his concerns regarding the municipal securities market to the municipal security problems in his home of Jefferson County, Alabama.⁸ Jefferson County was unable to repay \$3.9 billion in sewer bonds that were tied to interest rate swaps.⁹ Rather than resorting to bailouts of municipalities, Chairman Bachus proposed regulating financial advisors as a means to solve the problems in the national municipal securities markets. Chairman Bachus stated:

¹ See Legislative Proposals to Improve the Efficiency and Oversight of Municipal Finance: Hearing before the Committee on Financial Services, 111th Cong. 37 (2009) (hereinafter “Municipal Finance Hearing”).

⁴ *Id.*

² See *id.* at 1-2.

⁶ *Id.*

⁷ *Id.*

⁸ Municipal Finance Hearing at 3.

⁹ *Id.*

...I want to give the SEC real authority to oversee the municipal securities market, and I plan to introduce legislation to that effect or work with you on bipartisan legislation. The municipal securities market presents itself to the public as safe, stable, and secure for all investors. It should welcome more sunlight, consistency, and thorough disclosures that apply across the asset classes and commonsense modernization.¹⁰

Chairman Bachus expressed concern, however, over the ability of the SEC to regulate effectively municipal advisors.¹¹ Rather than delegate regulatory authority to the SEC, Chairman Bachus suggested that perhaps FINRA would have the resources and ability to examine and regulate the municipal securities market.¹²

Martha Haines, the head of the SEC's Office of Municipal Securities, testified at the Municipal Finance Hearing regarding her support for the Municipal Advisers Act and the need for SEC involvement in regulating the participants in the municipal securities market.¹³ It appears from this hearing that the SEC played an integral role in originating the municipal advisor registration requirements. Ms. Haines indicated that the SEC had been concerned with the lack of regulation of municipal financial advisors (especially those not registered as broker-dealers or investment advisors) and believed that SEC authority over the municipal securities market should be expanded. The Commission sought authority to set minimum qualifications for municipal advisors, to design conduct rules, to eliminate pay to play and to avoid or disclose conflicts of interest between municipal advisors and their clients.¹⁴ Ms. Haines testified that the expansion of authority sought by the Commission was to protect taxpayers, issuers and citizens that use and invest in the infrastructure funded by municipal bonds.¹⁵

Chairman Bachus referenced the testimony provided by Ms. Haines in the Municipal Finance Hearings in his comment letter to the SEC regarding the

¹⁰ *Id.* at 4.

¹¹ *Id.* at 3. Chairman Bachus cited the Bernie Madoff affair as an example of the SEC's present inability to regulate the investment advisers that were already registered with the SEC.

¹² *Id.* at 3.

¹³ Municipal Finance Hearings at 9.

¹⁴ *Id.*

¹⁵ *Id.*

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recently proposed municipal advisor registration rules.¹⁶ In this letter, which is attached as Attachment B1, Chairman Bacchus also referenced the engineering exception, stating: “the SEC has ignored an explicit exemption contained in Section 975 for ‘engineers providing engineering advice’ to municipal entities.”¹⁷

The municipal advisor registration regime was eventually incorporated into the House version of Dodd-Frank after the stand-alone Municipal Advisers Act was tabled. However, the engineering exception did not appear in the definition of “municipal advisor” until the draft of the Dodd-Frank Act that was first introduced in the Senate by Chairman Dodd on April 15, 2010.¹⁸ The engineering exception is not mentioned in transcripts of any hearings or in any conference reports.

¹⁶ Letter from Chairman Bachus, United States House of Representatives Committee on Financial Services, to Elizabeth Murphy, Secretary, Commission, dated February 23, 2011.

¹⁷ *Id.*

¹⁸ S. 327, 111th Cong. (2010). S. 327 was introduced on April 15, 2010 and the final version of the Dodd-Frank Act was passed by the House on June 30, 2010. S.327 was the last iteration of the Dodd-Frank Act that was proposed before the final version was adopted.

Attachment B1
Bachus Municipal Advisor Comment Letter

United States House of Representatives
Committee on Financial Services

Washington, D.C. 20515
February 28, 2011

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

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CHAIRMAN'S
CORRESPONDENCE UNIT

Dear Chairman Schapiro:

Section 975 of the Dodd-Frank Act (P.L. 111-203) directs the Securities and Exchange Commission ("SEC") to establish an effective registration and examination program for municipal financial advisors. I am supportive of the SEC's efforts to police this segment of the municipal market, particularly as I have closely followed the effects on Jefferson County, Alabama in my congressional district. Jefferson County's financial woes can partially be attributed to unscrupulous municipal advisors who pocketed the lucrative fees associated with the county's sewer bond offerings while ignoring the welfare of the taxpayers. Unfortunately, even though I agree with the goal, I cannot support the proposed rules 15Ba1-1 through 15Ba1-7, which are overly broad and would reach significantly more people than Congress intended.

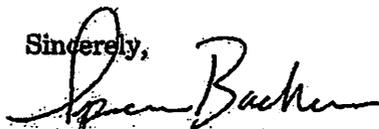
On May 21, 2009, during a Financial Services Committee hearing, I questioned the head of the SEC's Office of Municipal Securities, Ms. Martha Haines, about how quickly the SEC could establish an effective registration and examination program for municipal advisors. Ms. Haines responded that, "I am sure we could do it very promptly. There are really not all that many non-broker-dealer financial advisors. There are approximately 260 and so it should not be a huge undertaking." Unfortunately, contrary to Ms. Haines' testimony, the Commission's proposal to implement Section 975 will require a huge undertaking given the thousands of individuals who would qualify as a municipal advisor.

For example, the proposed rule would require appointed, non-*ex officio* municipal board members and officials to register with the SEC. Many small towns frequently appoint rather than elect their municipal administrators. Similarly, boards of trustees of public universities are appointed. Forcing these individuals, who often volunteer their time and expertise, to register with the SEC, would create a significant disincentive for qualified individuals to serve our communities. Additionally, the broad definition of "municipal financial products" combined with the failure to define "advice" would result in thousands of bank employees who conduct routine business with municipal entities having to register with the SEC. Finally, the SEC has ignored an explicit exemption contained in Section 975 for "engineers providing engineering advice" to municipal entities.

In developing rules under Section 975, the Commission must strike a balance that ensures that the 260 "non-broker-dealer financial advisors" referenced in Ms. Haines' testimony register with the SEC but does not force thousands of unsuspecting individuals to comply with yet another regulatory burden that would be detrimental to the very municipal entities we are trying to protect.

Thank you for your attention to this important matter.

Sincerely,


SPENCER BACHUS
Chairman