

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**[Release No. 34-87204; File No. S7-16-19]**

**Proposed Exemptive Order Granting a Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Registered Municipal Advisors**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Notification of proposed exemptive order; request for comment.

**SUMMARY:** Pursuant to Section 15(a)(2) of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 36(a)(1) of the Exchange Act, the Securities and Exchange Commission (“SEC” or “Commission”) is proposing to grant exemptive relief, subject to certain conditions, to permit municipal advisors registered with the Commission under Section 15B of the Exchange Act to engage in certain limited activities in connection with the direct placement of municipal securities without registering as a broker under Section 15 of the Exchange Act.

**DATES:** Comments should be received by December 9, 2019.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov).

Paper comments:

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-16-19. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s

Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for website viewing and printing in the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC 20549-1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that the Commission does not redact or edit personal identifying information from comment submissions. Commenters should submit only information that they wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Emily Westerberg Russell, Chief Counsel, Joanne Rutkowski, Assistant Chief Counsel, or Kelly Shoop, Special Counsel, at 202-551-5550, in the Division of Trading and Markets; Rebecca Olsen, Director, or Adam Wendell, Senior Special Counsel, at 202-551-5680, in the Office of Municipal Securities; Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:**

**I. Background**

**A. Municipal Advisor Registration Framework**

Section 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Exchange Act to create a new class of regulated persons, “municipal advisors.”<sup>1</sup> The Commission subsequently adopted registration rules for municipal advisors in 2013.<sup>2</sup> Exchange Act Section 15B(e)(4)(A) defines the term “municipal advisor” to include a

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<sup>1</sup> See 15 U.S.C. 78o-4(a)(1)(B).

<sup>2</sup> See *Registration of Municipal Advisors*, Exchange Act Rel. No. 70462 (Sept. 30, 2013), 78 FR 67468, 67483 n.200 (Nov. 12, 2013) (“Municipal Advisor Adopting Release”).

person that provides advice to or on behalf of a municipal entity<sup>3</sup> or obligated person<sup>4</sup> (together, “Municipal Issuers”) 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.<sup>5</sup>

In adopting the municipal advisor registration rules, the Commission stated that “‘advice with respect to the issuance of municipal securities’ should be construed broadly from a timing perspective to include advice throughout the life of an issuance of municipal securities, from the pre-issuance planning stage . . . to the repayment stage for those municipal securities.”<sup>6</sup> The Commission noted that, in connection with the issuance of municipal securities, a municipal advisor “may assist municipal entities in developing a financing plan, assist municipal entities in

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<sup>3</sup> Exchange Act Section 15B(e)(8) defines “municipal entity” as “any State, political subdivision of a State, or municipal corporate instrumentality of a State, including (A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities.” 15 U.S.C. 78o-4(e)(8); *see also* 17 CFR 240.15Ba1-1(g).

<sup>4</sup> Exchange Act Section 15B(e)(10) defines “obligated person” as “any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in an offering of municipal securities.” 15 U.S.C. 78o-4(e)(10). Exchange Act Rule 15Ba1-1(k) generally provides that obligated person has the same meaning as in Exchange Act Section 15B(e)(10), “provided, however, the term obligated person shall not include: (1) A person who provides municipal bond insurance, letters of credit, or other liquidity facilities; (2) a person whose financial information or operating data is not material to a municipal securities offering, without reference to any municipal bond insurance, letter of credit, liquidity facility, or other credit enhancement; or (3) the federal government.” 17 CFR 240.15Ba1-1(k). Obligated persons can include entities acting as conduit borrowers, such as private universities, non-profit hospitals, and private corporations. *See Municipal Advisor Adopting Release*, 78 FR at 67483 n.200.

<sup>5</sup> Exchange Act Section 15B(e)(4)(A)(i).

<sup>6</sup> *Municipal Advisor Adopting Release*, 78 FR at 67490.

evaluating different financing options and structures, assist in the selection of other parties to the financing (such as bond counsel and underwriters), coordinate the rating process, ensure adequate disclosure, and/or evaluate and negotiate the financing terms.”<sup>7</sup>

Unless otherwise excluded or exempted, a person who engages in municipal advisory activities is required to register with the Commission as a municipal advisor<sup>8</sup> and comply with the rules of the Municipal Securities Rulemaking Board (“MSRB”).<sup>9</sup> Exchange Act Section 15B(b)(2) requires the MSRB to develop rules that, among other things, prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors, municipal entities, obligated persons, and the public interest.<sup>10</sup>

Exchange Act Section 15B includes certain statutory exclusions from municipal advisor registration, which the Commission interpreted and provided certain additional regulatory exemptions when it adopted the municipal advisor registration rules.<sup>11</sup> For example, Exchange

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<sup>7</sup> *Id.* at 67472.

<sup>8</sup> Exchange Act Section 15B(a)(2).

<sup>9</sup> Exchange Act Section 15B(c)(1).

<sup>10</sup> *See* Exchange Act Section 15B(b)(2)(C). The MSRB has developed a regulatory framework that imposes requirements regarding, among other things, registration of municipal advisors with the MSRB (MSRB Rule A-12); professional qualification requirements (MSRB Rules G-2 and G-3); fair dealing obligations (MSRB Rule G-17); supervisory and compliance obligations (MSRB Rule G-44); restrictions on gifts, gratuities, and non-cash compensation (MSRB Rule G-20); restrictions on political contributions (MSRB Rule G-37); standards for advertising (MSRB Rule G-40); application for a CUSIP number when advising on a competitive sale of new issue municipal securities (MSRB Rule G-34); and books and records requirements (MSRB Rules G-8 and G-9). In addition, MSRB Rule G-42 establishes certain standards of conduct consistent with the fiduciary duty owed by a municipal advisor to its municipal entity clients, including, without limitation, a duty of care and loyalty as well as standards of conduct and duties owed by a municipal advisor to its obligated person clients.

<sup>11</sup> *See Municipal Advisor Adopting Release*, 78 FR at 67503-37; 17 CFR 240.15Ba1-1(d)(2).

Act Section 15B(e)(4)(C) provides a statutory exclusion from the requirement to register as a municipal advisor for brokers, dealers, and municipal securities dealers serving as underwriters,<sup>12</sup> which was further interpreted by the Commission in adopting the municipal advisor rules.<sup>13</sup> The statute is otherwise silent with respect to whether, and under what circumstances, municipal advisors would be required to register as brokers.

**B. Direct Placements of Municipal Securities**

Since 2009, municipal entities have increasingly relied on direct placements, that is, direct purchases of municipal securities and direct loans from banks and other lenders, as an alternative to public offerings of municipal securities.<sup>14</sup> The demand for these direct placements

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<sup>12</sup> The statutory definition of “municipal advisor” excludes a broker, dealer, or municipal securities dealer serving as an underwriter (as defined in Section 2(a)(11) of the Securities Act of 1933). 15 U.S.C. 78o-4(e)(4)(C).

<sup>13</sup> *See Municipal Advisor Adopting Release*, 78 FR at 67511-67517. A broker cannot rely on the exclusion and provide advice to a municipal entity on an issuance of municipal securities until it has been engaged to serve as the underwriter for a particular issuance of municipal securities. *See id.* at 67512-13.

<sup>14</sup> *See Amendments to Municipal Securities Disclosure*, Exchange Act Rel. No. 83885 (Aug. 20, 2018), 83 FR 44700, 44702 (Aug. 31, 2018) (“Amendments to Municipal Securities Disclosure”). *See also* MSRB Notice 2015-03, Bank Loan Disclosure Market Advisory (Jan. 29, 2015) (noting that “[direct placements] as an alternative to a public offering could provide potential advantages for issuers, among other things, lower interest and transaction costs, reduced exposure to bank regulatory capital requirements, simpler execution process, greater structuring flexibility, no requirement for a rating or offering document, and direct interaction with the lender instead of multiple bondholders.”), *available at* <http://msrb.org/~media/Files/Regulatory-Notices/Announcements/2015-03.ashx?n=1>; and Municipal Market Bank Loan Disclosure Task Force, Considerations Regarding Voluntary Secondary Market Disclosure about Bank Loans (May 1, 2013), *available at* <http://www.nfma.org/assets/documents/position.stmt/wp.direct.bank.loan.5.13.pdf>. The Task Force comprised representatives of the American Bankers Association, Bond Dealers of America, Government Finance Officers Association, Investment Company Institute, National Association of Bond Lawyers, National Association of Health and Educational Facilities Finance Authorities, National Association of Independent Public Finance Advisors, National Federation of Municipal Analysts, and Securities Industry and Financial Markets Association. *See also* National Association of Bond Lawyers,

has grown substantially over the past several years, as the involvement of commercial banks in the municipal capital markets has increased in terms of both purchases of municipal securities and extensions of loans to state and local governments and their instrumentalities.<sup>15</sup>

As noted above, the Municipal Advisor Adopting Release identifies a wide range of activities in which a registered municipal advisor may engage on behalf of its Municipal Issuer clients. Since the issuance of the Municipal Advisor Adopting Release, the Commission has received questions and requests that it clarify the application of the broker regulatory framework to registered municipal advisors with respect to their activities in facilitating direct placements of municipal securities.<sup>16</sup>

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*Direct Purchases of State or Local Obligations by Commercial Banks and Other Financial Institutions* (July 2017), at 2, available at [http://www.chapman.com/media/publication/783\\_Chapman\\_NABL\\_Direct\\_Purchases\\_State\\_Local-Obligations\\_Banks\\_Financial\\_Institutions\\_072617.pdf](http://www.chapman.com/media/publication/783_Chapman_NABL_Direct_Purchases_State_Local-Obligations_Banks_Financial_Institutions_072617.pdf).

<sup>15</sup> See *Amendments to Municipal Securities Disclosure*, 83 FR at 44731. Direct placements may be structured as either loans or municipal securities. See *id.* at 44702. The relief requested would apply (and would be needed) only with respect to direct placements structured as municipal securities.

<sup>16</sup> The Commission has received a number of letters on this topic over the past few years. See Letter to Chair Mary Jo White, Commission from Mike Nicholas, Chief Executive Officer, Bond Dealers of America (“BDA”) (Oct. 17, 2014); Letter to Chair Mary Jo White, Commission from Terri Heaton, President, National Association of Municipal Advisors (“NAMA”) (Dec. 15, 2014); Letter to Chair Mary Jo White, Commission from Leslie Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”) (Mar. 12, 2015). More recently, Commission staff has received additional letters on this topic with more specific requests for guidance, including a request from a registered municipal advisor. See Letter to Brett Redfearn and Joanne C. Rutkowski, Division of Trading and Markets and Rebecca Olsen, Office of Municipal Securities, from Cheryl Maddox, General Counsel, and Leo Karwejna, Chief Compliance Officer, Public Financial Management, Inc. (Oct. 30, 2018) (“PFM Letter”); Letter to Brett Redfearn and Joanne C. Rutkowski, Division of Trading and Markets and Rebecca Olsen, Office of Municipal Securities, from Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA (June 12, 2019); Letter to Brett Redfearn and Joanne C. Rutkowski, Division of Trading and Markets and Rebecca Olsen, Office of Municipal Securities, from Mike Nicholas, Chief Executive Officer, BDA (June 28, 2019); Letter to Brett Redfearn, Division of Trading and Markets

## II. Discussion of Proposed Relief

The Commission is proposing to grant exemptive relief pursuant to Sections 15(a)(2)<sup>17</sup> and 36(a)(1)<sup>18</sup> of the Exchange Act to permit a registered municipal advisor,<sup>19</sup> acting on behalf of a Municipal Issuer client, to solicit specified institutional investors in connection with the direct placement of municipal securities without registering as a broker under Section 15 of the Exchange Act, where certain conditions are met.

Congress, in enacting the municipal advisor provisions, established a framework for comprehensive regulation of those entities in connection with their business of providing 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. Registered

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and Rebecca Olsen, Office of Municipal Securities, from Susan Gaffney, Executive Director, NAMA (July 18, 2019); Letter to Brett Redfearn and Joanne C. Rutkowski, Division of Trading and Markets and Rebecca Olsen, Office of Municipal Securities, from Mike Nicholas, Chief Executive Officer, BDA (Sept. 9, 2019); Letter to Commissioner Robert J. Jackson Jr. from Mike Nicholas, Chief Executive Officer, BDA (Sept. 25, 2019); Letter to Brett Redfearn and Joanne C. Rutkowski, Division of Trading and Markets and Rebecca Olsen, Office of Municipal Securities, from Mike Nicholas, Chief Executive Officer, BDA (Sept. 25, 2019). All of the letters are available on the Commission's Office of Municipal Securities homepage.

<sup>17</sup> Section 15(a)(2) of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt from the registration requirements of Section 15(a)(1) any broker or class of brokers, by rule or order, as it deems consistent with the public interest and the protection of investors. *See* 15 U.S.C. 78o(a)(2).

<sup>18</sup> Section 36(a)(1) of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. *See* 15 U.S.C. 78mm.

<sup>19</sup> For purposes of the proposed exemption, the term "registered municipal advisor" means a municipal advisor that is registered in accordance with Section 15B(a) of the Exchange Act and Rule 15Ba1-2 thereunder. *See* 17 CFR 240.15Ba1-2.

municipal advisors are subject to a comprehensive regulatory framework, including rules that, among other things, are designed to prevent fraudulent and manipulative acts and practices as well as protect investors, municipal entities, obligated persons, and the public interest.<sup>20</sup> The Commission, as noted above, has described the role of a municipal advisor as assisting municipal entities in developing a financing plan, assisting in evaluating different financing options and structures, assisting in selecting other parties to the financing (such as bond counsel and underwriters), coordinating the rating process, ensuring adequate disclosure, and/or evaluating and negotiating the financing terms. The Commission has not previously addressed, however, whether and under what circumstances a registered municipal advisor may interact or negotiate with potential investors on behalf of its municipal entity client without being required to register as a broker, with respect to direct placements or other issuances of municipal securities.

Because the definition in the Exchange Act of the term “broker” and the registration requirements under Section 15(a) of the Exchange Act were drawn by Congress to encompass a wide range of activities involving investors and securities markets,<sup>21</sup> a municipal advisor that identifies and assesses potential providers for direct placements by a Municipal Issuer client could be viewed as engaging in solicitation, a factor relevant to a determination of broker

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<sup>20</sup> See Exchange Act Sections 15B(a)(5) and (c)(1) and *supra* note 10 for a description of the applicable MSRB rules.

<sup>21</sup> See, e.g., *Registration Requirements for Foreign Broker-Dealers*, Exchange Act Release No. 27017 (Jul. 11, 1989), 54 FR 30013, at 30014-15 (Jul. 18, 1989). Section 15(a)(1) of the Exchange Act prohibits any broker or dealer from making “use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security [ ] unless such broker or dealer is registered in accordance with” Section 15(b) of the Exchange Act. 15 U.S.C. 78o(a)(1). Section 3(a)(4)(A) of the Exchange Act defines broker generally as “any person engaged in the business of effecting transactions in securities for the account of others.” 15 U.S.C. 78c(a)(4)(A).

status.<sup>22</sup> This is particularly true in light of the fact that service providers in municipal securities transactions, including municipal advisors, typically are paid from the proceeds of the securities offering and thus routinely receive transaction-based compensation. The receipt of transaction-based compensation has been considered by courts as a factor indicating that registration as a broker may be required.<sup>23</sup> Absent an exception or exemption, a municipal advisor engaging in this activity could be required to register under Section 15(a) of the Exchange Act.<sup>24</sup> There is currently no exception or exemption promulgated by the Commission applicable to these situations and as noted above, the Commission has not previously addressed this issue.

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<sup>22</sup> See, e.g., *SEC v. Century Inv. Transfer Corp., et al.*, No. 71-cv-3384, 1971 WL 297, at \*5 (S.D.N.Y. Oct. 5, 1971) (Century “engaged in the brokerage business by soliciting customers through ads in the Wall Street Journal, and engaging in sales activities designed to bring about mergers between private corporations and publically held shells controlled by” a co-defendant); *SEC v. Hansen*, No. 83-cv-3692, 1984 WL 2413, at \*4 (Apr. 6, 1984) (defendant engaged in unregistered broker activity when he “sold or attempted to sell interest in the five [securities] by use of the mails, the telephone, advertisements in publications distributed nationally and by other interstate means of communication”); *SEC v. National Executive Planners, Ltd.*, et al., 503 F. Supp. 1066, 1072-73 (M.D.N.C. 1980) (defendant engaged in unregistered broker activity by using the mails and telephone to “solicit[] clients actively” in the offer and sale of securities); *SEC v. Earthly Mineral Solutions, Inc.*, No. 2:07-cv-1057, 2011 WL 1103349, at \*2 (D. Nev. Mar. 23, 2011) (defendant engaged in unregistered broker activity when, among other things, he “conducted general solicitations through newspaper advertisements”); *SEC v. Deyon*, 977 F. Supp. 510, 518 (D. Maine 1997) (defendants engaged in unregistered broker activity when they “solicited investors by phone and in person,” “distributed documents and...prepared and distributed sales circulars”).

<sup>23</sup> See, e.g., *SEC v. Helms*, No. 13-cv-01036, 2015 WL 5010298, at \*17 (W.D. Tex. Aug. 21, 2015) (“In determining whether a person ‘effected transactions [for purposes of the Exchange Act registration requirements],’ courts consider several factors, such as whether the person: (1) solicited investors to purchase securities, (2) was involved in negotiations between the issuer and the investor, and (3) received transaction-related compensation.”) (citing cases initiated by the Commission).

<sup>24</sup> Although Section 15(a) applies to both brokers and dealers, the proposed exemption would apply only to activities that historically have been associated with broker activity; that is, effecting securities transactions for the account of others.

The Commission is mindful that the municipal advisor regulatory scheme established a framework for comprehensive regulation of those entities in connection with their business of providing 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. The Commission, as noted above, has described the role of a municipal advisor as assisting municipal entities in developing a financing plan, assisting in evaluating different financing options and structures, assisting in selecting other parties to the financing (such as bond counsel and underwriters), coordinating the rating process, ensuring adequate disclosure, and/or evaluating and negotiating the financing terms. The Commission has not previously addressed, however, whether and under what circumstances a registered municipal advisor may interact or negotiate with potential investors on behalf of its municipal entity client without being required to register as a broker, with respect to direct placements or other issuances of municipal securities.

The Commission preliminarily believes that there are certain limited circumstances in which a registered municipal advisor should be permitted to solicit investors in connection with the direct placement of municipal securities by its Municipal Issuer client, without registering as a broker under Section 15 of the Exchange Act. Accordingly, the Commission is proposing to grant exemptive relief pursuant to Sections 15(a)(2) and 36(a)(1) of the Exchange Act<sup>25</sup> to permit such activity without registration as a broker, subject to certain conditions described below. For purposes of this exemption, “Municipal Issuer” would be defined as either a municipal entity or

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<sup>25</sup> See 15 U.S.C. 78o(a)(2); 15 U.S.C. 78mm.

an obligated person, consistent with Exchange Act Sections 15B(e)(8) and 15B(e)(10), respectively.<sup>26</sup>

The proposed exemption would apply only to a registered municipal advisor's activities in connection with the "direct placement" by a Municipal Issuer of an entire issuance of municipal securities with a single "Qualified Provider," which we propose to define as (i) a bank, savings and loan association, insurance company, or registered investment company; or (ii) an investment adviser registered with the Commission or with a state; or (iii) any other institution with total assets of at least \$50 million.<sup>27</sup> The proposed exemption thus would not be available in transactions involving retail investors, including public offerings of municipal securities.

The Commission is proposing to limit the universe of Qualified Providers to entities that otherwise would be "institutional investors" for purposes of FINRA rules or "sophisticated municipal market professionals" (other than natural persons) under MSRB rules, a status that is equated with a certain level of investor sophistication.<sup>28</sup> The Commission recognizes that there may be an inherent conflict between the interests of a municipal advisor on one hand, acting on behalf of its Municipal Issuer client, and those of a potential investor on the other. As discussed below, the proposed exemption is subject to conditions, including the requirement that the

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<sup>26</sup> See *supra* n. 3 and 4.

<sup>27</sup> The Commission's proposed definition of Qualified Provider tracks the definition of Institutional Accounts under FINRA rules and the definition of Sophisticated Municipal Market Professionals under MSRB rules, with the exception that a Qualified Provider could not be a natural person. This is consistent with the Commission's preliminary view that for purposes of the exemption permitted transaction participants should be limited to an institutional investor purchasing the entire issuance for its own investment purposes. See FINRA Rule 4512(c) and MSRB Rule D-15(a).

<sup>28</sup> See FINRA Rule 2111(b), which provides an exemption to customer-specific suitability for institutional investors if certain conditions are met. MSRB Rule G-48(c) provides a similar exemption.

investor be a Qualified Provider, that are intended to mitigate investor protection concerns.<sup>29</sup> Further, nothing in the proposed relief would preclude a Qualified Provider (or any other transaction participant) from engaging a registered broker or other intermediary for the transaction. The condition that the entire issuance be placed with a single Qualified Provider also reflects the Commission’s understanding of how these transactions are structured currently.<sup>30</sup>

As noted above, the proposed exemption would permit registered municipal advisors to solicit investors so long as (1) those investors meet the definition of Qualified Provider and (2) the solicitation is in connection only with a potential direct placement of an entire issuance of municipal securities with a single Qualified Provider by the registered municipal advisor’s Municipal Issuer client. The proposed exemption does not prescribe the means of solicitation. Permitted solicitation could take a variety of forms. For example, Qualified Providers could be identified and assessed in several ways: based upon the Municipal Issuer’s or registered

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<sup>29</sup> See *infra* pp. 14-15 (describing required disclosures to the Qualified Provider) and 16 (describing the municipal advisor’s duty of fair dealing and the Commission’s antifraud protections). The Commission is seeking comment on questions related to potential investor protection concerns associated with this proposed exemption. Among other things, it is the Commission’s understanding that in a direct placement the institutional investor—often a bank—performs its own due diligence on the issuer subject to the institution’s own underwriting standards and generally does not rely on a broker to perform that service.

<sup>30</sup> See MSRB Regulatory Notice 2016-12, Direct Purchases and Bank Loans as Alternatives to Public Financing in the Municipal Securities Market (April 4, 2016) (“The MSRB and FINRA are aware of the increasing practice of privately placing municipal securities directly with a single purchaser (sometimes referred to as “direct purchases”) and of the use of bank loans as alternatives to traditional public offerings in the municipal securities market.”) (emphasis added).

municipal advisor's prior knowledge and experience, the use of publicly-available information sources, or identification of Qualified Providers through broader solicitation activities.<sup>31</sup>

A registered municipal advisor wishing to rely on the proposed exemption would be subject to certain conditions:

First, the registered municipal advisor would be required to make written disclosures to the Qualified Provider stating that the registered municipal advisor represents solely the interests of the Municipal Issuer and not the Qualified Provider. The registered municipal advisor would also be required to obtain from the Qualified Provider written acknowledgment of receipt of those disclosures.

Second, the registered municipal advisor would also need to obtain a written representation from the Qualified Provider that the Qualified Provider is capable of independently evaluating the investment risks of the transaction. This condition is consistent with the established framework for the institutional investor exemption from a broker's customer-specific suitability obligations under FINRA rules as well as the analogous exemption under MSRB rules.<sup>32</sup>

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<sup>31</sup> The solicitation activities would be in addition to the core advisory activities in which a registered municipal advisor might otherwise engage, identified by the Commission in the Municipal Advisor Adopting Release as typical of municipal advisory activities with respect to the issuance of municipal securities, namely assisting municipal entities and/or obligated person clients in: (i) developing a financing plan; (ii) assisting in evaluating different financing options and structures; (iii) assisting in selecting other parties to the financing, such as bond counsel; (iv) coordinating the rating process, if applicable; (v) ensuring adequate disclosure; and/or (vi) evaluating and negotiating the financing terms with other parties to the financing, including the provider of the direct placement. *See* Municipal Advisor Adopting Release, 78 FR at 67472.

<sup>32</sup> *See* FINRA Rule 2111(b) and Supplementary Material .07 (deeming a broker's customer-specific suitability obligation fulfilled in instances where the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular

Finally, the proposed exemption would apply only with respect to the limited activities, and subject to the conditions described above, including that the entire issuance of municipal securities be placed with a single Qualified Provider and that the municipal advisor comply with all applicable Commission and MSRB rules. A registered municipal advisor that complies with the conditions of the exemption would be permitted to solicit Qualified Providers on behalf of its Municipal Issuer client and receive transaction-based compensation for services provided in connection with a direct placement as described above without being required to register as a broker under Section 15(a) of the Exchange Act.<sup>33</sup> These functions are some of the most relevant to a determination of broker status, which may therefore require registration.<sup>34</sup>

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transactions and investment strategies involving a security or securities and the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations). *See also* MSRB Rule G-48(c) (eliminating the broker, dealer, or municipal securities dealer's obligation to perform a customer-specific suitability analysis if it reasonably concludes the customer is a Sophisticated Municipal Market Professional as defined in MSRB Rule D-15).

<sup>33</sup> The Commission preliminarily believes that this exemption will also benefit firms that are dually registered as municipal advisors and brokers. A dually-registered firm that is acting in a municipal advisory capacity advising a Municipal Issuer client on a direct placement of municipal securities would be permitted as well to engage in limited solicitation activities in accordance with the terms and conditions of the proposed exemption without being required to comply with broker requirements, such as books and records requirements, with respect to those activities. Instead, so long as the terms and conditions of the exemption are met, the municipal advisor will be acting in the municipal advisory capacity through the completion of the transaction. The Commission believes disclosure clarifying the role of the municipal advisor is particularly critical for dual registrants to avoid confusion on the part of potential Qualified Providers as to the capacity in which the firm is acting with respect to a direct placement.

<sup>34</sup> *See, e.g., Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Section 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934*, Exchange Act Rel. No. 44291, 66 FR 27760, 27772-73 at n.124 (May 18, 2001) ("Solicitation is one of the most relevant factors in determining whether a person is effecting transactions."), *cited in Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants*, Exchange Act Rel. No. 75611 (Aug. 5, 2015), 80 FR 48964, 48976 (Aug. 14, 2015) ("The Commission has previously interpreted the term 'effecting transactions' in the context of securities transactions to

Accordingly, if any of the conditions are *not* met—for example, the municipal advisor fails to comply with the disclosure conditions described above—the municipal advisor could not rely on the exemption and would need to consider whether it is required to register with the Commission as a broker under Section 15(a) of the Exchange Act. The exemption would apply only with respect to the defined activities. A registered municipal advisor could not rely on this proposed exemption to engage in broker activity relating to municipal securities offerings beyond the scope of the proposed exemption, such as facilitating a public offering or the sale of securities to a retail investor. Further, a registered municipal advisor seeking to rely on the exemption would need to make and keep the records required by Exchange Act Rule 15Ba1-8(a)(1). Finally, consistent with the narrow scope of activities contemplated by the proposed exemption, a registered municipal advisor seeking to rely on this proposed exemption could not bind the Municipal Issuer client, or handle funds or securities in connection with the direct placement. The Commission preliminarily believes that these types of activities would implicate the policies underlying the broker regulatory framework.

The Commission preliminarily believes that the proposed conditions with respect to transaction participants, disclosure requirements, and transaction type—in combination with applicable regulatory protections—should sufficiently restrict the scope of the proposed exemption such that permitting solicitation activities in this limited context would not implicate the need for additional regulation of these activities under the broker regulatory framework. For example, like brokers, registered municipal advisors have an obligation to deal fairly with all

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include a number of activities, ranging from identifying potential purchasers to settlement and confirmation of a transaction.”); *Cornhusker Energy Lexington, LLC v. Prospect Street Ventures*, No. 8:04CV586, 2006 WL 2620985, at \*6 (D. Neb. Sept. 12, 2006) (“Transaction-based compensation, or commissions are one of the hallmarks of being a broker-dealer.”).

persons—which, as relevant here, includes any potential Qualified Providers.<sup>35</sup> Also, the antifraud provisions of the Exchange Act as well as the Securities Act of 1933 apply equally to any person, including registered municipal advisors and brokers.<sup>36</sup> The Commission preliminarily believes these are important safeguards that operate as a constraint on the conduct of registered municipal advisors, independent of whether they are registered as a broker. Additionally, as stated above, the proposed exemption would be limited to dealings with Qualified Providers, which are entities that meet an established threshold of investor sophistication, and the required disclosures include an affirmative representation by the Qualified Provider that it is capable of independently evaluating the risks, which is consistent with the institutional suitability exemption under existing FINRA rules.<sup>37</sup> Finally, the Commission notes that the proposed conditional exemption would not preclude any transaction participant in a direct placement from engaging a registered broker or other intermediary for the transaction.

Accordingly, for the reasons discussed above, the Commission preliminarily believes that the proposed conditional exemption would be consistent with the public interest and the protection of investors and would be necessary or appropriate in the public interest.

### **III. Request for Comments**

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<sup>35</sup> See, e.g., MSRB Rule G-17 (requiring municipal advisors to “deal fairly with all persons and ... not engage in any deceptive, dishonest, or unfair practice”); FINRA Rule 2010 (prohibiting brokers from effecting transactions in, or inducing the purchase or sale of, securities “by means of any manipulative, deceptive or other fraudulent device or contrivance”); FINRA Rule 2111 Supplementary Material .01 (“Implicit in all member and associated person relationships with customers and others is the fundamental responsibility for fair dealing.”)

<sup>36</sup> See 15 U.S.C. 78j and 17 CFR 240.10b-5; see also 15 U.S.C. 77q.

<sup>37</sup> See FINRA Rule 2111(b) and Supplementary Material .07.

The Commission is seeking comment on all aspects of the proposed exemption. In particular, the Commission requests comment on the following questions. When responding to the request for comment, please explain your reasoning.

1. Has the Commission appropriately identified the activities in which a registered municipal advisor would be able to engage when representing a municipal entity or obligated person in connection with direct placements pursuant to the exemption? Please explain.
2. Should any of the identified activities proposed to be included be eliminated or modified? Please explain.
3. Has the Commission appropriately defined Qualified Provider? If not, what would be a more appropriate definition and why?
4. Should the definition of Qualified Provider be edited to add “credit unions”? If so, please explain.
5. Does the definition of Qualified Provider, together with the required conditions, provide adequate assurance that the potential investors included in such definition will be sufficiently able to evaluate the creditworthiness of the Municipal Issuer and the relevant terms of the direct placement offering, among other things? If not, please explain.
6. Should the Commission limit the exemption to direct placements of a specific size threshold—e.g., limited by aggregate principal amount or by Municipal Issuers with a limited aggregate amount of municipal securities outstanding? If so, why and how should the Commission define such thresholds?
7. Should the exemption for municipal advisors with respect to direct placements be conditioned on municipal advisors being precluded from engaging in solicitation

activities on behalf of their Municipal Issuer clients? If so, which activities and why?

Please explain.

8. Has the Commission appropriately defined the conditions that should apply to the proposed exemption? Please explain.
9. Should any of the proposed conditions be eliminated or modified? Please explain.
10. Are there other or different conditions that should apply to the proposed exemption? Please explain.
11. Are there any specific written disclosures to Qualified Providers that should be required, beyond those that are a condition of the proposed exemption? For example, should the municipal advisor be required to provide a written disclosure to the Qualified Provider that it may elect to engage a registered broker or other intermediary for the transaction? Please explain.
12. Should the exemption be expanded to include transactions in which multiple Qualified Providers purchase portions of the entire municipal securities offering directly from the Municipal Issuer? What are the relevant issues for the Commission to consider in determining whether such an expansion is necessary or appropriate in the public interest, and consistent with the protection of investors? For example, would the participation of multiple purchasers necessitate additional or different conditions or present heightened investor protection concerns? Please explain.
13. Is the type of direct placement contemplated by this proposed exemptive order typically resold into the secondary market? If so, how often and to what type of investor? Does the possibility of such a resale raise any investor protection concerns? If so, please explain. How should the Commission address those concerns?

14. Under the proposed definition of “Municipal Issuers,” the exemption would apply to conduit transactions involving obligated persons—i.e., the issuance of municipal securities by a municipal entity to finance a project to be used primarily by a third-party obligated person, such as a non-profit hospital or private university. Are there reasons the exemption should not apply with respect to obligated persons? If so, why not? If the exemption should apply, should the Commission impose additional or different conditions concerning those transactions? Should the exemption be conditioned on additional or different disclosure requirements for transactions involving obligated persons? Please explain.
15. Should the Commission, instead of granting the conditional exemption, require municipal advisors wishing to solicit Qualified Providers for direct placements on behalf of their Municipal Issuer clients to also register as brokers? For example, would a broker registration requirement provide necessary protections for investors, and if so, what specific protections would result from broker registration with respect to direct placement transactions? What would be the impact of such a requirement on municipal advisors operating in this space, in terms of both cost and competitive considerations? Please explain.
16. With respect only to direct placement transactions described above, what are the practical implications of the requirements resulting from broker registration, for example those related to any due diligence or other investor protection obligations, that are not applicable to municipal advisors? What are the practical implications of the differences between broker obligations and municipal advisors’ fair dealing obligations? Please be

specific and limit the context of the response to direct placements in which a single institutional investor purchases the entire issuance.

17. Would the proposed exemption have a competitive impact—either positive or negative—on municipal advisors and/or brokers? For example, would this proposed exemption facilitate capital formation for smaller Municipal Issuers? Are the costs of engaging a broker for direct placements burdensome for smaller Municipal Issuers? Please explain.

By the Commission.

Jill M. Peterson,  
Assistant Secretary.

**October 2, 2019**