Securities Regulation Daily Wrap Up, MUNICIPAL SECURITIES NEWS —SEC hosts virtual Q&A on temporary broker exemption for municipal advisors, (Jul. 8, 2020)

Securities Regulation Daily Wrap Up

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SEC staff stressed that the exemptive relief is limited in scope and designed to help smaller municipal issuers struggling to meet unexpected financing needs due to the COVID-19 pandemic.

The SEC recently hosted a virtual discussion on its temporary conditional exemptive order for municipal advisor activities, which was issued to help smaller municipalities affected by the COVID-19 pandemic obtain financing by allowing municipal advisors to engage in certain advisory activities on financing alternatives without triggering the Exchange Act's broker registration requirement. The discussion took the form of a question-and-answer session, with several questions submitted by interested parties ahead of time.

Exemption. The June 15 temporary conditional exemption (TCE) allows registered municipal advisors to engage in solicitation of certain qualified providers (including banks and their wholly-owned subsidiaries, as well as credit unions) in connection with a potential direct placement of municipal securities by its municipal issuer client without being required to register as a broker under Exchange Act Section 15(a), subject to several conditions. The purpose of the TCE is to aid smaller municipal issuers that may be struggling to meet their unexpected financing needs due to challenges posed by the COVID-19 pandemic. The exemptive order notes that although the Federal Reserve revised the terms of its Municipal Liquidity Facility to expand lending to larger municipalities due to the COVID crisis, most municipal issuers, including small cities, towns, and villages, do not meet the Fed's thresholds and are therefore ineligible to access the facility.

The exemptive order also stressed that the limited nature of the relief is designed to diminish the likelihood of a secondary market resale of these direct placements, particularly to retail investors, because these direct placements may not be rated and are not required to have disclosure documents. The restrictions include a minimum authorized denomination issue of the direct placement of $100,000, a size limit on the aggregate principal amount of the direct placement of $20 million, and restrictions on transferability to only other qualified providers.

October 2019 proposal. Office of Municipal Securities Director Rebecca Olsen remarked that the SEC had proposed an exemption similar to the TCE in October 19 which, if implemented, would have permitted registered municipal advisers to engage in certain limited activities in connection with the direct placement of municipal securities without registering as a broker. The Commission has not moved forward on the proposal at this time, but Olsen inquired how that proposal differed from the TCE.

Kelly Shoop of the SEC advised that while the TCE is not directly connected to the October 2019 proposal, the staff did learn from the comment process from engaging with market participants. The TCE is much more limited than the 2019 proposal, she explained. For one, the TCE is time-limited because it expires on December 31, 2020. But the most critical difference between the two is the definition of "qualified provider," she said. The qualified providers under the TCE are limited to "bank plus" entities; that is, banks, their wholly-owned subsidiaries, and credit unions. This limits the pool of potential investors compared to the 2019 proposal, which defined "qualified provider" as (1) a bank, savings and loan association, insurance company, or registered investment company; (2) an investment adviser registered with the Commission or with a state; or (3) any other institution with total assets of at least $50 million, Shoop explained. And, unlike the TCE, the October

2019 proposal did not require notification of the SEC staff of the use of the exemption, and the TCE's written representation requirements are much more detailed and granular, she said.

Limits. Olsen also asked about the transactional limitation imposed by the order on those wishing to take advantage of the exemption. She posed a hypothetical relating to the $20 million limit on the aggregate principal amount of a direct placement under the TCE. If a municipal advisor starts working on a deal that is not supposed to exceed a $20 million aggregate principal amount but ends up going over the size limit, can the advisor still rely on the exemption, Olsen asked.

Emily Hanson Santana of the SEC said that in this circumstance, a municipal advisor would not be able to rely on the TCE. The staff advises municipal advisors to be conservative when determining whether they can rely on the order for a particular transaction and that this is a decision that should be made up front, Santana explained. Municipal advisors should take into consideration that some municipal transactions are more likely than others to change in size as the transaction progresses, while in other circumstances, a client may not be authorized to issue over a specific account, which may be a helpful factor when thinking about the limitations imposed by the TCE, according to Santana.

Olsen asked if a municipal advisor could work on two different issuances by the same municipal issuer if neither one of them exceeds the $20 million threshold even if they are close in time and still rely on the order. Santana said that municipal advisors should keep in mind that the key purpose of the exemption is to aid small municipal issuers, which is why the relief is only available in connection with a direct placement in the aggregate principal amount of $20 million or less. Municipal advisors working on two placements for the same clients that want to rely on the order for both of them must make it clear that the advisor is not just trying to make an end run around the $20 million limit by splitting one deal into two or more issuances of $20 million or less, Santana advised. While the SEC did not speak to this situation directly in its order, Santana listed some things advisors should take into consideration in this hypothetical situation: whether the issuances documented separately; whether there is a separation in time between the two issuances; whether the issuances for the same or for different purposes; and if the issuances share a source of repayment.

Notification requirement. The TCE requires a registered municipal advisor seeking to rely on the TCE to notify the SEC's Division of Trading and Markets no later than 30 days after the sale of securities in the direct placement. The notification must identify the municipal issuer, the date of the direct placement, the principal amount of the direct placement, and the qualified provider(s). Olsen asked what the Commission plans to do with this information and whether it will be made public.

Shoop responded that the notification requirement will give the staff information about when and how often the exemption is being relied upon. Shoop also noted that it is helpful to have this information since direct placements are not subject to the same disclosure regime as a public offering, and it is therefore difficult to get reliable data on private direct placements. The information will also aid examiners when they look at reliance on the terms of the order, she said.

Regarding whether the information will be made publicly available, Shoop advised that Chairman Clayton had told the House Financial Services Committee that the Commission is considering doing so. However, she also remarked that the information required to be submitted to the Commission is fairly basic and may already be available publicly.

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