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RECENT OBSERVATIONS FROM MUNICIPAL ADVISOR EXAMINATIONS *

With more than 450 municipal advisors (“MAs”) currently registered with the SEC, the Division of Examinations continues to make the examination of MAs a priority.¹ The rules of the SEC and those of the Municipal Securities Rulemaking Board (“MSRB”) address registration, disclosure of conflicts of interest, fiduciary duties, professional qualifications, and continuing education, among other aspects of MA operations.² In 2017, EXAMS published a Risk Alert that provided the staff’s observations from a series of examinations of newly registered MAs, with a focus on deficiencies observed in the areas of registration, recordkeeping, and supervision.³

This Risk Alert reminds municipal advisors of their obligations and raises awareness among municipal advisors and other market participants of the most often cited deficiencies and weaknesses observed in recent MA examinations, which include many of the areas covered in the Risk Alert issued in 2017, as well as deficiencies and weaknesses related to municipal advisors’ disclosure to clients. We encourage municipal advisors to review each of these areas and assess their compliance with each. In addition to the areas discussed below, the Division intends in the future for examinations to include a more prominent focus on the core standards of conduct and duties applicable to municipal advisors.

* The views expressed herein are those of the staff of the Division of Examinations (“EXAMS” or the “Division”). This Risk Alert is not a rule, regulation, or statement of the Securities and Exchange Commission (the “SEC” or the “Commission”). The Commission has neither approved nor disapproved the content of this Risk Alert. This Risk Alert, like all other staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person. This document was prepared by Division staff and is not legal advice.

¹ The Division’s Examination Priorities for [2019](#), [2020](#), [2021](#), and [2022](#) include a focus on municipal advisors.

² Section 15B(b)(2) of the Securities Exchange Act of 1934 (the “Exchange Act”) authorizes the MSRB to propose and adopt rules with respect to, among other things, municipal advisors providing advice to or on behalf of municipal entities or obligated persons. This Risk Alert does not address compliance by MAs or their affiliated municipal securities dealers with any FINRA rules that may apply.

³ Division, “[Observations from Municipal Advisor Examinations](#)” (Nov. 7, 2017).

Staff Observations from Examinations of Municipal Advisors

A. Registration and Filings

Regulatory Framework. [Section 15B\(a\)\(1\)\(B\)](#) of the Exchange Act requires all MAs to register with the Commission before engaging in municipal advisory activities. [Exchange Act Rule 15Ba1-2](#) requires an MA applying for registration to file [Form MA](#). In addition, subject to certain exemptions, the rule requires an MA to file a [Form MA-I](#) for each natural person associated with the municipal advisor and engaged in municipal advisory activities on its behalf. [Exchange Act Rule 15Ba1-5](#) requires an MA to update its Form MA annually, within a specific time frame, and to amend it promptly whenever a material event has occurred that changes the information previously provided. The rule also requires a municipal advisor to amend Form MA-I promptly whenever information on the form becomes inaccurate for any reason. After registering with the Commission, an MA must register with the MSRB on MSRB Form A-12 and pay to the MSRB initial and annual registration fees, pursuant to [MSRB Rule A-12](#). Municipal advisors are also required to affirm the Form A-12 annually during the “Annual Affirmation Period” pursuant to MSRB Rule A-12(k) and update it within 30 days of any of the information on the form becoming inaccurate.

Observations. There was significant overlap between the types of registration and filing deficiencies and weaknesses observed in the 2017 Risk Alert and those that continue to be the most commonly observed deficiencies and weaknesses in recent examinations from which this Risk Alert draws:

- *Filings with Inaccurate, Incomplete, or Inconsistent Information.* The staff observed municipal advisors that filed their SEC Forms MA and MA-I with inaccurate or incomplete information, including with respect to information about an MA’s affiliates, solicitation activities, other businesses, and the types of activities the MA engaged in with respect to municipal securities. For Form MA-I, there were municipal advisors that did not include accurate or complete information about their associated persons’ other business and required disclosures such as customer complaints and tax liens. In addition, the staff observed MAs that provided information on SEC Form MA that was inconsistent with information provided on MSRB Form A-12.
- *Failure to Amend and Untimely Amendments.* The staff observed municipal advisors that did not file amendments to SEC Forms MA and MA-I and MSRB Form A-12 when information became inaccurate or when material events occurred, or did not file amendments in a timely manner. For example, there were MAs that did not amend their Form MA to reflect changes concerning ownership and disciplinary disclosures. Similarly, the staff observed MAs that did not amend Form MA-I to reflect changes in an associated person’s employment or other business, or to add new disclosures involving civil judicial actions or judgment or liens. The staff also observed municipal advisors that did not amend their Form A-12 to reflect changes in items such as contact information and business activities.

- *Annual Filing Requirements.* The staff observed municipal advisors that (1) did not file annual updates to their SEC Form MA, in some instances for multiple years and/or (2) did not review, update, and affirm the information in MSRB Form A-12 on an annual basis.
- *MSRB Fees.* The staff observed municipal advisors that did not pay the required MSRB initial and annual registration fees.

B. Recordkeeping

Regulatory Framework. [Exchange Act Rule 15Ba1-8](#) requires MAs to make and keep certain books and records for specified periods of time. [MSRB Rules G-8](#) and [G-9](#) further specify certain books and records that MAs must make and the periods of time that required books and records must be preserved, respectively.

Observations. The staff continues to observe deficiencies and weaknesses related to books and records requirements similar to those highlighted in the 2017 Risk Alert. For example, the staff observed municipal advisors that did not make or keep true, accurate, and current copies of some of the books and records required by the rules, or did not preserve such records, including in the following categories:

- Originals or copies of written communications relating to municipal advisory activities, particularly electronic communications, such as emails relating to municipal advisory activities that were sent from a personal email address, text messages on mobile devices, and instant messages.
- Financial or accounting documents, including cash reconciliations and general ledgers.
- Records concerning compliance with the MSRB’s MA supervision and compliance rule (MSRB Rule G-44), including records of annual certifications and designations of chief compliance officers.
- Written consents to service of process from natural persons associated with the MA who engage in municipal advisory activities solely on behalf of such MA.
- Copies of documents created by the MA that were material to making a recommendation to a municipal entity or obligated person.
- Written agreements entered into by the MA with municipal entities and their employees, obligated persons, or otherwise relating to the MA’s business.

C. Supervision

Regulatory Framework. [MSRB Rule G-44](#) requires MAs to establish, implement, and maintain a system to supervise the MA activities of the municipal advisor and its associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, including MSRB rules. An MA’s supervisory system must provide for the establishment, implementation, maintenance, and enforcement of written supervisory procedures (“WSPs”) that

are reasonably designed to ensure that the conduct of the municipal advisory activities of the MA and its associated persons are in compliance with applicable rules. In addition, the WSPs must take into consideration factors such as the MA's size and organizational structure; nature and scope of municipal advisory activities; likelihood that associated persons may be engaged in relevant outside business activities; and any indicators of irregularities or misconduct.

Subject to certain exceptions, a municipal advisor's chief executive officer (or equivalent) must certify, annually, in writing that the MA has in place processes to establish, maintain, review, test, and modify written compliance policies and WSPs reasonably designed to achieve compliance with applicable rules. In addition, the rule requires an MA to designate one or more municipal advisory principals to be responsible for the supervision required by the rule and to designate an individual to serve as its chief compliance officer.

Observations. The staff continued to observe deficiencies relating to supervision, including many of the same types observed in the 2017 Risk Alert. Specifically, some of the most common deficiencies the staff observed related to the following topics:

- *Failure to Establish, Amend, or Design WSPs.* The staff observed municipal advisors that did not have any WSPs. Other MAs did not promptly amend their WSPs to reflect changes to applicable rules, such as the adoption of MSRB Rule G-42—which, among other things, establishes duties of care and loyalty and governs conflicts of interest and is discussed in the following section—and the MA advertising rule ([MSRB Rule G-40](#), which became effective in 2019). In addition, WSPs appeared not to be reasonably designed, or were not implemented and enforced, to ensure compliance with applicable rules, including rules relating to gifts, gratuities, and expenses; the preservation of electronic communications; and the filing and updating of required forms. The staff also observed municipal advisors whose WSPs did not take into consideration their organizational structure, nature of their municipal advisory activities, or the relevant outside business activities of their associated persons.
- *Annual Reviews and Certifications.* The staff observed MAs that did not conduct required at-least-annual reviews of their WSPs and MAs whose chief executive officers did not annually certify, in writing, that the MAs had in place processes to establish, maintain, review, test, and modify WSPs.

D. Disclosure to Clients (MSRB Rule G-42)

Regulatory Framework. Among other things, [MSRB Rule G-42](#) requires that before or upon engaging in municipal advisory activities, an MA must provide to its municipal entity or obligated person client full and fair disclosure, in writing, of all material conflicts of interest. The disclosure must be sufficiently detailed to inform the client of the nature, implications, and potential consequences of each conflict and include an explanation of how the MA addresses or intends to manage or mitigate each conflict. An MA that concludes it has no known material conflicts of interest based on the exercise of reasonable diligence must provide a written statement to the client to that effect. If a conflict cannot be managed or mitigated in a manner

that permits the municipal advisor to act in the client's best interest, the municipal advisor must not engage in municipal advisory activity for that client.⁴

In addition, an MA must evidence each of its municipal advisory relationships by documents created and delivered to the municipal entity or obligated person client before, upon, or promptly after the establishment of the relationship. The rule specifies the minimum elements that must be included in the documentation, including but not limited to the scope of the municipal advisory activities to be performed and any limitations on the scope of the engagement. An MA must promptly amend or supplement relationship documents to reflect any material changes or additions and promptly deliver any amendment or supplement to the client.

Observations. The most often cited deficiencies and weaknesses under MSRB Rule G-42 included:

- *No Disclosure of Conflicts.* The staff observed municipal advisors that did not disclose in writing to their clients all material conflicts of interest including, for example, conflicts regarding:
 - The nature of relationships between the MA and other MAs that shared a common client; between the MA and other relevant parties, such as underwriters or other parties providing services to or on behalf of a municipal entity client; or between the MA and the municipal entity client itself.
 - Fee-splitting arrangements involving the municipal advisor.
 - Compensation for municipal advisory activities that was contingent on the closing of the transaction or the size of the transaction.
- *No Statement of Lack of Known Conflicts.* The staff observed municipal advisors that did not provide their clients with written statements that the MA has no known material conflicts of interest (where applicable).
- *Inadequate Documentation of Relationship.* The staff observed municipal advisors that did not document their advisory relationships, did not include in their documentation all of the required elements, or did not promptly amend or supplement such documents to reflect material changes.
- *Untimely Documentation or Disclosure.* The staff observed MAs that did not provide the required conflicts disclosure or documentation of municipal advisory relationship prior to or upon engaging in municipal advisory activities, or promptly after establishment of the relationship, as required by the rule.

⁴ See Supplementary Material .02 to Rule G-42—Duty of Loyalty.

Conclusion

In sharing the information in this Risk Alert, EXAMS encourages municipal advisors to review their practices, policies, and procedures in these areas and to consider improvements in their compliance programs, as may be appropriate.

This Risk Alert is intended to highlight for firms risks and issues that EXAMS staff has identified. In addition, this Risk Alert describes risks that firms may consider to (i) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. Other risks besides those described in this Risk Alert may be appropriate to consider, and some issues discussed in this Risk Alert may not be relevant to a particular firm's business. The adequacy of supervisory, compliance and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.
