

Legal Update

SEC Municipal Advisor Examination Observations

SEC risk alert highlights areas of continuing deficiencies and future focus of examinations

On August 22, 2022, the Division of Examinations (the "Division") of the U.S. Securities and Exchange Commission ("SEC") published a risk alert (the "2022 Risk Alert") to raise awareness of the most frequently cited deficiencies and weaknesses observed in recent municipal advisor examinations.¹ Topics include municipal advisor registration and filings, recordkeeping, supervision and disclosure of conflicts of interest. The Division previously highlighted many of these topics in a 2017 risk alert (the "2017 Risk Alert") with respect to newly registered municipal advisors.² The Division has included examinations of municipal advisors as an examination priority each year since 2019.³

The 2022 Risk Alert, together with two SEC enforcement actions against municipal advisors in June of this year,⁴ may signal an increase in scrutiny from SEC examination and enforcement staff regarding municipal advisor practices, policies and procedures relating to the topics highlighted in the risk alert. As such, firms should consider reviewing and assessing their compliance with each of the topics. In this regard, we note that the Division indicated that it intends for future examinations "to include a more prominent focus on the core standards of conduct and duties applicable to municipal advisors."⁵

The following is a brief summary of the Division's key observations in the 2022 Risk Alert.

Registration and Filings

Municipal advisors filed SEC Forms MA and MA-I with inaccurate or incomplete information, including information regarding their associated persons' other business and other required disclosures (*e.g.*, customer complaints, tax liens). Additionally, municipal advisors did not amend, or did not amend timely, SEC Forms MA and MA-I and Municipal Securities Rulemaking Board ("MSRB") Form A-12, such as to reflect changes in ownership of the firm or disciplinary actions involving the firm or its associated persons (*e.g.*, disclosure of judicial actions or judgments/liens, change in employment or other business).

Recordkeeping

Municipal advisors did not make or keep true, accurate and current copies of certain required books and records, or did not preserve such records, including with respect to:

- *Written communications* relating to municipal advisory activities, particularly electronic communications, such as business-related email sent from a personal email address, text messages on mobile devices and instant messages. We note that this topic has been a focus of the SEC with respect to broker-dealers.
- *Financial and account documents*, including cash reconciliations and general ledgers.
- *Written agreements* entered into by the municipal advisor with municipal entities and their employees, obligated persons or otherwise relating to the firm's business.

Supervision

Municipal advisors either did not have any written supervisory procedures ("WSPs") or the WSPs were not sufficient, not implemented and/or not enforced. For example, deficiencies related to gifts, gratuities and expenses, and, as noted above, the preservation of electronic communications and/or the filing and updating of required forms. Moreover, some firms failed to promptly amend their WSPs to reflect the adoption of MSRB Rule G-42 (Duties of Non-Solicitor Municipal Advisors),⁶ which became effective in 2016, or MSRB Rule G-40 (Advertising by Municipal Advisors),⁷ which became effective in 2019. Firms also failed to conduct annual reviews of their WSPs pursuant to MSRB Rule G-44(b) and/or their Chief Executive Officers failed to certify annually, in writing, that the firm had in place processes to establish, maintain, review, test and modify WSPs, pursuant to MSRB Rule G-44(d).

Disclosure to Clients

Municipal advisors failed to disclose in writing to clients, or did not disclose timely, their material conflicts of interest, including with respect to the firms' relationships with other parties (e.g., underwriters or other parties providing services to or on behalf of a municipal entity client) or between the municipal advisor and the municipal entity client itself. Other deficiencies involved disclosures relating to fee-splitting arrangements and contingent compensation arrangements. Finally, firms failed to document, or did not document adequately or timely, their municipal advisory relationships.

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Endnotes

- ¹ See SEC Division of Examinations, [Risk Alert: Observations from Municipal Advisor Examinations](#) (Aug. 22, 2022).
- ² See SEC Office of Compliance Inspections and Examinations, [Risk Alert: Observations from Municipal Advisor Examinations](#) (Nov. 7, 2017) (“In sum, the staff observed that [municipal advisors] were generally unfamiliar with many of their regulatory obligations.”). The 2017 Risk Alert noted that “[s]ome firms were referred to the [SEC’s] Division of Enforcement.” *Id.* at 2.
- ³ See Examination Priorities for [2019](#), [2020](#), [2021](#) and [2022](#).
- ⁴ These cases involve municipal advisors who, among other things, breached their fiduciary duties to their municipal clients and, in one case, failed to disclose to nearly 200 municipal clients that the firm had material conflicts of interest arising from its compensation arrangements.
- ⁵ Risk Alert at 1.
- ⁶ Among other things, MSRB Rule G-42 establishes core standards of conduct, including duties of care and loyalty, and provides for the disclosure of conflicts of interest for municipal advisors that engage in municipal advisory activities, other than municipal solicitation activities.
- ⁷ MSRB Rule G-40 establishes requirements for advertisements by municipal advisors, including a requirement that each advertisement be approved in writing by a municipal advisor principal prior to first use.