

MEMORANDUM

TO: File Nos. 4-610 and S7-45-10

FROM: Alicia F. Goldin, Division of Trading and Markets

DATE: November 4, 2011

RE: Meeting with Representatives of Public Financial Management, Inc. ("PFM")

On November 2, 2011, the following representatives of PFM:

- F. John White, Chief Executive Officer
- Marty Margolis, Chief Investment Officer of PFM Asset Management LLC
- John Bonow, Managing Director and future Chief Executive Officer
- Leo Karwejna, Chief Compliance Officer of PFM Asset Management and future Chief Compliance Officer of PFM
- Joseph Connolly, General Counsel to PFM pursuant to delegation from PFM's principal law firm.

met with Commissioner Elisse B. Walter; Cyndi Rodriguez and Lesli Sheppard from the Office of Commissioner Walter; Mary Simpkins, John McWilliams, David Sanchez, David Dimitrious, Tom Eady, Brian O'Neill and Alicia Goldin from the Division of Trading and Markets; Amy Starr from the Division of Corporation Finance; Mark Zehner from the Division of Enforcement, Stanislava Nikolova from the Division of Risk, Strategy and Financial Innovation and Robert Miller and Mshyka Davis-Smith from the Office of Compliance, Inspections and Examinations to discuss issues related to the municipal securities market. The participants discussed, among other things, the matters associated with the file numbers above and the topics listed in the attached memorandum provided in advance of the call. See also Letter from John Bonow to Commissioner Elisse B. Walter, dated October 6, 2011 available at <http://www.sec.gov/comments/4-610/4610-70.pdf>.

MEMORANDUM TO SECURITIES AND EXCHANGE COMMISSION

Introduction

Public Financial Management, Inc. (“PFM”) appreciates the opportunity to meet with Commissioner Walter and members of the Commission Staff.

We have prepared this Memorandum to provide a general overview of the municipal marketplace and introduce to you our approach to the role of financial advisor - - as exemplified by our own practice and experience - - and to present our thoughts with respect to the business environment on which the Rulemaking process under the Dodd-Frank Act will have a significant effect.

The following topics are covered in this Memorandum:

- PFM Representatives
- Who We Are
- PFM Services for Public Sector Capital Financing
- The Marketplace for Municipal Financial Advisory Services
- The Dodd-Frank Act – Rational Rules for Fiduciary Duty and the Resolution of the Roles of Brokers and Municipal Advisors
 - Brokers’ Fiduciary Duties as Municipal Advisors – Preserving the Reality of Fiduciary Duty
 - Direct Bank Loans for Capital Financing
 - Even the Playing Field Between Brokers and Financial Advisors as Regards Fiduciary Duties

PFM Representatives

F. John White is the Chief Executive Officer of Public Financial Management, Inc. and has been a principal of the firm for more than 31 years. Prior to joining PFM in 1979, John was an official of the City of Philadelphia and held staff positions for a Member of the United States House of Representatives.

Marty Margolis since 1987 has been the Chief Investment Officer of Public Financial Management’s affiliate, PFM Asset Management LLC, a registered investment company. Prior to becoming engaged in the securities business, Marty was an assistant to the Governor of Pennsylvania.

John Bonow, a Managing Director of PFM has devoted his entire professional career of 20 years to PFM. John has been selected to be the Chief Executive Officer of PFM commencing in January 2012 when John White becomes non-executive Chairman.

Leo Karwejna is the Chief Compliance Officer of PFM Asset Management and will also become the Chief Compliance Officer of PFM. Prior to joining PFM Asset Management, Leo’s domestic and international regulatory compliance experiences include Prudential Financial Inc., Deutsche Asset Management and RREEF Alternate Investments.

Joseph Connolly serves as General Counsel to PFM pursuant to delegation from PFM’s principal law firm. Prior to his years in private law practice in Philadelphia, Joe

held several positions in the federal government, including Assistant Solicitor General of the United States and Assistant Watergate Special Prosecutor.

Who We Are

PFM is registered as a municipal advisor with the Commission and the Municipal Securities Rulemaking Board (MSRB). PFM and its affiliate, PFM Asset Management LLC, a registered investment advisor under the '40 Act, are under common control through a holding company which is owned by the senior professionals of the companies and by institutional investors.

PFM is what is known in municipal financial services as an “independent” financial advisor. That means that we do not underwrite or trade in any securities, and we do not have any fee sharing or soft dollar arrangements with any investment bank or other bond transaction participants. Those historic characteristics are, in our view, vital to our relationships with our clients. We are able to promise our clients that our advice cannot be affected by relationships with broker-dealers arising from prior or contemplated future syndicate transactions or by our trading positions or the trading positions of our clients. As a general recognition of the importance of this independence in the municipal market, some municipalities and non-profit institutions will engage only independent financial advisors.

The majority of the business of PFM consists of serving as financial advisor to state and local governments and authorities (including authorities which act as conduit issuers for governments and non-profit institutions; our clients also include non-profit institutions themselves, such as universities and healthcare institutions). Our services as financial advisor are more fully described in the next section of this Memorandum.

In addition to financial advisory services related to capital markets decisions, PFM has a substantial practice as advisor to governmental entities seeking to improve operations and identify efficiencies in the delivery of services and those experiencing some form of financial distress. We have an experienced professional staff - - one of the best in the United States, we believe - - in analyzing state and local government practices and in developing responses to critical situations. Our current or recent clients for these strategic planning services include the cities of New Orleans, Louisiana; Gary, Indiana; Nassau County, New York; Pittsburgh, Pennsylvania; and Vallejo, California. In addition to providing strategic advice to governments, we provide comprehensive financial planning advice to numerous universities and colleges, in many cases employing proprietary software for such services.

The strength of PFM's advisory business is the quality of our professionals. Most of the firm's senior professionals have more than a decade of service with PFM (and government financial departments). PFM's incoming class of college graduates begin with a quantitatively intense 10-week training course. Those who successfully complete that training course are assigned to one of PFM's many offices for further experience and training before their employment is confirmed.

PFM also maintains a program of semi-annual formal client training, which includes intensive seminars on financial markets, balance sheet decisions and bond math for which clients may obtain continuing education credit, and internal continuing

education and exchanges among professional staff throughout the Country to assist in client service.

PFM Services for Public Sector Capital Financing

The municipal debt market presents many characteristics which, in effect, have created the need for financial advisors. In the municipal market there are vastly more issuers than in the private sector market and a lack of transparency of the factors which must be considered by issuers. In addition, the officials of many government issuers are part-time officials who, unlike the personnel of corporate finance departments, frequently do not have a regular focus on the capital markets.

PFM's financial advisory business consists of a broad range of financial planning, capital formation and debt management services. An element of these services involves advising governments and non-profit entities with respect to debt portfolio structure and debt issuance. The larger of our clients generally select financial advisors (or a panel of several financial advisors) through an RFP process. Engagements obtained as successful RFP proposer most often involve a contractual relationship in which PFM will advise the client with respect to debt management over a designated period generally for a fee specified by the client, and will advise the client on bond structuring and issuance matters (e.g., underwriting syndicate composition, rating agency strategies and presentations, and bond pricing) in respect to debt offered during the contract period. The fee for bond issuance services generally is determined pursuant to the RFP - - often by a formula that takes account of the size of the offering - - and is payable only upon completion of the bond sale. In some instances, the RFP process is used with respect to a single offering of substantial size and contemplates a fixed fee to the financial advisor on completion of the sale. The monetization of tobacco settlement proceeds by several states and other entities through bond issuances are examples.

The greater number of PFM's financial advisor clients are smaller governments or non-profit entities which engage us on a regular basis on a variety of matters and often in respect to bond issuances. These clients have engaged PFM as a result of referrals from other clients or our own direct marketing efforts. PFM will make itself available to these clients to respond to capital program and debt management issues as needed. PFM will also bring suggestions to a client's attention, for example, when market circumstances present an attractive opportunity for refinancing of outstanding bonds at lower costs. Fees for such services are nominal or may be deferred. When a bond issuance does take place, if PFM is engaged to serve as financial advisor, we negotiate our fee based upon the complexity and size of the offering, which is payable upon completion of the sale.

In our experience, budgetary constraints preclude a government entity from agreeing to pay a fee for bond issuance services, including legal and advisory fees, except out of bond proceeds when they are received. As a practical matter, once formal action by the government to issue a bond has been taken, the proceeds are realized.

PFM seeks to engage in long-term relationships with its clients. There is no single collection of financial advisory services that is applicable to all our engagements, but we seek to provide advice on the execution of capital programs, rather than just municipal bond offerings. The scope of our services depends upon the sophistication of the client's

internal financial staff, bond counsel, and, the capabilities of the underwriter(s). In substantially all transactions we advise the client on market timing, issue size and structure and rating strategy. In those involving a negotiated sale to an underwriter (which, if selected, always is the client's election) we also advise the client as to the demonstrated underwriting capacity and bond distribution capabilities of the prospective underwriters. PFM will prepare financial analyses of various debt alternatives under current interest rate and hypothetical future interest rate conditions using both internally developed models and industry-standard software. We will assist bond or disclosure counsel and the underwriter and its counsel with review of the official statement and will review the client's historic financial statements. PFM arranges for the rating of the bonds by one or more rating agencies. In a negotiated offering, our most important service is to advise the client with respect to current interest rate conditions and to negotiate the pricing of the bond purchase with the underwriter. PFM devotes considerable operating expense to the maintenance of a centralized bond pricing group, the role of which is continuously to monitor bond sales and the trading prices of both recently issued municipal bonds and those secondary market trades that are relevant and to provide independent price views to the client. We have developed sophisticated trading models which rely on MSRB trading data and third-party generated market information, all of which give the issuer a tangible basis for negotiating the best price. The ultimate beneficiary of best pricing is, of course, the issuer's taxpayers.

If the client decides to sell its bonds in a competitive offering (whether by reason of applicable law or upon our recommendation) PFM will make arrangements for the sale through one of the electronic bidding services. Competitively sold offerings represent approximately 25.7% by par value (a larger percentage by number of issues) of the bond offerings on which PFM has advised in 2011 through September 30.

Finally, we wish to be clear that as between PFM and our client, it is the client exclusively which makes all decisions as to the terms of its indebtedness, the instrumentalities which will be used to carry-out the sale of bonds and whether, in fact, the debt will be incurred. We believe that we do a very good job in providing our clients with all of the information necessary for an intelligent and informed decision - - as evidenced by our ranking as the number one financial advisor in par value for the past 13 consecutive years.

The Marketplace for Municipal Financial Advisory Services

PFM competes with several classes of financial service providers in obtaining engagements for financial advisory services.

There is a broad range of independent and non-independent financial advisors, including some broker-dealer firms who actively provide financial advisory services for bond transactions. We estimate that there are fewer than one dozen firms that consistently seek financial advisory business on a national basis. PFM is the largest of these, having advised on \$26.4 billion of this year's transactions through September 30, 2011 (approximately 18% of transactions involving a financial advisor and approximately 14% of all municipal bond sales). In addition to the few independent financial advisory firms having a national practice, there are an untold number of independent firms having a single-state or regional practice. We understand that virtually all such firms have fewer

than ten employees and the majority may be sole practitioners with varied backgrounds and qualifications.

The most substantial competition for PFM comes from municipal brokers who generally complete transactions without an independent financial advisor being present. In one form of competitive scenario, a broker who has participated in previous transactions with an issuer or otherwise learns of a contemplated bond issuance seeks and obtains the role of financial advisor for the issue – the issuer’s process of selecting the financial advisor may or may not involve an RFP process. In our experience, the issuer does not perceive a need for a second or independent financial advisor, even if the broker/financial advisor morphs into the underwriter (a scenario which, as we discuss below, the MSRB has provided instructions for brokers to accomplish notwithstanding the revision of MSRB Rule G-23).

Brokers’ other barrier to the use of financial advisors is their ability to persuade a municipal client that the client does not require a financial advisor to assist in a bond sale in which the broker will serve as the underwriter in a negotiated sale. Experience shows that brokers regularly are successful in deterring the engagement of a financial advisor notwithstanding the Commission’s recognition that employing a financial advisor results in significant financial benefit to the issuer (see SEC Release 34-63576 and cited research studies). Of course there may be some governments or non-profit organizations that are so large or sufficiently resourced with experienced personnel that they can perform “in-house” some of the services that would be provided by an independent financial advisor, but in most instances, as best we can determine experientially, the issuer ultimately relies on the broker’s recommendation as to the configuration of the debt and to rely solely upon the broker’s assurance of the fairness of the price which the broker will pay.

The Dodd-Frank Act - - Rational Rules for Fiduciary Duty and the Resolution of the Roles of Brokers and Municipal Advisors

We use the following segments of this Memorandum to express our views with respect to a few of the current issues in municipal finance for which the Dodd-Frank Act, and the recognition of fiduciary duties to issuers, have direct implications.

1. Brokers’ Fiduciary Duties as Municipal Advisors

In circumstances where no independent financial advisor has been engaged, the broker has the opportunity to influence the structure or terms of the bond issue to its preferences - - which may not be congruent with the best interests of the government issuer. Although the recent revision of Rule G-23 was intended to protect issuers from a broker who thereafter seeks to distribute the bond issue, the “Guidance” issued by the MSRB would lead issuers to believe that in the forgoing circumstances a broker could avoid Rule G-23 and could escape the fiduciary duty that Congress said would attach to one who advises a municipal issuer with respect to a securities offering simply by continuously claiming to be an underwriter.¹

¹ The following is the form of waiver which one of the larger brokerage firms requires municipal entities to sign:

There is serious doubt that such waivers, extracted from municipal entities, of their protected position are fair or are enforceable under Section 29 of the Exchange Act. More importantly, the potential for abuse in an environment in which advice is claimed not to be “advice” compels the attention of the Commission. It is PFM’s position that the mandate of the Dodd-Frank Act is that in the absence of an independent, non-broker financial advisor giving counsel to the municipal issuer, a broker seeking to participate in a bond offering has a choice of mutually exclusive alternatives. The broker can seek engagement as a municipal advisor and assist the client, as a fiduciary, in shaping the financing in the client’s best interest. Or it can propose to purchase and distribute the securities which the municipal entity has decided to sell.

The statutory exception to the duties of municipal advisor for “service as an underwriter,” as evidenced by the definition adopted by Congress, does not comprehend the variety of deal-shaping proposals made by brokers before and after bonds are put out for sale. The Commission knew that when it stated, contrary to the MSRB’s “Guidance” that a “broker-dealer advising a municipal entity with respect to the investment of bond proceeds or the advisability of a municipal derivative would be a municipal advisor with respect to those activities” (76 Fed. Reg. at 832).

2. Direct Bank Loans for Capital Financing

Municipal clients increasingly have expressed interest in obtaining capital financing (or refinancing) through direct borrowings from commercial banks (and from the banking affiliates of investment banks). PFM and other municipal advisors are obligated, under the MSRB’s interpretation of fiduciary duty (and as a matter of common and commercial sense), to assist our clients in evaluating such transactions.

Direct borrowings are potentially attractive to municipal governments because of the relative efficiency of the borrowing as compared with underwritten bond sales, and reduced transaction costs, including, in most instances, the absence of the need to pay a fee to a broker. That latter feature may have prompted the MSRB to issue two public admonitions in the last few months to the effect that participation in such borrowings may require registration with the MSRB as a broker and observance of a host of MSRB operational rules.

“We [the municipal issuer] acknowledge that neither [the brokerage firm] nor any of its associated persons is acting as a municipal advisor and their opinions and views are not intended to be, and do not constitute, advice within the meaning of Section 975 of the Dodd-Frank [Act] * * *.”

In connection with the provision of [the broker’s services], we understand and acknowledge that * * * the Services and related information are being provided solely at arms-length and [broker] is not providing the Services as a municipal advisor or fiduciary * * *.”

The Commission undoubtedly will need to address the issue spearheaded by the MSRB, because it rests on various rationales previously articulated by the Commission (particularly following the withdrawal of the Dominic Resources Letter) in support of an expanded concept of brokers' activity reaching well beyond the statutory language of "effect[ing] transactions in securities". It is our view that that concept, as to municipal securities, has been superseded by the Dodd-Frank Act itself. If the Congress had been persuaded that stretching the Exchange Act definition was correct, Congress could have expressly included in the statutory definition of broker the previously unregulated participants. Instead, in the municipal securities market the Congress created a new class of regulated entities from this diverse group - - financial advisors, placement agents, etc. - - and subjected that class to registration and substantive regulation nearly indistinguishable from brokers' rules. Thus, the policies which underlay that expansive line of rulings are gone. Investors are as well protected by the rules, substantially the same as broker rules, which the newly classified municipal advisors must follow. And in the particular case of direct loans from banks, the entities to be "protected" happen to be the one class of counterparties in the United States that has the greatest ability to assess creditworthiness, which is what municipal borrowings are all about.

As to the companion question whether a direct bank loan creates a "security", although Reves v. Ernst & Young, extensively cited by the MSRB, represents the Supreme Court's most recent consideration of exceptions to the definition of a "note" as a "security", Reves is not dispositive in the present context because the theory of the decision invites exceptions based upon the policy of the Securities Act. The decisions culminating in Reves reflect concern whether recognizing an instrument to be a "security" is necessary to afford the purchaser the protections of the securities laws against fraud and manipulative practices. Those concerns, as noted above, are entirely absent in the direct negotiations between a bank and a very public borrower.

3. Even the Playing Field Between Brokers and Financial Advisors as Regards Fiduciary Duties

Our comments to the MSRB's "Interpretive Notices" with respect to the proposed revision of MSRB Rule G-17 and new MSRB Rule G-36 have been mooted (temporarily, we suppose) by the MSRB's withdrawal of its applications to the Commission for approval of those Rules. The MSRB's "Notices" accompanying both proposed Rules mandate that every municipal advisor rehearse with its client (and obtain the client's written waiver to) a litany of hypothetical, potential "conflicts of interest" alleged to be presented by nearly every form of compensation employed in advisory engagements. That proposed requirement demeans financial advisors as compared with the MSRB's treatment of underwriters, who have exactly the same fiduciary duty to the issuer when they render advice as to the terms and distribution of a bond issue. No such requirement is imposed on brokers. If the MSRB truly believed that such alleged conflicts of interest were real, rather than speculative, the remedy would be to prohibit the compensation arrangement, rather than put a governmental entity to the choice of consenting to something which the

MSRB says is bad for the government, or foregoing the financial advice which the government desires to improve its negotiating position vis-à-vis the underwriter.

PFM believes the requirement that a financial advisor deliver a list of Board-conceived “conflicts of interest” as an introduction for discussions with a governmental client is vastly beyond precedent in the judicial protection of fiduciary duties. To begin with, in most instances government financial officials set the compensation structure even before a financial advisor is selected. Moreover, PFM knows of nowhere else in the federal securities law in which regulation injects into a private transaction a formality which necessarily rests on the sole presumption that one of the parties is out to violate its statutorily mandated duty.