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MEMORANDUM

To: Securities and Exchange Commission ("SEC")

From: Swap Financial Group ("SFG")
Nat Singer
Senior Managing Director

Concerning: 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 – Request for Comment

Date: December 3, 2019

As the individual that began the discussion (in my role as Chair of the Municipal Securities Rulemaking Board) with the SEC regarding the clarification of a Municipal Advisor's role in the execution of direct placements of municipal borrowings including municipal securities, I applaud the SEC's proposed order which would grant an exemption from broker registration requirements. I have followed the discussion regarding this issue, much of it in the press, and wish to clarify the genesis of the issue and the importance of this exemption as it relates to facilitating this type of borrowing and at the same time protecting state and local governments and their instrumentalities.

The issue itself is extremely straightforward and may be explained best by comparing the roles of various participants in public market offerings vs. the roles of these same participants in direct lending transactions (for the avoidance of doubt, all references to lending herein include both loans and securities).

Traditional Public Offering

In a traditional public offering there are four major participants involved in the borrowing/lending transaction.

1. The Borrower. We typically refer to the borrower as the "Issuer." This entity may be a Municipal Entity such as a state or local government, an Obligated Person such as a hospital or educational institution, or some other instrumentality of a municipal government looking to either refund outstanding debt or raise new money for various types of projects.
2. The Lender. Typically the lender is referred to as the "Buyer" when securities are offered through a public sale, either through a negotiated or a competitive process. The buyer can be an insurance company, a mutual fund, a retail investor, a bank buying for

its own account, an investment advisor, etc. The buyer is seeking to “put money to work” and achieve the best terms possible (i.e. the highest interest rate and the strongest credit terms) subject to the individual characteristics of the transaction.

3. The Underwriter. The underwriter is typically either a bank or a broker-dealer registered as a broker pursuant to Section 15(a) of the Securities Exchange Act of 1934. The role of the underwriter is essentially to facilitate the borrowing/lending of money and as such establish the rate of interest, the redemption features, the debt structure (i.e. term and amortization), etc. Essentially, the underwriter stands between the borrower and the lender. The underwriter does not have a fiduciary relationship with respect to its relationship with the borrower (i.e. the issuer).
4. The Municipal Advisor. The role of the Municipal Advisor on these transactions is to assist the issuer in the borrowing of money and provide either a duty of care and/or a duty of loyalty with respect to all aspects of the transaction depending on the type of issuer. The Municipal Advisor’s specific tasks in conjunction with the engagement may vary across various transactions, but typically focus on ensuring that the deal structure and pricing established by the underwriter reflects market conditions and, in conjunction with the issuer’s counsel, confirms that the credit terms associated with the borrowing conform to the issuer’s specific indenture and/or guidelines. In the case where the issuer is a Municipal Entity, the Municipal Advisor takes on a fiduciary role.

The market is very familiar with these public borrowings and it is very easy to identify the role played by each of these market participants on any given transaction.

Direct Placement

Direct placement transactions have gained in popularity and actual execution over the past decade as an alternative to the traditional public offering. In a typical direct placement an individual lender, often a bank or broker-dealer, enters into a transaction with a borrower/issuer as the sole lender without utilizing a public offering process. While the major participants in a public offering as described above includes four distinct parties, a direct lending typically includes two, and sometimes three parties.

1. The Borrower.....identical to the description above.
2. The Lender. In this case the lender is typically a bank or broker-dealer.....often the same entities as the Underwriter described above. Effectively, the underwriter is “switching hats” to act as lender, or buyer, on direct placement transactions. As will be emphasized below this is not a bad thing, and in fact it has been very good for the municipal market as banks and broker-dealers have increasingly engaged in direct lending as it provides an alternative source of funds for issuers, often times at more competitive prices/yields and with better terms than can be achieved in the public market.
3. The Municipal Advisor. In some cases, but not always, a Municipal Advisor may assist its municipal borrowers on direct lending transactions in the same manner they do for public offerings.

Here is the issue: In the case of the public transaction described above, the four parties can be easily identified as can their roles. However, in the direct lending transaction we have (1) a

borrower who is easily identified, (2) a lender, often the bank or broker-dealer, and (3) the Municipal Advisor. Where is the underwriter (or placement agent)? It clearly isn't the issuer. It clearly can't be the lender? So is the Municipal Advisor....the issuer's fiduciary....somehow going to be deemed to be playing the role of a (unregistered) broker? For the benefit of all parties associated with the transaction as well as for the well-being of the municipal market, the answer has to be "no" as described below and the proposed exemptive order needs to be enacted to ensure that municipal borrowers continue to be able to seek advice and execute these direct lending transactions.

It should be emphasized, that as a Municipal Advisor, I am in no way seeking to either replicate the role of the underwriter nor push a registered bank or broker-dealer out of the transaction(s). I want bank and broker-dealer involvement in these transactions as direct lending is often times an advantageous form of borrowing for my clients. I am just seeking clarity that I can continue to do my job as a Municipal Advisor assisting my clients in these types of borrowings and ensuring that they are achieving market rates and terms. At the same time, I don't want my involvement to be construed as acting as an unregistered broker and be subject to fines, sanctions or other types of enforcement.

The Risks Associated with Not Granting Exemptions

To the extent that the SEC does not move forward with this order, a number of deleterious outcomes would likely ensue.

1. Municipal Advisors avoid assignments associated with direct lending transactions. If the order is not approved, it is a safe assumption that the dispositive result will crowd Municipal Advisors away from direct lending transactions for fear of regulatory action. This would clearly be a negative for the municipal market as a whole. Direct lending transactions play an important role in the market and action should be taken to facilitate direct lending. A plethora of issues would likely arise if Municipal Advisors avoided these deals including but not limited to:
 - IRS compliance issues related to the establishment of on-market tax-exempt yields. Without a Municipal Advisor, the only entity that would be able to attest to the on-market yield would be the bank, who in this case is the borrower. The borrower is clearly in a conflicted position with respect to certifying to the on-market yield as they are biased towards receiving the highest yield possible. A Municipal Advisor can independently attest to the on-market yield and as the issuer's fiduciary has a duty to assist in attaining the lowest possible yield, consistent with IRS objectives in the area of tax-exempt yield compliance.
 - Potential rating agency issues. Again, the borrower is trying to negotiate the best possible terms on the transaction....as they should. We have seen instances in the past, on transactions where there is no Municipal Advisor, terms on direct lendings that place the borrower ahead of other existing bondholders due to negotiated acceleration provisions or other credit related terms. As part of the banks' negotiations, often times led by a commercial banker as opposed the municipal finance banker, terms are embedded in the direct lending transaction that conflict with "parity debt" definitions, even

though the transaction is often listed as “Other Parity Debt” in the issuer’s balance sheet statements. We have seen situations where an issuer’s senior debt has been downgraded (some by several notches) as a result of embedded terms within direct lending transactions which essentially subordinate outstanding bonds relative to the direct loan. Municipal Advisors are in a unique position to assist issuers when negotiating the terms of a direct loan to avoid such an unintended consequence.

- Off-market pricing and terms may be agreed to by the issuers. Municipal Advisors are often in a unique position in that they negotiate transactions with a number of different banks and as such are able to get a broad overview of pricing and terms. Issuers don’t have the benefit of this perspective if they have not engaged an advisor. While there is likely no nefarious motivation on the part of the bank or broker-dealer acting as lender, they also have no motivation to survey the terms associated with other institutions direct lending transactions and offer to improve their own terms to match the rest of the industry. Having a Municipal Advisor on board allows an issuer to at least make an informed determination of the set of credit terms and pricing offered by the lender after being presented with other “market standard” terms being agreed to in the market.
2. “Puppet” underwriters are engaged for direct lending transactions. We have already seen this bad practice effectuate itself on some direct lending transactions. As the buyer, the lender, and the advisor have no one to point to as the underwriter or placement agent on a transaction, they collectively agree to engage a “puppet underwriter” for a nominal fee to fill the void. At best this is ridiculous and needless practice, at worst an overt step to appease a perceived regulatory gap. On these deals the “underwriter” plays essentially no role (i.e. they do not negotiate terms, they do not confirm pricing, etc.) other than that of a strawman.
 3. Issuers avoid the direct lending market and focus solely on public transactions. As highlighted above, direct lending transactions are often more efficient and more cost effective than public market offerings. Banks and broker-dealers, in the role of lenders, provide an effective financing alternative for many issuers. In addition, these products are profitable to the banks and broker-dealers as many providers find that these transactions are much more favorable to their balance sheet than other forms of lending as well as providing letters or lines of credit. They should be encouraged to continue to offer this product. To the extent that the order is not approved, many Municipal Advisors will be forced to refrain from participating in these transactions, as highlighted above. As a result, their issuer clients will seek other forms of borrowing which would likely be both more expensive as well as less profitable to the banks and broker-dealers that participate in this space.

I applaud the efforts of the SEC in promulgating this much needed guidance and exemptive relief to the municipal market. From my perspective there is no downside to this action. While the bank and broker-dealer community has stated its concern that this order in some way is an effort whereby Municipal Advisors are attempting to take business away from the underwriters, that is clearly not the case. Speaking for the Municipal Advisor community we are solely looking to help facilitate these transactions by clarifying the necessary role of the

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advisor so that banks and broker-dealers can continue to offer this product and at the same time issuers receive the necessary guidance and protection.

Thank you.

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