COMMENTS OF THE NATIONAL ASSOCIATION OF HEALTH & EDUCATIONAL FACILITIES FINANCE AUTHORITIES

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Securities and Exchange Commission Proposed Rule on Registration of Municipal Advisors (File No. S7-45-10)

Charles A. Samuels
Mintz Levin Cohn Ferris Glovsky & Popeo, P.C.
701 Pennsylvania Avenue, N.W.
9th Floor
Washington, DC 20004
(p) (202) 434-7311
(f) (202) 434-7400
casamuels@mintz.com
on Behalf of
the National Association of
Health & Educational Facilities
Finance Authorities

Introduction and Summary

The National Association of Health and Educational Facilities Finance Authorities ("NAHEFFA") respectfully submits these comments regarding the definition of "municipal advisors" under the new authority in Section of 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

NAHEFFA represents 40 state authorities which issue tax-exempt conduit bonds for non-profit education and health care institutions. See www.naheffa.com Each of these authorities is constituted by specific state statute which provides directives on, among other things, the number, the type and qualification of authority directors, their duties and responsibilities, and in that statute or other regulations, executive orders or legislation requirements regarding conflicts of interest, disclosure, fiduciary duties, and related matters. Some of the authorities are stand-alone governmental authorities, some are directly under the control and authority of state treasurers, and some report directly to state governors.

The board members of NAHEFFA member authorities range from *ex officio*, statutorily-designated members, such as treasurers, comptrollers and similar public officials, to other statutorily-designated state and local employees and to appointed volunteer members representing a variety of backgrounds, including private sector employees or retirees associated with healthcare or educational institutions, financial, banking or bond experts, and unaffiliated citizens. These individuals serve pursuant to their sense of civic duty and responsibility. In many states, these citizens are appointed to the board of the authority by the Governor and are approved by the legislature.

The recipients and beneficiaries of the tax-exempt bond proceeds issued by these authorities are non-profit or governmental institutions such as hospitals, clinics, colleges and private schools. These institutions, in turn, have boards and trustees who are subject to state non-profit corporate law and other state and federal requirements.

NAHEFFA supports the policy and intent of the Dodd-Frank Act to regulate the municipal advisors to authorities and to the borrowing obligor institutions. In general, we support the SEC and MSRB regulations in this area. Our serious problem with the January 6, 2011 proposed rule is the scope and definition of a "municipal advisor" as interpreted by the Commission to apply to board members of our state authorities and the obligors' employees and board members.

There are at least three scenarios that are of particular concern, where the application of the proposed regulatory requirements would have a severely deleterious effect on the proper functioning of non-profit financing across the United States. The breadth of the proposed application of this rule is improper, unnecessary and raises serious federalism and constitutional issues. The proposed rule also does not comport with the President's recent action seeking regulatory balance and reasonableness.

<u>The Commission Should Not Extend This Regulation to Authority or Borrower Boards or Employees.</u>

First, board members of state authorities, however they are named, whether *ex officio*, by other board members or through nomination or appointment by state officials in the executive or legislative branch, are not "municipal advisors." They may receive, evaluate, discuss and respond to advice in the course of their consideration of transactions, but they are not "advisors" even if they consider or offer their own knowledge and expertise in voting or debating questions relating to the issuance of bonds or otherwise acting within the scope of their duties as board members.

Second, there should be no implication that an employee of a borrower carrying out his or her job responsibilities in connection with tax-exempt borrowing or investing, such as a hospital or a university chief financial officer, is through that activity "advising" his or her employer or the state authority. Third, board members or trustees of our borrowing institutions who discuss, debate about or authorize a bond financing for their institution in the ordinary course of their duties should not thereby be treated as a "municipal advisor."

In all these cases, when acting within the scope of their duties as trustees, board members do not provide "advice" that Congress contemplated or to which the Commission could reasonably extend this regulation. Unless these individuals are acting *ultra-vires*, it is patently absurd to extend the regulation to employees or board members carrying out their responsibilities to their employees or the institutions they govern. Treatment as a "municipal advisor" only make senses in the case of third party firms or individuals who are paid to provide their expertise to authorities and borrowers.

Employees of borrowers are part of the entity, not outsiders giving advice. The abuses Dodd-Frank sought to eliminate simply are not part of board deliberations or employees working with borrowers on structuring transactions.

The confusion and the over-breadth of the proposed rule can only be resolved by a "bright line" exemption or interpretation for authority and borrower board members and employees. This can be accomplished through the definitions of "advice," "employee" or "municipal advisor" and/or by recognizing that board members who make decisions for municipal entities are not distinguishable from the exempt "municipal entities" for this purpose. <u>It cannot be resolved by making artificial and impractical distinctions between board deliberations and the provision of advice.</u> It is the obligation of board members -- one of the reasons they are chosen -- to engage in a free flow of communications with fellow board members, staff and even borrowers. Similarly, it is the obligation of certain employees of the borrower and its board members to engage in deliberation, communication and decision making relating to the borrower's source of financing and investment of funds. These discussions should not be hampered by fear on the part of these individuals that exceeding an arbitrary, impossible-to-define line will result in significant federal regulatory burdens. Simply, bond issuing authority and borrower board members and employees while in those roles are not municipal advisors.[1/]

The Commission must consider the legal absurdity that a municipal entity's governors -- the board -- can possibly advise itself in a way that implicates federal regulatory obligations. This rule fails to recognize that the governing board of municipal entity cannot be a municipal advisor to such entity. Entities act through governing bodies which are necessarily comprised of individual members.

The Commission's overview and description of the municipal advisors in the proposed rule make clear that the conventional way of looking at municipal advisors does not apply to the persons described above. See 76 Fed. Reg. at 825. These municipal advisors are separately hired professionals, not board members or employees. The proposed rule properly describes these persons as "market professionals." 76 Fed. Reg. at 827. Clearly, issuer board members and employees and board members of obligors do not fall within the three categories described by the Commission as financial advisors, investment advisers or third party marketers and solicitors. See 76 Fed. Reg. at 829.

The Commission states that: "[t]he Commission does not believe that appointed members of a governing body of a municipal entity that are not elected or *ex officio* members should be excluded from the definition of a 'municipal advisor.' The Commission believes that this interpretation is appropriate because employees and elected members are accountable to the municipal entity for their actions. In addition, the Commission is concerned that appointed members, unlike elected officials and *ex officio* members, are not directly accountable for their performance as citizens of a municipal entity." 76 Fed. Reg. at 834.

The Commission's rationale is flawed. First, state authorities report to higher public officials such as governors, treasurers, state auditors and controllers and legislative oversight committees, but do not report to the citizens at large any more or less than SEC commissioners do. Authority and obligor board members have the same fiduciary duties and obligations set forth in state laws as elected or *ex officio* appointed members. Through their appointment by treasurers, governors, legislatures and other public officials or through other mechanisms, they have the same public obligations as elected and ex-officio appointed members. And, such appointed members are subject to removal for various causes.

Second, the Dodd-Frank Act seeks to regulate "municipal advisors" in order to protect the entities advised. Municipal entities are governed by, and act through, their boards. Moreover, board members are subject to legal and ethical requirements, including fiduciary duties, conflicts of interest and financial disclosure requirements that impose conditions and constraints on their eligibility to serve and on the manner in which they fulfill their responsibilities. It is not reasonable to think that the Dodd-Frank Act intended to protect municipal entities from their own governing bodies.

[1/] These arguably retroactive requirements may put literally tens of thousands of citizens in peril of violating federal requirements. The Commission should immediately make clear that it will not apply any broadened definition retroactively.

Further, since neither Section 15B nor the proposed rules contain any exclusion from the definition of "municipal advisor" for board members or employees of "obligated persons," it appears that persons, such as a hospital or college chief financial officer and other employees or board members who provide "advice" to the hospital or colleges on borrowing through the state authority might be treated as "municipal advisors." Neither board members of issuers nor borrowers should be covered by this regulation. Borrower employees acting within the scope of their employment also should not be subject to this regulation.

Board members must be free, without fear of implicating federal registration and related obligations, to debate, to suggest, to propose or to approve bond issuances or the investment of authority funds and to ask questions and lend their views and expertise regarding the structure, timing, terms or other similar matters.

The Commission Proposal will Result in Volunteers Being Unwilling to Serve on Authority Boards and have Other Impacts which could lead to a Serious Disruption of the Bond Finance Market. The Commission must Undertake a More Thorough Analysis of the Costs and Benefits of the Regulation.

The superficial analysis in the proposed rule (see 76 Fed. Reg. at 873-876) relates almost entirely to filling out paperwork and hardly scratches the surface of the true regulatory burden. A meaningful consideration of the economic burden as well as the impacts on federalism requires a full analysis of the burdens of obtaining and retaining board members, providing legal counsel that must be paid for by individuals or authorities (considering that many authorities are part time or have only a few employees), whether insurance will cover these new liabilities or premiums will be significantly increased, and other economic aspects, particularly significant disruption to the proper functioning of state and local bond financing.

The proposal has great potential for disrupting the process of borrowing and the operations of borrowers and issuers. It will increase the difficulty of recruiting board members who generally serve voluntarily and without compensation. This rule will be economically counter-productive to efficient bond financing. Instead of increasing accountability, it will prevent individuals from serving on boards for fear of increased regulatory burden and potential personal liability associated with registering as a "municipal advisor."

The effects of the proposed regulation must be considered in light of the Office of Management Budget guidance memorandum on February 2, 2011 asking independent agencies to comply with the regulatory reviews ordered by President Obama in Executive Order 13563 which in turn references prior executive orders on regulatory burden. This requires sensitive consideration, given the current economic circumstances of state and local governments and non-profits. Executive Order 13563 affirms and supplements existing Executive Order 12866 and requires more than guesstimates on how many hours it takes to fill out paperwork. Executive Order 12866, for example, requires an agency to "tailor its regulations to impose the least burden on society, including individuals, businesses of differing sizes, and other entities (including small communities and governmental entities), consistent with obtaining the regulatory objectives, taking into account, among other things, to the extent practicable, the cost of cumulative regulations." Exec. Order No. 12866, § 1(b) (11), 3 C.F.R. 638 (1993-2000), *reprinted in* 5 U.S.C. § 601 (1994).

The proposed rule as it applies to board members and employees, does not respect the directives in these executive orders. We urge a complete application of these executive orders in the Commission analysis with respect to the municipal advisor requirements. The Commission should consider a more "tailored," reasonable and limited application of municipal advisor to the common sense industry understanding of the term. This analysis should account for the many thousands of board members and employees affected.

State Laws Provide Numerous Substantive Requirements for Authority and Non-Profit Directors

The Commission should not be concerned that limiting the application of this regulation will leave a regulatory vacuum. In fact, board members are subject to numerous legal and ethical requirements. These requirements should allay any concerns that entities need to be protected from their own board members. State laws applicable to board activities should be treated with respect and deference by the Commission. Here are a few examples applicable to NAHEFFA members.

The Colorado Health Facilities Authority:

Board members' duties are delineated in the authority enabling statute and the Colorado Standards of Conduct. Colo. Rev. Stat. §§ 25-25-101to131 and Colo. Rev. Stat. §§ 24-18-101 to 113, respectively. The Colorado Health Facilities Authority (COHFA) statute prohibits board members from engaging in conflicting affiliations by requiring the members to disclose conflicts of interest to the board and abstaining from deliberation and actions where a business affiliation is present (e.g., if a board member is a trustee, director, officer, employee of any health institution, financial institution, investment banking, commercial bank or trust company, brokerage firm, or insurance company.) Colo. Rev. Stat. §25-25-105(5).

Section 24-18-108.5 of the Colorado Standards of Conduct applies to board members and provides that a board member "shall not perform an official act which may have a direct economic benefit on a business or other undertaking in which such member has a direct or substantial financial interest." An official act is defined to include any vote, decision, recommendation, approval, disapproval or other action, including inaction. Colo. Rev. Stat. § 24-18-102(7).

In addition, Colorado's criminal laws also impose ethical obligations on board members. For example, laws related to "bribery" and "corrupt influence" (Colo. Rev. Stat. §§18-8-302 to 303) and "abuse of a public office" (Colo. Rev. Stat. §§18-8-401 to 409) apply to board members. The criminal code makes it a crime to violate duties of these and other statute including civil statutes. Therefore, violation of the Colorado Standards of Conduct or COHFA statute may be a crime of "official misconduct." Under Colo. Rev. Stat. § 18-8-308, a public servant commits a crime for failing to disclose a conflict of interest if he exercises substantial discretionary function in connection with the government contract, purchase, payment, or other pecuniary transaction without giving prior notice of potential conflict of interest.

Kansas Development Finance Authority:

KDFA Board members are subject to the Kansas Governmental Ethics Act, Kan. Stat. Ann. § 46-215 to 46-293 and Kan. Stat. Ann. § 46-237(a). Specifically, pursuant to Kan. Stat. Ann. § 46-247(c), the board members must annually file a written statement of substantial interest with the Secretary of State, which then becomes a public record. Pursuant to KDFA policy board, members are also required to disclose any conflict they may have relating to any business before the Authority. Kan. Stat. Ann. § 46-247(b).

Maine Health and Higher Educational Facilities Authority:

In Maine, as in other states, the statutory definition of municipal entities include instrumentalities of the state. Many municipal entities do not have citizens. See Me. Rev. Stat. Ann., tit. 22, ch. 413, § 2054 (1). To say, therefore, that board members of state authorities should be deemed municipal advisors because they are not accountable to citizens is a non-sequitur. MHEFFA has 12 members, eight of whom are non-ex-officio state residents. Id. Three must be affiliated with health care facilities and one experienced in state and municipal finance. Id.

There are limitations on the number of board members from any one political party. Id. The governor makes appointments and members may be removed for misfeasance, malfeasance or willful neglect of duty. Id. The statute also has conflict of interest requirements for the board members. Id. at § 2054 (7). "Consultants and agents" are recognized separately under the statute. Id. at § 2055 (9).

Minnesota Higher Education Facilities Authority:

In Minnesota, appointed members of administrative boards and agencies, including the Minnesota Higher Education Facilities Authority ("MHEFA") are subject to removal by the appointing authority, and the appointing authority is generally an elective office. See generally, Minn. Stat. § 15.0575(4); see also Minn. Stat., S§ 136A.01 (MHEFA member is appointed by the governor with the advice and consent of the senate and serves at the pleasure of the Governor). In Minnesota, as in many other jurisdictions, appointed board members to state agencies are subject to substantial regulation involving, among other things, open meetings, ethics, conflicts of interest, and data privacy. See generally, Minn. Stat. §§10A.07, 13.03, 13D.01, and 15.0575. In addition, the Governor has adopted by executive order a Code of Conduct for administrative officials, included appointed board members.

Nebraska Educational Finance Authority:

The Nebraska Educational Finance Authority was created under Neb. Rev. Stat. § 85-1710 as a public instrumentality and its authorities are considered to be the "performance of an essential public function of the state." Id. The board members are appointed by the governor.

Id. at § 85-1711. Section 85-1711 provides that no more than four members may be from the same political party. The statute also requires that at least one board member be affiliated with private institutions of higher education; at least one should have skill, knowledge and experience in finance; at least one should have abilities in the educational building construction field; and one should have experience in public accounting. Id. Members of the authority may be removed by the Governor for misfeasance, malfeasance, willful neglect of duty or other cause. Id. Section 85-1717 regulates conflicts of interest and specifically prohibits representative of banks and investment banking or other financial institutions who write the bonds for these authorities from becoming directors. Section 85-1727 authorizes the hire of finance experts and agents. Additionally, matters must be generally considered in open meeting, notes of which shall be publicly distributed, Id. at 84-140a - 84-1414. The Public Records Act applies to the board members. Id. at §85-1749.

New Jersey Educational Facilities Authority:

N.J. Stat. Ann. § 18A: 72A-22 states that any member agent or employee who is interested in any contract of the authority with a third party or in the sale of real or personal property to the authority shall be guilty of a misdemeanor. The New Jersey Conflicts of Interest Law (N.J. Stat. Ann. §52:13D-12 et seq.) applies to the authority as well as the following executive orders[2/]:

N.J. Exec. Order No. 37 of Gov. Corzine, 38 N.J. Reg. 4526(a) (issued Sept. 26, 2006), provides responsibilities of boards;

N.J. Exec. Order No. 1 of Gov. Corzine 38 N.J. Reg. 1110(c) (issued Jan. 17, 2006), provides for financial disclosure including business ownership and ethics requirements;

N.J. Exec. Order No. 122 of Gov. McGreavey, 36 N.J. Reg. 3613(b) (issued July 2004), requires board to have audit committee and establishes standards for selection of outside auditor.

State Nonprofit Corporation Laws:

There are a variety of state and federal requirements affecting the board members of the borrowing institutions. For example, the Revised Model Non-Profit Corporation Act (1987) ("RMNCA"), adopted in approximately half of the states, provides that courts may remove directors for acts such as fraudulent or dishonest conduct or gross abuse of authority of discretion and such actions can be taken by members of the corporation as well as the attorney general. RMNCA, § 8.10 (a) (1987). Subchapter C of RMNCA provides standards of conduct for directors, requiring, among other things, good faith and actions in the best interest of the corporation. RMNCA, § 8.30. Under RMNCA, director conflicts of interest are prohibited [RMNCA, § 8.31] and loans and distributors to directors are also regulated. RMNCA, § 8.33.

[2/] These executive orders can be found at: http://www.state.nj.us/infobank/circular/eoindex.htm.

<u>Federal Guidelines for Fiduciary Duties of Non-Profit Board Members</u>:

The Internal Revenue Service is focused on non-profit governance issues, and tax-exempt organizations are required to fill out the new Form 990 disclosing more than a dozen governance issues.

While the IRS does not require non-profits to have specific governance and management policies, it does review an organization's exemption and annual information to determine whether the organization has implemented policies relating to executive compensation, conflicts of interest, investments, fundraising, governance decisions, and whistleblower claims. This information is public. See IRS Form 990 and IR -2007-117, June 14, 2007. Therefore, in addition to applicable state laws for non-profit borrowers, there is transparency through the information submitted to the IRS. Interestingly, the IRS's view is the governing board should be composed of persons who are informed and active and will exercise good judgment. Governance and Related Topics – 501(c) (3), http://www.irs.gov/pub/irs-tege/governance_practices.pdf. The IRS encourages exactly the type of active interest and "advice" on financial issues that may be impeded by the Commission's proposed rule.

<u>Tenth Amendment</u>:

The proposed reach of the Commission's requirements into the day-to-day affairs of state authority board members will, as a practical matter, impose either new extensive regulatory burdens on board members or board members will have to significantly alter and restrict their activities and actions despite state law expectations and requirements. This micro management of the composition of the boards of statutorily-created state authorities, which have been specifically set, delineated and balanced by state legislatures, implicates the Tenth Amendment which provides that the "powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the States respectively, or to the people." US Constitution, Amendment X.

The United States Supreme Court has struck down vague, overreaching federal legislation and regulation that encroaches on state authority. See <u>Gregory</u> v. <u>Ashcroft</u>, 501 U.S. 452, 460-461 (1991). In 1991, in <u>Gregory</u> v. <u>Ashcroft</u>, 501 U.S. 452, the Supreme Court faced a conflict between a state (Missouri) constitution mandating the retirement of state court judges at seventy years of age, and the federal Age Discrimination in Employment Act (the "ADEA") as applicable to states. The court held that Missouri judges were exempt from the scope of ADEA, explaining that "[t]he present case concerns a state constitutional provision through which the people of Missouri establish a qualification for those who sit as their judges. This provision goes beyond an area traditionally regulated by the States; it is a decision of the most fundamental sort for a sovereign entity. Through the structure of its government, and the character of those who exercise government authority, a State defines itself as a sovereign. 'It is obviously essential to the independence of the States, and to their peace and tranquility, that their power to prescribe the qualifications of their own officers . . . should be exclusive, and free from external interference, except so far as plainly provided by the Constitution of the United States.' <u>Taylor</u> v. <u>Beckham</u>, 178 U.S. 548, 570-571 (1900); <u>see</u> also <u>Boyd</u> v. <u>Nebraska ex rel. Thayer</u>, 143 U.S.

135, 161 (1892) ('Each State has the power to prescribe the qualifications of its officers and the manner in which they shall be chosen')." Gregory v. Ashcroft, 501 U.S. at 460.

Federal government micro management of the qualifications of the board members of state boards is constitutionally impermissible. The Commission should operate most sensitively when it intrudes on and threatens essential states rights regarding "the character of those who exercise government authority."

For the reasons stated above, the proposed breadth of the scope of "municipal advisor" is not required, is highly undesirable and may well be unconstitutional. The laudatory goals of Congress and the Commission to regulate true municipal advisors can be achieved with an appropriate definition. Therefore, NAHEFFA respectfully requests that SEC make it absolutely clear that board members of bond issuers and conduit borrowers and their respective employees are not "municipal advisors" subject to the proposed regulators when carrying out their duties.

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