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March 21, 2011

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File Number SR-MSRB-2011-03

Dear Ms. Murphy:

The National Association of Independent Public Finance Advisors ("NAIPFA") appreciates this opportunity to provide comments to the Securities and Exchange Commission ("SEC") on proposed Rule G-23 and the accompanying interpretive notice submitted for consideration by the Municipal Securities Rulemaking Board ("MSRB").

NAIPFA, founded 21 years ago, is a professional organization of independent public finance advisory firms that provide public finance advice to municipal and non-profit entities. NAIPFA comprises thirty two member firms serving all fifty states from locations in twenty–six states. Independent public finance advisors offer a wide variety of consulting services to issuers and obligated persons. In 2009, NAIPFA members represented clients on over 2,800 separate bond issues with approximately $75 billion in proceeds.

Preliminary Statement

Since its adoption in 1977, MSRB Rule G-23 has been the subject of much discussion within the industry and in the financial press. The Rule has been modified - or ***not*** modified - several times. The concerns raised primarily related to the conflicts of interest inherent in permitting broker-dealers to serve as financial advisors then later resign to become the underwriter of the issue they helped structure. It is problematic because the firm in its role as advisor sets out to and does, in fact, gain the trust and confidence of its client. When a broker-dealer advisor suddenly resigns and shifts its role to that of an underwriter, the firm's interests are then at odds with its former municipal entity client (the issuer), because it is negotiating to purchase the bonds with a goal to resell them to investors for a profit.

On several occasions, NAIPFA has asked the MSRB to consider whether it was appropriate for a broker-dealer to provide the kind of advice that financial advisors typically provide, *i.e.*, advice with regard to the structure, timing and similar matters related to a financing, and then switch roles.[1] Among the concerns raised were that broker-dealer firms were developing relationships of trust and confidence through their actions and statements, but disclaimed legal responsibility when their municipal clients sought under local law to hold them to the fiduciary standards that others who provided similar advice were held.

In 2010, having seen that numerous municipalities suffered significant losses in connection with sometimes extremely complex financial transactions promoted by underwriters or underwriters acting as financial advisors, Congress determined that some issuers were not sophisticated enough to make

[1] See, *e.g.*, letters from NAIPFA dated October 28, 2005 and May 18, 2007, copies of which are attached.

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informed financial decisions or were taken advantage of by unscrupulous market participants. Through passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), and particularly Section 975 thereof, Congress created a new class of regulated entity – the municipal advisor – and directed the SEC and the MSRB, among others, to adopt rules to protect issuers and obligated persons. Understanding Congressional concerns and SEC initiatives, the MSRB in August 2010 proposed for comment changes to its Rule G-23. It received 73 comments, including a letter from NAIPFA supporting changes to the Rule.[2] In its current filing with the SEC, the MSRB proposes to modify Rule G-23 (the "Proposed Rule") and also to issue interpretive guidance (the "Guidance").

NAIPFA commends the MSRB for revisiting this issue. The proposed Rule takes some steps in eliminating conduct that NAIPFA and others have long recognized puts issuers and the public at risk. NAIPFA supports those changes that prohibit firms from acting as advisors and then switching roles. NAIPFA agrees with the following MSRB responses set forth in SEC Exchange Act Release No. 34-63946:

- The MSRB does not believe the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act;
- The MSRB believes current Rule G-23 permits inherent conflicts of interest, which are not cured by disclosure and waiver provisions of the Rule;
- The MSRB believes that the potential negative impact on fees and market accessibility for small and/or infrequent issuers would be minimal compared to the protections that will be afforded to such issuer;
- The MSRB does not believe that exceptions should be provided for smaller offerings;
- The MSRB does not believe the use of electronic bidding platforms mitigates the conflict of interest posed by a dealer financial advisor's switching to an underwriter role;
- The MSRB does not believe requiring advance notice of competitive sale would provide adequate protections against conflicts of interest;
- The MSRB agrees that the role and interests of the dealer financial advisor are "significantly different" from the role and interests of a dealer acting as the underwriter for the same governmental unit; and
- The MSRB agrees that the issuer does not fully understand the implications of the ending of the financial advisory relationship with the issuer (which ends the dealer's fiduciary obligation to the issuer) and the arm's length relationship that is necessary due to the dealer's financial advisor becoming the underwriter of the transaction.

Unfortunately, notwithstanding clear direction from Congress, the MSRB failed to recognize the important distinction between providing advice and acting as an underwriter. Accordingly, NAIPFA objects to the Proposed Rule and Guidance to the extent it exempts from the definition of a municipal advisor all underwriters that render "advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities." Underwriters would still be able to provide the same advice as a municipal advisor without a fiduciary duty to the issuer.

As NAIPFA understands the purpose of Dodd-Frank, advice is only to be rendered to issuers by licensed municipal advisor professionals, registered with the Commission, who have appropriate expertise. Congress intended that those providing advice with respect to the *issuance of municipal securities,*

[2] See Letter dated September 30, 2010, from Steven F. Apfelbacher (the "2010 Comment Letter"), a copy of which is attached.

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including advice with respect to the structure, timing, terms, and other similar matters concerning such issues would be deemed fiduciaries with a duty to act in the best interests of the issuer client. This MSRB proposal is at variance with the purpose of the Act because the one party with potentially the most significant conflicts of interest - the underwriter – would still be permitted to give issuers advice with respect to the *issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such issues* without a corresponding fiduciary duty.

NAIPFA therefore reiterates its request set forth in the 2010 Comment Letter that the final sentence of section (b) of Rule G-23 be amended to read:

> *Notwithstanding the foregoing, for purposes of this rule, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker, dealer or municipal securities dealer provides information to an issuer relating to the sale of the securities to investors such as transactional structures, the underwriter's capabilities to sell various securities, how particular terms of a security structure may affect rates and yields, and matters incidental to the underwriting of a new issue of municipal securities.*

In addition, the Guidance should make clear that the phrase "in the course of acting as an underwriter" means that the firm has either been retained by an issuer to purchase and distribute its securities, or is responding to requests for proposals or requests for qualifications from a potential issuer seeking an underwriter and has requested that such information be provided by the responding firms. In all other instances, providing "advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities" would constitute financial advisory activities for purposes of Rule G-23.

NAIPFA's suggested changes to proposed Rule G-23 are consistent with the law, and consistent with the views we expressed in our comment letter to the SEC relating to municipal advisor registration.[3] Should the SEC disagree with our views and construe the underwriter's exception under §15B(e)(4)(C) of the Exchange Act to permit underwriters to provide advice to municipal entities regarding the issuance of municipal securities without either having to register or act with a fiduciary duty, NAIPFA urges the SEC to compel the MSRB to include in either Rule G-23 or the Guidance:

- Underwriters must decide prior to communicating with an issuer whether the underwriter will offer its services as an advisor or underwriter. The underwriter should not be allowed to rebut the role of municipal advisor "if the dealer clearly identifies itself as an underwriter from the earliest stages of the relationship with the issuer with respect to that issue."

- Brokers, dealers and municipal securities dealers ("underwriters") providing advice to issuers must disclose in no uncertain terms – in a document similar to Appendix A proposed within the MSRB's Proposed Rule G-36 and Rule G-17 Guidance to Municipal Advisors - that they:

[3] See letter dated February 22, 2011 from Colette Irwin-Knott, a copy of which is attached.

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- Are not acting as advisors but as underwriters;
- Are not fiduciaries to the issuer but rather counterparties dealing at arm's length;
- Have conflicts with issuers because they represent the interests of the investors or other counterparties which may result in benefits to other transaction participants at direct cost to the issuer;
- Seek to maximize their profitability and such profitability may or may not be transparent or disclosed to the issuer; and
- Have no continuing obligation to the issuer following the closing of transactions.

NAIPFA further urges that the rule changes be effective immediately upon SEC approval and not in six months as proposed. Additionally, underwriters should be prohibited from serving as municipal advisor and underwriter for an issuer at the same time. Last, changes to Rule G-23 should be considered only after the market has absorbed all regulatory changes and regulators can review objective evidence to assess any impact due only to Rule G-23.

Discussion

1. **NAIPFA objects to the MSRB's expansive view of the advisory activities in which dealers can engage without being deemed financial advisors.**

Congress was very clear about the activities that it considers to be advisory in nature. These changes are to be made in the municipal market and not within other markets. A municipal advisor is a person

> *who provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or undertakes a solicitation of a municipal entity.*

Congress also drafted its legislation to specifically include certain market participants and exempt others, at least when they are acting in certain defined and limited capacities. Thus, in the Exchange Act, Congress states that a "broker, dealer or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933) is not a municipal advisor. Section 2(a)(11) provides that an "underwriter" is

> *any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.*

In short, Congress has clearly defined municipal advisory activities to mean advising issuers and borrowers with respect the structure, timing, terms and similar matters concerning a municipal bond issue. At the same time, it has defined underwriting activities to mean purchasing and distributing securities.

The distinction between advisory activities and underwriting activities has always had legal significance. Advisors sit on the same side of the table with the issuer, with all the legal responsibilities that go along with being an advisor, while the underwriter sits at arm's length on the other side of the table, negotiating

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the terms pursuant to which it will purchase the bonds with the end goal of making a profit when they are resold.[4] This distinction is further confirmed within the standard form of Bond Purchase Agreement developed by the industry. The purchase agreement makes it clear the underwriter is in an arm's length relationship with the underwriter.

The MSRB acknowledges the provisions in the law set forth above, but tries to draw lines that are inappropriate in concept and likely unworkable in practice. In the Guidance, the MSRB states that "a dealer that provides advice to an issuer with respect to the issuance of municipal securities will be presumed to be a financial advisor with respect to that issue." However, it goes on to say that the

> *presumption may be rebutted if the dealer clearly identifies itself as the underwriter from the earliest stages of its relationship with the issuer with respect to that issue. Thus, a dealer providing advice to the issuer with respect to the issuance of municipal securities (including the structure, timing and terms of the issue . . .) generally will not be viewed as a financial advisor for purposes of Rule G-23, if such advice is rendered in its capacity as underwriter for such issue. Thus, a dealer providing advice to an issuer with respect to the issuance of municipal securities (including the structure, timing and terms of the issue and other similar matters, such as the investment of bond proceeds, a municipal derivative, or other matters integrally related to the issue) generally will not be viewed as a financial advisor for purposes of Rule G-23, if such advice is rendered in its capacity as underwriter for such issue. Nevertheless, a dealer's subsequent course of conduct (e.g., representing to the issuer that it is acting only in the issuer's best interests, rather than as an arm's length counterparty, with respect to that issue) may cause the dealer to be considered a financial advisor with respect to such issue. In that case, the dealer will be precluded from underwriting that issue by Rule G-23(d).*

As a result of the way business is conducted today, the Guidance is unworkable in most situations. However, one plausible scenario in which the Guidance can work is a scenario in which the issuer has retained a financial advisor to represent its interests in connection with a contemplated financing. The advisor recommends and the issuer agrees that the best course of action is to pursue a negotiated financing. The issuer (with the assistance of the advisor) then conducts an RFP/RFQ process for the purpose of selecting the underwriter. The RFP solicits, among other things, ideas about the "structure, timing and other terms of the issue" being proposed. NAIPFA posits that providing information in that context should not cause the potential underwriter – whether it is ultimately selected or not – to be an advisor. Nor, after it is selected, should the underwriter be deemed an advisor for providing ideas about the "structure, timing and other terms of the issue." In this scenario, the issuer can readily distinguish between the roles of the advisor and the underwriter because it has engaged one of each. Where the Guidance becomes problematic is in the much more frequent scenario, the one where a potential issuer does not yet have – and may never have – an independent advisor working with it.

Issuers are routinely contacted by independent financial advisors, by firms that act only as underwriters and by firms that provide both advisory and underwriting services. Sometimes, but not always, the issuers have a prior relationship with a firm that has or is soliciting them for the purpose of obtaining their business. These contacts are often in writing but are just as likely to be oral. Topics addressed are likely to include the issuer's current financial situation and opportunities that may exist to accomplish one or more of what the firm knows or supposes to be the objectives of the issuer. The firm's communication

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[4] For detailed discussions and analysis on this point, see, *e.g.*, submissions to the SEC relating to Exchange Act Release No. 34-63576 (File No. S7-45-10) from Robert Doty and Nathan R. Howard.

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with the issuer may well suggest that a particular transaction, described generally or in detail, might be advantageous to the issuer. In addition, the firm may offer to discuss the financial matters of a particular transaction more fully at a later time. Assuming that the communications described above – or an ensuing discussion – contains "advice with respect to the structure, timing, terms or other similar matters concerning the issuance of municipal securities," then, based on the Guidance as proposed, if the firm that contacted the issuer was a dealer, that firm would be presumed at that time to be a financial advisor unless it expressly identified that it was acting as an underwriter. However, the firm could *not* be acting as an underwriter at that time, because no such role would then exist.[5] **The only possible role that could exist at such a preliminary stage is that of advisor.**

In the normal course, the issuer may have discussions with several firms, some of which may be independent financial advisors who only provide financial advice and others may be dealers who sometimes serve as financial advisors and sometimes as underwriters. At the time these conversations are taking place, the issuer may not have even decided whether to pursue a transaction, let alone made any of the decisions about whether it will pursue a private loan or similar financing, a private placement or a public offering of bonds and, if the latter, whether the offering will be a competitive or negotiated bond sale. How is the dealer firm to indicate what role it is playing at such a preliminary stage? More importantly, what is the issuer supposed to think? The opportunity for confusion is great, as is the possibility that the issuer might decide to pursue a transaction using the dealer firm and never retain a financial advisor to provide the independent advice that it may have believed it already received.[6]

Congress intended to insulate municipalities from obtaining advice from individuals whose interests are contrary to those of the issuer. Therefore, NAIPFA respectfully suggests that this intent can only be realized if the exemption for underwriters under §15B(e)(4)(C) of the Exchange Act applies only when the underwriter has made clear what role it is playing in the transaction and thereafter does not influence the decision making process by providing advice or by providing information in a manner that could be perceived as advice. Notably, however, proposed Rule G-23 fails to accomplish this intent. Accordingly, we suggest, as we did in September 2010, that the final sentence of section (b) of Rule G-23 be amended to read:

> *Notwithstanding the foregoing, for purposes of this rule, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker, dealer or municipal securities dealer provides information to an issuer relating to the sale of the securities to investors such as transactional structures, the underwriter's capabilities to sell various securities, how particular terms of a security structure may affect rates and yields, and matters incidental to the underwriting of a new issue of municipal securities.*

Proposed Rule G-23 only perpetuates the *status quo.* This will frustrate Congress' intent as it will leave the most vulnerable issuers open to the same abuses Congress sought to prevent with the passage of Dodd-Frank. What is more, when proposed Rule G-23 is taken together with proposed rules G-17 and G-

[5] *See* Letter from Nathan R. Howard, Esq., Municipal Advisor, WM Financial Strategies, to the Securities and Exchange Commission, dated February 22, 2011.

[6] As the MSRB itself states in its submission to the SEC supporting the proposed Rule changes, "[s]mall and infrequent issuers are, in many cases, unable to appreciate the nature of the conflict they are being asked to waive by the very dealer financial advisor that will benefit from the waiver."

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36, the potential for underwriters to wield dangerous levels of influence over municipal entities becomes clear, a result unequivocally contrary to the purpose of Dodd-Frank. As NAIPFA reads proposed Rule G-36, municipal advisors would have duties of loyalty and care to their municipal entity clients, which would include requirements that they take steps to learn the essential facts about the client's financial circumstances and objectives, only undertake assignments which they have the expertise and resources to perform, agree on the services to be performed and the compensation to be paid, disclose all conflicts, including any applicable to their compensation arrangement, and provide advice about all the feasible financing options then reasonably available. At all times the advisor must act in the best interests of the client without regard to its own financial and other interests.

Conversely, underwriters will not be bound by the dictates of proposed Rule G-36, and will be bound instead by the limited duties imposed by Rule G-17. Under proposed Rule G-17, underwriters would merely have a duty to deal fairly with the issuer, which the MSRB states is akin to a 10b-5 duty. In other words, an underwriter may not misrepresent the facts but its obligations do not include any affirmative duty to inquire into the financial circumstances and objectives of the issuer, to disclose the risks associated with a transaction it recommends or even to have any basis – reasonable or otherwise – for any transaction it recommends.[7]

Given the very limited duties the MSRB believes underwriters owe to municipal issuers, NAIPFA would argue that it not only contravenes Congressional intent but is affirmatively dangerous to extend to firms acting as underwriter the right to provide advice to issuers. Instead, as NAIPFA has stated on numerous occasions, an issuer should have the benefit of advice provided by a regulated municipal advisor whose interests are, and always will be, to do what is best for the client.

2. **NAIPFA objects to the notion of a rebuttable presumption when dealers provide advice but, if the presumption is rebuttable, dealers should be required to make affirmative disclosures of the conflicts inherent in their role as underwriter.**

For the reasons set forth above, NAIPFA asserts that the exemption from the definition of financial advisor in Rule G-23 is contrary to Dodd-Frank. However, should the SEC adopt the expansive view of what constitutes "acting as an underwriter" advanced by the MSRB, we believe that underwriters acting as financial advisors should be required to decide which role they will play with the issuer before they talk with the issuer and affirmatively disclose the conflicts inherent in their underwriting role to the issuer if that is the role they decide to purse. The MSRB highlights the conflict at the heart of the issue:

> *While underwriters have a duty of fair dealing to issuers under Rule G-17, they also have a duty to investors, whose interests are generally adverse to those of issuers.*

The MSRB also recognizes that the opportunity for confusion on the part of those issuers dealing with firms that provide a variety of services when it stated "that a dealer may not avail itself of the underwriter exception unless it maintains an arm's length relationship with the issuer." Nevertheless, the only affirmative requirement that the MSRB proposes to impose on a dealer providing advice to an issuer regarding matters related to the issuance of municipal securities is that the dealer "clearly identif[y] itself as an underwriter from the earliest stages of its relationship with the issuer with respect to that issue."

NAIPFA notes in this context the MSRB's proposals related to Rules G-36 and G-17. In particular, we note the extensive affirmative disclosure obligations the MSRB would seek to impose on municipal

[7] Underwriters have somewhat greater disclosure obligations when the transaction they recommend is "complex."

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advisors, and the lack of similar disclosures required of dealers. NAIPFA asserts that dealers providing advice should be required to do more than merely state they are acting as an underwriter to avoid being deemed a financial advisor for purposes of Rule G-23 (and otherwise). Instead, they should be required to state– in a document similar to Appendix A proposed within the MSRB's Proposed Rule G-36 and Rule G-17 Guidance to Municipal Advisors - that they:

- Are not acting as advisors but as underwriters;
- Are not fiduciaries to the issuer but rather counterparties dealing at arm's length;
- Have conflicts with issuers because they represent the interests of the investors or other counter parties which may result in benefits to other transaction participants at direct cost to the issuer;
- Total revenues and profitability may not be transparent or disclosed to the issuer; and
- Have no continuing obligation to the issuer following the closing of transactions.

NAIPFA calls on the SEC to also modify G-23 in a way that requires the underwriter acting as a financial advisor to decide before the underwriter approaches the issuer that the underwriter is presenting its services as an advisor or underwriter. This would avoid confusion on the part of the issuers as to the intentions of the underwriters acting as an advisor. Further similar conflict disclosure to the disclosure proposed for municipal advisors should be required by the underwriter if this is the role they have decided to pursue.

In addition, NAIPFA has seen situations where the underwriter acting as a financial advisor has resigned to purchase the debt issue but its financial advisor contract with the issuer remains in effect. The underwriter would then revert back to its role as financial advisor once the bonds were closed. This contract maneuver does not allow for another firm to assume the role of the financial advisor during the transaction or an opportunity to compete for the financial advisor role. Any regulatory actions should require that any contract the underwriter acting as an advisor had with an issuer be terminated when the dealer firm is hired or seeks to be hired as an underwriter to the issuer, swap counterparty or in any other role that is inconsistent with the role of a fiduciary.

3. NAIPFA objects to the MSRB's proposal that the proposed changes to Rule G-23 be effective for new issues awarded six months following approval of the Rule by the SEC.

The MSRB proposes that "the proposed rule change be made effective for new issues for which the Time of Formal Award . . . occurs more than six (6) months after the SEC approval." The stated reason for this effective date is "to allow issuers of municipal securities time to finalize any outstanding transactions that might be affected by the proposed rule change." NAIPFA believes – as apparently does the MSRB – that the substantive changes to Rule G-23 relating to role-switching are mandated by the imposition of a federal fiduciary duty and accordingly, that dealers acting in the role of advisor breach their fiduciary duty to an issuer when they switch roles to become a financial advisor. Because they had such a fiduciary duty under federal law effective October 1, 2010, NAIPFA asserts that any role-switching that occurred after that date was a violation of the Exchange Act.

Even assuming that issuers and underwriters were waiting for guidance on how the MSRB viewed Rule G-23 in light of Dodd-Frank, they were on notice in August 2010 when the MSRB proposed for comment the very changes it has now formally proposed to the SEC for adoption. The changes should be effective immediately upon approval by the SEC.

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The MSRB believes that the proposed rule would principally affect dealer financial advisors that are not small municipal advisors. Applying the rule effective on adoption would have provided sufficient time for the underwriter acting as an advisor to determine its appropriate role with an issuer. It would also provide immediate clarity to the issuer who is the party that is to benefit most from Dodd-Frank.

4. NAIPFA believes an underwriter should be prohibited from serving as a municipal advisor and underwriter for an issuer at the same time.

Within the MSRB filing, the MSRB agrees that the role and interests of the dealer financial advisor are "significantly different" from the role and interests of a dealer acting as the underwriter for the same governmental unit. Yet upon review of the comment letters, the MSRB has determined:

- Not to impose a cooling off period between the time a dealer completes a financial advisory engagement with an issuer and the time the dealer may serve as underwriter for a different issue by the same issuer. Rule G-23 is to be applied on an "issue by issue basis" so that the dealer financial advisor could serve as advisor on one issue and then serve as the underwriter on another issue for the same client even if the two issues are in the market at the same time; and
- It is appropriate that there be a one year cooling off period during which a dealer financial advisor could not serve as remarketing agent for the same issue of municipal securities. The MSRB goes on to state that a one year timeframe would more than adequately address any potential or actual conflicts of interest.

NAIPFA does not understand how there can be a conflict between the advisor/underwriter roles and a need for a cooling off period from the role as dealer financial advisor and yet the modified Rule G-23 change would allow for the underwriter acting as an advisor to undertake both activities at the same time with the same issuer. We all agree there is a conflict between the advisor/underwriter roles. Proposed Rule G-23 should be modified in a way that would force the underwriter acting as an advisor to decide which role they will play for the issuer and not be able to play both roles at the same time. NAIPFA further believes that if the one year cooling off period for remarketing conflicts is appropriate, there should be a one year cooling off period from the time an advisor underwriter terminates its role as municipal advisor and the advisor underwriter would be allowed to negotiate an issue with the issuer, act as swap counterparty or serve in any other role that is inconsistent with the role of a fiduciary. This modification would ensure that Rule G-23 would be fair and consistent in its application.

5. NAIPFA believes future changes to Rule G-23 should be considered only after the market has absorbed all regulatory changes and regulators can definitively assess any impact due only to Rule G-23.

Because the industry is having to react to and incorporate so many changes, NAIPFA respectfully requests that the SEC and MSRB not revisit Rule G-23 changes until sufficient time has elapsed to truly assess whether future changes will have the effect intended. The regulatory changes being discussed are significant and will likely change the current business models of advisors and underwriters. After the final rules of regulation have been established, there will be a period of time for the advisor and underwriters to adjust to the changes. Only when the market has adjusted to these significant changes and objective evidence has been gathered will regulators be able to assess the real impact of G-23.

Summary

We understand the pressure there is to adopt rules that meet the intent of Dodd-Frank. The fact is that Congress has determined to accept that, within the municipal market, there are municipal advisors and

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broker-dealers that serve as both municipal advisors and underwriters. In a less complicated scenario, advisors advise issuers and underwriters buy issuer bonds. This is a part of the conflict Congress intended to correct with Dodd-Frank. The MSRB agrees that the role and interests of the broker-dealer financial advisor are "significantly different" from the role and interests of a broker-dealer acting as the underwriter for the same governmental unit; yet the proposed Rule G-23 will allow broker-dealers acting as advisors to continue business as usual. NAIPFA's concern is that broker-dealers would be allowed to provide the same advice as municipal advisors without municipal advisor obligations. Broker-dealers could still be engaged by an issuer and then decide if they want to be the advisor or underwriter. Broker-dealers could work as the advisor and underwriter on different issues at the same time. It is clear that broker-dealers who act as advisors want to continue their lucrative business model. This business model of the past, however, must change if the full intent of Dodd-Frank is executed into regulation.

NAIPFA believes broker-dealers should not be allowed to provide unlimited advice without being an advisor with fiduciary duty to the issuer. As a result NAIPFA believes section (b) of Rule G-23 must be amended to provide guidance on the type of advice an underwriter can provide. Should the SEC believe, however, that underwriters have a broader exemption to provide advice, underwriters must be required to decide before they approach an issuer whether they will present themselves to the issuer as a municipal advisor or an underwriter. NAIPFA believes broker-dealers should be required to decide if they are in the advisor business or underwriting business. The broker-dealer should be able to do both but each role should follow the appropriate rules and regulations. Broker-dealers acting as advisors should not be allowed to confuse issuers as to their true role. Additionally, appropriate conflict disclosure should also be required for either role when they talk with the issuer and the rule should be effective immediately.

NAIPFA once again expresses its appreciation for the opportunity to submit its views on the MSRB's proposed Rule G-23 and interpretive guidance. We would be pleased to discuss any issues or concerns raised in this letter with representatives of the SEC. If we can be of any assistance or answer any questions, please feel free to contact me.

Sincerely,

Colette Irwin-Knott

Colette J. Irwin-Knott, CIPFA
President, National Association of Independent Public Finance Advisors

cc: The Honorable Mary L. Schapiro, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Michael Coe, Counsel to Commissioner Aguilar
Martha Haines, Assistant Director and Chief, Office of Municipal Securities
Lynette Hotchkiss, Executive Director, Municipal Securities Rulemaking Board

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October 28, 2005

Municipal Securities Rulemaking Board
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Alexandria, VA 22314

Ladies and Gentlemen:

The National Association of Independent Public Finance Advisors ("NAIPFA") is respectfully submitting these comments to the Municipal Securities Rulemaking Board with respect to the Board's Rule G-23. NAIPFA believes that developments in our market over the past 30 years have rendered the Rule in its present form inadequate to address current market practices and potential abuses. Our proposals would afford issuers in the state and local government securities market the benefits of enhanced competition and ensure that all issuers are making truly informed choices related to the implementation of their debt financings.

Rule G-23 was adopted originally in its present form in order to regulate potential breaches of fiduciary duties by dealers serving as financial advisors who wish to underwrite their issuer clients' securities offerings. One goal was to provide the issuers with an additional choice in the selection of underwriters.

Unfortunately, the application of Rule G-23 in practice has been overcome by emergent unduly legalistic and technical practices and by market developments. A result is that the Rule may be used by some dealers in a manner that actually denies informed choice to many issuers, and tolerates potentially abusive breaches of the very responsibilities that lie at the heart of the fiduciary relationship between financial advisors and their issuer clients.

We are providing with this letter data relating to hundreds of municipal securities transactions in Texas indicating extensive switching practices involving smaller issuers. As we explain throughout this letter, these data, we believe, raise serious questions about the effectiveness of Rule G-23 in its present form.

We cannot determine solely from the Texas data or other available public data the extent of actual technical compliance with Rule G-23. One may need access to transactional documentation to make a complete analysis. Given the great extent of the practice by some firms of switching from their fiduciary roles to arms'-length underwriting roles, however, we would fully anticipate that a documentation strategy is in place for technical compliance with the Rule. Questions relating to fiduciary roles and responsibilities are complex and fact intensive, although an advisory relationship invariably creates a fiduciary responsibility to render advice solely in the best interests of the issuer client.[1] Therefore, for such reasons, we do not level any accusation of Rule violation at any firm or of violation by any firm of fiduciary responsibilities. Our point is that the extent of switching activity demonstrates that the existing Rule is inadequate.

NAIPFA commends the Board for undertaking a review of Rule G-23. We appreciate this opportunity. We are hopeful that the Board will find our comments to be constructive and helpful.

Important Differences between Financial Advisors and Underwriters

State and local government securities issuers require independent and affirmative financial advice with respect to their issues of securities and other financial matters.

The Securities and Exchange Commission has asserted repeatedly, and a number of courts and administrative law judges have agreed, that financial advisors have responsibilities to render independent and affirmative advice, as fiduciaries, to their issuer clients.

Important differences exist between the fiduciary responsibilities of financial advisors to issuers of state and local government securities, on one hand, and on the other, the absence of responsibilities to those issuers of underwriters functioning solely as principals dealing with the issuers at arms'-length.

Financial advisors, as fiduciaries, must make affirmative disclosures to their issuer clients. The financial advisors are not permitted to remain silent regarding information important to their issuer clients in connection with the subject matters of the financial advisors' employment. That information includes conflicts of interest, appropriateness of securities structure, timing, terms, interest rates and pricing, costs, transactional risks, due diligence or other investigatory activities, disclosure, swaps and other related transactions, and other matters of importance to the issuer clients within the scope of the relationship.

In sharp contrast to responsibilities of financial advisors, underwriters functioning solely as arms'-length principals generally assert that they are not responsible to render independent or

[1] Even a later resignation in order to accommodate switching roles does not obviate the fiduciary nature of the relationship while it exists. Thus, in the course of advising an issuer on securities structure or at the time of resignation, a financial advisor is still a financial advisor with fiduciary responsibilities to act in the issuer clients' best interests and to render affirmative advice to the client.

When a continuing contract is in place, while a firm also is serving the issuer as underwriter, the conflicts are completely impossible to resolve when the issuer is unsophisticated, despite the resignation for a specific transaction.

affirmative advice to issuers. Instead, they contend that they are free to function in relation to issuers solely in their own interests as arms'-length principals.

Underwriters owe fiduciary, statutory and regulatory duties to investors, whose interests often differ significantly from the interests of issuers.

A change in roles from that of a fiduciary to an issuer client to one in which the fiduciary will function as a principal dealing with the issuer solely at arms'-length inherently entails significant conflicts of interest on subjects including, but not limited to, appropriateness of a transaction for the issuer client, as opposed to the interests of a particular underwriter or the interests of investors. Yet, despite contentions as to arms'-length dealings, underwriters actually often voluntarily assume advisory roles and draw the issuers into relationships of trust and confidence that, although unintended by underwriters, may not be governed entirely by contractual limitations. In fact, it is not uncommon for underwriters actually to undertake, directly or through their legal counsel, to prepare the issuers' disclosure documents for the issuers (and for which the SEC asserts that issuers are primarily responsible)—an important advisory role with fiduciary overtones.

NAIPFA

NAIPFA is a nonprofit association of independent public financial advisory firms serving state and local governments across the country. NAIPFA is keenly aware of the key fiduciary roles and responsibilities of our firm members and their officers and employees with respect to issuers in the process of financing state and local government projects and programs.

To that end, NAIPFA imposes ethical standards on its members; certifies those officers and employees of our member firms who pass a professional examination for recognition as Certified Independent Public Finance Advisors ("CIPFAs"); and conducts continuing education through an annual conference, newsletters and other forms of communications. CIPFAs are required to demonstrate, on a triennial basis, their participation in qualifying continuing education programs. As a part of fiduciary duties, our members are expected to disclose affirmatively to their issuer clients all the compensation that the members receive in connection with their advisory relationships with the issuers, whether from securities issues, investments, swaps or other derivatives.

One of NAIPFA's key emphases is the importance of the fiduciary roles and responsibilities of financial advisors to our issuer clients. Our ethical standards are designed to promote competence, diligence in representing our clients, and independence in rendering advice. We endeavor constantly to remind our members of such roles and responsibilities and to provide them with tools and education to further their satisfaction of their roles and responsibilities.

The fiduciary roles and responsibilities to which we believe our members, and indeed all financial advisors, are subject impose a strict level of regulation upon us. That regulation is reflected in our ethical and educational requirements, as well as in actions brought by the Securities and Exchange Commission and issuer clients against firms that serve in advisory capacities.

NAIPFA and its members are deeply concerned about abuses of Rule G-23. We recognize that the Rule, at the time of its adoption, was intended to give issuers choices as to the selection of underwriters.

While some of the activities described in this letter may, at times, violate Rule G-23, our primary concern is that the Rule itself, as well as legalistic and technical practices that have evolved over time under the Rule since its adoption almost 30 years ago, appear to foster the potential for confusion especially of smaller, less sophisticated issuers.

Background

A number of important changes have occurred in the municipal securities market environment since Rule G-23's adoption in the 1970s.

Moreover, unfortunately, as experience demonstrates, the Rule is subject to distorted application by some members of the dealer community in such a manner as to deny issuers the very informed choices that were intended. We stress that these actions are not committed by many dealers. The actions tend to be prevalent in certain geographic regions of the country.

We believe that in some cases, the Rule appears to have become a vehicle, at times, for potential issuer confusion, and to provide an opportunity for unwarranted cover for such confusion. Some dealers purport to comply legalistically and technically with the Rule's requirements. Nevertheless, the issuer clients of those dealers all too often do not fully comprehend important implications of the dealers' roles or actions.

Issuer Characteristics

Public finance differs in numerous respects from corporate finance. Public finance courses are not taught at most colleges and universities. Instead, while some university public finance courses are offered, public finance usually is learned by actual experience and attendance at conferences and continuing education seminars, such as those conducted by NAIPFA and the Government Finance Officers Association.

It is unusual for members of issuer governing bodies and key issuer staff of smaller issuers to be municipal finance specialists or to have a working familiarity with finance concepts.

Thus, the vast majority of issuers in the state and local government securities market, even though their governing body members and key issuer staff may be intelligent and energetic leaders in their communities, are generally unsophisticated as to public finance and quite unfamiliar with public finance concepts and the application and implications of those concepts.

There simply are not a sufficient number of finance professionals to staff internally the tens of thousands of issuers. Moreover, the expertise is expensive. Since the expertise is needed only sporadically and infrequently by most of the issuers, it would be impossible and inefficient for the vast majority of state and local government securities issuers to carry those professionals on their staffs.

Consequently, the vast majority of issuers satisfy their needs for these financial services, at the time, if any, that the needs actually arise. They do so by employing outside financial professionals to advise and assist the issuers in structuring, marketing and completing their finance transactions.

The public finance professionals have a substantially greater level of specialized expertise in the subject matter of state and local government finance than do these issuers.

Governmental issuers, therefore, commonly look to and rely upon financial advisors for financial advice and assistance. While many issuers do not understand the full implications of the concept of "fiduciary responsibilities," they sense inherently that their advisors owe them affirmative responsibilities to render advice. What such issuers often do not understand is that underwriters are very different, and purport (usually after the fact, when the adequacy of advice is questioned) to deal solely at arms'-length. Neither do many of those issuers understand the implications of such a different status. Underwriting personnel may contribute actively, at times, to such confusion through assurances to issuers.

Without that financial advice and assistance, a vast number of governmental issuers would be unable to conduct their financing transactions. That would severely and adversely impact the conduct of the public's business and would be adverse to the public interest.

Professionals who are outside specialists, including both independent financial advisors and dealers, being aware of these circumstances, commonly assure the issuers or the issuers' officials, either in writing or orally, that the professionals are especially skilled in their specialized areas of activity, will look out for the issuers' interests, will conduct the issuers' financing activities appropriately without conflicts of interest, and will protect the issuers from untoward occurrences.[2]

Many dealers never mention to the issuers that the dealers purport to be dealing with the issuers solely at arms'-length. Such claims commonly are reflected solely in obscure boilerplate provisions of bond purchase contracts. Issuers may not be advised on such matters by legal

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[2] Regardless of contractual provisions, the Securities and Exchange Commission and United States Attorneys have asserted, and the courts have held, that underwriters have fiduciary responsibilities to issuers when certain factors are present in the relationship.

counsel. Thus, many issuers are unaware of such postures assumed by their underwriters, and being unaware, are not in a position to negotiate such provisions in an informed manner.

Those issuers, instead, simply rely upon whatever advice they receive. The finance professionals also commonly induce this reliance through representations as to how the professionals are able to and will advise and assist the issuers effectively in the accomplishment of the issuers' finance goals, and even advise and assist the issuers in defining the issuers' finance goals. Indeed, front line underwriting personnel commonly explicitly or implicitly lead issuer personnel to believe that the underwriters are representing, and acting in, the issuer's best interests.

Under such conditions, then, most issuers in the state and local government securities market rely upon and are heavily dependent on the outside financial professionals, whether independent financial advisors or dealers, who serve and advise the issuers. It is quite common for a state or local government securities issuer simply to turn over a substantial degree of control of financing transactions to their financial professionals and to follow, step by step, the advice and recommendations of those professionals.

Therefore, it is crucial to structure Rule G-23 in such a manner as to minimize confusion by the tens of thousands of smaller, unsophisticated issuers as to the roles and responsibilities of the differing finance professionals who serve them.

Changes in Market Environment

In the almost 30 years since Rule G-23 was adopted, there have been many significant changes in practices and in the market environment that have come to impact the Rule's effectiveness or lack thereof today.

Fiduciary Responsibilities of Financial Advisors

Not the least of the changes over the past 30 years has been the considerable enhancement of the market's view, and the views of the Securities and Exchange Commission and the courts, of the nature and importance of financial advisors' fiduciary roles and responsibilities. In just the last 10 to 15 years, the SEC has asserted repeatedly that financial advisors are fiduciaries. The courts have agreed repeatedly. A substantial body of precedent has thus been developed on that subject. That large body of precedent did not exist 30 years ago.

By requiring only that resigning dealer/financial advisors disclose that a conflict in roles "may" exist, Rule G-23 acknowledges only a possibility of what is now an undeniable fact– financial advisors to state and local governments *are* fiduciaries, and as such, are obligated to render to their issuer clients affirmative, sound and unconflicted advice as to the issuers' alternatives in the issuers' financings. In sharp contrast, dealers functioning as underwriters almost invariably assert that they are principals dealing at arms'-length, with no affirmative obligation to advise the issuers as to other, more effective financing alternatives departing from those maximizing the dealers' profits.

Potential for Abuses of Rule

Rule G-23 was intended to protect issuers from abuse and to offer choices to issuers. Instead, the Rule may be routinely abused in those geographic regions of the nation in which some dealers use Rule G-23 most frequently. Rule G-23 was intended to provide issuers with choices, but the potential for abuses can deny informed choices especially to the tens of thousands of smaller, unsophisticated issuers.

By way of example, some dealers commonly gain employment as financial advisors pursuant to continuing open-ended contracts protected by state law from competitive interference. Despite such contracts, patterns of business conduct strongly suggests that some of those dealers may not intend to serve their issuer clients as fiduciaries.

Those abuses do not necessarily assume the form of violations of Rule G-23, but rather often take the form of legalistic and technical compliance. Indeed, this practice is so common that we would frankly be surprised, as noted earlier, if some have not developed a documentation strategy to comply with the provisions of the Rule. We view this as evidence of the inadequacy of the existing Rule.

Recognition That a Key Argument for Rule G-23 in Its Present Form Is Invalid

The municipal securities market is a highly competitive market. It is unimaginable that a financial advisor working with any issuer, other than one totally without credit, would not be able to identify other firms anxious to purchase the issuer's securities.

At the time Rule G-23 was adopted in the 1970s, certain smaller issuers asserted that they needed to have access to underwritings by their dealer financial advisors because no other firms would bid on or propose to underwrite their bonds.

Whatever the merits or lack of merits of that assertion three decades ago, the municipal securities market now has the benefits of the phenomenal growth of the national communications networks; expanded commercial dealings leading to active bond marketing and trading across state and regional boundaries; emergence and enhancement of computer technology; and the presence of the internet.

Those significant factors, which were not present in the more primitive and regional market environment of the 1970s, have given rise to a recognition today to the fact that all issuers and their securities offerings are highly desired by numerous competing underwriting firms across the nation.

Thus, in the current highly competitive market in which firms battle strenuously for even small transactions, an issuer that does not receive other offers or proposals to purchase its securities (other than an offer from the issuer's financial advisor) has employed a financial advisor that is not fulfilling the advisor's affirmative fiduciary roles and responsibilities to market the issuer's securities aggressively.

Today, an issuer making an assertion that no firm (other than the issuer's financial advisor) will bid for or propose to purchase the issuer's securities evidences thereby both a substantial ignorance of the process of marketing that issuer's securities and an undue influence over the issuer by the dealer serving the issuer as financial advisor.

Availability of Pricing Data

The availability of real time bond trading data provides enhanced tools for evaluation of the capabilities and performance, in both past transactions and current transactions, of dealers serving as underwriters. That is a significantly positive development in the market environment, for which the Board is due significant recognition and credit.

While we have seen assertions by some that independent financial advisors do not have equal access to market trading data, we strongly dispute such assertions. The availability of the Board's pricing data is another example of how skilled independent financial advisory firms are able to discuss with their clients prevailing market conditions and trends, as well as the adequacy of pricing and other offers made by arms'-length underwriters functioning as principals. We are actively in the process of developing additional arrangements for superior market access for our clients.

Smaller, unsophisticated issuers, however, will not be able to access or interpret such data. When the fiduciaries serving such issuers are also the underwriters of the issuers' securities, those issuers will be deprived of important independent information and analysis as to the quality of the underwriters' performance on behalf of those issuers.

Those issuers now need to be informed of the significance of such independent advice. They need to be informed explicitly and specifically that, when their fiduciaries resign to serve at arms'-length, the issuers will not have access to the benefits of independent evaluation of the underwriting services the issuers are receiving.

Abuses of the Rule

NAIPFA believes data suggest that Rule G-23 may be abused, and that the Rule itself, in its present form, encourages that potential for abuse. That is especially applicable in specific regions of the country. Through a combination of such abuses and state laws protecting continuing contracts, dealers are able to effectively "lock up" issuers totally and completely from the competition that is so essential to a healthy securities market.

Such "lock up" practices deny those issuer clients the very choice that Rule G-23 was intended originally to promote.

NAIPFA wishes to re-emphasize that such practices are not followed by a substantial number of members of the dealer community. Nevertheless, in the regions of the country in which such abusive practices appear to be followed, smaller, unsophisticated issuers may be often repeatedly denied access to competitive underwriting services.

Those issuers are denied informed choices through legalistic and technical compliance with Rule G-23.

Outset of Contracts

We are transmitting to the Board with this letter a listing indicating hundreds of transactions in Texas in which certain dealers repeatedly served issuers as both financial advisors and underwriters in both competitive and negotiated sales. Data can be produced relating to Missouri, Wyoming, Colorado, Arizona, and a number of other specific Midwestern, Southwestern and Mountain states. The sheer volume of such transactions suggests the potential for a serious problem at the outset of financial advisory contracts.

We want to stress that these appear to be transactions in which the firms may not have violated the Rule in a legalistic and technical sense. Yet, there is an appearance that some may have gained repeated employment as financial advisors and then commonly served, nevertheless, as underwriters. The historic patterns of commercial practices may be a common and important feature of some business plans.

In such circumstances, issuers, especially smaller, unsophisticated issuers, may not receive the fiduciary services for which they have contracted, and may not receive either affirmative advice as to alternatives available to them or optimal structuring and pricing for their securities offerings.

NAIPFA believes that it is a deceptive and misleading practice to the extent dealers gain employment by issuers as financial advisors, with a fiduciary obligation to render independent and affirmative advice to those issuers, while having the intention to switch from their fiduciary responsibilities in order to function as underwriters in the role solely of principals dealing with the issuers at arms'-length. While we are not in a position to evaluate any firm's intentions, we also believe that there is a potential for abuse of Rule G-23 when dealers engage in frequent business patterns of gaining employment as financial advisors and then serve as underwriters.

One of the key fiduciary duties of a financial advisor is to encourage competition in securities offerings, either through competitive bidding or through competitive proposal processes. Some issuers, at times, are under the mistaken belief that there are no other underwriters interested in the issuers' securities. In the highly competitive municipal securities market, that suggests some issuers may be misled about the market by the very fiduciaries who are obligated to serve the issuers.

Such activities are not necessarily violative of Rule G-23, but are facilitated by the Rule, and by the legalistic and technical practices that have evolved over several decades under the Rule. It is time now to end these practices by assuring not only that the issuers continue to have the flexibility to choose their underwriters freely, but that those choices are truly informed choices.

Structuring of Financings

Different underwriting firms have different strengths and weaknesses. Some have broad institutional investor contacts. Some have strong retail capabilities. Some have both. Some have only limited marketing capabilities, and often "dump" the issuers' securities to more capable firms at yields that are unfavorable to the issuer clients.

When issuers' financial advisors, acting as fiduciaries, structure municipal securities for their issuer clients with a view to underwriting the transactions, the dealers will naturally look to structures that best fit the dealers' sales capabilities and profits, not to the optimal structures for the issuer clients. Rule G-23, in its present form, does not require that issuers be advised of such conflicts of interest. At the point at which such activities occur, the dealers are financial advisors, *i.e.*, fiduciaries.

Even when acting solely as underwriters, some dealer firms venture beyond the activities sheltered by Rule G-23 ("structure, timing, terms and other similar matters") and assume broader advisory roles. Those broader roles commonly occur without the written financial advisory agreements required by Rule G-23. Such activities, being fact intensive, are almost impossible to monitor.

Thus, the advice rendered in the course of structuring an offering may extend beyond the structure, timing and terms of state and local government securities transactions to other ancillary services in representing the issuer's interests. The dealers, with an expectation of compensation, commonly represent the issuer clients in dealings with third parties or render advice on underwriter costs or compensation, interest rates, transactional risks, due diligence or investigatory activities, or disclosure—even to the point of preparation of the issuers' official statements. Rule G-23's requirement of a written financial agreement under such circumstances is broadly ignored.

Course of Resignations

When a dealer is to resign as financial advisor in order to serve the issuer client as underwriter in negotiated transactions, Rule G-23 requires that the dealer provide written information stating that a conflict of interest "may" be involved.

That statement is highly misleading. Recent legal precedent establishes that a conflict certainly exists when a party with a fiduciary duty to advise resigns in order to deal with the client at arms'-length. Such a change in roles alters fundamental characteristics of the relationship. Smaller, unsophisticated issuers, however, fail to comprehend the full nature and implications of fiduciary relationships or the conflicts of interest.

Further, some legal counsel either may be unfamiliar with those issues, or may fail to render advice to the issuers. The same counsel may also work for underwriters and may not wish to offend the underwriting community.

At the time at which a dealer requests an issuer's consent to the dealer's resignation as financial advisor, it is crucial to recognize that the dealer still is the issuer's financial advisor, with all attendant fiduciary duties, including without limitation, duties to render affirmative advice.

NAIPFA believes that it is insufficient for a financial advisor to an issuer merely to resign from its fiduciary role in order to serve as an arms'-length underwriter, if there is significant information known to the financial advisor, but not disclosed affirmatively by the financial advisor to, or otherwise known by, the members of the governing body of the issuer client, with respect to a variety of matters, including without limitation, the quality, costs and price of the services to be rendered by the advisor firm in a subsequent arms'-length role as underwriter.

NAIPFA also believes that it is insufficient for a financial advisor to an issuer merely to resign from its fiduciary role in order to serve as underwriter, if the financial advisor fails to advise the members of the governing body of the issuer client affirmatively of the important fiduciary benefits the issuer client will lose as a result of the change in roles. Vague and ambiguous statements that a conflict "may" exist are inadequate to the task.

Therefore, NAIPFA believes that the Rule should provide, at the time of issuer consents to dealer/financial advisors' service as underwriters, for **(1)** full disclosure to the issuers' governing bodies that a conflict of interest *does* (not merely "may") exist between the two roles, with a full explanation of the significance for the issuers of the fundamental change in roles; and **(2)** affirmative advice to the issuer clients, solely in the best interests of the issuer clients, based upon the dealer's sound professional knowledge, as to structural and transactional alternatives reasonably available to the issuers and the significance of those alternatives for the issuers.

Absence of True Issuer Consent to Resignations

Rule G-23 also requires that issuers consent to the resignations. This is another area in which legalism and technical compliance with the Rule fails to protect issuers.

All too often such consents are signed by issuer officers who act on their own, without consideration or authorization by issuer governing bodies. The documents may be presented for execution in stacks of other documents without discussion or explanation. Commonly, in such settings, regardless of the appropriateness of the practice, issuer officials sign literally dozens of documents without reading them carefully or at all.[3] Dealers accept such forms of consent as if given with due authorization. Legal counsel may not question the practice.

[3] Another emerging market practice exacerbates the problem. The practice has evolved in recent years in which the parties may dispense with formal closings. Signature pages are circulated and collected without the parties meeting at a closing table. In such cases, issuer officials may execute signature pages circulated by courier without actually seeing or discussing the consent documentation at all, especially when the consent is a small part of a much larger document.

NAIPFA submits respectfully, however, that the change in status from a fiduciary one to an arms'-length status is such a fundamental modification of the character of the relationship that dealers should be permitted to accept the consents only upon formal authorizing action by issuers' governing bodies, and then only in a separate actions (not buried in extraneous lengthy legal documentation), after the governing bodies are fully informed by the resigning dealers (who at that point, after all, are still fiduciaries).

Continuing Contracts

A key practice that has evolved to lock-up issuers, and to deny them choices, is the use of open-ended financial advisory agreements. Such contracts continue in existence even when issuers consent to dealer/financial advisors' underwriting of specific transactions.

A smaller, unsophisticated issuer may not be able to understand, in the face of the continuing contracts, that the resigning dealer is no longer serving as the issuer's financial advisor and no longer has fiduciary duties to render affirmative advice to the issuer without conflicts of interest. Moreover, since the contracts are open-ended, competing firms are inhibited from contacting the issuers in some states due to threats or potential threats of litigation for interference with contracts.

The open-ended nature of such continuing contracts is in direct contradiction of Rule G-23's original intent. Such legalistic and technical practices that have evolved over the past 30 years effectively deny the issuers choices in the employment of underwriters.[4]

Further, it is confusing and misleading, especially to smaller, unsophisticated issuers, when a financial advisor acts as underwriter for a single securities issue, while simultaneously leaving in effect its financial advisory contract on a continuing basis for other services. Such issuers often believe that the underwriters continue to be obligated to serve, and are serving, the issuers' best interests. The issuers commonly expect affirmative advice from such firms as financial advisors. They may not appreciate that the dealers are actually dealing solely at arms'-length in the conflicting dealer/underwriters' and investors' best interests.

Thus, Rule G-23, in conjunction with such practices, has become an abusive vehicle for denying issuers effective choices, not a vehicle for enhancing choice!

Therefore, NAIPFA believes that the Rule should provide for complete termination of the financial advisory contract when a financial advisor changes roles to serve the issuer as underwriter.

[4] While there may be a technical process for termination of the contracts after a lengthy period following notice of intent to terminate, the result is that such issuers and their officials may then be subjected to substantial pressures from the dealer/financial advisors without the opportunity to receive input from competing firms.

Need for Cooling Off Period

As discussed, substantial conflicts of interest have become recognized between advisory and underwriting roles to a far greater extent than existed at the time of adoption of Rule G-23. Widespread legalistic and technical compliance practices have evolved under the Rule over the past 30 years.

NAIPFA believes that smaller, less sophisticated issuers need protections from undue pressure by dealers whom the issuers perceive as having responsibilities to serve the issuers' best interests.

Issuers should be afforded the benefits of a cooling off period in order to evaluate the quality of performance of the issuers' former fiduciaries who dealt with the issuers at arms'-length.

Because state law may strongly discourage communications by competitors when one dealer already has a contract with an issuer, if a dealer re-enters into the financial advisory contract immediately upon sale of an issuer's securities, the issuer may never have the opportunity to hear differing opinions.

NAIPFA believes that the issuers should have the benefits of opportunities to receive communications from other competing firms in an atmosphere that reduces pressures upon the issuers and overcomes state law prohibitions against interference with contracts.

Therefore, NAIPFA believes that Rule G-23 should provide for 180-day cooling off periods following completion of offerings before dealers are permitted to re-enter new financial advisory contracts with issuers.

Such a step would maximize informed issuer choice and provide the maximum benefits of competition.

Role Reversals

In researching the listing of transactions that NAIPFA is providing to the Board, we identified circumstances in which dealer firms act as financial advisors and underwriters for different issuer clients in close temporal proximity, at times on the same day.

For example, Firm A may serve Issuer 1 as financial advisor, while Firm B serves as underwriter. Then, reversing the roles Firm B may serve Issuer 2 as financial advisor, while Firm A serves as underwriter. Such practices are not uncommon, especially between certain firms, so that the circumstances, at times, may have the appearance of more than coincidence.

Such practices offer significant potential for abuse. While such occurrences may arise for valid reasons, they also could be more than coincidental. Rule G-23, in its present form, does not contemplate any such potential for conflicts of interest. The Rule should be updated to prohibit agreements and understandings among underwriting firms to enter into role reversal arrangements.

An alternative approach would be to require issuers and financial advisors who are seeking to underwrite to substitute a financial advisory firm that is not a potential role reversal partner, *i.e.*, an independent financial advisor. We note an emerging practice in some parts of the country, pursuant to which an incumbent advisor is replaced by an independent financial advisor on those transactions where the incumbent advisor will serve as underwriter. We would support this as an appropriate option.

Interest Rate Swap Agreements

One development since the enactment of Rule G-23 has been the proliferation of interest rate swap agreements. G-23 speaks to the ability of financial advisors to serve as underwriters and remarketing agents, but it is silent on the subject of financial advisors serving as counterparties in swap agreements. Clearly, the financial implications, lack of market transparency, arbitrage abuse potential, and risk elements of swaps demand that issuers obtain independent financial advice. We believe that Rule G-23 should be updated to explicitly prevent financial advisors from serving as swap counterparties with their clients.

Request for Recusal

NAIPFA respectfully requests, in the interests of a full and fair review of Rule G-23, that members of the Board whose firms may actively pursue practices about which we are raising questions recuse themselves from participation in reconsideration of the Rule.

Conclusion

NAIPFA appreciates the Board's reconsideration of Rule G-23 and the practices surrounding it. NAIPFA urges respectfully that issuers be given true, effective choices, without abuse or deception, and without undue pressures, and without "lock up" practices. We encourage the Board to examine the changes in the municipal finance industry over the past 30 years, and update the rule to reflect current market conditions, financial products and documented abuses in the market over the years.

In the end, when issuers are allowed to make policy choices informed by truly independent, nonconflicted advice, and are protected from abuse, the market as a whole will benefit from a healthier and more competitive environment.

Yours very truly,

NATIONAL ASSOCIATION OF
INDEPENDENT PUBLIC FINANCE ADVISORS

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May 18, 2007

Municipal Securities Rulemaking Board
Attention: Christopher A. Taylor, Executive Director
1900 Duke Street Suite 600
Alexandria, VA 22314

Re: MSRB Rule G-23

Ladies and Gentlemen:

As President of the Board of Directors of the National Association of Independent Public Finance Advisors ("NAIPFA"), I am writing on behalf of NAIPFA to request your consideration of modifications to MSRB Rule G-23. Our request is made with the sincere belief that the suggested modifications will increase the integrity of the municipal market.

In summary form, our request includes the three following items with respect to negotiated municipal securities offerings:

1. Require that a dealer resigning from the role of financial advisor to an issuer in order to serve as underwriter for the subject offering, explicitly inform the issuer's policy makers in writing that there *are* (not "*may* be") conflicts of interest resulting from the fundamental change in roles, and the nature of those conflicts of interest;

2. Require that the dealer receives explicit formal consent from the issuer's policy-makers to the fundamental change in roles and acknowledgement of the conflicts of interest; and

3. Require, unless the issuer contemporaneously employs more than one financial advisor, that the advisory contract between the dealer as advisor and the issuer-client be terminated completely.

The balance of this document provides explanation and substantiation of our request. We feel that our purpose is in lockstep with the mission of MSRB and respectfully request your consideration.

Yours very truly,

Kathleen A. Aho, CIPFA
President
National Association of Independent Public Finance Advisors

Cc: Securities and Exchange Commission

NAIPFA REQUEST RELATIVE TO MSRB Rule G-23

NAIPFA is a national association that has sought actively for almost 20 years to strengthen the financial advisory profession. Moreover, our members firms are significant in the market. Each year, NAIPFA member firms rendered advice to governmental issuers on significant number of municipal securities issues with a significant market share.

For your information, I am enclosing the following documents:

1. A Resolution adopted by the Board of Directors of NAIPFA on October 4, 2006; and

2. A paper entitled *"Let Me Advise You on How Much to Pay Me"—Subverting Fiduciary Duties and Roles*, prepared by Dr. Tamar Frankel of the Boston University School of Law, a noted author on issues of honesty and conflicts of interest in the financial markets. The paper was commissioned by NAIPFA. Selected excerpts from Dr. Frankel's paper appear in Appendix A to this letter.

Since its inception, the Municipal Securities Rulemaking Board ("*MSRB*" or the "*Board*") has been a positive force and a leader in improving municipal securities dealer practices. NAIPFA applauds the MSRB for its efforts and many successes, such as early MSRB actions against pay-to-play practices. NAIPFA itself joined the MSRB in that initiative when NAIPFA members voluntarily entered into a contemporaneous agreement not to engage in pay-to-play activities. Most recently, the MSRB radically enhanced market informational access through real-time trade reporting, an extremely valuable contribution.

Responsibilities as Advisors

MSRB Rule G-23 stands in sharp contradiction to the positive steps taken by the Board. It is materially misleading for dealers to "disclose," as Rule G-23 contemplates, simply that conflicts of interest "may" exist, when they definitely do exist in underwriter-issuer relationships. By accommodating those materially misleading statements by dealers to issuers about whether, and the extent to which, conflicts of interest exist when dealer financial advisors resign to underwrite their issuer clients' bond issues, Rule G-23 represents a severe policy lapse in the municipal securities market.

The role of advisors is to advise. The role of advisors is not to engage in conflicted business transactions with issuer clients. So that there is no confusion, the conflicts exist in the adversarial issuer-underwriter relationships that result from dealer resignations pursuant to the Rule. The resignations directly facilitate the creation of those conflicts between the issuers and their trusted advisors. Until the resignations are fully effective, the dealer-advisors remain just that—trusted nonadversarial advisors with duties affirmatively to advise their issuer clients, in the issuers' best interests, about conflicts of interest fundamentally affecting the relationships. In seeking the resignations, the dealers, *while still wearing their advisor hats*, are representing, implicitly, if not explicitly, to the issuer clients that the dealers are the best parties whom the issuers are able to employ as underwriters. That advice has anticompetitive characteristics, as well, because at times, it disadvantages more able underwriters.

Generally, until an advisory relationship is completely terminated, an advisor retains its duty affirmatively to advise the issuer client about the existence and the nature of material conflicts of interest implicated in the business transaction and relationship proposed by the financial advisor to the issuer client. The advisor violates its duty to the issuer-client by suggesting that conflicts of interest may not exist, when the conflicts definitely do exist.

<u>Changes Needed in Rule G-23</u>

In light of the deficiencies in MSRB Rule G-23 as it currently exists, NAIPFA respectfully strongly urges the following modifications to Rule G-23 with respect to negotiated municipal securities offerings:

4. Require that a dealer resigning from the role of financial advisor to an issuer in order to serve as underwriter for the subject offering, explicitly inform the issuer's policy makers in writing that there *are* (not "*may* be") conflicts of interest resulting from the fundamental change in roles, and the nature of those conflicts of interest;

5. Require that the dealer receives explicit formal consent from issuer's policy-makers to the fundamental changes in roles and acknowledgement of the conflicts of interest; and

6. Require, unless the issuer contemporaneously employs more than one financial advisor, that the advisory contracts between the dealer as advisor and the issuer-client be terminated completely.

Rule G-23 is an anachronism that requires significant policy modification. In the three decades since the original adoption of Rule G-23, there has been a continual improvement in the principles of honesty, and disclosure practices, in the municipal securities market and a greater awareness of the responsibilities that professionals owe to issuers, as well as investors. Rule G-23 has failed to maintain pace with those positive market developments.

<u>Maturing Industry Products Blur Lines between Independent & Self-Serving Advice</u>

Throughout the 30-year period since Rule G-23's adoption, there has been increased sophistication in the municipal financial transactions undertaken—swaps, caps, variable rate debt, *etc.* At the same time, there is a blurring of the roles of various service providers. For example, a dealer may serve as a "financial advisor" to a governmental issuer, but then become the seller of a swap to the issuer client, as well. When that occurs, the dealer's advice no longer is independent, but the issuer may not recognize that important change in the relationship. Rule G-23 speaks only to underwriter and remarketing agent relationships, and says nothing of those other types of roles, leaving the common law (and for that matter, the pending investigations) to deal with them.

During those 30 years, the vast majority of financial advisors, dealers and other professional firms involved in the municipal securities market have significantly improved their practices and their sensitivity to such complex issues.

Recognized Market Data Sources Evidence Need for Changes in Rule G-23

Despite recent publicity and a rash of investigations, only a small number of firms contradict that encouraging trend. That small number of firms is the principal problem. It is necessary to modify Rule G-23 because the tens of thousands of small and often unsophisticated municipal securities issuers—estimates are in the tens of thousands—are commonly unskilled in public finance and are highly dependent upon, and trust, their financial advisors. That trust should not be violated. Issuers need to know when their "financial advisor" is providing independent advice and, on the other hand, when services principally provide sales profits and a competitive advantage to the "financial advisor" advocating the sale.

NAIPFA fully understands that the Board reviewed Rule G-23 last winter and failed to take the necessary action to revise the Rule to eliminate the abuses that the Rule fosters. That was the wrong decision for the integrity of our market and the public's perception of it. NAIPFA once more respectfully requests that the MSRB review and amend Rule G-23.

In connection with that earlier request, NAIPFA provided the MSRB extensive lists from two recognized market data sources of literally many hundreds of transactions, often (if not always) reported by dealer firms themselves. Those lists from those recognized data sources establish clearly that a small number of dealers in limited regions of the country routinely serve as financial advisors and underwriters in the same transactions. The lists reflect that those practices occur repeatedly in large numbers of transactions each year.

Despite aggressive assertions arguing that the lists from those two recognized data sources somehow are not accurate,, no inaccuracy has been demonstrated in those data. Further, no explanation has been given as to why or how the transactions would have been reported systematically in so many transactions inaccurately by those dealers themselves (or anyone else) to both those data sources.

Current Market Scrutiny Supports Need for Changes in Rule G-23

The municipal securities market is now under substantial scrutiny, this time by the Justice Department, the Internal Revenue Service and the Securities and Exchange Commission with respect to allegations of conflicts of interest, collusion, illegal and hidden payments and other issues of honesty that have serious potential to damage our market. In such a context, the MSRB simply cannot fail to ignore the deeply troubling abuses that are accommodated by Rule G-23 in its present form.

The municipal securities market and municipal securities issuers deserve a market that is free from such disturbing conflicts of interest and even the appearance of such conflicts. Everyone in the market is tainted by the accommodation of these conflicts of interest and the public's perception of the manner in which the market operates. The damage that issuers suffer from conflicted advice is too great. The costs to issuers are too great.

Evidence of Harm to Issuers Supports Need for Changes in Rule G-23

Evidence provided by local governmental securities issuers supports the need for changes in Rule G-23. When NAIPFA first requested a review of Rule G-23, legal counsel to communities in several states sent letters to the MSRB describing how the communities had been greatly damaged by the conflicts of interest of dealers serving as financial advisors and underwriters in the same transactions. Those conflicts of interest, which were not isolated occurrences, led the dealers to recommend transactions that were not in the best interests of those communities. Some communities lost hundreds of thousands, and even millions, of dollars

NAIPFA recognizes that a number of parties also sent to the MSRB what essentially were often form letters opposing changes in Rule G-23. Those letters, especially as form responses, demonstrate the strong hold that certain investment banking firms in certain regions of the country exercise over their clients pursuant to continuing financial advisory contracts that remain in effect, even while the dealers serve the issuers as underwriters.

The letters, generated by dealers who appear to wish to avoid full and accurate disclosure to their issuer clients, also demonstrate that sound bites, not analysis, formed the basis for those communications. Examples of those sound bites are enumerated in Appendix B to this letter.

Despite the inaccurate sound bites, dealers who intend to, or as a common business practice, resign as financial advisor in order to serve as underwriter or in another role that is not truly independent (and investors to whom the dealers owe fiduciary duties), do in fact have, in *every* transaction in which these practices are followed, direct and fundamental conflicts of interest with the dealers' issuer clients.

Conflicts of Interest between Underwriters and Issuers

The pervasive conflicts of interest between underwriters and issuers, resulting from the adversarial nature of underwriter-issuer relationships, require disclosure of material information to the policy-makers of affected issuers, when the dealers resign from financial advisory roles. Generally, consideration should be given to disclosures in at least in the following subject areas:

Financial Conflicts

- How much should the underwriter be paid? How does that compensation compare to compensation received by other underwriters?
- What are reasonable bond prices, discounts, premiums and bond yields? What is available elsewhere in the market?
- What expenses should be paid by the issuer? What expenses, and how much, would other underwriters expect to be paid?

Conflicts Relating to Bond Terms

- What is the security for the bonds? How will the proposed security affect future issuer flexibility, operations and financing plans?

- What are acceptable maturity structures and call provisions?
- What is acceptable coverage in revenue issues? What are acceptable additional bonds tests?
- How should other bond terms be resolved (*e.g.*, issuer covenants, representations and warranties, flows of funds)?

Procedural Conflicts

- Are the bonds best offered in negotiated or competitive sales? What are the relative advantages of a negotiated or competitive sale for the particular issuer and the particular offering?
- In a negotiated sale, is the underwriter the best qualified firm to utilize?
- What are the underwriter's capabilities to sell this particular bond issue?
- Is the underwriter actually selling the bonds, or is the underwriter merely passing the bonds to intermediaries who skim profits that the issuers could obtain through lower interest yields? If the bonds do not come to rest after the underwriter has finished its work, did the underwriter truly earn its compensation and perform adequately for the issuer? Who is available to evaluate and give the issuer's policy-makers nonconflicted, independent advice on the quality of the underwriter's work?
- Who should prepare the issuer's disclosure documents for which the issuer is "primarily responsible" and "ultimately liable,"—underwriter counsel whom the underwriter employs or parties with whom the issuer has a direct contractual relationship?
- How well do the issuer's policy makers understand the existence and nature of the conflicts of interest? Who is available to give the issuer's policy-makers nonconflicted, independent advice on such matters?

Additional Products

- When are investment contracts, interest rate swaps and other derivatives or other products advantageous for the issuer?
- What are suitable prices and pricing procedures for those products?
- Are there conflicts of interest inherent in the sale of those other products?
- What are the dealers' profits relating to those products?

Issuers Need Protections

More than ten years ago, the Securities and Exchange Commission emphasized its concerns about "disclosure of potential conflicts of interest and material financial relationships among issuers, advisers and underwriters … ."[1] Like investors, issuers deserve critical protections from the detrimental effects of conflicts of interest. We note that the securities laws protect sellers of securities, as well as purchasers.[2]

If the advice issuers are receiving from their purported "advisors" is not independent, issuers need to be told that is the case and need to be provided with material information regarding the specifics of how the issuers are disadvantaged.

Therefore, it is essential that an issuer's policy makers—the governing body or issuer officials with policy making authority to approve bond issues and their terms—be informed that conflicts of interest *definitely* exist from the moment that a dealer contemplates the potential for underwriting its advisory issuer client's bond issues or providing other noncompetitive services for which dealers will not be independent. That very contemplation is the precise point at which a dealer's interests begin to conflict seriously with the interests of the issuer client. From that point onward in the progression of the transaction, the issuer's policy makers need to be made aware that the issuer no longer is receiving advice from a completely disinterested advisor.

SEC Action Supports Need for Change in Rule G-23

The Securities and Exchange Commission has stated a disclosure principle strongly reinforcing the need for change in Rule G-23. Recently, the SEC rendered its decision in *In the Matter of Dolphin & Bradbury, Inc.*[3] That action underscores, in the paraphrased words of an SEC Staff member involved in the action, that "Municipal bond issuers and other transaction participants cannot just disclose to investors in bond offering documents that something might happen that will threaten the bonds when they know that it definitely will happen … ."[4] Issuers, as sellers of securities, should have corresponding protections.

Rule G-23 stands in stark contrast to the disclosure principle at the heart of the *Dolphin & Bradbury* decision. Rule G-23 allows dealers merely to inform issuers that a conflict "*may*" exist as a result of a resignation as financial advisor, when numerous serious and pervasive conflicts of interest *definitely* do exist in the issuer-underwriter relationships that are created, sometimes even while dealer-underwriters retain advisory contracts and titles. By accommodating incomplete, ambiguous and materially misleading "disclosure," Rule G-23 stands in direct contrast to that key disclosure principle inherent in the Commission's opinion in the *Dolphin & Bradbury* action.

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1 SEC Rel. 33-7049, 34-33741, 59 F.R. at 12748 (March 9, 1994).

2 We note that SEC Rule 10b-5 prohibits, making, "in connection with the purchase … of any security,"

> any untrue statement of a material fact [and omitting] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

3 *In the Matter of Dolphin & Bradbury, Inc., et al.*, SEC Rel. Nos. 33-8721, 34-54143 (July 13, 2006).

4 Hume, "*SEC Enforcement Case Shows General Disclosure Not Enough*," The Bond Buyer Online (Apr. 27, 2004), paraphrasing comments of Mark Zehner.

This is no time for a lack of sensitivity to serious conflicts of interest issues in the market. This is no time for an important market organization—the MSRB—to accommodate less than the highest and best principles of honesty regarding disclosure of conflicts of interest.

For the reasons set forth above, NAIPFA respectfully re-asserts its request that the MSRB review and modify Rule G-23 to eliminate the abuses Rule G-23 accommodates.

APPENDIX A

EXCERPTS FROM FRANKEL PAPER

Dr. Frankel concludes in her paper that "This situation requires a change." She outlines her analysis of requirements applicable to conflicted financial advisors, as follows:

> Dealers, acting as principals, who advise clients have conflicts of interests. The dealers may at times give clients inappropriate advice even if they do not clearly violate the law. Such an advise may result in the sale to clients of securities or products that may not be in the clients' interest, or to sell clients securities or products at higher prices than others might offer. However, clients who receive the dealers' "advice" are not misled. They know that the advice is "sales advice" which salespersons provide prospective buyers. That advice is taken with a grain of salt, or is ignored altogether.
>
> But clients who receive advisers' advice, and who do not know that the advisers will resign and change their status to become underwriters ***with respect to the same transactions,*** have been misled. Those advisers had conflicts of interest ***while acting as advisers, even though they seemed to have no conflicts.*** In fact, these so-called advisers harbored conflicts from the first moment they began to serve as advisers. Their conflicts of interest are pernicious because they have expertise and information that the client lacks. As advisers, their expertise and information is offered to the clients for the clients' sole benefit. As dealers and underwriters, the expertise and information is used either for the sole benefit of the dealers and underwriters or in part for their benefit. Perhaps the dealers are not greedy and offer advice that may not harm the clients as much as the dealers could. But human nature being what it is we can assume that the dealers offer the clients the best deal for the dealers and not the best deal for the clients, unless the two deals are identical.
>
> Assume that the so-called "advisers" did not intend to resign and become dealers or underwriters. Assume that the idea occurred to them only later, after they had been hired as advisers. Even then, they may not change their position and become underwriters without explaining to the clients clearly that (1) as underwriters they are dealing solely as principals with their advisee-issuer clients, and (2) that they have conflicts of interest with the interests of the clients and (3) what the nature and extent of the conflicts may be. Unsophisticated clients might believe that these underwriters are still devoted fully to the clients' interest (especially so, if the advisory contracts remain in effect), while in fact the underwriters are not, and cannot be, so devoted. They are likely to prefer themselves to those of the clients. The conflict of interest taints their judgment. [Emphasis in original.]

* * *

Dr. Frankel adds:

> The third way in which the dealers can offer advisory services to municipal issuers is to offer the services first, then resign as advisers, and then put on their underwriter hats. Thus, the rule prohibits anyone from serving as adviser and dealer at the same time.

The rule, however, allows dealers to do so sequentially with respect to the same transaction. They can advise first, and when they finish advising they can resign and become overnight underwriters to perform the same transaction. They need only make disclosure to, and obtain consent of, some issuer official (not necessarily a policy maker). They need only disclose that a conflict of interest "may" exist, not that there actually is a conflict. They need not disclose the nature of the conflict or what it means for the issuer client.

Further, that metamorphosis can be achieved in an instant. Adviser finishes its advisory role and in the next minute it can offer services in a dealer or underwriter role. What effect could this change have on an issuer who is used to the adviser? My assumption is that with the right form of presentation the effect is zero. The issuer continues to view the adviser with trust that this adviser did not earn.

What are the consequences for the issuer of this "technicality"? An adviser to municipal issuers is expected to represent the issuers in their negotiations with the underwriters. In this case the "technicality" enables the adviser to represent himself and the issuer at the same time, and conduct the negotiations on both sides of the table. The more expert this adviser-underwriter is, the more helpless the municipal issuer becomes because the gap of expertise between the issuers and the adviser-underwriter becomes wider. There is no way in which most municipal issuers can examine the terms of the underwriting and bargain with the new-old underwriter who the day before was their trusted adviser on the same issuance. There is no way in which the citizens who are paying for this tainted arrangement can protect themselves from expert underwriters who wear the advisory clothes and negotiate for the citizens and for themselves at the same time.

* * *

According to Dr. Frankel:

A salesperson that appears in an adviser's clothes and acts as a consultant, gaining the issuer's trust, might retain the issuer's trust even after changing his status into a salesperson who would benefit from getting the brokerage business. That occurs even though, as adviser, he advises the issuer about the dealers and underwriters that the issuer should employ. Personal trust and confidence in a relationship lingers on, even when the adviser reappears in another capacity. Thus, acting in the capacity of an adviser, a salesperson can gain the issuer's deeper trust. After he "resigns" and reappears the next moment as an underwriter he has a good chance of gaining the business about which he advised the issuer.

Issuers might question the true commitment of underwriters that introduce themselves as independent advisers first, and then change their status to that of underwriters. But these so-called advisers do not represent themselves as potential underwriters. They represent themselves first as advisers to be entirely trusted, without any suspicion of conflicting interests. Once the relationship is established, unsophisticated issuers cannot easily reduce their reliance. The personal trust in the relationship takes over. Then, and only then, do these so-called advisers change their status to become the dealers and underwriters.

APPENDIX B

INACCURATE SOUND BITES

The following are among the inaccurate sound bites expressed in letters generated by conflicted dealers in opposition to changes in Rule G-23 to require accurate and meaningful disclosure:

- *Inaccurate sound bite:* Rule G-23 already requires "full disclosure."

  Correction: As this letter demonstrates, that simply is not the case. Rule G-23 actually accommodates the provision of materially misleading information by dealer-advisors to issuers, allowing dealers to suggest, through ambiguous purported "disclosures," that conflicts of interest *may not* exist. The Rule also fails to require disclosure to issuers' policy makers. It does not require that issuers be informed of the nature or the extent of the very real conflicts, particularly with the complex roles that may be present in a given transaction.

- *Inaccurate sound bite:* Changes in Rule G-23 would reduce or restrict issuer choices.

  Correction: Disclosure would instead enable issuers to make materially informed choices about their advisors and underwriters. Issuers would remain fully able to employ any financial advisors and underwriters they wish.

- *Inaccurate sound bite:* Changes in Rule G-23 would increase costs for issuers.

  Correction: Disclosure by dealer-advisors who utilize such practices would do nothing to increase issuer costs. Elimination of conflicts of interest and abuses would instead reduce issuer costs and increase issuer flexibility and protections.

- *Inaccurate sound bite:* Changes in Rule G-23 would prevent dealer-advisors from underwriting their clients' bond issues, from bidding in competitive bond sales, or from engaging in private placements.

  Correction: The modifications for which NAIPFA is arguing would require disclosure of material information to and consents of issuer policy makers, but would not prohibit any of those activities.

- *Inaccurate sound bite:* Requiring disclosure to issuers would regulate issuer policy options.

  Correction: Again, the modifications for which NAIPFA is arguing would require disclosure of material information to and consents of issuer policy makers. By informing issuers, disclosure would enhance and result in more informed issuer policy choices. No restrictions whatsoever would be placed upon issuers.

- *Inaccurate sound bite:* Because NAIPFA members, as independent financial advisors, compete with dealer advisors, NAIPFA members are seeking to prevent dealers from serving as financial advisors.

  Correction: Nothing proposed by NAIPFA would restrict or inhibit dealers in any manner whatsoever from serving honestly as financial advisors rendering independent advice. That independent advice, in contrast to conflicted advice, would benefit issuers significantly. Further, dealer-advisors would remain completely free, subject only to a requirement of material disclosure and consents, to resign in order to underwrite their issuer clients' securities.

- *Inaccurate sound bite:* Independent financial advisors are not regulated, so the serious abuses against issuers that Rule G-23 accommodates should be ignored.

  Correction: This assertion is wholly unrelated to the question of whether dealer-advisors should be permitted by an MSRB Rule to make materially misleading statements to their issuer clients or to operate with undisclosed conflicts of interest. In fact, financial advisors who also provide investment advice, or who serve as broker-dealers, are regulated in those capacities. Moreover, financial advisors, as advisors to issuers, are subject to the securities laws and common law responsibilities, and a number (who are not, NAIPFA is happy to say, members of NAIPFA) have been the subject of Securities and Exchange Commission actions. If opponents of change to Rule G-23 wish for Congress to regulate independent financial advisors still further, they are free to ask Congress to do so.

  In any case, taking its own affirmative action, NAIPFA many years ago established rules and requirements applicable to its members. NAIPFA administers tests and imposes qualifications for, and certifies, qualified independent public finance advisors, known as Certified Independent Public Finance Advisors ("CIPFAs"). NAIPFA also requires that those CIPFAs participate regularly in continuing education in order to maintain their CIPFA status, and conducts annual substantive conferences to educate our members and to enhance our professionalism. Further, as already noted NAIPFA members have agreed voluntarily not to engage in pay-to-play practices.

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September 30, 2010

Leslie Carey, Associate General Counsel
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: MSRB Notice 2010-27 Request for Comments on Rule G-23

Dear Ms. Carey:

As President of the Board of Directors of the National Association of Independent Public Finance Advisors ("NAIPFA"), I am writing on behalf of NAIPFA to respond to the Municipal Securities Rulemaking Board's ("MSRB") request for comments regarding the draft changes to Rule G-23. NAIPFA's members are independent public finance advisors that, among other tasks, advise public entities regarding the structure, timing, terms, and related matters during the process of issuing municipal securities.

NAIPFA would like to commend the MSRB in proposing to amend Rule G-23. While we believe the proposed draft is a significant step forward in reducing the conflict of interest that results when broker-dealers acting as financial advisors ("broker-dealer financial advisors") switch roles and then underwrite the bonds, we believe that further refinements should be made. Our suggested modifications are intended to (i) eliminate conflicts of interest never fully addressed by Rule G-23, (ii) define the distinct roles of financial advisors and underwriters intended by the Dodd – Frank Wall Street Reform and Consumer Protection Act (the "Act"), and (iii) increase the integrity and transparency of the municipal securities market.

Background

In connection with our comments, we want to convey our observations regarding the conflicts of interest that now exist. We trust that Rule G-23 as amended will not contain loopholes or exceptions.

NAIPFA recognizes that underwriters and issuers engage in arm's-length commercial transactions in which the buyer and seller work together to establish mutually acceptable terms and prices. However many issuers, by themselves, do not have the expertise to determine whether they have obtained favorable terms. They rely on their financial advisors for that purpose. While many reputable broker-dealers would not switch roles, those that do have effectively elected to work in their own self interest and not in the best interest of the issuer or public trust. This is due to the fact that under current rules, when a broker-dealer terminates its financial advisory relationship and becomes the underwriter, the broker-dealer continues to provide advice to the issuer. Upon termination of the financial advisory relationship, their advice may become self-serving, may no longer be objective and may not be in the issuer's or public's interest. The following is a sampling of some of the significant conflicts of interest that are created when a broker-dealer financial advisor changes roles to become the underwriter of transaction:

Financial Conflicts: A financial advisor turned underwriter continues to provide advice with respect to the following:

- How much the underwriter will be paid;
- What are reasonable bond prices, discounts, premiums and yields; (The issuer may no longer have unbiased access to what is available elsewhere in the market.)
- What expenses should be paid by the issuer and how much is reasonable; or
- Who should or should not be hired as part of the financing team.

Instrument Conflicts: A financial advisor turned underwriter continues to provide advice with respect to the following:

- The financial instrument that will be utilized (the underwriter may recommend an instrument that is more favorable to the interests of the ultimate buyer than to the issuer who may not have the financial expertise on staff to fully measure or manage the risks or underwriter profitability associated with such instruments). These include, among others:
  - VRDO instruments,
  - Auction rate instruments,
  - Derivative or synthetic instruments.

Structural Conflicts: A financial advisor turned underwriter continues to provide advice with respect to the following:

- The structure that will be utilized. (The underwriter may recommend a structure that is easy to sell to investors, not necessarily the structure that is most favorable to the needs of the issuer.) These terms include, among others:
  - Maturity structures,

- Call provisions,
- Negative and affirmative covenants, such as coverage and additional bonds tests, representations and warranties, and flows of funds,
- Ratings (Whether to obtain a rating or sell non-rated securities), and
- Credit enhancement (Bond insurance or a letter-of-credit).

Sale Conflicts: A financial advisor turned underwriter may have convinced the issuer that:

- The best method of sale is a negotiated sale (Competitive bidding, competitive proposals or a private placement are not considered).
- Its own firm is the best qualified underwriter for the transaction (Competitive underwriting proposals are not considered).
- That the yields and prices it has offered are favorable (The underwriter may select "comparable" issues that support the firm's pricing and may not direct the issuer to secondary market pricing sources).
- There may be a need for short-term financing before the permanent bonds can be sold (This might be a way to bill multiple fees or circumvent a state law requiring competitive bids).

Based on this background, NAIPFA respectfully submits the following comments:

We recommend amendments to Section (b) of Rule G-23 in order to conform the Rule to the Act.

The first sentence of Section (b) should be modified to reflect provisions of the Act.

The sentence now reads *"For purposes of this rule, a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services."*

Under the Act, any person that provides "advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues" will be deemed to be municipal advisor. It is our understanding that this could include certified public accountants, urban planners, feasibility study providers, engineers, and any broker-dealer serving in the capacity of financial advisor or providing such services that constitute service as a financial advisor.

Consequently the sentence should now read *"For purposes of this rule, a financial advisory relationship shall be deemed to exist when a person including broker, dealer, or municipal securities dealer renders or enters into an agreement to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services."*

In addition, the last sentence of Section (b) should be modified to reflect the Act. The sentence now reads *"Notwithstanding the foregoing, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker, dealer or municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities."*

As presently written, Rule G-23 allows underwriters to provide substantially the same "advice" as a financial advisor which is not consistent with the changes to law contemplated by the Act. (Please review Attachment A regarding our conclusions as further supported by the MSRB definitions of terms found on Attachment B). The sentence must be modified to recognize that "advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities" is now a function reserved for financial advisors. While this distinction is a matter of law that can be debated among lawyers, the distinction between financial advisors and underwriters is already clearly understood by municipal market participants.

On September 17, 2008, the Securities Industry and Financial Markets Association (SIFMA) released a "Model Bond Purchase Agreement" which states "The Issuer acknowledges and agrees that (i) the purchase and sale of the Securities pursuant to this Agreement is an arm's-length commercial transaction between the Issuer and the Underwriters, (ii) in connection with such transaction, each Underwriter is acting solely as a principal and not as an agent or a fiduciary of the Issuer, (iii) the Underwriters have not assumed (individually or collectively) a fiduciary responsibility in favor of the Issuer with respect to the offering of the Securities or the process leading thereto (whether or not any Underwriter, or any affiliate of an Underwriter, has advised or is currently advising the Issuer on other matters) or any other obligation to the Issuer except the obligations expressly set forth in this Agreement and (iv) the Issuer has consulted with its own legal and financial advisors to the extent it deemed appropriate in connection with the offering of the Securities."

Consequently, brokers, dealers and municipal securities dealers must be restricted to the role of underwriting, trading and selling securities as defined by the MSRB. To reflect this legal distinction, the last sentence of Section (b) of Rule G-23 should be modified as follows: *"Notwithstanding the foregoing, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker, dealer or municipal securities dealer provides information to an issuer relating to the sale of the securities to investors such as transactional structures, the underwriter's capabilities to sell various securities, how particular terms of a security structure may affect rates and yields, and matters incidental to the underwriting of a new issue of municipal securities."*

Alternatively, the above sentence could be deleted entirely provided that is understood that providing advice requires the underwriter to be registered as a municipal advisor. We believe it is best to provide guidance to underwriters by adopting the above language.

We recommend amendments to Section (c) of Rule G-23 to prevent conflicts of interest arising from compensation.

All municipal market participants should be paid directly by the public entity and there should be no sharing of fees between underwriters and financial advisors. To further ensure independence between the two roles, underwriters should be restricted from selecting or recommending to the public entity, the municipal advisor for hire. Section (c) should be modified to reflect these concerns.

Section (d) Prohibition on Engaging in Underwriter Activities of Rule G-23 seems reasonable as drafted and as a result NAIPFA supports the proposed change.

NAIPFA's Responses to MSRB's Questions

NAIPFA is concerned that these questions may be intended to, and could lead to, special exceptions to G-23. NAIPFA believes that small and infrequent issuers have historically and will continue to have access to the capital markets if they have access to independent advice and have well-structured, credit worthy municipal security issues.

Question 1 Comment: A broker-dealer financial advisor should be precluded from serving as underwriter for any transaction of an issuer for a period of two years following the termination of its financial advisory relationship with such issuer.

We believe that a financial advisor should be precluded from serving as underwriter to an issuer for a defined time period. We have considered a number of options regarding an appropriate time frame and are recommending a period of two years from the time the financial advisory contract expires or is terminated. A two-year prohibition is recommended for the following reasons:

Under Rule G-37 and the proposed changes to Rule A-3, the MSRB has established a precedent for imposing two-year bans. Under Rule G-37, when a broker-dealer makes certain political contributions, the firm is banned from underwriting securities of that issuer for a period of two years.

In connection with MSRB's proposed changes to Rule A-3, the MSRB has determined that an individual is "independent, as defined by the Board, of entities regulated by the MSRB" if "the individual is not and, within the last two years, was not associated with a municipal securities broker, municipal securities dealer, or municipal advisor, and that the individual does not have a relationship with any municipal securities broker, municipal securities dealer, or municipal advisor, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision making of the individual."

Similarly, we believe a financial advisor will remain independent if precluded from serving as an underwriter for a term of two years from the expiration or termination of the financial advisory relationship. A two-year ban will discourage underwriters from engaging in a financial advisory relationship for the purpose of later switching to an underwriter and will provide adequate time to protect an issuer from the conflicts of interest created from role change. Given MSRB's two year precedent, failure to impose a specific time ban or a ban other than two years would be arbitrary and inconsistent.

Question 2 Comment: There should be no exceptions for competitive sales.

The purpose of competitive bidding is exactly as the name implies, to create competition. Not all underwriters engage in the practice of role switching, but those that do may seek to reduce competition in order to improve their opportunity to be the firm submitting the winning bid. Stated differently, if a bid fails it is most likely because the broker-dealer financial advisor failed to properly advertise, circulate documents and/or perform other activities to obtain the largest number of bids possible. If a financial advisor has performed their role properly and yet there are no bidders, it is likely that the credit of the issuer's debt obligation should not be publicly sold.

Recognizing that a remote possibility may exist in which competitive bidding is required by local/state law and the possibility of only one interested underwriter, we believe the issuer would be better served by employing an independent municipal advisor to arrange the competitive sale rather that relying on the potential "sole bidder" to serve as both financial advisor and sole bidder. The independent municipal advisor may recommend that the bid be rejected which could provide other legal options for the debt placement. Providing special exemptions in Rule G -23 will create non-competitive bidding environments which are not in the issuer's or public's best interest. "Sole bidders" have the opportunity to charge higher fees and impose higher yields. As a result, the only beneficiary of exemptions in Rule G -23 will be the broker-dealer financial advisor that is ultimately the underwriter of the bonds. In addition, exceptions to Rule G-23 encourage anti-competitive practices which are not in the public interest and would leave the issuer without an advisor if the underwriter were not able to honor the Bond Purchase Agreement at closing.

Question 3 Comment: There should be no exceptions for small issuers.

The primary beneficiaries of a strong Rule G-23, that is void of loopholes and exceptions, will be small and infrequent issuers. A strong Rule G-23 will benefit the thousands of small and infrequent municipal securities issuers that are not skilled or experienced in public finance. These issuers have historically been more prone to abuse.

We are not aware of any study proving that "small" or "infrequent" issuers have difficulty marketing their issues. We maintain that properly structured credit worthy issues have always been, and will continue to be, sought by multiple buyers. We have also seen the dedication and tenacity of public finance professionals to be hired by issuer clients, no matter how small the issuer or distant the location. We find it unlikely that issuers with an open selection process have only one underwriting choice. Furthermore, Rule G-23 does not require either competitive bidding or the engagement of financial advisor. Under Rule G-23 issuers will continue to have flexibility to sell their bonds by a private placement with a local bank, directly negotiate the sale with an underwriter, or work with a financial advisor who will assist in selecting an underwriter for a negotiated sale. This flexibility eliminates the need for special exemptions.

Question 4 Comment: There should be no exceptions that allow financial advisors to simultaneously serve as underwriter on separate issues for the same issuer.

As noted above, we believe there should be a ban prohibiting a financial advisor from serving as underwriter for any transactions of the issuer for a period of two years from the date the financial advisory relationship is expired or terminated.

We have enumerated several of the conflicts of interest that occur when a broker-dealer financial advisor changes roles and acts as underwriter. These conflicts are further magnified when a broker-dealer performs the two roles simultaneously. Can a financial advisor that acts in a fiduciary capacity to its clients simultaneously serve the client in an arm's-length commercial transaction without violating its fiduciary responsibilities? When serving as an underwriter while still wearing their advisor hats, the underwriter is representing implicitly, if not explicitly, to the issuer client that negotiated sales are the best method of sale, that their firm is the best underwriter for the transaction and that a financial advisor is not required. Can the "fiduciary hat" once worn, be removed by the fiduciary with a shift to a non-fiduciary role? What disclosures will be made to the issuer, to the effect that for one transaction the broker-dealer is a fiduciary and for one they are performing an "arm's-length commercial transaction?" Will a small municipal issuer be told and understand that a conflict of interest does exist?

We can't imagine how a financial advisor, whose role is to act in a fiduciary capacity to the issuer, can simultaneously work as underwriter and state that the roles can be clearly separated. We also hold, any exception on this matter is inconsistent with the Act. Accordingly, we recommend that this practice be prohibited by G-23.

Questions 5 and 7 Comment: We believe there should be no exceptions.

As noted herein, we can see no justification to make any exceptions that will create loopholes, dilute Rule G-23 and negate the fiduciary role needed by small and infrequent issuers that are not skilled in public finance.

Conclusion

NAIPFA supports the proposed changes to Rule G-23 as presently drafted, provided that the revisions noted above are made including the two year ban to serve as underwriter after serving as a financial advisor. In addition, we do not support any exceptions for small issuers or for competitive bidding. NAIPFA appreciates this opportunity to comment and looks forward to continuing dialogue with the MSRB.

Sincerely,

Steven F. Apfelbacher

Steven F. Apfelbacher, CIPFA
President
NAIPFA

ATTACHMENT A- ANALYSIS OF MUNICIPAL ADVISOR ROLE

Current MSRB Rule G-23(b) provides in part that a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker dealer or municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities. The current proposal by the Board to amend Rule G-23 does not propose to modify this language. This violates the Dodd-Frank Wall Street Reform and Consumer Protection Act since advice can only be provided by municipal advisors.

The Dodd-Frank Wall Street Reform and Consumer Protection Act §975(e) added Section15B(e)(4) defining the term "municipal advisor," as follows—

(4) the term "municipal advisor"—

(A) means a person (who is not a municipal entity or an employee of a municipal entity) that—

(i) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, *including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues*; or

(ii) undertakes a solicitation of a municipal entity;

(B) includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors, if such persons are described in any of clauses (i) through (iii) [sic] of subparagraph (A); and

(C) *does not include a broker, dealer, or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933) (15 U.S.C. 77b(a)(11))*, any investment adviser registered under the Investment Advisers Act of 1940, or persons associated with such investment advisers who are providing investment advice, any commodity trading advisor registered under the Commodity Exchange Act or persons associated with a commodity trading advisor who are providing advice related to swaps, attorneys offering legal advice or providing services that are of a traditional legal nature, or engineers providing engineering advice[.] [Emphasis added.]

Further, municipal advisors are subject to unique provisions imposing a fiduciary duty and prohibiting fraud.

In the past, MSRB Rule G-23 permitted certain limited categories of "advice" to be provided by underwriters to issuers ("advice with respect to the structure, timing, terms, and other similar matters concerning" a municipal securities issue, which is the same language used in the new definition of "municipal advisor"), but that advice now is squarely within the "advice" that causes a party to fall within the definition of "municipal advisor." As a result an underwriter to issuers must now register as a municipal advisor to provide this type of advice.

The exclusion for "a broker, dealer, or municipal securities dealer functioning as an underwriter" refers only to an underwriter "as defined in section 2(a)(11) of the Securities Act of 1933) (15 U.S.C. 77b(a)(11)." That definition includes the following parties: any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking ...

The Securities Act definition quoted above describes traditional underwriting functions. Note that the definition of "underwriter" omits all mention of providing "advice" to issuers. The underwriter definition, therefore, excludes from "municipal advisor" regulation only parties engaged in true underwriting functions.

Now, under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the provision of advice to issuers causes an underwriter to be a "municipal advisor." As a result, Rule G-23(b) cannot continue to stand in its present form.

For example, if a dealer were not only to "serve" as an underwriter (as narrowly defined), but also to provide "advice," especially advice as to decisions issuers should make in their own interests, then it is a reasonable interpretation that the underwriter also is a "municipal advisor."

Of course, underwriters communicate with issuers in the course of underwriting municipal securities issues. The Government Finance Officers Association, in its *Best Practice On Selecting Underwriters for Negotiated Sales*, describes this as providing ideas and suggestions" and continues that "[a] negotiated bond sale does not entail the purchase of any goods or services by an issuer from an underwriter," as follows—

State and local governments select underwriters for the purpose of selling bonds through a negotiated sale. The primary role of the underwriter in a negotiated sale is to market the issuer's bonds to investors. Assuming that the issuer and underwriter reach agreement on the pricing of the bonds at the time of sale, the underwriter purchases the entire bond issue from the issuer and resells the bonds to investors. In addition, negotiated sale underwriters are likely to provide ideas and suggestions with respect to structure, timing and marketing of the bonds being sold.

Underwriters do not have a fiduciary responsibility to the issuer.

A negotiated bond sale does not entail the purchase of any goods or services by an issuer from an underwriter. Therefore, an RFP process for underwriters should not be treated as a procurement process for goods or services, notwithstanding the obligation of the issuer to comply with state and/or local procurement requirements. The only legal relationship between the issuer and an underwriter is created by a Bond Purchase Agreement signed at the time of the pricing of the bonds, wherein the issuer agrees to sell the bonds to the underwriter at an agreed upon price. [Emphasis added.]

Another way to view the communications between issuer and underwriter is that underwriters appropriately provide "information" to issuers, such as market conditions, availability of particular transactional structures, their capabilities to sell various securities structures and the relative benefits of each, and how investors will react to particular terms of a security.

The MSRB must recognize this change in law due to the Dodd-Frank Wall Street Reform and Consumer Protection Act and amend regulatory rules including Rule G-23 so it complies with Congress' action. All financial advisors, including underwriter financial advisors, are required to register as a municipal advisor.

ATTACHMENT B

The following MSRB definitions of terms are currently being used for rulemaking. You will find that the definition of dealer, broker, broker-dealer and dealer bank does not include any reference to "advise" or "advice". With passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act Congress only included the concept of providing "advise" within the definition of a municipal advisor which also reflected in the MSRB definitions. Any consultant including underwriters who advises the issuer on matters pertinent to the issue, such as structure, timing, marketing, fairness of pricing, terms and bond ratings is a municipal advisor.

FINANCIAL ADVISOR – With respect to a new issue of municipal securities, a consultant who advises the issuer on matters pertinent to the issue, such as structure, timing, marketing, fairness of pricing, terms and bond ratings. A financial advisor may also be employed to provide advice on subjects unrelated to a new issue of municipal securities, such as advising on cash flow and investment matters. The financial advisor is sometimes referred to as a "fiscal consultant" or "fiscal agent." A broker-dealer that acts as a financial advisor is subject to MSRB rules. **Compare: PRICING ADVISOR.**

PRICING ADVISOR – A consultant who provides a fairness letter to an issuer or its agent regarding the pricing of a new issue of municipal securities. **Compare: FINANCIAL ADVISOR. See: FAIRNESS LETTER.**

FAIRNESS LETTER or FAIRNESS OPINION – A letter or opinion prepared by a financial advisor, pricing advisor or similarly qualified person opining on the fairness of the price paid by the underwriters to the issuer in connection with a new issue of municipal securities or paid by purchasers of assets. The term also sometimes refers to similar letters delivered by an investment banker, financial advisor or similarly qualified person regarding the fairness of the price being paid by an issuer or conduit borrower for assets being purchased with bond proceeds. **See: FINANCIAL ADVISOR; PRICING ADVISOR.**

DEALER – A person or firm that engages in the business of underwriting, trading and selling securities for its own account acting as principal. A person or firm engaged in the business of effecting principal trades in municipal securities is known as a "municipal securities dealer." Although for purposes of the Securities Exchange Act of 1934 the term "dealer" generally does not include a bank, the term "municipal securities dealer" expressly does include a bank, or a separately identifiable department or division of a bank, that is engaged in underwriting, trading and selling municipal securities for its own account, other than in a fiduciary capacity. In colloquial usage, these terms are used to refer to both securities firms and dealer banks. **Compare: BROKER. See: BROKER-DEALER; DEALER BANK.**

BROKER – A person or firm that acts as an intermediary by purchasing and selling securities for others rather than for its own account through agency trades. A broker engaged in the business of effecting agency trades in municipal securities is known as a "municipal securities broker." For purposes of the Securities Exchange Act of 1934, the terms "broker" and "municipal securities broker" generally do not include a bank. **Compare: BROKER'S BROKER; DEALER. See: BROKER-DEALER.**

BROKER-DEALER– A general term for a securities firm that is engaged in both buying and selling securities for customers (*i.e.*, agency trades) and also buying and selling for its own account (*i.e.*, principal trades). The term generally would not be used (except in this Glossary) to refer to a dealer bank or a broker's broker. For purposes of this Glossary, the term broker-dealer is used as a collective term for any firm that is a broker (including a broker's broker) and/or a dealer (including a dealer bank). **Compare: BROKER'S BROKER; DEALER BANK. See: BROKER; DEALER.**

BROKER'S BROKER – A broker-dealer that executes securities transactions exclusively with other broker-dealers and not with public investors. Broker's brokers generally do not take inventory positions in securities. A broker's broker engaged in the business of effecting trades in municipal securities is known as a "municipal securities broker's broker" or, colloquially, a "municipal securities broker." **See: BROKER; MUNICIPAL SECURITIES BROKER.**

DEALER – A person or firm that engages in the business of underwriting, trading and selling securities for its own account acting as principal. A person or firm engaged in the business of effecting principal trades in municipal securities is known as a "municipal securities dealer." Although for purposes of the Securities Exchange Act of 1934 the term "dealer" generally does not include a bank, the term "municipal securities dealer" expressly does include a bank, or a separately identifiable department or division of a bank, that is engaged in underwriting, trading and selling municipal securities for its own account, other than in a fiduciary capacity. In colloquial usage, these terms are used to refer to both securities firms and dealer banks. **Compare: BROKER. See: BROKER-DEALER; DEALER BANK.**

DEALER BANK – A bank, or a separately identifiable department or division of a bank, that is engaged in the business of buying and selling municipal securities for its own account. Dealer banks must be registered as dealers or municipal securities dealers under the Securities Exchange Act of 1934. See: **DEALER; SID.**

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February 22, 2011

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File Number S7-45-10

Dear Ms. Murphy:

The National Association of Independent Public Financial Advisors (NAIPFA) appreciates this opportunity to provide comments to the Securities and Exchange Commission (SEC) on proposed rules related to the registration of Municipal Advisors.

NAIPFA, founded 21 years ago, is a professional organization of independent public finance advisory firms that provide public finance advice to municipal and non-profit entities. NAIPFA is comprised of thirty-two member firms serving all fifty states from locations in twenty-six states. Independent public finance advisors offer a wide variety of consulting services to issuers and obligated persons. In 2009, NAIPFA members represented clients on over 2,800 separate bond issues with approximately $75 billion in proceeds.

I. PRELIMINARY STATEMENT

NAIPFA members differ from municipal advisors associated with broker-dealer firms and investment advisers in several key respects: they do not underwrite or trade municipal securities; they do not act as counterparties on swaps; and, except for certain firms that are also investment advisers, they do not recommend investments or have custody of client funds. Many advisors are former investment bankers, bond attorneys, or government finance officers who started their practices in order to provide greatly needed independent advice to municipal entities. Given their expertise and the personal relationship between advisors and their clients, most of these individuals chose to do business as sole proprietors or in small partnerships operating within a state or regional area. Consequently, many of our members operate out of a small office and some out of their homes. From membership information, NAIPFA believes that the median number of public finance advisors within its member firms is three to four. Approximately two-thirds of NAIPFA members have five or fewer employees engaging in public finance advisory activities. Indeed, only five member firms have twenty or more employees who would qualify as municipal advisors under the rules proposed.[1] Several member firms have only one or two employees acting as public finance advisors and operate with no secretarial or administrative staff.

Though not all independent municipal advisory firms are members of NAIPFA, its membership is likely representative of the universe of independent public finance advisory firms.

[1] The largest NAIPFA member has approximately 250 employees.

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While we are unaware of any NAIPFA member being a party to any disciplinary action related to the credit crisis or other concerns that prompted Congress to legislate that municipal advisors be regulated, NAIPFA recognizes the need for change among municipal market participants. Making clear who is an advisor, with a corresponding fiduciary duty to its client will increase transparency, professionalism and accountability in the market as well as aid in the protection of municipal entities and investors in municipal bonds.

Congress also made clear that regulators tasked with implementing its directives must take into account the impact the rules would have on small firms and also imposed deadlines for getting the rules in place. We applaud the SEC (and the MSRB) for its efforts to learn about our business, and recognize the constraints that limited resources put on that effort. The fact is, however, that the proposed rules we address in this comment and rules being proposed are coming at the early stages of the learning process, before the SEC or MSRB fully understand who we are, what we do and how we do it. We are also concerned that the SEC and MSRB may not be coordinating their efforts in a way that will result in regulation that is maximally efficient and minimally burdensome.

We believe that regulation of municipal advisors will fall hardest on the small firms that make up the large majority of independent public finance advisory firms. Indeed, we believe that, if adopted as proposed, these rules and others we have seen or anticipate will – in their totality – significantly increase direct and indirect costs and likely force a significant number of independent public finance advisors out of the business altogether or into other commercial arrangements.

For these reasons, and as further explained within this comment letter,

1. NAIPFA suggests that the SEC recognize that the business model and services provided by independent public finance advisors, or IPFAs, are different than the other market participants it regulates, and accordingly, the rules it promulgates should take into account those differences.
2. NAIPFA urges that the SEC recognize that the large majority of IPFAs would fall within the definition of "small business" that the SEC has proposed it adopt; indeed, a high percentage of IPFA firms likely generate revenue in amounts substantially less than $7 million per year. Accordingly, all of the regulations it proposes, individually and collectively, will place substantial burdens on these firms.
3. NAIPFA requests that the SEC follow the express language of Congress and reject the position taken by the MSRB that underwriters can provide "advice" with respect to the issuance of municipal securities without becoming a municipal advisor with a fiduciary duty.
4. NAIPFA asks that the SEC clarify which services typically offered by IPFAs do and do not qualify as municipal advisory activities.
5. NAIPFA recommends that the SEC not impose an ADV brochure requirement similar to the one imposed on registered financial advisers.
6. NAIPFA opposes any requirement that independent parties review or audit municipal advisors, either prior to the first application or on an annual or other periodic basis thereafter. The SEC review of regulated firms will be sufficient to provide feedback on firm practices.
7. NAIPFA proposes that the recordkeeping requirements be modified to eliminate the need to retain all written communications, and that other requirements be clarified.

Given the express direction of Congress that the effect on small advisory firms be considered in all rulemaking, and the likely effect these rules would have on NAIPFA members and other IPFAs, we strongly urge the SEC to modify its proposed rules taking into account the concerns raised in this comment letter.

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II. WHAT IS AN INDEPENDENT PUBLIC FINANCE ADVISORY FIRM?

A. Structure. IPFAs can be differentiated from other market participants that provide services to municipal entities in that an IPFA generates all or substantially all of its revenue from the provision of advice. An IPFA does not underwrite or trade municipal securities as broker-dealers do. It does not act as counterparty in swap transactions as investment and commercial banks do. An IPFA generally does not recommend investments or manage money as retail brokerage firms and registered investment advisers do. In addition, an IPFA does not maintain accounts in which it holds customer securities or funds. And, an IPFA does not solicit on behalf of any third-party.

The business model of a typical NAIPFA member is vastly different than that of a broker-dealer, commodity trading advisor or a registered investment adviser. Independent public finance advisors are essentially consultants selling their time and financial expertise.

Consider, for example, the profile of a relatively successful independent municipal advisor. Assuming the advisor charges $175/hour for their time and is able to bill fifty-four percent of the time they devote to their business, their revenue would be $196,560.[2] A median-sized IPFA firm with four professionals would be generating less than $800,000 per year in gross revenue. Out of this gross revenue, the firm must pay all overhead costs, including staff, office, insurance, benefits, and taxes. IPFAs will also now incur the costs of being regulated.

Compensation for dealer and registered investment advisors can be very lucrative when compared to compensation for IPFAs, in part because these other market participants generate revenue in a variety of ways. In the case of underwriters or swap counterparties, they can earn spreads or profits on the transactions in which they participate and often serve as the underwriter, investment adviser, swap advisor and/or swap counterparty on the same transaction. In the case of registered investment advisers, they sometimes charge on a per transaction basis, on the basis of assets under management or as a percentage of the investment return. They may also receive fees from third-parties or share in revenue earned by their affiliates. Clients of such firms may have a difficult time understanding all the ways other financial service providers earn their money. This is also the very reason G-23 is such an issue. Underwriter municipal advisors will earn substantially higher compensation negotiating an issue instead of acting solely as a municipal advisor soliciting competitive bids. On the other hand, IPFA clients have no difficulty understanding how, and how much, they are paying for service.

Clients of IPFAs are also not confused by the conflicts inherent in their relationship because they rarely arise. IPFAs serve no master other than the municipal client. They do not have investor clients seeking to purchase the bonds the municipality is planning to sell. They are not engaging in proprietary transactions for their own account with the bonds the municipality is issuing, nor are they acting as principal in swap transactions, or as counterparty to guaranteed investment contracts or conflicted on receiving higher compensation by negotiating the issue.

[2] 2080 hours X 54% x $175/ per hour = $196,560 gross revenue. $175 per hour is a blended rate, as clients sometimes prefer to pay by the hour or pay a flat fee per project or financing.

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B. Services Provided. When assisting public and non-profit entities, the following illustrative services are often provided by an IPFA:

1. General consulting or pre-debt transaction services (Consulting services ***not tied to a specific bond issue***):
   - General financial planning such as capital improvement planning, overall long-range financial planning, or financial projections for replacement of current facilities;
   - Helping develop financial management, debt, reserve, liquidity and/or other related policies;
   - Projecting tax impact for an operating levy referendum;
   - Understanding the need or impact of a Utility Rate study;
   - Assisting in the creation of special revenue districts such as Tax Increment Districts, Business Districts, Tax Abatement Districts, Special Assessment Districts and Special Tax Districts; and
   - Benchmarking or comparison of communities to financial data (like debt per capita or debt per valuation).
2. Debt Transaction Services (Consulting services ***tied to a specific bond issue***):
   - Reviewing a specific revenue source to support a specific debt transaction in a feasibility study or fine-tuning a general planning document;
   - Explaining the various debt options available to the issuer client;
   - Assisting in the sizing and structuring of a debt issue;
   - Assisting to prepare (and reviewing responses to) Requests for Proposal from other service providers, potentially including: bond counsel, underwriters, internet sale option providers, rating agencies, verification agents, trustees, registrar or paying agents, escrow verification agents, registered investment advisors, auditing firms, insurance companies, printers, and any other financial services firms needed;
   - Coordinating the finance team;
   - Assisting in the preparation and/or review of disclosure and other documents for the transaction;
   - Assisting in the preparation of, and the issuer's presentation to, the rating agencies and insurance companies;
   - Recommending the method of sale, i.e., competitive or negotiated;
   - Preparing financing models and mathematical computations;
   - Reviewing with the issuer and negotiating the preliminary and final pricing on all negotiated issues;
   - Preparing the bid documents and conducting competitive bond sales by advertising for, receiving and analyzing the bids received;
   - Assisting in the review of all closing documents.

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3. Post-transaction Services (Consulting services ***after a specific bond issue has been closed*** and funds delivered but not including investment of bond proceeds):
   - Providing arbitrage and rebate calculations;
   - Providing services related to Continuing Disclosure and its dissemination; and
   - Projecting future pledged and unpledged revenues for outstanding debt service funds.

III. COMMENTS

A. DEFINITION OF MUNICIPAL ADVISOR AND MUNICIPAL ADVISORY ACTIVITIES

Given the nature of the activities in which NAIPFA member firms engage, NAIPFA's comments on this subject will be directed primarily to two issues: (a) which activities do and do not qualify as advisory activities "with respect to the issuance of municipal securities;" and (b) when an underwriter crosses the line and becomes a municipal advisor.

The proposed rule adopts the definition of "municipal advisor" set forth in the Dodd-Frank amendments to the Exchange Act, using as its basis the activities in which a person engages. A municipal advisor is a person

> *who provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or undertakes a solicitation of a municipal entity.*

<u>The Underwriter Exemption</u>

The law and the proposed rule also specifically include certain market participants and exempt others. In the Exchange Act, Congress states that a *"broker, dealer or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933"* is not a municipal advisor.

Section 2(a)(11) provides that an "underwriter" is

> *any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.*

Congress has clearly defined municipal advisory activities to include advising issuers and borrowers with respect to the structure, timing, terms and similar matters concerning a municipal bond issue. At the same time, it has limited underwriting activities to purchasing or distributing the bonds issued. The distinction has always been understood to be that the advisor is sitting on the same side of the table with

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the issuer, with all the legal responsibilities that attach to being an advisor, while the underwriter is on the other side of the table, negotiating the terms pursuant to which it will purchase the bonds with the end goal of making a profit when they are resold. It has for years been that distinction that allowed underwriters to advise municipal issuers even though its relationship was purely commercial and its duties limited by the terms of the bond purchase contract it negotiated. Thus, when accused of misleading issuers, failing to disclose conflicts or otherwise not acting in the best interests of the issuer, underwriters argued that financial advisors might be fiduciaries, but they (underwriters) were not.

In section II.A.c of the proposed release, the SEC acknowledges the provisions of the law set forth above and makes clear that engaging in municipal advisory activities "in a capacity other than as an underwriter" would require registration and subject the firm to a fiduciary standard of care. Thus, even if the firm is at that very moment acting as an underwriter, if it engages in any municipal advisory activities such as, for example, "advising a municipal entity with respect to the investment of bond proceeds or the advisability of a municipal derivative," it is a municipal advisor.

NAIPFA believes the same logic applies when a firm acting as an underwriter provides advice with respect to the structure, timing or terms of the bond issue it seeks to purchase and distribute. Those activities have been clearly defined by Congress to be advisory in nature, and carry with them the obligations to act as a fiduciary.[3] Because the role of an underwriter conflicts with the duties of a fiduciary, the SEC should clarify that underwriters may not provide such advice.

Scope of Municipal Advisory Activities

NAIPFA described above the various services that its member firms provide to municipal entities and obligated persons. It segregated those activities into three categories:

1. Consulting services either unrelated to a debt issue at all or unrelated to a particular debt issue;
2. Consulting services directly related to a particular debt issue; and
3. Consulting services provided after the issuance of debt.

NAIPFA reads the definition of "municipal advisory activities" to include the activities set forth in category 2 above, *i.e.*, those advisory activities tied to a debt offering, would qualify as activities covered by the rule. This understanding is based not only on its reading of the definition but on proposed Form MA. Specifically, Item 4K lists a number of activities "relating to municipal securities." Activity (1) is

> *Advice concerning the issuance of municipal securities (including, without limitation, advice concerning the structure, timing, terms and other similar matters, such as the preparation of feasibility studies, tax rate studies, appraisals and similar documents,* ***related to an offering of municipal securities****.*

[3] Notwithstanding the history and what NAIPFA views as a clear expression of Congressional intent in this area, the MSRB in its Rule G-23 release issued on February 9 did not propose amending its rule to modify its existing position that underwriters do not become financial advisors for purposes of Rule G-23 when, in the course of acting as an underwriter, they provide advice on the structure, timing or terms of the bond issue. NAIPFA urges the SEC to take a different approach, one that in our opinion gives effect to Congressional intent to impose a fiduciary duty on those providing advice.

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For the same reason, NAIPFA understands generally the services provided in sections 1 and 3 above would not qualify as "municipal advisory activities." NAIPFA notes that few, if any, of the services in categories 1 and 3 are listed in Item 5 (Other Business Activities) either, and seeks clarification as to whether a member that provides one or more of those services would be expected to list them under (17), "other financial product advisor."

NAIPFA seeks confirmation from the SEC regarding NAIPFA's interpretation. Understanding which of its activities are and are not municipal advisory activities is important because firms need to know not only how to fill out the forms but how to operate within the regulatory framework. More importantly, firms need to know which activities will be subject to a fiduciary standard and which fall within the jurisdiction of the SEC and the other federal regulators. NAIPFA understands and seeks confirmation that activities that are not municipal advisory activities will, for example, not be subject to the proposed recordkeeping requirements nor will those activities be subject to examination by the SEC or any organization designated by the SEC. The distinction is also important in helping firms determine which of their associated persons will and will not need to be registered as municipal advisors.

As noted above, NAIPFA recognizes that the SEC is diligently trying to learn about what advisory firms do. NAIPFA will be happy to provide the SEC with further information, examples or clarification about the various activities in which member firms engage to assist the SEC in its rulemaking.

B. FORM ADV/BROCHURE

The SEC seeks comment on whether municipal advisors should be required to prepare and distribute a brochure such as the one registered investment advisers will soon be required to produce for their clients. NAIPFA believes such a brochure is completely unnecessary for IPFAs.

An IPFA, competing with other municipal advisors servicing this business area or geographic area, is generally retained either for a defined period of time or on a project basis. A common practice is for the issuer to retain a municipal advisor by soliciting competitive proposals as part of a Request for Proposal (RFP) process. The issuer will require the responding municipal advisors to provide information such as qualifications, experience, training, compensation and project approach. After a selection process, the municipal advisor is appointed by their elected board. Each relationship with an issuer client is unique and the terms of the agreement, including fees, are negotiated separately with each issuer client. Fees are not based on financial performance outcomes.

Unlike investment advisers who may see their compensation increase if the value of their client's account increases, an IPFA does not see its compensation increase based on the interest rate the municipality achieves in the transaction.[4] IPFAs do not charge ancillary fees, nor do they receive compensation from third parties, affiliated or otherwise. There are no investment strategies to explain. Sometimes it is the municipal client that establishes the terms or insists that its form of contract be utilized.

[4] Fees may in some cases be contingent upon the closing of a transaction. Fees may vary depending on the par amount of the transaction.

Thus, while registered investment advisers are likely to experience changes in their fee structure, soft dollar practices, directed brokerage, investment strategies or other matters the SEC has deemed appropriate to be disclosed, there is little likelihood that anything of a similar commercial nature material to an IPFA client will change during the term of its relationship. Accordingly, there is no reason to impose on IPFAs any requirement to prepare a brochure or distribute one annually or otherwise.

NAIPFA notes that MSRB Rule G-23(c) requires that dealers acting as financial advisors have a written understanding with their client setting forth

> *the basis of compensation for the financial advisory services to be rendered, including provisions relating to the deposit of funds with or the utilization of fiduciary or agency services offered by such [dealer] or by a person controlling, controlled by, or under common control with such [dealer] in connection with the rendering of such financial advisory services.*

We expect that the MSRB will be issuing a similar Rule applicable to advisors that are not dealers. We suggest that such a Rule would be the appropriate place to define the scope of the information an IPFA or other municipal advisor should disclose.

With regard to other information that might be of interest to a municipal client, NAIPFA notes that this set of proposed rules requires firms and individuals to disclose a wealth of information, most of which is intended to be made available to the public. This information will also be required to be updated. In addition, most firms have a website which provides information about the municipal advisor. A brochure would, therefore, seem to be redundant.

Apart from the reasons why such a brochure does not seem to be needed, the cost of having to put one together and distribute it could be substantial. Absent a compelling reason to create one, the cost would seem to outweigh the benefit.

C. SELF-CERTIFICATION AND THIRD-PARTY REVIEW

In its proposal, the SEC sets forth a series of self-certification requirements, including conducting a review of the firm's business, and asks if it is necessary to establish minimum review standards and/or have independent review of the firms making the certifications. NAIPFA has no objection to the requirement that the signatory to the initial and annual certification certify that it has reviewed the business, but strongly opposes the imposition of minimum review standards or independent review.

As noted throughout this comment letter, IPFAs are different than other entities the SEC regulates. The nature of the services they perform, the relative simplicity of their business model, the size of the firms, the transparency of the services they provide and the fees they charge, the small number of clients they have at any time, the absence of customer accounts holding securities or funds – all of these factors speak against the need for a complicated, multi-faceted review of the business, particularly a review conducted by an independent party such as an accounting firm or law firm. NAIPFA fails to see in what way either issuers or investors would benefit from such a requirement. Additionally, the SEC at the time of their review of the firm will provide feedback.

In addition, the cost of retaining a professional to conduct a review will likely be substantial. Given that there is minimal, if any, benefit to be gained, that cost seems hard to justify.

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D. RECORDKEEPING

The SEC has asked for comment on proposed Rule 15Ba1-7, which specifies the books and records requirements applicable to municipal advisors. NAIPFA believes the requirements as proposed will be overly burdensome for IPFAs with little corresponding benefit. Accordingly, NAIPFA suggests that the SEC modify its proposal.

Of particular concern to NAIPFA is the requirement that firms retain originals or copies of all written communications, internal or external, relating to its municipal advisory activities. As noted above, IPFAs engage in many activities that are not municipal advisory activities. IPFAs are also generally quite small, and therefore do not have much infrastructure. Moreover, if the broker-dealer experience is any guide, merely keeping records will not be sufficient. Regulators will expect that firms produce, on demand, email relating to certain persons, certain transactions or for a certain period of time. The information technology and storage facilities required to keep all email or similar electronic communication and to segregate those that relate to municipal advisory business from other unrelated email is expensive. Firms would be required to either outsource this function or develop the capability in-house, which would necessitate hiring one or more IT professionals. Either way, the cost would be significant to firms with such limited revenue.

NAIPFA believes it would be more appropriate to eliminate this requirement in light of the other recordkeeping requirements proposed, which NAIPFA generally supports. NAIPFA believes that virtually all documents material to a transaction or relationship would be covered by items 2-8 in proposed Rule 15Ba1-7, and so believes that the costs and logistical burdens associated with item 1 outweigh the benefits. Alternatively, NAIPFA suggests that only certain communications with a client or generated internally, such as recommendations or approvals, should be required to be kept.

NAIPFA does request clarification with respect to one type of document. In the normal course of business, IPFAs generate multiple iterations of commonly used and routinely changing technical financial documents, typically referred to as "numbers runs". NAIPFA asks that the SEC confirm that not every iteration of a numbers run would need to be retained, but rather any iteration either sent to a client or used internally to form the basis for a recommendation to a client would need to be retained.

E. SMALL FIRMS

Dodd-Frank requires all those charged with developing rules to implement the legislation to take into account the effect on small firms, and not impose an undue regulatory burden. The legislation does not define small firm and so the SEC proposes using $7 million in annual revenue (prior fiscal year), provided the firm is not affiliated with another firm that is not a small business. This is the criterion established by the Small Business Administration with respect to entities that provide financial investment and related activities. NAIPFA recognizes that such a definition might be appropriate for some purposes, but it should not be determinative of whether a given regulation is or is not unduly burdensome. Instead, the SEC should consider the nature of the proposed rule, the purpose of that rule, the potential benefit to municipal clients or investors and the burden it would impose.

As noted above, NAIPFA believes that the SEC should recognize the unique nature of the IPFAs and issue regulations that are tailored to fit such entities, perhaps differentiating the larger of such firms from the smaller. As noted above, NAIPFA believes that a very high percentage of all IPFAs, and therefore a significant percentage of all entities that have or will register as municipal advisors, will have revenues less than $7 million per year. Accordingly, the SEC might consider a lower threshold, perhaps $1 million per year in annual revenues, and offer truly meaningful relief to those firms.

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We have attempted to convey in this letter the fact that independent public finance advisors, or IPFAs, are different than the other market participants both the SEC and MSRB regulate. The size of IPFA firms is small. Our business model is different since we generally are compensated for our time. Please take this into consideration as you establish permanent regulations. If I can be of any assistance or answer additional questions, feel free to contact me.

Sincerely,

Colette Irwin-Knott

Colette Irwin-Knott, CIPFA

President

National Association of Independent Public Finance Advisors

cc: Michael E. Coe, SEC
Lynette Kelly Hotchkiss, MSRB

Subject: File Number S7-45-10
From: Nathan R. Howard, Esq.
Municipal Advisor, WM Financial Strategies

I appreciate this opportunity to comment on Securities and Exchange Act Release No. 34-63576 (the "Release"). The Securities and Exchange Commission (the "Commission") has been entrusted with the responsibility of undertaking a daunting task and overall should be commended for the work that it has done. However, some further clarifications are necessary with respect to the definition of municipal advisor and, in particular, the exclusion from the definition for brokers, dealers, and municipal securities dealers ("broker-dealers") serving as underwriters and for attorneys providing services of a traditional legal nature. In addition, this letter will address generally a method by which the Commission can create additional exclusions for individuals who provide municipal advisory services.

Background

With the enactment of the Securities Act of 1933 (the "Securities Act") and the Securities and Exchange Act of 1934 (the "Exchange Act"), Congress effectively created two securities markets, the corporate securities market and the municipal securities market. This is exemplified by the many exemptions for municipal securities from the provisions of the Securities Act and the Exchange Act.[1] Then, beginning in 1975, through the enactment of the Securities Act Amendments of 1975 (the "1975 Amendments"), Congress began to clarify the distinctions between the corporate and municipal securities markets, a fact illustrated by the creation of the Municipal Securities Rulemaking Board whose mission was to "promulgate rules concerning broker and dealer transactions in *municipal* securities."[2]

Although the 1975 Amendments further clarified the distinction between the corporate and municipal securities markets, the historical participants found in both the municipal and corporate securities markets (e.g. banks, underwriters, and bond counsel) continued to engage in substantially similar activities. For example, underwriters acting in both the corporate and municipal securities markets provided advice on matters such as the type and amount of securities to be sold, the timing of the issuance, the terms and other similar matters concerning the issuance of securities.[3]

However, with the enactment of Section 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), Congress further emphasized the distinction between the corporate securities market and the municipal securities market through the creation of a category of regulated municipal market participants designated as

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[1] *See* Securities Exchange Act Release No. 63576 (December 20, 2010), ("Registration of Municipal Advisors"), at 12.
[2] *See id.* at 13 (emphasis added).
[3] *See* James D. Cox et al., Securities Regulation: Cases and Materials 120 (Vicki Been ed., Aspen Publishers) (2006). *See also* Municipal Securities Rulemaking Board (the "MSRB") Rule G-23(b) (a broker, dealer or municipal securities dealer acting as underwriter may render advice to an issuer with respect to the structure, timing, terms or other similar matters concerning a new issue of municipal securities).

"municipal advisors." If there were any lingering questions, the Dodd-Frank Act made the distinction unequivocal, there are, in fact, two very distinct securities markets, one corporate and one municipal, and each operates under a distinct set of rules.

In adopting the Dodd-Frank Act, Congress determined that the municipal market had developed a unique set of market participants who provide advice to municipal entities on matters such as the type and amount of securities to be sold, the timing of the issuance, and other similar matters concerning the issuance of municipal securities or municipal financial products, and defined these individuals as "municipal advisors." These individuals are now subject to the requirements of the Exchange Act, including registration and fiduciary duty, regardless of the role they played in the municipal market prior to the Dodd-Frank Act. To clarify, prior to the enactment of the Dodd-Frank Act, any individual, such as an attorney, financial advisor, engineer, or broker-dealer, could provide advice relating to the structure, timing, terms, and other similar matters concerning municipal financial products or the issuance of municipal securities without having to register or act with a fiduciary duty. Under the Dodd-Frank Act, however, if an individual chooses to provide this kind of advice, this person must now register as a municipal advisor and act as a fiduciary when providing this advice.

Comments

1. In general, further clarification of the exclusions from the definition of municipal advisor should be provided.

Under the Exchange Act, the term "municipal advisor" is defined as:

> a person that provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues.[4]

The Commission properly states that the definition of a municipal advisor "includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors that *engage in municipal advisory activities*."[5] In addition, the Commission further clarifies that the term "financial advisor" includes, but is not limited to, "broker-dealers already registered with the Commission, that provide advice[6] to municipal entities with respect to their issuance of municipal securities and their use of municipal financial products."[7]

The Commission also properly defines the term "municipal advisory activities," *inter alia*, as advice provided "to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities (including advice with

[4] §15B(e)(4)(A)(i) of the Securities and Exchange Act of 1934 (the "Exchange Act").
[5] Release No. 63576, at 20 (internal quotations omitted) (emphasis added).
[6] The Commission should clarify that the term "advice," as it is used here, is referring to "*municipal advisory* advice," as that term is defined herein.
[7] Release No. 63576, at 21.

respect to the structure, timing, terms and other similar matters concerning such financial products or issues) or undertake a solicitation of a municipal entity or obligated person"[8] (hereinafter referred to as "municipal advisory activities," "municipal advisory advice," and "municipal advisory services").

The Exchange Act also contains various exclusions from the definition of municipal advisor. Excluded from the definition of municipal advisor are "municipal entities and employees of municipalities."[9] In addition, the Commission properly states that the term municipal advisor "explicitly excludes a broker, dealer, or municipal securities dealer serving as an underwriter, as well as attorneys offering legal advice or providing services that are of a traditional legal nature and engineers providing engineering advice."[10] These exclusions can be broadly categorized into two distinct groups: (i) those without limitations, and (ii) those with limitations. Those without limitation are "municipal entities and employees of municipal entities" (the "Entities and Employees Exclusion").[11] All other individuals excluded from the definition of municipal advisor are limited exclusions (the "15B(e)(4)(C) Exclusions"). [12] This characterization of the exclusions is reinforced by the textual structure of the Exchange Act; the Entities and Employees Exclusions are specifically set out in §15B(e)(4)(A) of the Exchange Act, whereas 15B(e)(4)(C) Exclusions are specifically set out in §15B(e)(4)(C) of the Exchange Act. This illustrates that Congress intended that these groups be treated differently; one set of rules applies for those excluded under §15B(e)(4)(A) and another set of rules applies for those excluded under §15B(e)(4)(C).

Notably, the Entities and Employees Exclusions exempt individuals from the definition of municipal advisor regardless of the type of advice they provide. Therefore, municipal entities and employees of municipal entities can engage in municipal advisory services with respect to the issuance of municipal securities and the use of municipal financial products without regard to any provision of the Exchange Act relating to municipal advisors.

However, individuals excluded under §15B(e)(4)(C) of the Exchange Act are excluded from the definition of municipal advisor only if they do not provide municipal advisory advice. Section 15B(e)(4)(C) of the Exchange Act specifically excludes individuals giving certain kinds of "non-municipal advisory advice"[13] from the definition of municipal advisor because the services they provide during the course of a municipal issuance or transaction involving municipal products are **not** municipal advisory activities.

As currently written, the Release creates ambiguities by not emphasizing this distinction. This has led to confusion and anxiety among some market participants who are uncertain as to whether they engage in municipal advisory activities.

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[8] *Id.* at 20.
[9] §15B(e)(4)(A) of the Exchange Act.
[10] *Id.* (internal quotes omitted).
[11] *Id.*
[12] §15B(e)(4)(C) of the Exchange Act.
[13] Non-municipal advisory advice is to be understood to mean all advice provided to a municipal entity or obligated person except for advice with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues.

To avoid ambiguities and confusion, the definition of municipal advisor should be clarified by adding the following to Section II.A.1.b. of the Release:

> Any individual who provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities (including advice with respect to the structure, timing, terms and other similar maters concerning such financial products or issues), is a municipal advisor and must register as a municipal advisor, unless the advisor is a municipal entity or the employee of a municipal entity.[14]
>
> Individuals who do not engage in municipal advisory activities, which includes individuals engaged in the specific types of activities identified in §15B(e)(4)(C) of the Exchange Act, will not be deemed to be municipal advisors under the Exchange Act and therefore do not have to register as municipal advisors. Conversely, all individuals, including, but not limited to, brokers, dealers, municipal securities dealers, attorneys, engineers, investment advisors and accountants, that engage in municipal advisory activities, will be deemed to be municipal advisors and must comply with the affirmative obligations of the Exchange Act with respect to municipal advisors, including the registration and fiduciary duty requirements.

2. Further guidance and clarification are needed with respect to the exclusion of underwriters under §15B(e)(4)(C) of the Exchange Act.

As currently written, the Release is unclear as to (i) when a broker-dealer will be excluded from the definition of municipal advisor, and (ii) what services a broker-dealer can provide prior to being deemed a municipal advisor. Therefore, I respectfully request that the Commission clarify the exclusion for broker-dealers serving as underwriters under §15B(e)(4)(C). The Commission should also state, unequivocally, that a broker-dealer who provides municipal advisory services will be deemed to be a municipal advisor with respect to those services, and that the exclusion is limited to broker-dealers who are providing underwriting services, such as the purchasing, offering and selling of municipal securities.

Section 15B(e)(4)(C) of the Exchange Act sets forth an illustrative list of individuals who are excluded from the definition of municipal advisor. In the Release, the Commission clarifies the type of advice that can be provided by the various market participants without triggering the municipal advisor registration and fiduciary duty requirements. With the exception of the exclusion for broker-dealers acting as underwriters, the Release includes precise unequivocal statements regarding the 15B(e)(4)(C) Exclusions, which are as follows:

Investment Advisers. Investment advisers were excluded under §15B(e)(4)(C) if the advice they provide falls within the Investment Advisers Act. The Commission properly states that "a

[14] The Commission has stated that it is including within this group, elected officials acting within the scope of his or her role as an elected member. *See* Release No. 63576, at 40-41.

registered investment adviser or an associated person of a registered investment adviser would not have to register as a 'municipal advisor' with respect to the provisions of any *investment* advice subject to the Investment Advisers Act."[15] Conversely, an investment adviser "must register [...] as a municipal advisor if the adviser or associated person engages in any municipal advisory activities that would not be investment advice subject to the Investment Advisers Act.[16] Thus, investment advisers providing investment advisory services are exempt, whereas those providing municipal advisory services are not exempt.

Commodity Trading Advisors. Commodity trading advisors ("CTAs") were excluded under §15B(e)(4)(C) if the advice they provide is advice related to swaps. However, the Commission properly states that "a commodity trading advisor [...] must register with the Commission as a municipal advisor if the commodity trading advisor [...] engages in municipal advisory activities that do not include advice related to swaps."[17]

Attorneys. Attorneys were excluded under §15B(e)(4)(C) if they are providing legal advice or if they provide services that are of a traditional legal nature. The Commission properly states that attorneys are excluded from the definition of municipal advisor "*unless* the attorney engages in municipal advisory activities."[18] The Commission goes on to clarify that offering legal advice or providing services that are of a traditional legal nature to a client that is a municipal entity, are not municipal advisory activities.[19]

Engineers. Engineers were excluded under §15B(e)(4)(C) if the advice provided is engineering advice. However, the Commission properly concludes that the "exclusion does not include circumstances in which the engineer is engaging in municipal advisory activities [...] *even if those activities are incidental* to the provision of engineering advice."[20]

Accountants. Although not specifically excluded under §15B(e)(4)(C), the Commission properly states that accountants, like individuals specifically excluded under §15B(e)(4)(C), are exempt if they provide non-municipal advisory services.[21] The Commission noted that some accountants do engage in municipal advisory activities and therefore a "blanket exclusion"[22] would not be appropriate.[23] However, accountants who provide services, such as "preparing financial statements, auditing financial statements, or issuing letters for underwriters for, or on behalf of, a municipal entity or obligated person," are not engaged in municipal advisory activities and are therefore excluded from the definition of municipal advisor.[24]

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[15] *Id.* at 34 (emphasis added).
[16] *Id.*
[17] *Id.* at 36.
[18] *Id.* at 38.
[19] *Id.*
[20] *Id.* at 39 (emphasis added).
[21] *See id.* at 37.
[22] The term "blanket exclusion", as used herein, refers to an individual who can provide municipal advisory services without having to comply with any of the aspects of the Exchange Act relating to municipal advisors, including the registration and fiduciary duty requirements, such as, for example, employees of a municipal entity.
[23] *See* Release No. 63576, at 36-37.
[24] *Id.*

Banks. Similar to accountants, banks and trust companies were not specifically excluded under §15B(e)(4)(C); however, the Commission has properly entertained the possibility of clarifying that banks and trust companies are excluded from the definition of municipal advisor when banks provide "traditional banking services" and when banks and trust companies provide "investment advisory services."[25] The Commission also properly states that a bank or trust company would not be excluded from the definition of municipal advisor if the bank or trust company provides municipal advisory services to a municipal entity or obligated person.[26]

While these clarifications will be extremely helpful to market participants in determining the types of services they can provide without being deemed to be a municipal advisor, a similar clarification was not made with respect to the services provided by a broker-dealer serving as an underwriter.

The Commission states, *inter alia*, that

> a broker, dealer or municipal securities dealer would not be excluded from the definition of a "municipal advisor" if the broker, dealer or municipal securities dealer engages in municipal advisory activities when acting in a capacity other than as an underwriter on behalf of a municipal entity or obligated person.[27]

The Commission goes on to provide two examples of activities of broker-dealers that the Commission would consider to be municipal advisory activities.[28] However, the examples provided in the Release are of only minimal utility because they do not clarify when a broker-dealer is acting in the capacity of an underwriter versus in a capacity other than as an underwriter. Further, the examples do not touch on the type of services that a broker-dealer can provide without being deemed to be a municipal advisor. Can, for example, a broker-dealer serving as an underwriter provide advice on matters such as the structure, terms, timing or other similar matters? Because the examples provided are not specific on these matters, it is unclear when a broker-dealer who otherwise would be exempt as an "underwriter" crosses the line and becomes a municipal advisor subject to the dictates of the Exchange Act.

Furthermore, it is my understanding that there will likely be numerous clarifications over the next several years with regard to the definition of municipal advisor and its exclusions. However, of immediate concern is the inconsistent regulatory framework that the Commission will create with regard to the 15B(e)(4)(C) Exclusions, if the Commission does not state with specificity when a broker-dealer will be considered to be a municipal advisor versus an underwriter. Unlike the other exclusions discussed above, the Commission does not specify when it will consider a broker-dealer to be acting as an underwriter. What is more, the lack of specificity leaves open the possibility that broker-dealers will be able to provide municipal advisory services without being deemed to be municipal advisors, a result that would be inconsistent with the purpose of the Dodd-Frank Act. Therefore, in continuing to clarify the exclusion for broker-dealers acting as underwriters, the Commission should consider the following:

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[25] *Id.* at 41.
[26] *Id.* at 42.
[27] *Id.* at 31.
[28] *See id.* at 31-32.

Under the Exchange Act, broker-dealers are granted an exclusion from the definition of municipal advisor only when they "serv[e] as an underwriter (as defined in Section 2(a)(11) of the Securities Act of 1933)."[29] Section 2(a)(11) of the Securities Act of 1933 ("Section 2(a)(11)") states, *inter alia*, that the term "underwriter" is limited to:

> Any person who *has purchased* from an issuer *with a view to*, or offers or sells for an issuer in connection with, *the distribution* of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking.[30]

Further clarification of the term "underwriter" can be found in Rule 144 of the Securities Act ("Rule 144"), entitled "Persons Deemed Not to Be Engaged in a Distribution and Therefore Not Underwriters," which was adopted by the Commission prior to the enactment of the Dodd-Frank Act to specifically address the issue of determining when a person is acting as an "underwriter." In the preliminary note to Rule 144, the Commission states, that the interpretation of the definition of the term "underwriter" has traditionally focused on the words "with a view to" in the phrase "purchased from an issuer with a view to . . . distribution." Rule 144 makes clear that to be deemed an underwriter, an individual must (1) either purchase, offer or sell securities for an issuer, and (2) do so with a view to the distribution of any security. Therefore, an individual is not an "underwriter" if he has not purchased, offered or engaged in the selling of securities.[31]

This interpretation of Section 2(a)(11) and Rule 144 is consistent with §15B(e)(4) of the Exchange Act. Section §15B(e)(4)(C) of the Exchange Act does not provide an exclusion from the definition of municipal advisor for broker-dealers who engage in municipal advisory activities. In fact, when sections 15B(e)(4)(A)(i) and (e)(4)(C) of the Exchange Act are read in conjunction with Section 2(a)(11) and Rule 144, it becomes clear that a broker-dealer who provides municipal advisory services to a municipal entity is acting as a municipal advisor, not as an "underwriter." A broker-dealer is only exempt under §15B(e)(4)(C) of the Exchange Act when he purchases, offers or sells securities with a view to distribution. Thus, when a broker-dealer provides certain kinds of advice (i.e. municipal advisory advice) prior to the issuance of securities (i.e. prior to the existence of the securities), there has been no purchase, offer or sale of securities, and, therefore, the broker-dealer is providing advice as a municipal advisor, not as an underwriter.[32]

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[29] §15B(e)(4)(C) of the Exchange Act.

[30] §2(a)(11) of the Securities Act of 1933 (emphasis added).

[31] *See also* MSRB Glossary of Municipal Securities Terms Second Edition (January 2004), http://msrb.org/msrb1/glossary/glossary_db.asp?sel=u (last visited February 21, 2011) (The term "Underwriter" is defined as "A broker-dealer that *purchases* a new issue of municipal securities from the issuer for resale . . .") (emphasis added).

[32] This is consistent with the MSRB's understanding of the terms "Underwriting", "Underwriter", and "Underwriting Period", which, when taken together, clearly illustrate that a broker-dealer is not engaged as an underwriter until securities are either purchased or an order has been placed. *See Id.*

Under this view, the Commission should take an approach similar to that put forth by the Commission in the case *SEC v. Howey Co.*[33] to determine whether a broker-dealer falls within the definition of municipal advisor or underwriter. Put simply, the Court in *Howey* adopted an economic realities test and determined that although a particular "investment contract" was not specifically referred to as a "security," it looked like a security and smelled like a security and had all of the "essential ingredients" of a security, and was therefore deemed to be a "security" within the meaning of the Securities Act without regard to "the legal terminology in which [the security] was clothed."[34] The Supreme Court applied this economic realities test again in *United Housing Foundation v. Forman,* and stated that "[b]ecause securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto."[35]

Similarly, the Commission should refrain from attempting to delineate the distinction between broker-dealers acting as municipal advisors and broker-dealers acting as underwriters merely in terms of titles or contractual relationships. Instead, I respectfully request that the Commission utilize an approach similar to that taken by the Commission and, ultimately, the Supreme Court in *Howey* and *Forman,* and clarify that a broker-dealer will be deemed to be a municipal advisor based on the type of advice provided regardless of title or contractual relationship. Congress intended for these statutes to turn on the communicative realities underlying a transaction, and not on the name appended thereto. For example, if a broker-dealer states orally or in writing that it is acting solely as an "underwriter," but thereafter provides recommendations and advice related to items such as the structure, terms, timing and other similar matters concerning such financial products or securities, the Commission should consider this broker-dealer to be a municipal advisor even though statements to the contrary were made. This approach is also consistent with Section 2(a)(11) and Rule 144, which take a similar approach to defining who will be considered an "underwriter." For example, under Section 2(a)(11) and Rule 144, if a contract states that an individual is going to act as a "municipal advisor," but the individual thereafter purchases, offers or sells securities for the purpose of distribution, the Commission would consider this individual to be an "underwriter" without regard to the title utilized by the parties to the contract. In other words, the Commission would disregard the contract title of "municipal advisor" and deem the individual to be an "underwriter" because the individual had purchased the securities for the purpose of distribution.

What is more, apart from being contrary to the clear language of the Exchange Act, granting broker-dealers a blanket exclusion from the definition of municipal advisor would create an inherent conflict of interest and problems of accountability. Unlike municipal entities and municipal employees who are accountable for the advice they provide,[36] a broker-dealer engaged in municipal advisory activities but granted a blanket exclusion as an "underwriter" under §15B(e)(4)(C) of the Exchange Act would not be accountable for the advice it provides, even where the advice provided is detrimental to the municipal entity. This result is inconsistent with the purpose of the Dodd-Frank Act which sought to protect municipal entities and the public's interest.

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[33] *Securities and Exchange Commission v. Howey Co.*, 328 U.S. 293 (1946).
[34] *See id.* at 297-301.
[35] *United Housing Foundation, Inc. v. Forman New York v. Forman,* 421 U.S. 837, 849 (1975).
[36] *See* Release No. 63576, at 41.

Furthermore, granting a blanket exclusion from the definition of municipal advisor for broker-dealers will only exacerbate the inherent conflicts of interest that existed prior to the enactment of the Dodd-Frank Act. For example, if underwriters are permitted to provide advice, without a fiduciary obligation, such advice to a municipal entity could include any or all of the following recommendations: (i) issue securities through a negotiated sale when a competitive sale would be beneficial (e.g. a municipal entity would benefit, in terms of interest costs, by selling most general obligation securities via a competitive sale); (ii) undertake an issuance of securities when such an issuance is unnecessary or detrimental to the municipal entity (e.g. recommending the issuance of securities when a low-interest state loan may be available); (iii) issue securities of a particular type because the broker-dealer's firm prefers that type of issue (e.g. recommending the issuance of securities that are annual appropriation obligations which bear significantly higher interest rates than obligations secured by a dedicated source of revenue); or (iv) refinance a prior securities issue when there are no material benefits to the municipal entity (e.g. where a refunding issue is purportedly being done to achieve "real" savings, but where the present value of the savings are in fact inconsequential).

The Dodd-Frank Act sought to insulate municipal entities from obtaining advice from individuals who lack the requisite competency and accountability.[37] Congress made the determination that allowing municipal entities to obtain municipal advisory advice from individuals who are not registered and operating as municipal advisors is not in the best interest of the municipal entity or the public as a whole. Thus, any interpretation of the Exchange Act that allows municipal entities to obtain advice that is not in their best interest from unaccountable parties would be contrary to the purpose of the Dodd-Frank Act. Therefore, the Commission should state unequivocally that any broker-dealer who engages in municipal advisory activities is a municipal advisor under the Exchange Act, and must comply with all affirmative obligations of the Exchange Act, including the registration and fiduciary duty requirements. Furthermore, as the Commission made clear with regard to engineers,[38] even if the municipal advisory advice is a service "incidental" to the provision of other services, the individual will be deemed to be a municipal advisor. Therefore, I respectfully request that the Commission clarify that even if municipal advisory services are "incidental" to the provision of underwriting services, a broker-dealer providing those services is acting as a municipal advisor, not an underwriter.

Alternatively, if the Commission is not inclined to adopt the above interpretation, further clarification is needed with regard to when a broker-dealer is subject to the Exchange Act's registration and fiduciary duty requirements, and when a broker-dealer is excluded as an underwriter. In its current form, the Release further complicates the matter by leaving in place an uncertain regulatory framework with which to operate. The Release does not provide a clear distinction between broker-dealers subject to the Exchange Act as municipal advisors and those excluded as underwriters. Consequently, broker-dealers will be unaware as to (a) whether they are required to register as municipal advisors, and (b) whether the services they provide with constitute advice thereby triggering the fiduciary duty requirements of the Exchange Act.

[37] *See infra*, at 11-12.

[38] *See supra*, at 5.

However, Congress has determined that an individual who gives certain kinds of advice to municipal entities or obligated persons, is a municipal advisor, regardless of the individual's title or contractual relationship (e.g. a CPA is a municipal advisor if the CPA gives municipal advisory services even where the CPA does not call himself a municipal advisor).[39] This interpretation is consistent with §15B(e)(4)(C) and, when this interpretation and §15B(e)(4)(C) are taken together, it becomes clear that a broker-dealer who acts beyond the scope of Section 2(a)(11) of the Securities Act by providing municipal advisory advice, becomes a municipal advisor by virtue of the advice given and must comply with all aspects of the Exchange Act relating to municipal advisors;[40] individuals should not be allowed to shirk their responsibilities under the Exchange Act by merely calling themselves underwriters.

3. Any individual who merely provides information, is not a municipal advisor, and, more specifically, a broker-dealer who merely provides information is not a municipal advisor.

As noted above, individuals and, in particular, broker-dealers should not be excluded from the definition of municipal advisor when they provide municipal advisory services. However, when the services provided are merely informational non-municipal advisory services, the individual should be excluded from the definition of municipal advisor. Therefore, the Commission should clarify that so long as an individual does not provide or engage in municipal advisory activities, that individual will not be deemed to be a municipal advisor and will not have to register as such.

This concept is particularly important when addressing the questions posed by the Commission with regard to broker-dealers. In the Release, the Commission asks whether a broker-dealer should be excluded from the definition of municipal advisor if the broker-dealer merely provides a municipal entity with price quotations with respect to particular securities which the broker-dealer would be prepared to sell as principal or acquire for a municipal entity.[41] The Commission also asks whether a broker-dealer should be excluded from the definition of municipal advisor if the broker-dealer provides to a municipal entity a list of securities meeting specified criteria that are readily available in the marketplace, but without making a recommendation as to the merit of any investment particularized to the municipal entity's specific circumstances.[42]

Excluding broker-dealers who merely provide information and ideas would be consistent with the Exchange Act since providing information is not the same as providing advice. Additionally, as noted above, any individual who engages in non-municipal advisory activities is not a municipal advisor and would therefore not be subject to the registration and fiduciary duty requirements of the Exchange Act. Therefore, a broker-dealer who merely provides information is engaged in a non-municipal advisory activity and should not be deemed to be a municipal advisor. For example, if a broker-dealer were to provide a municipal entity with either a list of securities or various debt service models, but did so without making a specific

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[39] *Id.*
[40] *See* §15B(e)(4)(A) and (C) of the Exchange Act.
[41] Release No. 63576, at 53.
[42] *Id.*

recommendation as to the structure, terms, timing, merit, or similar matter, the broker-dealer would not be engaged in municipal advisory activities and would not be subject to the dictates of the Exchange Act related thereto.

4. Further guidance and clarification are necessary with respect to the exclusion of attorneys under §15B(e)(4)(C) of the Exchange Act.

The Release adequately addresses the exclusion for attorneys providing services of a traditional legal nature. However, the example of "services of a traditional legal nature" provided in the Release is missing a key piece of terminology that may lead to an unintended exclusion for attorneys providing certain kinds of advice that would otherwise have been considered municipal advisory advice.

The Commission properly states that advice provided by a lawyer to a municipal entity or obligated person is a non-municipal advisory service and is of a "traditional legal nature" so long as the advice provided is with respect to the

> structure, timing, terms and other similar matters concerning municipal financial products or the issuance of municipal securities [and] is provided within a lawyer-client relationship specifically related to such products *in conjunction with related legal advice*.[43]

The Commission then sets forth an example of services of a traditional legal nature (the "Example"). The Example, in part, states that:

> Advice comparing the structures, terms, or associated costs of issuance of different types of securities or financial instruments (such as fixed rate bonds or variable rate demand obligations) given by an attorney hired to advise a municipal entity client embarking on a bond offering, would be considered to be services of a traditional legal nature.[44]

However, the Example does not describe an activity that is of a traditional legal nature. As currently written, the Example describes an activity that is primarily financial in nature. Merely giving advice comparing the structures, terms, or associated costs of issuance of different types of securities or financial instruments does not require legal training and, in fact, to be done properly, such an analysis requires extensive training in matters primarily financial in nature. Anecdotally, at no point in either my legal training or experience as an attorney was I provided with the knowledge or ability to compare the structures, terms, or associated costs of issuance of different types of securities or financial instruments. I only felt confident in my ability to adequately compare structures, terms or associated costs after extensive training as a financial advisor.

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[43] *Id.* at 38 (emphasis added).
[44] *Id.*

Additionally, the Example appears to be inconsistent with the Commission's definition of services of a traditional legal nature, which states that attorneys may provide advice with respect to the structure, timing, terms and other similar matters only if such advice is given *in conjunction with related legal advice*.[45] However, unlike, for example, advice concerning the tax consequences of alternative financing structures, which is advice obviously legal in nature, or advice recommending a particular financing structure due to *legal* considerations,[46] the Example is not obviously legal in nature and does not specifically state that the comparison is being given in conjunction with related legal advice.

Therefore, the Commission's example should be clarified as follows: An attorney renders services of a traditional legal nature, for example, where the attorney provides advice comparing the ***legal aspects*** of the structures, terms, or associated costs of issuance of different types of securities or financial instruments (such as fixed rate bonds or variable rate demand obligations) given by an attorney hired to advise a municipal entity client embarking on a bond offering.

5. Any additional exclusion created for individuals who engage in municipal advisory activities should satisfy the competency and accountability requirements of the Exchange Act.

In the Release, the Commission asks whether the Commission should provide for an exclusion for all activities of an attorney as long as the attorney has an attorney-client relationship with the municipal entity or obligated person. In addressing this question, the Commission should consider adopting the following test as a basis for creating any additional exclusions to the definition of municipal advisor.

Under the Exchange Act, individuals who engage in municipal advisory activities must meet certain minimum standards of competency through continuing education and by undergoing periodic examination.[47] Additionally, the Exchange Act imposes a fiduciary duty on individuals who engage in municipal advisory activities,[48] creating a level of accountability that otherwise would not have existed but for the Exchange Act. Notably, Congress only excluded those individuals falling within the Entities and Employees Exclusions from the competency and accountability requirements of the Exchange Act.[49] Therefore, the Commission, prior to creating any additional exceptions for individuals who engage in municipal advisory activities, must, as a threshold matter to ensure compliance with the purpose of the Dodd-Frank Act, establish that the group to be excluded meets the minimum standards of competency and that they are "independently accountable"[50] to the municipal entity for the advice they provide.

[45] *Id.*
[46] *See id.*
[47] *See* §15B(b)(2)(A)(iii), (E) and (L)(ii) of the Exchange Act.
[48] §15B(c)(1).
[49] The Commission noted, however, that employees and elected officials are independently accountable to the municipal entity. *See* Release No. 63576, at 41.
[50] An individual is "independently accountable" if that individual can be held legally accountable for any advice or services provided, without the imposition of a fiduciary duty by the Exchange Act.

Therefore, under this view, an exclusion for all activities of an attorney who possesses an attorney-client relationship with a municipal entity would be inappropriate. Attorneys are excluded from the definition of municipal advisor if they provide "services of a traditional legal nature";[51] however, when the advice is "primarily financial in nature,"[52] attorneys are acting as municipal advisors and are subject to the requirements of the Exchange Act. Therefore, if the Commission wanted to create an exception for attorneys who engage in municipal advisory activities, the Commission would establish that attorneys acting within an attorney-client relationship meet the Exchange Act's minimum standards of competency and that they are independently accountable. In this case, attorneys possessing an attorney-client relationship would be independently accountable for the advice they provide as a result of their attorney-client relationship (i.e. fiduciary relationship). However, although attorneys do possess the training and ability to provide legal advice and advice of a traditional legal nature, because municipal advisory advice is "primarily financial in nature", it is unlikely that attorneys possess the requisite competency to provide this kind of advice since attorneys, as a group, generally lack the necessary training and ability to advise on matters primarily financial in nature.[53] Thus, the Commission should not create a blanket exclusion for all activities of attorneys possessing an attorney-client relationship with a municipal entity or obligated person because possessing a level of independent accountability, alone, is an insufficient substitute for minimum standards of competency in matters primarily financial in nature.

If the Commission adopts this approach to the creation of exceptions for individuals who provide municipal advisory services, the Commission can ensure that municipal entities receive the same level of protection contemplated by the Dodd-Frank Act, namely, that the advice given is from a competent source and that the individual providing the advice can be held accountable for the advice they provide. However, if the Commission creates exclusions that were not specifically contemplated or intended by the Dodd-Frank Act, the purpose of the Dodd-Frank Act will be diminished. Furthermore, creating additional unintended exclusions will act as a means for individuals to circumvent their legal and regulatory obligations under the Exchange Act, a result that will not adequately serve the public interest.

Conclusion

I respectfully request that the Commission adopt the following interpretation with regard to the definition of municipal advisor: *any* individual, except for a municipal entity or an employee of a municipal entity, who engages in municipal advisory activities will be deemed to be a municipal advisor and, conversely, an individual will *not* be deemed to be a municipal advisor so long as the individual is engaged exclusively in non-municipal advisory activities.[54]

With regard to broker-dealers, the Commission should clarify that broker-dealers who engage in municipal advisory activities will be deemed to be municipal advisors,[55] but that a broker-

[51] §15B(e)(4)(C) of the Exchange Act.
[52] *See* Release No. 63576, at 38.
[53] *See supra,* at 11.
[54] *Id.* at 2-4.
[55] *Id.* at 4-10.

dealer who merely provides information will not be deemed a municipal advisor[56]. In addition, the Commission should also clarify that the title of the relationship, title of a party, or recitations of titles in a contract are irrelevant in making a determination of whether an individual is a municipal advisor.

With regard to attorneys, the Commission should refine its example of "services of a traditional nature" to emphasize that the advice provided must be with regard to some legal aspect of the matter being discussed.[57]

Finally, I respectfully request that the Commission, prior to creating any additional exclusions for individual who engage in municipal advisory activities, establish that the group of individuals being excluded meets the minimum competency standards of the Exchange Act and that the group of individuals possess a level of independent accountability.[58]

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[56] *Id.* at 10-11.
[57] *Id.* at 11-12.
[58] *Id.* at 12-13.