**Subject: File No. SR-MSRB-2011-03**
**From: Nathan R. Howard, Esq.**
**Municipal Advisor, WM Financial Strategies**
**Dated: June 24, 2011**

## Introduction

I appreciate this opportunity to comment on Release No. 34-64564 (the "Release"). The Municipal Securities Rulemaking Board ("MSRB") has sought to eliminate certain conflicts of interests and has attempted to bring the language of Rule G-23 into alignment with Section 15B of the Securities and Exchange Act of 1934 (the "Exchange Act") as amended by Section 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). Rule G-23 (the "Rule") successfully eliminates some of the inherent conflicts of interest that existed prior to the enactment of the Dodd-Frank Act. However, the Rule fails to accurately reflect the language of the Dodd-Frank Act, specifically with regard to the provision of advice by underwriters. Additionally, the Rule is inconsistent with other MSRB conflicts of interest rules in its approach to the presentation of the writing by underwriters to municipal issuers.

## Comments

To create an effective regulatory framework, there must be a synergy between the law and the regulation; in other words, the principle set forth by the law should be clarified and not contracted by all rules and regulations adopted that concern the law. This is in stark contrast to the approach taken by Rule G-23.

Although Rule G-23 is merely a conflicts of interest rule, the Rule is addressing provisions of the Dodd-Frank Act, and in particular, the provision of the Dodd-Frank Act that defines the term "municipal advisor"[1]. Under the Dodd-Frank Act, the term "municipal advisor" is defined as follows:

> 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.[2]

[1] Rule G-23 utilizes the term "financial advisor" in place of municipal advisor. However, the Act, the MSRB and the Commission all indicate that the term "municipal advisor" includes individuals traditionally considered to be "financial advisors". Therefore, for purposes of this letter, the term "municipal advisor" will be utilized exclusively.

[2] §15B(e)(4)(A)(i) of the Securities and Exchange Act of 1934.

Rather than adopt a rule that is consistent with this law, the MSRB instead drafted a rule that states, *inter alia*, that

> a financial advisory relationship shall **not** be deemed to exist when […] 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 the issuance of municipal securities.[3]

On its face, this rule clearly contradicts the Act. The Act put forth clear role delineations; however, in wholesale contradiction, Rule G-23 eliminates these delineations.[4] It would be ideal to have this inconsistency cleaned up. Yet, in the absence of a substantive change that alleviates this inconsistency, I respectfully request that the following be considered and that an appropriate amendment be made to Rule G-23 in conformity therewith.

Under Rule G-23, the only distinction between a broker-dealer acting as a financial advisor and a broker-dealer acting as an underwriter is that a broker-dealer-underwriter must "identif[y] itself in writing".

Although the Rule couches the "writing" in terms of a mere disclosure of conflicts of interest[5], the reality is that this writing will not take the form of what traditionally would be considered a "disclosure"[6]. Instead, underwriters will utilize this writing to disclaim liability, which will require a waiving of rights on the part of the issuer of municipal securities. More specifically, the underwriter will disclaim[7] any responsibility for the provision of "advice" relating to the structure, timing, terms, etc. of an issuance of municipal securities.[8] Concurrently, the issuer of municipal securities will effectively waive[9] its rights to sue on the "advice" that it receives from the underwriter even where that advice may be harmful to their interests.

Rule G-23 creates a slippery slope scenario in which rules can be created that allow virtually any individual to escape regulatory oversight by merely providing a writing, even where the individual undertakes an action that would otherwise cause them to be regulated. The MSRB

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[3] MSRB Rule G-23(b) (emphasis added).

[4] To further clarify this inconsistency, an in-depth discussion can be found in Appendix A and Appendix B.

[5] MSRB Notice 2011-29 (May 31, 2011) Securities and Exchange Commission Approves Amendments to MSRB Rule G-23 Relating to the Activities of Financial Advisors ("[A] dealer clearly identifies itself in writing as an underwriter and not as a financial advisor . . . will be considered to be "acting as an underwriter" . . . The writing must make clear that the primary role of an underwriter is to purchase, or arrange for the placement of, securities in an arm's-length commercial transaction between the issuer and the underwriter and that the underwriter has financial and other interests that differ from those of the issuer.")

[6] The term "disclose", the passive form of the term "disclosure", is defined as: To make known or reveal to another or the public. "disclose." *Merriam-Webster's Dictionary of Law*. Merriam-Webster, Inc. 20 Jun. 2011. <Dictionary.com http://dictionary.reference.com/browse/disclose>.

[7] The term "disclaimer" is defined as: A denial of responsibility for a thing or act. "disclaimer." *Merriam-Webster's Dictionary of Law*. Merriam-Webster, Inc. 20 Jun. 2011. <Dictionary.com http://dictionary.reference.com/browse/disclaimer>.

[8] *See, e.g.,* Appendix C.

[9] The term "waiver" is defined as: The act of intentionally or knowingly relinquishing or abandoning a known right, claim, or privilege. "waiver." *Merriam-Webster's Dictionary of Law*. Merriam-Webster, Inc. 20 Jun. 2011. <Dictionary.com http://dictionary.reference.com/browse/waiver>.

has not provided any rationale for the exception being granted to underwriters under Rule G-23. Are underwriters being allowed to give advice because the MSRB believes that they are competent to do so, or is the exception being given merely as a way of preserving the status quo? Because there has been no rationale put forth to justify the exception, it is easy to envision similar rules being adopted in the future for other individuals who periodically act as municipal advisors, such as engineers, attorneys, CPA, etc. Under a Rule G-23-type approach, other rules could easily be adopted that would allow an individual to present a writing and act just as a municipal advisor but without all of those pesky regulatory hassles such as obtaining the appropriate licensing or acting as a fiduciary.

So, what sort of environment does Rule G-23 create? Is it appropriate to create a municipal securities market where individuals can disclaim liability, provide services without proper licensing, and do so with relative ease?

What is the basis for allowing Rule G-23 to create exceptions not found in the law when no other rule creates a similar sort of exception. For example, consider Securities Act Rule 144 ("Rule 144"). As described more fully in Appendix B, Rule 144 deals primarily with clarifying when an individual will be considered an "underwriter" as that term is defined under Section 2(a)(11) of the Securities Exchange Act of 1934. However, unlike Rule G-23, Rule 144 does not allow unlicensed individuals to act as underwriters and disclaim liability when and if they disclose that they are "not acting as an underwriter". To be clear, Rule 144 does not allow an individual to provide the exact same services as an underwriter so long as the individual provides a "writing" disclaiming liability. Furthermore, Rule 144 does not provide an opportunity of any kind for an individual other than an underwriter to perform "underwriting services".

Outside of the context of the securities market, other professions impose certain regulatory duties. However, unlike Rule G-23, none these other professions allow individuals to either disclaim liability or perform duties when they do not possess a license to do so. For example, consider the following: (i) Attorneys – individuals cannot engage in the practice of law without a license, and there are no laws that allow an individual to act as a lawyer by merely disclosing that they are "not acting as a lawyer"; (ii) Doctors – just as with attorneys, individuals cannot practice medicine without a license and no individual can act as a doctor by merely disclosing that they are "not acting as a doctor"; (iii) Cosmetology – in most states, an individual cannot even work as a beautician without the appropriate license and, again, an individual cannot circumvent their obligations by merely disclosing that they are "not acting as a beautician".

Is the role played by financial advisors in the municipal market so insignificant that it, unlike the cosmetology profession, can be brushed away by a disclosure? Given that no other profession allows unlicensed individuals to act just as licensed individuals by merely disclosing that they are "not acting as a licensed individual", why is it acceptable to allow underwriters to act as municipal advisors if they merely disclose that they are "not acting as a municipal advisor"?

This all then begs the question, what kind of precedent does it set where a rule can be developed that allows an individual to circumvent their regulatory responsibilities by merely providing a writing, a writing that does not have to be expressly consented to and that does not require the obligated person to even acknowledge that they've received it? What harm will come to unknowledgeable, unsuspecting, or unsophisticated municipal issuers who realize after the fact, if at all, that the advice that they've received may not have been in their best interest? What harm will occur to the municipal market if municipal issues go into default as a result of advice received from an underwriter who cannot be held responsible for the advice that they've provided? These are the questions that will need to be addressed as a result of Rule G-23 if no additional amendments or clarifications are made.

Due to the seriousness and potential ramifications to municipal issuers and to the municipal market, and assuming that an underwriter's ability to provide advice is not curtailed by some other rule, Rule G-23 should be amended to bring it into alignment with the other MSRB conflicts of interest rules, specifically, proposed rules G-17 and G-36. Under proposed Rule G-17, underwriters and municipal advisors must follow specific although distinct procedures when presenting disclosures of conflicts to obligated persons.[10] Similarly, proposed Rule G-36, although solely relating to disclosures of conflicts by municipal advisors, provides clear guidance on how disclosures of conflicts must be presented to issuers.[11] However, Rule G-23 provides no similar guidance as to how the "writing" is to be presented. Furthermore, because underwriters who provide advice relating to the structure, timing, terms, etc. will be acting more like municipal advisors, any amendment concerning the presentation of the writing should be more in-line with the requirements of Rule G-36 and the municipal advisor portion of Rule G-17, rather than the underwriter portion of Rule G-17. Under this approach, such an amendment could look like the following:

> The presentation of a writing requirement of Rule G-23 may only be satisfied if the underwriter first obtains informed consent from its municipal issuer client. The underwriter must receive written consent to its writing by an official of the issuer with the authority to bind the obligated person by contract with the underwriter before the underwriter may provide advice or services to the issuer. For purposes of Rule G-23, an issuer will be deemed to have consented to the writing, if the issuer expressly acknowledges the existence of such a writing. Because of the severity of the conflict of interest that exists when an underwriter provides advice to a municipal issuer, such express acknowledgement must be obtained in writing.
>
> The presentation of a writing, coupled with written consent, will not satisfy the requirements of Rule G-23 in instances in which the underwriter has reason to believe that such consent is not informed. In such cases, an underwriter should make additional efforts reasonably designed to inform the officials of the issuer of the nature and implications of the underwriter's writing.

[10] *See* MSRB Notice 2011-13 (February 14, 2011), Request for Comment on Draft Interpretive Notice Concerning the Application of MSRB Rule G-17 to Municipal Advisors. *See* MSRB Notice 2011-12 (February 14, 2011), Request for Comment on Draft Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities.

[11] *See* MSRB Notice 2011-14 (February 14, 2011), Request for Comment on Draft MSRB Rule G-36 (On Fiduciary Duty of Municipal Advisors) and Draft Interpretive Notice.

Due to the fact that the writing provided to municipal issuers by underwriters will take the form of a disclaimer of liability, such an amendment is essential to ensure that municipal issuers understand what they are agreeing to. In addition, because the writing will likely require municipal issuers to waive their rights, written acknowledgement by municipal issuers is essential.

Furthermore, because Rule G-23 merely requires that the writing be given to the issuer, without requiring the issuer to take any affirmative action to illustrate that it acknowledges and/or understands the writing, it is highly likely that the issuer will assume that their underwriter is providing advice that is in their best interest since there is no assurance that they will read the writing. The amendment proposed above would ensure that municipal issuers who agree to waive their rights and who agree to the underwriter's disclaimer of liability, do so with the necessary information to make an objective decision prior to proceeding with an underwriter.

Finally, without further amendment, Rule G-23 in its current form is akin to allowing registered municipal advisors who are not also register broker-dealers to purchase securities with a view to distribution as long as they provide municipal issuers with a writing stating that they are "not acting as an underwriter". In this regard, Rule G-23 creates an inconsistent regulatory framework, and while the Commission can alleviate this inconsistency by revising Rule 144 to mirror Rule G-23, I respectfully urge the Commission to take the more appropriate and logical step of either requiring Rule G-23 to be further amended, or adopting a rule that curtails an underwriter's ability to provide advice to a municipal issuer with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues.

# APPENDIX A

**Subject: File No. SR-MSRB-2011-03**
**From: Nathan R. Howard, Esq.**
**Municipal Advisor, WM Financial Strategies**
**Dated: March 21, 2011**

## Introduction

I appreciate this opportunity to comment on Release No. 34-63946 (the "Release"). The Municipal Securities Rulemaking Board ("MSRB") has sought to eliminate certain conflicts of interests and has attempted to bring the language of Rule G-23 into alignment with Section 15B of the Securities and Exchange Act of 1934 (the "Exchange Act") as amended by Section 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). Proposed Rule G-23 (the "Rule") successfully eliminates some of the inherent conflicts of interest that existed prior to the enactment of the Dodd-Frank Act. However, the Rule fails to accurately reflect the language of the Dodd-Frank Act, specifically with regard to the provisions setting forth the definition of municipal advisor and the exceptions thereto.[1]

## Comments

The MSRB's proposed changes to Rule G-23 with regard to the provision of advice by broker-dealers acting as either financial advisors or underwriters will confuse market participants, especially small infrequent municipal issuers, and is in direct conflict with the Dodd-Frank Act. To further illustrate why the suggested changes, *infra*, are necessary in order to make the Rule consistent with the Dodd-Frank Act, I have attached Appendix B, which makes clear that a broker-dealer who provides "advice" must be registered as a municipal advisor and must act in a fiduciary capacity, and that the exception for "underwriters" only extends to broker-dealers to the extent that they are involved in the transaction as purchasers and distributors of securities. Because the Rule in its current form is inconsistent with the Dodd-Frank Act, it must be amended and the Commission should consider the following:

The Rule utilizes the term "advice" with regard to the activities of a broker-dealer acting as either a "financial advisor" ("dealer financial advisor") or as an "underwriter". In the section of the Rule entitled "Guidance on the Prohibition of Underwriting Issues of Municipal Securities for which a Financial Advisory Relationship Exists Under Rule G-23" (the "Guidance"), the MSRB makes it clear that an underwriter seeking to avoid (i) becoming a financial advisor, or (ii) entering into a financial advisory relationship, must not act within a "course of conduct [that causes] the dealer to be considered a financial advisor with respect to such issue." However, because the Rule utilizes the term "advice" to describe both the actions of a dealer financial advisor who possesses a fiduciary duty and an underwriter who does not possess a fiduciary duty, market participants, especially municipal entities, will be confused as to the type of services that may be provided by a dealer financial advisor versus an underwriter, while the Guidance offers little in terms of clarifying the matter. Therefore, to

[1] *See* §15B(e)(4)(A) and (C) of the Securities and Exchange Act of 1934 (the "Exchange Act").

clarify this ambiguity for both underwriters seeking to avoid classification as "financial advisors" and municipal entities attempting to make an informed decision regarding the choice of service providers, the MSRB should remove all references to the term "advice" and, when appropriate, replace "advice" with either the terms "recommendations or guidance" or the term "information."

The Dodd-Frank Act does not define the term "advice" and the SEC has stated that it will not attempt to define the term.[2] In situations where the meaning of a term is neither defined by statute nor rule, the Supreme Court has stated that the word should be construed "in accord with its ordinary or natural meaning."[3] The term "advice" has two definitions that may be applicable here. Advice may be defined as either: (i) guidance offered by one person to another[4], or a recommendation regarding a decision or course of conduct[5]; or (ii) information or notice given[6]. Because of this, one interpretation of Section 15B(e)(4) of the Exchange Act could be that Congress intended to prohibit individuals from providing either recommendations, guidance, or information to municipal entities regarding municipal securities issues or financial products unless they are registered municipal advisors acting with a fiduciary duty. However, in contemporary American English, the ordinary or natural meaning of the term "advice" is rarely associated with the provision of mere information, and is almost exclusively associated with the provision of recommendations or guidance.

For purposes of illustration, consider the following: When we go to buy a car, the car sales person often will provide information about the car. For example, the sales person may provide information about the types and variety of cars that the dealership can offer. Generally, we do not consider this information to be advice. However, if the car sales person were to say something such as "Given your current yearly income you can afford Car X" or "Given all of the things you've told me about your needs and finances, you should get Car Y", this would be different; in these cases, we would generally consider these statements by the sales person to be guidance or recommendations and thus advice.

In our contemporary understanding of the term "advice", the primary difference between the provision of recommendations or guidance versus the provision of information is that when we are provided with a recommendation or guidance we believe that these statements are being given with our best interest in mind. For example, if your local banker were to say, "I've looked at your financial situation and you should put your money into an auction rate security", right or wrong, we would believe that the banker was acting in our best interest and rendering "advice". However, when the statements are purely informational, no similar conclusion is generally made. For example, if our local banker were to say, "You could put your money in CD's, money markets, checking accounts or savings accounts", we would not perceive this to be "advice" because it is purely informational.

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[2] Joan Quigley, *Haines Defends SEC Proposal on Muni Advisers, Citing Past Instances of Abuse*, The Bond Buyer, Mar. 4, 2011, http://www.bondbuyer.com/issues/120_43/sec_chief_defends_muni_proposal-1024014-1.html (last visited March 18, 2011).

[3] *Smith v. United States*, 508 U.S. 223, 228 (1993).

[4] "advice." *Black's Law Dictionary – 8th Edition.* West Publishing Co. 2004.

[5] "advice." *Merriam-Webster's Dictionary of Law.* Merriam-Webster, Inc. at http://www.merriam-webster.com/dictionary/advice (last visited March 18, 2011).

[6] *Id.*

Similarly, when a municipal entity seeks guidance or a recommendation from a broker-dealer with respect to the issuance of municipal securities, including guidance or a recommendation with respect to the structure, timing, terms and other similar matters concerning such issue, and either guidance or a recommendation is actually obtained, the municipal entity will believe that the advice is being given with their best interest in mind and that the advice obtained is actually the best course of action for them to take. However, when a municipal entity merely obtains information from a broker-dealer who, as the Rule contemplates, provides affirmative disclosures as to the nature of the relationship prior to the provisions of services, there is generally no reason to think that a municipal entity will believe that this individual is acting in the municipal entity's best interest. Yet, this is not necessarily the case in the municipal market due to the historic role played by broker-dealers serving as underwriters.[7]

Because, historically, underwriters were permitted to provide recommendations and guidance to municipal entities, municipal entities often considered their underwriter to be a trusted advisor. Consequently, even if underwriters only provide "information", it is very likely that municipal entities will believe that underwriters are acting in their best interest. For example, if, historically, an individual has obtained recommendations and guidance from an attorney regarding legal matters, and now that attorney is no longer licensed and only provides information but does not disclose this fact, in writing, the individual will likely believe that the unlicensed attorney is providing advice;[8] even though only information has been provided, the individual will likely believe that the attorney is still his trusted advisor and will perceive this information to be advice. Therefore, to avoid confusion, affirmative disclosures as to the nature of the relationship are crucial. Thus, as the Rule contemplates, if the underwriter does not want to be deemed a financial advisor, it must make affirmative disclosures prior to providing any services. To that end, in order to ensure that municipal entities will understand that the underwriter is not acting in their best interest and is not serving as their financial advisor, and to avoid any question as to the nature of the relationship between the municipal entity and the underwriter, these disclosures must be made in writing.[9]

To reiterate, the above interpretation of the term "advice" is consistent with a plain reading of the Rule. The MSRB has sought to clarify that an individual who provides "advice" while acting in the issuer's best interest will be deemed to be a "financial advisor", while the provision of "advice" by an individual not acting in the issuer's best interest will be deemed to be an "underwriter." However, rather than clarify the distinction between the different kinds of "advice" provided by a "financial advisor" versus an "underwriter", the Rule uses the blanket term "advice". Because the MSRB has not clarified that the "advice" provided by "financial advisors" is different from the "advice" provided by "underwriters", broker-dealers and municipal entities will be confused and neither will know whether the broker-dealer is acting as a financial advisor or in the capacity of an underwriter. Therefore, the Rules should

[7] *See* Appendix B, at B-1.

[8] *See also* Model Rules of Prof's Conduct R. 1.7 cmt. 20 (2010) ("Model Rule 1.7") (if there exist any conflicts of interest requiring disclosure, a writing is generally required in order to impress upon clients the seriousness of the decision they are being asked to make and to avoid disputes or ambiguities that might later occur in the absence of a writing).

[9] *Id.* (although not applicable to broker-dealers, Model Rule 1.7 provides insight as to the wisdom of requiring disclosures of conflicts of interest to be in writing).

be amended to clarify that a broker-dealer who provides "recommendations or guidance" with respect to the structure, timing, terms or other similar matters concerning the issuance of municipal securities will be deemed to be a "financial advisor". Whereas, a broker-dealer who provides "information" with respect to the structure, timing, terms or other similar matters concerning the issuance of municipal securities will be deemed to be an "underwriter". Furthermore, in order to ensure that a broker-dealer who is merely providing information is not considered a financial advisor, the broker-dealer should identify itself as an underwriter, in writing, from the earliest stages of its relationship in order to ensure that the "information" provided does not cause the municipal entity to believe that the "underwriter" is acting in its best interest when it provides such information.

With these suggested alterations, proposed Rule G-23(b) would read as follows:

> (b) *Financial Advisory Relationship*. 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 consulting services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including **recommendations or guidance** ~~advice~~ with respect to the structure, timing, terms and other similar matters concerning such issue or issues. 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** ~~renders advice~~ to an issuer, including **information** ~~advice~~ with respect to the structure, timing, terms or other similar matters concerning a new issue of municipal securities.

In addition, if the Guidance were amended as follows, it would provide significantly more guidance:

> For purposes of Rule G-23, a dealer that provides **any recommendations or guidance** ~~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, ~~that presumption may be rebutted~~ if the dealer clearly identifies itself as an underwriter**, in writing,** from the earliest stages of its relationship with the issuer with respect to that issue **and does not provide recommendations or guidance with respect to the issuance of securities, the dealer will not be presumed to be a financial advisor**. Thus, a dealer providing **information** ~~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 **the information is provided** ~~advice is rendered~~ in its capacity as underwriter for such issue. Nevertheless, a dealer's subsequent course of conduct (*e.g.*, **providing a recommendation or guidance, or** 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**, even if the underwriter has clearly identified itself as an underwriter, in writing, from the earliest stages of its relationship**. In that case, the dealer will be precluded from underwriting that issue by Rule G-23(d).

By adopting the above interpretation and amending the Rule in accordance therewith, the MSRB can strike the appropriate balance between (i) the desires of the underwriting community to continue to interact with municipal entities with regard to the structuring, timing, terms and similar matters concerning the issuance of municipal securities, (ii) the MSRB's mandate to protect municipal entities who, but for these alterations, will not be able distinguish between financial advisors acting with fiduciary duties and underwriter acting at arm's length, and (iii) the need to clearly define when a broker-dealer will be deemed to be a "financial advisor" versus an "underwriter".

## Conclusion

In order to clarify the language of the Rule and to avoid contradiction with the Exchange Act, the Rule must make a distinction between the services that a broker-dealer registered and acting as a financial advisor can provide, versus the types of services that a broker-dealer acting as an underwriter can provide. Under the Exchange Act, advice may only be provided by a registered financial advisor and the underwriting exception is limited to broker-dealers who purchase and distribute securities, but the exception does not extend to broker-dealers who provide advice. This is the distinction that needs to be made and this is the distinction lacking from the Rule. To that end, and to avoid causing harm to municipal entities who otherwise will be unaware of the distinction, the Rule must be modified to clarify that registered financial advisors provide "advice", whereas underwriters cannot and disclosures to that effect must be made, in writing.

# APPENDIX B

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

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## 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 "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

[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).

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 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").

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[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.
[8] *Id*. at 20.

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.

* * *

[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.

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

* * *

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)."[14] 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.[15]

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.[16]

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,

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[14] §15B(e)(4)(C) of the Exchange Act.
[15] §2(a)(11) of the Securities Act of 1933 (emphasis added).
[16] *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).

offer or sale of securities, and, therefore, the broker-dealer is providing advice as a municipal advisor, not as an underwriter.[17]

Under this view, the Commission should take an approach similar to that put forth by the Commission in the case *SEC v. Howey Co.*[18] 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."[19] 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."[20]

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

[17] 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.*
[18] *Securities and Exchange Commission v. Howey Co.*, 328 U.S. 293 (1946).
[19] *See id.* at 297-301.
[20] *United Housing Foundation, Inc. v. Forman New York v. Forman*, 421 U.S. 837, 849 (1975).

inherent conflict of interest and problems of accountability. Unlike municipal entities and municipal employees who are accountable for the advice they provide,[21] 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.

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.[22] 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,[23] 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.

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[21] *See* Release No. 63576, at 41.
[22] *See* Letter from Nathan R. Howard, Municipal Advisor, WM Financial Strategies, to Commission in connection with Release No. 63576, dated February 22, 2011, at 11-12.
[23] *See id*, at 5.

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**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.[24] 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.[25]

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 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.

[24] Release No. 63576, at 53.
[25] *Id.*

**APPENDIX C**

BDA Bond Dealers of America

## Summary

In response to member requests, the BDA has developed model language for firms to use in communications with issuers that states the communication is being provided in the capacity of an underwriter and not as a financial advisor. Several firms in the industry are already using such language. When the MSRB submitted the proposed revised Rule G-23 to the SEC, it included proposed guidance that said that if a firm makes clear from the earliest contact that it is acting as an underwriter and not as a financial advisor, communications about the issuance would not be considered financial advice that would bar the firm from serving as an underwriter. Subsequently, the MSRB indicated that dealers should expect proposed modifications to that guidance. Those modifications, as well as final action by the SEC, may require the BDA's model disclaimer language to be changed in the future. Firms are encouraged to adapt the language to their specific circumstances.

## Suggested G-23 Disclaimer Language

Our [proposal] is delivered to you for the purpose of working with you as an underwriter on the transaction described [in the attached proposal] and we wish to define the nature of our relationship. We are providing the information contained in this proposal for discussion purposes in anticipation of serving as an underwriter to you [and understand that you cannot make a commitment at this time with respect to designating senior managers or co-managers of the syndicate or any level of allocation with respect to the transaction described in this proposal.] In our capacity as underwriter, we will be acting as a principal in a commercial, arms' length transaction and not as a municipal advisor, financial advisor or fiduciary to you regardless of whether we, or an affiliate has or is currently acting as such on a separate transaction. The information we provide to you is not intended to be and should not be construed as "advice" within the meaning of Section 15B of the Securities Exchange Act of 1934 and we encourage you to consult with your own legal, accounting, tax, financial and other advisors, as applicable, to the extent you deem appropriate.

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