MSRB
Municipal Securities
Rulemaking Board

July 21, 2011

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

Re: Approval of Proposed Rules on Activities of Financial Advisors

Dear Ms. Murphy:

On May 27, 2011, the Securities and Exchange Commission ("Commission" or "SEC") granted expedited approval of a proposed rule change to MSRB Rule G-23, on the activities of financial advisors.[1] The proposed rule change had two components: (1) amendments to Rule G-23 ("Amendment No. 1") and (2) a proposed interpretive notice addressing the type of advice an underwriter could provide without violating Rule G-23. Simultaneously with the approval of the proposed rule change,[2] as amended by Amendment No. 1, the Commission published Amendment No. 1 for comment. The Commission received eleven comment letters related to the proposed rule change and the Municipal Securities Rulemaking Board ("MSRB") appreciates the opportunity to respond to the comment letters. The MSRB is not proposing any further changes to Rule G-23 at this time.

SUMMARY OF COMMENT LETTERS

Comment letters were received from AGFS, the Government Finance Officers Association, the Securities Industry and Financial Markets Association, the National Association of Independent Public Finance Advisors, Public Financial Management, Zions First National Bank, WM Financial Strategies (2), Kidwell & Company, First Southwest, and MetroWest Regional Transit Authority. A summary of the comments and the MSRB's responses follow.

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1 *See* Securities Exchange Act Release No. 34-64564 May 27, 2011 (File No. SR-MSRB-2011-03) (the "Approval Order").

2 The rule change is effective for new issues for which the Time of Formal Award (as defined in MSRB Rule G-34(a)(ii)(C)(1)(a)) occurs after November 27, 2011 (the "Effective Date").

1900 Duke Street, Suite 600
Alexandria, VA 22314-3412
p 703 797 6600
f 703 797 6700
www.msrb.org

- **Comment: More clarity is needed on the role of the underwriter.** The Government Finance Officers Association (GFOA) urged the Commission to require underwriters to state to issuers that they do not have a fiduciary duty to issuers as underwriters. On the other hand, Public Financial Management (PFM) said that the Rule G-23 interpretive notice will encourage waivers by issuers of their fiduciary rights. Kidwell & Company said that Rule G-23 fosters confusion versus clarity in the interpretation of the rules while inviting opportunity for continued abuses of municipal issuers now and in the future, and that it conflicts with the stated mission of the MSRB, which is to protect the interests of issuers, investors, and the public trust.

- **MSRB Response:** As of the Effective Date, the interpretive notice will require that a dealer that wishes to be considered to be "acting as an underwriter" within the meaning of Rule G-23(b) must provide written disclosure to the issuer that it is an underwriter, rather than a financial advisor, and that, as such, its primary role is to purchase securities from the issuer or place the issuer's securities as an arm's-length counterparty. It also will require the underwriter to state that it has financial and other interests that differ from those of the issuer. Finally, the dealer's course of conduct must not be inconsistent with its written disclosures. The MSRB considered a requirement that an underwriter disclose that it is not a fiduciary to an issuer. However, the MSRB did not want to presuppose whether an underwriter might be a fiduciary under state law. Amendments to Rule G-23, as suggested by this comment, might actually have the effect of limiting an issuer's position under state law, as suggested by PFM, so the MSRB does not consider it advisable.

- **Comment: Dealers providing advice on investments and derivatives should be required to provide conflicts disclosure.** GFOA expressed the view that underwriters that provide advice on investments of bond proceeds and derivatives, in addition to engaging in underwriting activities, should be required to provide conflicts disclosures to their clients.

- **MSRB Response:** The MSRB has already published draft Rule G-36 (on fiduciary duty of municipal advisors) and interpretive guidance under Rule G-36 and Rule G-17. The interpretive guidance would require municipal advisors with municipal entity clients or obligated person clients to provide written conflicts disclosures to their clients. If the SEC determines that underwriters providing advice on investments of bond proceeds and derivatives are municipal advisors to that extent, the proposed MSRB guidance will apply to those activities of the underwriters and require the conflicts disclosure recommended by the GFOA.

- **Comment: Written disclosures may be buried.** AGFS commented that the written disclosures required by underwriters may be buried and, therefore, not drawn to the attention of policymakers of the issuer.

- **MSRB Response:** The MSRB suggests that an underwriter that attempts to bury its disclosures in long documents such as responses to requests for proposals would likely run afoul of the requirement of the notice that its course of conduct may not be inconsistent with its written disclosures. There seems little other purpose for burying the required disclosures. As of the Effective Date, dealers that wish to clarify their role as underwriter under Rule G-23 will be well-served by providing disclosures that are designed to attract the issuer's attention, rather than burying them.

- **Comment: Additional MSRB guidance suggested.** AGFS suggested that the MSRB consider issuing additional guidance for financial advisors, including guidance on their fiduciary duties to issuers in competitively bid underwritings and the circumstances under which they might be required to register as brokers due to their involvement in financings that, while characterized as "bank loans" and "leases," may, in fact, be municipal securities offerings.

- **MSRB Response:** The MSRB appreciates AGFS's suggestions for additional guidance and agrees that these are areas that merit the MSRB's consideration.

- **Comment: The Rule G-23 interpretive notice is contrary to the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").** The National Association of Independent Public Finance Advisors (NAIPFA) said that Dodd-Frank does not permit underwriters to provide advice on the structure, timing, terms, and similar matters with respect to the issuance of municipal securities without registration as a municipal advisor, but that the Rule G-23 interpretive notice would permit underwriters to provide this type of advice. Joy Howard of WM Financial Strategies (Ms. Howard) agreed and said that the Commission should clarify that the underwriting exception to the definition of "municipal advisor" only allows an underwriter to provide ideas and information that are incidental to the buying and selling of municipal securities.

- **MSRB Response:** It is the view of the MSRB that the exception from the definition of "municipal advisor" for "dealers serving as underwriters" would not be necessary if underwriters were not permitted to provide advice on the structure, timing, terms, and similar matters with respect to the issuance of municipal securities. Therefore, the MSRB considers the Rule G-23 interpretive notice to be consistent with the provisions of Dodd-Frank.

- **Comment: Restrictions on post-engagement conduct unworkable.** NAIPFA noted that, under the Rule G-23 interpretive notice, even if a firm has taken the requisite steps to make clear to the issuer that it is acting in an underwriting capacity, it would still be precluded from underwriting the issue if it engages in a "course of conduct that is inconsistent with an arm's length relationship with the issuer in connection with the issue being underwritten." NAIPFA said that it does not believe this approach will effectively work in practice, because it believes that such inconsistent and subsequent conduct will be ignored. NAIPFA said that the Rule G-23 interpretive notice would not be effective and should be eliminated.

  While SIFMA generally supported the language in the Rule G-23 interpretive notice on the meaning of "acting as an underwriter," it said that the provision of the language that would permit a dealer's conduct subsequent to its underwriter disclosure to cause it to be treated as a financial advisor would be subject to considerable ambiguity in its application. SIFMA requested that the sentence on subsequent conduct be deleted.

- **MSRB Response:** Without the subsequent conduct provision, the underwriter disclosure could become boilerplate that is ignored in practice. The MSRB believes that dealers should not only declare themselves to be acting as underwriters, but that they should also act like underwriters. The MSRB expects that, by the Effective Date, most underwriters will adapt to this requirement. If there is evidence to the contrary, the MSRB expects that appropriate enforcement agencies would enforce the notice.

- **Comment: The SEC and MSRB should make changes to proposed rules or interpretations other than Rule G-23.** NAIPFA suggested that some of its concerns about underwriters providing advice could be addressed as follows:
  - It said that the SEC should limit the activities in which an underwriter may engage without registration as a municipal advisor to activities directly relating to the distribution of securities. It said that providing advice as to the structure, timing and terms of the bond issue would not fall within the permitted activities, at least not without a fiduciary duty attached.
  - It also said that the MSRB should require under Rule G-17 that an underwriter make specific disclosures about its conflicts, in the same manner as it requires municipal advisors to make any disclosures of their conflicts. It said that this should include the requirement – to the extent it is also required of advisors – to obtain acknowledgment and/or consent from an appropriate official of an issuer.
  - Finally, it said that the MSRB should require under Rule G-17 – in the same manner and to the same extent as advisors are required – to have a reasonable basis for any recommendations underwriters make and to disclose material risks about the course of conduct they recommend, along

with the risks and potential benefits of reasonable alternatives then available in the market.

- **MSRB Response:** The MSRB believes that limiting the role of the underwriter in the manner proposed by NAIPFA would be inconsistent with the provisions of Dodd-Frank. As to the suggested Rule G-17 guidance, NAIPFA has made those comments directly to the MSRB and the Board has considered them in making revisions to its Rule G-17 interpretive guidance for underwriters, which it plans to file with the Commission in the near future. That filing will address the MSRB's responses to those comments.

- **Comment: Exemption for small competitively bid issues.** First Southwest said that Rule G-23 would harm small issuers if an exemption for competitively bid issues under $5 million were not created. SIFMA expressed the same view with respect to smaller and less frequent issuers. MetroWest Regional Transit Authority supported an exemption for competitively bid issues of small and non-rated issuers.

- **MSRB Response:** As the MSRB has previously stated, the Board has significant concerns about the ability of small issuers to understand the conflict posed by their financial advisor becoming their underwriter. The MSRB will, however, continue to monitor whether removing the financial advisor as a possible bidder for the issuer's securities actually has the negative effect that First Southwest predicts.

- **Comment: Rule G-23 should not be an issue-by-issue rule.** Ms. Howard said that a dealer financial advisor for one issue might advise the issuer to hire it as underwriter for another issue.

- **MSRB Response:** A dealer financial advisor is a municipal advisor that is subject to a fiduciary duty to its issuer client under Section 15B(c)(1) of the Securities Exchange Act of 1934, as amended by Dodd-Frank. A dealer financial advisor that gave advice to its client that was contrary to the client's best interests would violate that fiduciary duty. That required standard of conduct should address the concerns expressed by Ms. Howard.

- **Comment: Rule G-23's conflicts disclosures should be the same as those in draft MSRB Rule G-36.** Nathan Howard of WM Financial Strategies (Mr. Howard) said that, at a minimum, the Rule G-23 interpretive notice should follow draft MSRB Rule G-36 and require that the disclosures made by underwriters should be made to officials of the issuer with the authority to bind the issuer by contract and that the underwriters should be required to obtain the informed consent of such officials or, at least, written acknowledgement that such conflicts existed.

- **MSRB Response:** Mr. Howard's comment has merit; however, the MSRB's Rule G-36 interpretive notice is not yet final. Once that notice is final and the Commission's municipal advisor rulemaking is complete, the MSRB may revisit the underwriter disclosure requirement of Rule G-23 to conform it to draft MSRB Rule G-36.

- **Comment: Rule G-23 should not prohibit banks that are financial advisors from providing loans to those clients.** Zions First National Bank appears to think that Rule G-23 contains this prohibition.

- **MSRB Response:** Rule G-23 only concerns offerings of securities. If a bank loan is a true loan and not a security, Rule G-23 would not apply.

The MSRB appreciates the opportunity to provide these comments. Should any SEC staff members have any questions, I would be pleased to address them.

Very truly yours,

Margaret C. Henry

Margaret C. Henry
Deputy General Counsel