BDA Bond Dealers of America

21 Dupont Circle, NW • Suite 750
Washington, DC 20036
202.204.7900
www.bdamerica.org

May 29, 2015

VIA ELECTRONIC MAIL

Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

RE: File Number SR-MSRB-2015-03

Dear Secretary Fields:

On behalf of the Bond Dealers of America ("BDA"), I am pleased to submit this letter in response to the filing by the Municipal Securities Rulemaking Board ("MSRB") of proposed Rule G-42 (the "Proposed Rule"). BDA is the only DC-based group representing the interests of middle-market securities dealers and banks focused on the U.S. fixed income markets. Accordingly, we believe that we uniquely offer insight into how the Proposed Rule would impact middle-market securities dealers.

Timing of Disclosure of Conflicts of Interest and Other Information. The Proposed Rule provides a different timing requirement with respect to the delivery of conflicts of interest and other information than its requirement to evidence municipal advisory relationships. Under paragraph (b) of the Proposed Rule, a municipal advisor would be required to deliver conflict of interest and other disclosures "prior to or upon engaging in municipal advisory activities." In contrast, under paragraph (c), municipal advisors would be required to evidence their municipal advisory relationships by writing "upon or promptly after the establishment of the municipal advisor relationship." Municipal advisory activities are broadly defined to mean any activities that would cause a person to become a municipal advisor, which could occur by simply providing a municipal entity or an obligated person advice concerning municipal financial products or the issuance of municipal securities. Our read of paragraph (c) is that the Proposed Rule sensibly provides two sets of requirements for municipal advisors – one set for when a person becomes a municipal advisor and one set for when they create a municipal advisory relationship. By becoming a municipal advisor, the fiduciary duty to municipal entities, the duty of care to obligated person clients, the duty of fair dealing and many other requirements attach to the municipal advisor's conduct. But the municipal advisor is only required to evidence its relationship in writing once a conventional engagement between the municipal advisor and its client has been formed. We think this makes sense in light of the activities-based definition of municipal advisor. We believe the same should be true of provision of conflict of interest and other disclosures. Otherwise,

municipal advisors could not engage in any municipal advisory activities without providing these disclosures. The likely situations that would matter are questions by issuers that would need to remain unanswered without or until the provision of disclosures which are only relevant if the issuer decides to form a municipal advisory relationship with the municipal advisor. In addition, often times municipal advisor engagements are established and documented before municipal advisory activities actually commence. This is particularly the case when an obligated person client engages and/or begins to work with an advisor that eventually will become a municipal advisor, once negotiations with a municipal entity conduit issuer commence. We believe that municipal entities and obligated persons should be in a position to review and understand conflicts of interests of their municipal advisors, and that these disclosures only in fact matter, when they enter into their municipal advisory relationships. Consequently, we believe that it is important for paragraph (b) to be changed to harmonize its timing with paragraph (c).

Principal Transactions. The BDA remains concerned with how the MSRB has drafted the prohibition in Section (e)(ii) of the Proposed Rule. Section (e)(ii) states, "A municipal advisor to a municipal entity client, and any affiliate of such municipal advisor, is prohibited from engaging in a principal transaction **directly related** to the same municipal securities transaction or municipal financial product as to which the municipal advisor is providing advice." (Emphasis added.) We think the term "directly related to" is vague and open to interpretation. It is not clear to us exactly what transactions would be considered "directly related to" other transactions. As examples of where we believe that clarity would be valuable:

- We believe that selling securities, as a principal, after winning a competitive bid for an open market refunding escrow, on a refunding bond issue for which the firm was a municipal advisor would not be "directly related to" the bond issue because they would constitute separate transactions. In addition, we believe that a dealer who acts as an underwriter for a refunding bond issue for a municipal entity could also serve as a municipal advisor for the investment of the escrow proceeds, if separately documented, as these also represent separate transactions.

- We believe that acting as a municipal advisor for a municipal entity entering into a swap while acting as the underwriter on a related series of variable rate bonds would be more closely related but still not clear if it is "directly" related; whereas, we believe that acting as a municipal advisor merely for a municipal entity's termination of a swap while acting as the underwriter on the issuance of fixed rate bonds, if separately documented, when the swap termination payment would be financed by the issuance of the fixed rate bonds, would not be "directly related."

- We believe that time should have an impact on when transactions are directly related also. For example, we believe that a dealer who serves as a municipal advisor with respect to an issuance of municipal securities by a municipal entity may serve as the underwriter for a later refunding of

that bond issuance because those are separate transactions. As another example, if a dealer provides investment advice as to how a municipal entity should invest the proceeds from the issuance of municipal securities, a later investment of the same proceeds is not "directly related" just because the investment involves the same proceeds.

In our comment letter to an earlier draft of the Proposed Rule, we suggested the following alternative language to the MSRB in an earlier proposal which was not incorporated in the Proposed Rule:

> "A municipal advisor, and any affiliate of such municipal advisor, is prohibited from engaging in a principal transaction with a municipal entity client if the structure, timing or terms of such principal transaction was established on the advice of the municipal advisor in connection with a municipal advisory relationship with such municipal entity client."

We believe that this re-phrased language addresses the core concern of the MSRB, which is to prohibit situations in which a municipal advisor structures a transaction and then creates a potential conflict of interest by participating as a principal in that transaction or a related transaction on which it has rendered advice.

Documentation of Recommendations. Paragraph (d) of the Proposed Rule requires municipal advisors to make suitability determinations with respect to municipal securities transactions or municipal financial products that municipal advisors recommend or review and then to inform their clients concerning risks, benefits and characteristics of the transaction or product and concerning other matters. In addition, proposed Rule G-8(h)(iv) imposes requirements on municipal advisors to create and maintain documentation concerning some of what is required by paragraph (d) of the Proposed Rule. We think that these very specific requirements for each transaction and for all clients are too burdensome and sweeping. Like attorneys and other professionals, these kinds of determinations and reviews should be left to the professional discretion of municipal advisors and regulated by the more general duties of municipal advisors. Municipal advisors should have the flexibility to fashion their review and client communication depending on their discretion of what the representation merits.

In addition, while the Proposed Rule does not specifically require that the communication to clients under paragraph (d) be written, we think that the Proposed Rule should specifically state that such communication may be oral. It is frequently the case that informing a client of risks, benefits or other aspects of a transaction in writing may not be in the best interests of the client because much of that writing may be obtainable through Freedom of Information Act requests and other means. Accordingly, we believe that it is important that the Proposed Rule specifically state that any communication with clients pursuant to paragraph (d) of the Proposed Rule may be oral and is not required to be in writing.

Reference to Rule G-23. In note .07 under supplemental materials, the Proposed Rule states that the principal transaction prohibition in paragraph (e)(ii) does not apply to

the acquisition as principal from an issuer of all or any portion of an issuance of municipal securities. The note proceeds to state that this is "on the basis that the municipal advisor provided advice as to the issuance because that is a type of transaction that is addressed and prohibited in certain circumstances by Rule G-23." This is another revision by the MSRB of similar language and we are still confused about what the MSRB is attempting to address in its reference to Rule-G-23. Rule G-23's only material prohibition is that broker-dealer financial advisors working with issuers may not serve as underwriters with respect to an issuance of municipal securities, subject only to certain very limited exceptions set forth in Rule G-23 (d)(ii) and (iii). Further, this prohibition is largely subsumed by the more stringent provisions of the Proposed Rule. Accordingly, we do not understand why this note continues to mention Rule G-23.

Reference to Bank Loans. Note .11 of the supplemental materials addresses when bank loans may constitute an "other similar financial product" for purposes of the principal transaction prohibition. In that regard, note .11 references a bank loan that is "economically equivalent to the purchase of one or more municipal securities." The apparent intended purpose of this language is to develop a standard that does not depend on determining when a bank loan constitutes a municipal security. But we believe that this language, using undefined terms, is too ambiguous and does not provide clarity. We have all struggled to apply the *Reves* test to determine when bank loans are securities, but merely by stating "economically equivalent" will compound the confusion. As a practical matter, five structural components typically differentiate a conventional bank loan from what are referred to as "direct purchase" products in the municipal securities market, and they are: ratings, CUSIP numbers, certificated bonds, transfer provisions and registration under DTC. We think that the MSRB should be clear about exactly which features of a direct purchase structure cause it to fall within the definition of "other similar financial products" rather than use an additional, undefined term.

Thank you for the opportunity to submit these comments on the Proposed Rule.

Sincerely,

Michael Nicholas

Chief Executive Officer