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Invested in America

May 28, 2015

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

Re: File Number SR-MSRB-2015-03: Notice of Filing of a Proposed Rule Change Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors

Dear Mr. Fields:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "**SEC**") on the Municipal Securities Rulemaking Board ("**MSRB**") Proposed Rule G-42 ("**Proposed Rule G-42**") on the standards of conduct and duties of municipal advisors when engaging in municipal advisory activities other than solicitations.[2]

I. Executive Summary

SIFMA applauds the MSRB's efforts in preparing Proposed Rule G-42 in light of comments received in connection with the two rounds of public comment which the MSRB solicited prior to submitting Proposed Rule G-42 to the SEC as a proposed rule change.[3] SIFMA believes that the MSRB has made important strides in making Proposed

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] Exchange Act Release No. 74860 (May 4, 2015); 80 Fed. Reg. 26752 (May 8, 2015) (the "**Proposing Release")**.

[3] SIFMA commented in detail on these prior drafts. *See* Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, to Ronald W. Smith, MSRB (Aug. 25, 2014), *available at* http://www.sifma.org/issues/item.aspx?id=8589950587 (the "**SIFMA August 2014 Letter**"); Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, to Ronald W. (…continued)

Rule G-42 workable without compromising protections to municipal entities, obligated persons or investors. However, SIFMA still has significant concerns regarding certain aspects of Proposed Rule G-42, which render it unreasonably burdensome and anti-competitive in ways that do not clearly promote the fundamental policies of the municipal advisor provisions of Section 15B of the Securities Exchange Act of 1934 (the "**Exchange Act**"). As such, Proposed Rule G-42, as currently drafted, is inconsistent with the standards for MSRB rulemaking under Section 15B(b)(2)(C).[4] SIFMA's most pressing comments are the following:

- The proposed principal transaction ban in Proposed Rule G-42(e)(ii) should:

  (i) apply only to transactions that are directly related to the *advice* provided by the municipal advisor, and not more broadly to municipal securities *transactions or municipal financial products* as to which the municipal advisor is providing or has provided advice;

  (ii) not apply to business units of a municipal advisor and its affiliates that have no significant connection to, or knowledge of, a municipal advisory engagement;

  (iii) clearly not treat investment funds advised by a municipal advisor (or its affiliates) as being affiliates of the municipal advisor, and therefore subject to Proposed Rule G-42, solely as a result of the investment advisory relationship;

  (iv) have a clear end date that is defined by or in relation to the termination or completion of the municipal advisory relationship that gave rise to the ban; and

  (v) in any situation where a principal transaction would otherwise be prohibited, permit the principal transaction if the municipal entity is otherwise represented by another municipal advisor with respect to the principal transaction.

(continued…)
Smith, MSRB (Mar. 10, 2014), *available at* http://www.sifma.org/issues/item.aspx?id=8589947958 (the "**SIFMA March 2014 Letter**").

[4] Section 15B(b)(2)(C) of the Exchange Act requires that the MSRB's rules, among other things, be designed "to protect investors, municipal entities, obligated persons, and the public interest; and not be designed to permit unfair discrimination among customers, municipal entities, obligated persons, municipal securities brokers, municipal securities dealers, or municipal advisors … or to impose any burden on competition not necessary or appropriate in furtherance of the purposes of" the Exchange Act. In addition, under Section 3(f) of the Exchange Act, in determining whether to approve a proposed MSRB rule, the SEC must consider "whether the action will promote efficiency, competition, and capital formation."

- In order to avoid significant impairment of the availability of municipal entities to receive full-service brokerage and securities execution services, the MSRB should modify Proposed Rule G-42 to:

    (i) temporarily exclude from the principal transaction ban sales of fixed-income securities by a broker-dealer providing incidental advice on investment of bond proceeds (constituting municipal advisory services) until the SEC and the Department of Labor (the "**DOL**") have concluded their ongoing consideration of the application of a fiduciary duty to dealings as principal in fixed-income securities in the context of the potential uniform duty of broker-dealers and investment advisers when rendering personalized investment advice and ERISA accounts, respectively. Subsequently, the MSRB could harmonize the application of the municipal advisor fiduciary duty in the context of principal dealing in fixed-income securities in accordance with the final actions that are ultimately taken by the SEC and DOL; and

    (ii) rationalize the application of the Proposed Rule's documentation, due diligence, risk disclosure and suitability requirements as applied to brokerage and securities execution services;

- The proposed safe harbor for inadvertent advice in Supplementary Material .06 should be expanded to provide an exception from the principal transaction ban and certain other requirements under Proposed Rule G-42 if the proposed conditions are satisfied;

- The duty of care in Proposed Rule G-42 and Supplementary Material .01 **should not** impose a duty to conduct reasonable diligence with respect to information provided by the municipal advisor's own client upon which the municipal advisor bases its recommendations, but **should** be clarified to squarely place upon a municipal advisor that assists in the preparation of an official statement in connection with a competitive transaction the responsibility to perform reasonable diligence with respect to the accuracy and completeness of any portion of the official statement as to which the municipal advisor assisted in the preparation;

- The MSRB should clarify the duties of a municipal advisor to a municipal entity by eliminating the phrases "includes, without limitation" in Proposed Rule G-42(a)(2), "includes, but is not limited to" in Supplementary Material .02, and "without regard to the financial or other interests of the municipal advisor" in Supplementary Material .02; and

- The disclosure and documentation standards in Proposed Rule G-42(b) and (c) should not apply to municipal advisory engagements that are in effect as of the compliance date for Proposed Rule G-42, and municipal advisors should not be

obliged to provide new disclosures or additional relationship documentation to supplement or modify the terms of engagements that exist at that time.

II. Principal Transactions

Proposed Rule G-42(e)(ii) would prohibit a municipal advisor to a municipal entity client, and any affiliate of such municipal advisor, 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 or has provided advice."

SIFMA recognizes that engaging in principal transactions with advisory clients raises significant conflicts of interest, and in fact, in certain circumstances these conflicts of interest may be too great to manage. However, as SIFMA has suggested to the MSRB in several comment letters,[5] an outright prohibition on principal transactions is unnecessary and inconsistent with other fiduciary duty and similar regimes. Even investment advisers, which have long been recognized as owing a fiduciary duty and the utmost good faith in dealings with their clients,[6] and whose obligations are cited as the basis for the MSRB's proposed fiduciary rule,[7] are not subject to an immutable prohibition on transacting with a client as principal. Rather, consistent with its fiduciary duty, an investment adviser and its affiliates may engage in a principal transaction with a client so long as the adviser obtains the client's consent after disclosing the capacity in which the adviser will act, any compensation the adviser will receive and any other relevant facts.[8]

While SIFMA continues to believe that the MSRB's proposed ban is inappropriate, as a general principle, SIFMA believes that such a ban, if imposed at all, should be narrowly tailored to (i) those situations in which there is an obvious risk to municipal entities of biased advice, (ii) where any actual or potential conflict cannot be managed or alleviated through less burdensome means, and (iii) clearly define the circumstances in which the ban falls away.

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[5] *See* SIFMA August 2014 Letter; SIFMA March 2014 Letter. *See also* Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIFMA, to Ronald W. Smith, MSRB (Apr. 11, 2011) (providing comments on draft Rule G-36, a previous iteration of Proposed Rule G-42).

[6] *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

[7] *See* Proposing Release at 3.

[8] *See* Advisers Act § 206(3). *See also* SEC Staff Study on Investment Advisers and Broker-Dealers (Jan. 2011) at 24–26.

A. The MSRB Should Limit the Principal Transaction Ban to Transactions that are Directly Related to the Advice Rendered by the Municipal Advisor

Proposed Rule G-42(e)(ii) would prohibit a municipal advisor or its affiliate(s) from engaging in a principal transaction that is "directly related to the same municipal securities transaction or municipal financial product as to which the municipal advisor is providing or has provided advice" to a municipal entity.

The scope of the prohibition is unnecessarily broad and burdensome. Rather, the MSRB should only prohibit (if at all) principal transactions that are directly related to the *advice* that the municipal advisor provides, rather than advice relating to the same municipal securities *transaction*.[9] The prohibition, as proposed, would unnecessarily prevent parties from engaging in transactions unrelated to the prior advice and therefore free of any conflict of interest.

For example, a municipal advisor may provide guaranteed investment contract ("**GIC**") brokerage to a municipal entity client. In that context, a municipal advisor may advise on investing the proceeds of an issuance of municipal securities in a GIC. Having advised solely on GICs the municipal advisor would not have a conflict of interest that would justify prohibiting it from, for example, acting as a counterparty on a swap that, broadly speaking, is in connection with the same overall financing transaction. Such a prohibition would merely limit the municipal entity's choice of counterparty and unnecessarily limit and burden competition without providing any discernible protection to a municipal entity. In such a case, the interests of the municipal entity would be broadly served by the conflict disclosure and management requirements and documentation standards of Proposed Rule G-42.

Accordingly, SIFMA previously recommended to the MSRB that Proposed Rule G-42(e)(ii) should be revised as follows: "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 *advice rendered by such municipal advisor*."[10] The MSRB declined to accept this suggestion, arguing that "such a change could leave transactions that have a high risk of self-dealing insufficiently addressed. For example, a municipal advisor that provided advice to a municipal entity regarding the timing and structure of a new issuance arguably would not be prohibited from acting as principal in entering into an interest rate swap for the same issuance so long as the advisor refrained

[9] A prohibition on principal transactions relating to the same "transaction" poses practical challenges as well. It may not always be clear when a potential principal trade relates to the same "transaction," while it is much clearer whether the proposed principal transaction relates to the subject matter of the advice provided.

[10] *See* SIFMA August 2014 Letter.

from advising on the swap."[11] But, in SIFMA's view, this is a reason for clarifying the standard, not imposing an unnecessarily broad and burdensome prohibition. SIFMA agrees that a conflict of interest would arise in the particular example provided by the MSRB—acting as principal on a swap that hedges a risk inherent in the structure the municipal advisor advised on.

As illustrated by the examples provide above, however, there are myriad instances where a municipal advisor or its affiliates could advise on one aspect of a transaction and act as principal on another, free of any conflict or with only potential conflicts that could be addressed through disclosure and other means. As such, the MSRB should only prohibit a "principal transaction directly related to the advice rendered by such municipal advisor," and, if necessary, provide guidance on those transactions that would be prohibited as a result.

B. The Principal Transaction Ban Should Be Limited to Areas of a Municipal Advisor and its Affiliates That Have Actual Knowledge of the Municipal Advisory Relationship and its Scope

The principal transaction ban in Proposed Rule G-42(e)(ii) is currently drafted in a manner that could be read to prohibit principal transactions by areas of a municipal advisor and its affiliates that have no knowledge of the advisory engagement or its scope and where the municipal advisory business: (i) has not advised, directed or encouraged the municipal entity to engage in the principal transaction with such other area or affiliate and (ii) has no direct economic interest in any such principal transaction ("**Remote Businesses**"). In effect, the ban, as drafted, imposes a strict liability standard on the legal entity that is acting as a municipal advisor and its affiliates.

In SIFMA's view, the purpose of a principal transaction ban is to ensure that the municipal advisor, through its advisory personnel, provides disinterested advice that is not influenced by the potential for profiting through self-dealing. No policy is furthered by a ban that purports to extend to Remote Businesses. If such a strict liability standard were extended to Remote Businesses, multi-service firms that consist of numerous departments and corporate affiliates would need to implement extensive internal processes to ensure that Remote Businesses and their personnel did not inadvertently violate the principal transaction ban. Not only would such processes be costly and burdensome to implement, and serve no practical benefit, but they potentially would result in inappropriate sharing of customer information and leakage of material nonpublic information around an extensive organization, which would run contrary to the information barriers and other informational safeguards that are at the core of most

[11] *See* Proposing Release at 105.

financial institutions' compliance programs and cultures and which are in many cases legally mandated.[12]

Accordingly, SIFMA previously recommended to the MSRB that Proposed Rule G-42(e)(ii) should be revised to exclude from its ambit principal transactions by Remote Businesses. Specifically, SIFMA recommended that MSRB include a knowledge qualifier, as follows: "A municipal advisor to a municipal entity client, and any affiliate of such municipal advisor, is prohibited from *knowingly* engaging in a [prohibited] principal transaction …"[13] Indeed, the prototypical fiduciary duty in the securities law context, under the Investment Advisers Act of 1940 (the "**Advisers Act**"), from which the MSRB purports to draw,[14] includes a "knowingly" standard with respect to its prohibition on principal transactions.[15]

The MSRB declined to add such a "knowingly" standard, on the basis that such a standard "would be overly stringent, which could hinder regulatory examinations and enforcement."[16] SIFMA disagrees—in adopting the most closely parallel fiduciary duty, Congress did not deem such a standard to be too "stringent," and SIFMA does not believe that this statutory standard has hindered the SEC's enforcement of the Advisers Act.

C. The MSRB Should Clarify That Investment Vehicles Advised by Municipal Advisors and Their Affiliates are not Themselves "Affiliates" for Purposes of the Principal Transaction Ban

The MSRB should state explicitly that an investment vehicle, such as a mutual fund, that is advised by a municipal advisor or its affiliate is not itself an "affiliate" of the municipal advisor solely on the basis of the advisory relationship. Otherwise, an investment fund may be unable to invest in a municipal security if an affiliate of the

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[12] *See e.g.,* Exchange Act § 15(g) (requiring registered broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business, to prevent the misuse of material nonpublic information by the firm or its associated persons in violation of the Exchange Act).

[13] *See* SIFMA August 2014 Letter. The MSRB has shown sensitivity to the problem of inadvertent violations in proposing Supplementary Material .06 concerning inadvertent advice. Similar considerations are present in this situation, but would not be addressed by Supplementary Material .06 as proposed.

[14] *See* Proposing Release at 3.

[15] *See* Advisers Act § 206(3) ("It shall be unlawful for any investment adviser … acting as principal for his own account, *knowingly* to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, *knowingly* to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction." (emphasis added)).

[16] Proposing Release at 113.

fund's adviser acted as a municipal advisor on the transaction. Aside from difficulties of monitoring and tracking such relationships, the application of the ban in this type of situation is unnecessary. As an example, mutual funds and other similar vehicles have independent boards and their affiliates do not have significant equity stakes in the funds that they advise. Therefore, the sorts of conflicts of interest considerations that the MSRB seeks to address by applying the principal transaction ban to corporate affiliates are not present where a fund may only be considered affiliated as a result of the status of its adviser.

D. The MSRB Should Clarify When the Principal Transaction Ban Ends

Proposed Rule G-42(e)(ii) would prohibit a municipal advisor to a municipal entity client, and any affiliate of such municipal advisor, 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 *or has provided* advice" (emphasis added). SIFMA notes that the "or has provided" language was not included in the draft versions of Rule G-42 that the MSRB proposed for comment prior to its filing with the SEC.

The addition of the "or has provided" language raises significant ambiguities and risk of unintentional violation. For example, several years after an issuance of municipal securities on which a municipal advisor advised, a municipal entity may approach an affiliate of that firm to act as underwriter on a refunding of the earlier issuance, or to enter into a new swap relating to the outstanding securities. Absent clarification, firms would constantly need to consider advisory engagements they or their affiliates undertook years earlier prior to entering into new principal transactions. Because the advisory engagements already ended, the conflicts of interest that the MSRB seeks to address through the prohibition would not be present. As such, the "or has provided" language should be eliminated or clearly limited to the time period before the municipal advisory engagement has ended or some other clearly defined period thereafter.

E. The MSRB Should Temporarily Exclude Fixed Income Securities Brokerage from the Principal Transaction Ban

An outright prohibition on a municipal advisor or its affiliates engaging in principal transactions with municipal entity clients is particularly problematic for ordinary broker-dealer transactions in fixed-income securities, which are primarily sold on a principal basis. In particular, a broker-dealer may provide incidental advice as part of its ordinary brokerage services, including where a brokerage account includes bond proceeds. If adopted as proposed, the principal transaction ban would effectively prohibit broker-dealers from providing municipal entities incidental advice regarding fixed-income securities.

A number of regulators are currently grappling with how a fiduciary duty, and its attendant limitations on acting as principal, can practically apply to ordinary transactions

in fixed-income securities. For example, in the context of potentially imposing a uniform fiduciary duty on broker-dealers and investment advisers providing personalized investment advice to retail investors, the SEC has had to consider whether broker-dealers subject to a fiduciary duty would be permitted to engage in principal transactions.[17] Similarly, the DOL has proposed new fiduciary standards for investment advice provided, including by broker-dealers, to employee benefit plans or individual retirement accounts, and had to consider the issue.[18]

Indeed, there are indications that the SEC, if it adopts a uniform fiduciary duty, would not do so in a way that prohibited a broker-dealer with a fiduciary duty from engaging in principal transactions.[19] Similarly, although ERISA and its implementing regulations impose stringent fiduciary standards for broker-dealers and others providing advice to retirement accounts, the DOL, in consideration of the way in which fixed-income securities are sold, has proposed to "allow investment advice fiduciaries to engage in purchases and sales of certain debt securities out of their inventory (i.e., engage in principal transactions) with plans, participant or beneficiary accounts, and IRAs, under conditions designed to safeguard the interests of these investors."[20]

As recognized by the SEC and the Commodity Futures Trading Commission (in the context of providing advice regarding swaps to "special entities") and proposed by the DOL, transacting as principal while acting as an advisor is not necessarily an unmanageable conflict of interest; the issue, rather, is how the conflict is managed and what conditions should apply. In order to avoid creating a standard that is unnecessarily inconsistent with the broader regulatory context, the MSRB should temporarily exclude from the principal transaction ban sales of fixed-income securities by a broker-dealer providing incidental advice on investment of bond proceeds (constituting municipal advisory services). Once other regulators have adopted rules with broader applicability in this area, the MSRB could reconsider its temporary exemption and adopt a standard consistent with the broader regulatory scheme for fiduciary relationships. Thereafter, the MSRB could conform the application of the principal transaction ban in this area to such other standards if it chose to do so. During this interim period, municipal entity clients would, of course, be protected by other applicable provisions of Proposed Rule G-42 and other MSRB Rules, such as the fair dealing standards of MSRB Rule G-17.

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[17] *See, e.g.*, Exchange Act Release No. 69013 (Mar. 1, 2013).

[18] *See* DOL, Proposed Rule: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21928 (Apr. 20, 2015).

[19] In requesting data and comment on a potential uniform fiduciary duty, the SEC asked commenters to assume that "[b]roker-dealers also would continue to be permitted to engaged in, and receive compensation from, principal trades." Exchange Act Release No. 69013 (Mar. 1, 2013) at 26–27.

[20] DOL, Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21989 (Apr. 20, 2015) at 21990.

F. The MSRB Should Permit Principal Transactions Where the Municipal Entity Client is Represented by an Independent Registered Municipal Advisor

The MSRB should revise Proposed Rule G-42 to permit any otherwise prohibited principal transaction where the municipal client is represented by a separate registered municipal advisor (an "**SRMA**") with respect to the principal transaction. By analogy to Rule 15Ba1-1(d)(3)(vi) (the independent registered municipal advisor exemption),[21] the exception to the prohibition could be available where (i) the municipal entity represents in writing that it is represented by, and will rely on the advice of, an SRMA with respect to the principal transaction, and (ii) the municipal advisor discloses in writing to the municipal entity, copying the SRMA, that it has acted as a municipal advisor in connection with the transaction and therefore has certain conflicts of interest.[22]

Such an exemption from the prohibition would allow municipal entities to contract with the counterparty of their choice, while maintaining the municipal entity protections that the MSRB seeks to promote. Such an exemption would serve a practical purpose, as municipal entities may have multiple municipal advisors for different functions. It would also discourage anti-competitive effects, as without an exemption and where a municipal entity has multiple advisors, all advisors and their affiliates could be disqualified from principal transactions, thus limiting the market.

Indeed, a municipal entity often hires several municipal advisors to advise on different matters relating to the same transaction. This situation would facilitate compliance with SIFMA's proposed exception to allow principal trades when a municipal entity is advised by a separate, additional, municipal advisor. While each municipal advisor representing the municipal entity client would generally be prohibited from engaging in principal transactions, another municipal advisor that is already representing the municipal entity regarding other subject matter could act as the SRMA for any principal transactions that relate to the scope of its representation.[23]

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[21] Of course, because the municipal advisor is registered as such and acting in that capacity, it need not rely on the actual exemption from registration as a municipal advisor under Rule 15Ba1-1(d)(3)(vi).

[22] The MSRB may also consider whether, similar to Rule 15Ba1-1(d)(3)(vi), a SRMA should be subject to a level of independence from the municipal advisor seeking to rely on the proposed exemption.

[23] The impact of the MSRB's proposed ban on principal transactions relating to the same "transaction" is even more profound where a municipal entity has multiple municipal advisors for different aspects of the same transaction. In such a case, the municipal entity would be barred from engaging in principal transactions with each and every one of these municipal advisors and all of their affiliates. Such a situation would severely limit the municipal entity's choice of counterparty and unduly burden competition.

III. Scope of the Fiduciary Duty Standard

Proposed Rule G-42(a)(ii) requires that a "municipal advisor to a municipal entity client shall, in the conduct of all municipal advisory activities for that client, be subject to a fiduciary duty that includes, *without limitation*, a duty of loyalty and duty of care" (emphasis added). SIFMA notes that the "without limitation" language was not included in the draft versions of Rule G-42 that the MSRB proposed for comment prior to its filing with the SEC.

The addition of the "without limitation" language raises significant and unnecessary ambiguities, as a fiduciary duty is generally understood to encompass a duty of care and duty of loyalty. If the MSRB believes other duties are included, it should specify, rather than including a vague catch-all. Similarly, in discussing the duty of loyalty, Supplementary Material .02 states that "[t]he duty of loyalty includes, but is not limited to…" It is fundamentally unfair to adopt rules that, rather than clarify the scope of the fiduciary duty,[24] impose explicitly vague standards for which any conduct could be second-guessed in hindsight.

IV. Application of Proposed Rule G-42(b) and (c) to Brokerage Services

Proposed Rule G-42(c) would require a municipal advisor to evidence each of its municipal advisory relationships by a writing or writings created and delivered to the municipal entity or obligated person client prior to, upon or promptly after the establishment of the municipal advisory relationship, including that the particular detailed elements must be documented.

A broker-dealer that maintains a securities brokerage account for a municipal entity may, in the ordinary course of business, provide incidental advice with respect to the investment of the funds in the account—which may include bond proceeds. While SIFMA acknowledges that this activity may cause the broker-dealer to become a municipal advisor, Proposed Rule G-42 appears to have primarily contemplated advice provided in the context of a municipal securities offering. As such, the manner in which elements of Proposed Rule G-42 apply to these ordinary brokerage transactions needs to be reconsidered.

Proposed Rule G-42(f)(vi) notes that a "municipal advisory relationship" is "deemed to exist when a municipal advisor enters into an agreement to engage in municipal advisory activities for a municipal entity or obligated person." Proposed Rule G-42(b) would further require specific disclosures be made "prior to or upon engaging in municipal advisory activities."

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[24] *See* Exchange Act § 15B(b)(2)(L)(i) (directing the MSRB to "prescribe means reasonably designed to prevent acts, practices, and courses of business as are not consistent with a municipal advisor's fiduciary duty to its clients").

The requirement to evidence a municipal advisory relationship in a written document and provide the required disclosures is highly impractical in the context of ordinary securities or brokerage/securities execution services relationships. In this context, a certain amount of frequent and ordinary course discussion takes place between a broker and its clients that may amount to "advice." These discussions and related investments occur frequently and are not significant enough to warrant special engagements for each individual advisory event or transaction. Requiring that they be treated as such would stifle these communications, preventing municipal entities from obtaining this incidental advice.

SIFMA recommends that the MSRB reconsider in detail how, if at all, these requirements should be applied to the brokerage and execution services context, given the qualitative differences between this relationship and other activities municipal advisors engage in. SIFMA believes that it would be preferable to exclude municipal advisory relationships that arise solely from this sort of informal advice that is incidental to providing brokerage/securities execution services from being subject to the written documentation requirement under Proposed Rule G-42(c) and the disclosure requirements under Proposed Rule G-42(b). Although subject to a fiduciary duty when providing this incidental advice to a municipal entity, satisfying these documentation and disclosure requirements would be impractical in the context of ordinary, relatively insignificant, brokerage transactions.[25]

However, if the MSRB determines to retain these requirements, they should be revised so as not to require transaction-by-transaction disclosure or documentation for incidental advice provided as part of a brokerage relationship. If compliance with the documentation and disclosure requirements were required on a transaction-by-transaction basis, broker-dealer municipal advisors would simply be unable to provide incidental advice relating to the investment of bond proceeds, harming municipal entities that are accustomed and expect to receive this incidental service.

[25] We note that there are other contexts in which minor or incidental municipal advisory services, outside the context of a municipal securities transaction, should not trigger the full proposed documentation requirements. For example, a municipal entity that previously issued municipal securities may contact a firm, on a very informal telephone basis, seeking its view of the materiality of an event and whether disclosure would be required. While providing this type of advice could constitute municipal advisory activities, it would be impractical (and indeed prohibitive) to require that such informal and relatively short-lived relationship be fully documented in accordance with Proposed Rule G-42(c).

V. Required Disclosures

A. The MSRB Should Clarify the Application of the Documentation and Disclosure Requirements to Pre-Existing Ongoing Relationships

Proposed Rule G-42(c) requires certain relationship documentation be entered into "upon or promptly after the establishment of" a municipal advisory relationship and Proposed Rule G-42(b) would require certain disclosures be provided "prior to or upon engaging in municipal advisory activities."

The MSRB, in the Proposing Release to Proposed Rule G-42, at first noted that the documentation requirement set forth Proposed Rule G-42(c) would not require municipal advisors to create a new contractual relationship, or modify existing contracts or agreements with their municipal advisor clients.[26] However, the MSRB nonetheless states that this is only true "[s]o long as the content of the documentation adheres to the requirements of the proposed rule."[27] Indeed, the MSRB suggests that, to satisfy the proposed rule for preexisting contracts, a municipal advisor would need to "provid[e] separate or supplemental documents to any preexisting contract, agreement or writing previously provided."[28]

Reviewing and likely supplementing the documentation for all existing municipal advisory relationships will be overly burdensome both for municipal advisors and clients. In addition, as the relationships are already in existence, new disclosures will likely not impact the client's decision to engage the municipal advisor. Instead, if an engagement is in effect at the compliance date of Proposed Rule G-42, the municipal advisor and existing client should be permitted to rely on their existing engagement under their current terms, without needing to update or modify the agreement to take into account any new requirements under Proposed Rule G-42.

VI. Other Matters

A. The MSRB Should Expand the Safe Harbor for Inadvertent Advice to Include the Prohibition on Principal Transactions

Supplementary Material .06 of Proposed Rule G-42 helpfully provides a limited and conditional safe harbor that specifies the steps that may be taken if a party inadvertently engaged in municipal advisory activities does not intend to continue the municipal advisory activities or enter into a municipal advisory relationship. In such a

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[26] Proposing Release at 66.

[27] *Id.*

[28] *Id.*

case, Proposed Rule G-42 permits the person to elect to seek a safe harbor from the requirements of sections (b) and (c) of Proposed Rule G-42 relating to disclosure of conflicts of interest and documentation of the municipal advisory relationship.

While Supplementary Material .06 would protect a municipal advisor from the disclosure and documentation requirements of Proposed Rule G-42, it would not protect municipal advisors from other requirements under Proposed Rule G-42, such as the principal transaction prohibition under Proposed Rule G-42(e)(ii). Because what constitutes advice can be subject to uncertainty and relying on the safe harbor affirmatively would require an affirmative determination that advice was provided, SIFMA believes that firms are unlikely to rely on the safe harbor unless it also provides an exemption for inadvertent advice triggering the prohibition on principal transactions.

Moreover, even without an exception from the principal transaction ban, the safe harbor is too limited to be useful. As drafted, it would not eliminate the need to comply with various other requirements of Proposed Rule G-42 that are not sensibly attached to inadvertent advice, such as the requirements related to making recommendations and reviewing third party recommendations. Without explicitly expanding the safe harbor to apply to all elements of Proposed Rule G-42, firms will be unlikely to elect to rely on it.

SIFMA therefore suggests that Supplementary Material .06 be revised as follows: "A municipal advisor is not required to comply with sections (b)*, (c), (d) and (e)(ii)* of this rule if the advisor meets all of the following requirements."

B. The Proposed Requirement that a Municipal Advisor May Not Rely on the Information Provided by its Client is Inappropriate as Related to the Case of Providing Advice to the Client, but Insufficiently Clear in Its Application to the Preparation of Official Statements

1. Advice to the Client

Supplementary Material .01 to Proposed Rule G-42 would require that a municipal advisor "undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information." In explaining this requirement in the Proposing Release, the MSRB explained that it "believes that requiring municipal advisors to conduct a reasonable investigation about the accuracy and completeness of the information. . .on which they will be basing their advice is necessary to ensure that clients will be able to make an informed decision based on facts and choose a prudent course of action."[29] The MSRB further noted in the Proposing Release that "obtaining a representation from the municipal advisor's client that the information it has provided, with no or insufficient diligence conducted by the municipal advisor, would not satisfy either [Proposed Rule G-42(d)] or Supplementary

[29] Proposing Release at 83.

Material .01. . .because such a representation would not sufficiently preclude the potential for the risks associated with providing advice or recommendations without a reasonable inquiry into the accuracy and completeness of the information upon which such advice or recommendations are based."[30]

The MSRB appears to require that municipal advisors must due diligence the truth of their own client's representations to the municipal advisor, or potentially be liable to their client for the client's own misrepresentations to the municipal advisor. This seems entirely unreasonable and inconsistent with standards applicable to broker-dealers and investment advisers, neither of whom are required to challenge the statements of their clients in connection, for example, with account opening, suitability determinations or investment applications. A municipal advisor, in the context of providing advice to a client, should not be obligated to question the truthfulness of the client's representations to the advisor when considering the suitability of recommendations.

It is unclear to SIFMA why a municipal entity client cannot be relied upon to provide accurate information to a municipal advisor about its own financial situation and objectives, the authority of the persons acting on its behalf when seeking or receiving advice from a municipal advisor.

2. Preparation of Official Statement

While a municipal advisor should be permitted to rely on information provided by its municipal entity client for purposes of providing advice to the client, it should be subject to a due diligence standard when preparing information on behalf of a municipal entity for dissemination to investors. The Proposing Release suggests that this is a component of Proposed Rule G-42,[31] but this obligation should be made explicit in the text of Rule G-42.

Municipal advisors are often called on to prepare certain sections of an official statement or to review the disclosures prepared by a municipal entity. Because municipal entities are subject to potential liability for material misstatements or omissions in an official statement, both municipal entities and investors expect that material included in the official statement have been prepared with a high degree of care. As part of its fiduciary duty to its client, so as to protect it from potential liability, a municipal advisor should be explicitly obligated to undertake a reasonable investigation to confirm that those sections of an official statement that it or the municipal entity prepare do not contain any material misstatements or omissions.

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[30] Proposing Release at 84.

[31] *See* Proposing Release at note 9 and accompanying text ("The duty of care … would apply to the provision of comments following the review of any document and the provision of language for use in any document -- including an official statement …").

Indeed, the SEC staff has stated, with respect to broker-dealers acting as underwriters in connection with municipal securities offerings, that "[b]y holding itself out as a securities professional and, especially in light of its relationship with the issuer, a municipal underwriter also makes a representation that it has a reasonable belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offering."[32] If this is the case for a dealer involved in a transaction—where no fiduciary duty exists—at least such a standard must apply to a municipal advisor involved in the preparation of the official statement. Further, SIFMA believes that municipal advisors should be subject to documentation and record retention standards (including regulator examination expectations) in connection with this due diligence consistent with those requirements applied to broker-dealers engaged in due diligence in connection with acting as underwriters.

C. Accuracy of Invoices

Proposed Rule G-42(e)(i)(B) would prohibit a municipal advisor from delivering an invoice for fees or expenses that do not accurately reflect the activities actually performed or the personnel that accurately performed the activities. SIFMA agrees that such practices should be prohibited, however, errors may occur in the ordinary course and unintentional billing errors do not ordinarily rise to the level of regulatory violation.

SIFMA suggests adding materiality and knowledge qualifiers (*i.e.*, a municipal advisor may not *intentionally* deliver a *materially* inaccurate invoice), so as to avoid prohibiting immaterial or unintentional errors, would be appropriate.

[32] SEC Office of Compliance Inspections and Examinations, National Exam Risk Alert, *Strengthening Practices for the Underwriting of Municipal Securities* (Mar. 19, 2012).

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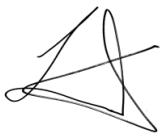
SIFMA appreciates your consideration of these views. Please do not hesitate to contact me at (212) 313-1130, or our counsel, Lanny A. Schwartz of Davis Polk & Wardwell LLP, at (212) 450-4174 with any questions.

Sincerely yours,



Leslie M. Norwood
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