

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-64564; File No. SR-MSRB-2011-03)

May 27, 2011

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Amend Rule G-23, on Activities of Financial Advisors

On February 9, 2011, the Municipal Securities Rulemaking Board (“Board” or “MSRB”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend MSRB Rule G-23, on activities of financial advisors. The Commission published the proposed rule change for comment in the Federal Register on February 28, 2011 (the “Commission Notice”).<sup>3</sup> The Commission received eighteen comment letters.<sup>4</sup> On May 27, 2011, the MSRB filed an amendment (“Amendment No. 1”) to the

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 63946 (February 22, 2011), 76 FR 10926.

<sup>4</sup> See letter from F. John White, Chief Executive Officer, Public Financial Management, Inc., dated February 25, 2011 (“PFM Letter”); e-mail to Mary N. Simpkins, Senior Special Counsel, Commission, from Patricia Bowen, Vice President, Eastern Bank, dated March 2, 2011 (“Eastern Bank Letter”); letter from Robert W. Doty, President, American Governmental Financial Services, dated March 10, 2011 (“AGFS Letter”); letter from Hill A. Feinberg, Chairman and CEO, First Southwest Company, dated March 16, 2011 (“First Southwest Letter”); letter from Carl Giles, dated March 16, 2011 (“Giles Letter”); letter from Keith Kolb, Managing Director, Director of Baird Public Finance, Robert W. Baird & Co. Incorporated, dated March 18, 2011 (“Baird Letter”); letter from Joy A. Howard, Principal, WM Financial Strategies, dated March 18, 2011 (“Joy Howard Letter”); letter from Christopher Hamel, Head of Municipal Finance, RBC Capital Markets, LLC, dated March 21, 2011 (“RBC Letter”); letter from Nathan R. Howard, Municipal Advisor, WM Financial Strategies, dated March 21, 2011 (“Nathan Howard Letter”); letter from Mike Nicholas, Chief Executive Officer, Bond Dealers of America, dated March 21, 2011 (“BDA Letter”); e-mail from David A. Wagner, Senior Vice President and Financial Advisor, Ehlers Associates, Inc., dated March 21, 2011 (“Ehlers Letter”); letter from Colette J. Irwin-Knott, President, National Association of Independent Public Finance Advisors, dated March 21, 2011 (“NAIPFA Letter”); letter

proposed rule change.<sup>5</sup> The Commission is publishing this notice and order to solicit comments on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No.

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I. Description of Proposed Rule Change and Summary of Comments

As described in the Commission Notice, the MSRB is proposing to amend its Rule G-23, on activities of financial advisors. Proposed Rule G-23 would, subject to limited exceptions, (i) prohibit a dealer financial advisor with respect to the issuance of municipal securities from acquiring all or any portion of such issue directly or indirectly, from the issuer as principal, or acting as agent for the issuer in arranging the placement of such issue, either alone or as a participant in a syndicate or other similar account formed for that purpose; (ii) apply the same prohibition to any dealer controlling, controlled by, or under common control with the dealer financial advisor; and (iii) prohibit a dealer financial advisor from acting as the remarketing agent for such issue. In addition, the proposed interpretive guidance, as amended, would provide

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from Steve Apfelbacher, President, Ehlers Associates, Inc., dated March 21, 2011 (“Apfelbacher Letter”); letter from Leslie M. Norwood, Managing Director and Associate General Counsel, The Securities Industry and Financial Markets Association, dated March 21, 2011 (“SIFMA Letter”); letter from Larry Kidwell, President, Kidwell & Company Inc., dated March 21, 2011 (“Kidwell Letter”); e-mail from Robert J. Stracks, Counsel, BMO Capital Markets GKST Inc., dated March 22, 2011 (“BMO Letter”); letter from Susan Gaffney, Director, Federal Liaison Center, Government Finance Officers Association, dated March 21, 2011 (“GFOA Letter”); letter from Thomas M. DeMars, Managing Principal, Fieldman, Rolapp & Associates, dated March 23, 2011 (“Fieldman Letter”).

<sup>5</sup> Amendment No. 1 partially amends the text of the original proposed interpretive notice to: (i) clarify that Rule G-23 is solely a conflicts rule; (ii) eliminate the rebuttable presumption that a dealer providing certain advice is a financial advisor; (iii) emphasize that Rule G-23(b) does not require a writing in order for a financial advisory relationship to exist; (iv) provide additional clarity as to when a dealer will be deemed to be “acting as an underwriter” and not as a financial advisor for purposes of Rule G-23(b); and (v) provide guidance on certain activities (in addition to underwriting activities) in which a dealer may engage without violating Rule G-23(d).

guidance on when a dealer that renders advice would be considered to be “acting as an underwriter” rather than as a financial advisor for purposes of proposed Rule G-23.

The proposed rule change resulted from a concern that a dealer financial advisor’s ability to underwrite the same issue of municipal securities, on which it acted as financial advisor, presented a conflict that is too significant for the existing disclosure and consent provisions of Rule G-23 to cure. Even in the case of a competitive underwriting, the perception on the part of issuers and investors that such a conflict might exist was sufficient to cause concern that permitting such role switching was not consistent with “a free and open market in municipal securities,” which the Board is mandated to perfect.<sup>6</sup> Of the eighteen comment letters received on the proposed rule change,<sup>7</sup> eleven commenters expressed some support for the proposed rule change, including the general principle that prompted the proposed rule change, but these commenters also suggested certain changes to or exemptions from the proposed rule change.<sup>8</sup> Seven commenters objected to all or part of the proposed rule change.<sup>9</sup>

The MSRB’s responses to comments and changes to the proposed rule change made by Amendment No. 1 are described below.

A. Scope of “Acting as an Underwriter” and Rule G-23(b)

Several commenters stated that the proposed rule change would preserve the general confusion between the role of a financial advisor and the role of an underwriter and preserve

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<sup>6</sup> See Commission Notice, supra note 3 at 10927.

<sup>7</sup> See supra note 4.

<sup>8</sup> See PFM Letter, AGFS Letter, First Southwest Letter, Joy Howard Letter, Nathan Howard Letter, Ehlers Letter, NAIPFA Letter, Apfelbacher Letter, Kidwell Letter, GFOA Letter and Fieldman Letter.

<sup>9</sup> See Eastern Bank Letter, Giles Letter, Baird Letter, RBC Letter, BDA Letter, SIFMA Letter and BMO Letter.

historically abusive market practices.<sup>10</sup> One commenter expressed concern that the exemption for underwriters under the proposed interpretive guidance is inconsistent with the underwriter exemption provided under the Dodd-Frank Act and the Commission’s proposed rules,<sup>11</sup> and would help underwriters evade fiduciary duties.<sup>12</sup> Another commenter stated that the proposed rule change: (i) undermines the will of the Exchange Act to adhere to clear lines between interests that are public and interests that are private; (ii) perpetuates a culture of conflict that the Exchange Act intended to eliminate; (iii) creates loopholes for bank/broker dealers to continue to serve in multiple roles and represent conflicting interests in transactions; (iv) avoids the intent of the Exchange Act to impose fiduciary duties on municipal advisors who are bank/broker dealers; (v) creates confusion and perplexity as opposed to clarity and precision as a baseline for interpretation of the rules; (vi) invites opportunity for continued abuses of municipal issuers; and (vii) conflicts with the stated mission of the MSRB to protect the interests of issuers, investors, and the public trust, and not those of the bank/broker dealer community.<sup>13</sup>

Another commenter stated that it has asked the MSRB, on various occasions, to consider whether it is appropriate for a broker-dealer to provide the kind of advice that financial advisors

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<sup>10</sup> See Joy Howard Letter at 1-2. See also Kidwell Letter at 2-3 and Nathan Howard Letter at 1. One commenter expressed the belief that the current financial crisis was caused in part by the acts of financial advisors who engaged in conflicts of interest that were either undisclosed, or disclosed and misunderstood, by debt issuers, borrowers, and investors. See *id.* at 2.

<sup>11</sup> See Exchange Act Release No. 63576 (December 20, 2010), 76 FR 824 (January 6, 2011) (“Municipal Advisor Registration Proposing Release”).

<sup>12</sup> See PFM Letter at 2-4.

<sup>13</sup> See Kidwell Letter at 4. This commenter stated that state and local governments and their instrumentalities should be held to a different and higher standard than individuals or corporations because the risk associated with loss due to a conflict of interest is of public monies, where the officials responsible for the allowance of the conflict bear no personal financial responsibility in association with such actions. See *id.* at 3.

typically provide.<sup>14</sup> This commenter stated that the MSRB has failed to recognize the distinction between providing advice and acting as an underwriter, and objected to the exemption from the definition of municipal advisor for underwriters that render “advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities.”<sup>15</sup>

Other commenters expressed concern that the lack of distinction between the “advice” provided by municipal advisors and the “advice” provided by underwriters will reduce market transparency and the distinction between the roles, and as such will confuse market participants, including small infrequent municipal issuers.<sup>16</sup> Specifically, one commenter stated that because the proposed rule change uses the term “advice” to describe both the actions of financial advisors and underwriters, market participants will be confused as to the type of services that may be provided.<sup>17</sup> This commenter suggested using the term “recommendation or guidance” in the context of municipal advisors, and the term “information” in the context of underwriters.<sup>18</sup>

Several commenters suggested enhanced disclosure by dealers who act as underwriters. According to one commenter, with regard to negotiated sales, dealers, in their course of engagement as underwriters, typically provide input regarding matters related to the structure, timing, and terms of the bonds.<sup>19</sup> The commenter stated its belief that this input should not be substituted for advice the issuer receives from a financial advisor.<sup>20</sup> This commenter also

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<sup>14</sup> See NAIPFA Letter at 1.

<sup>15</sup> Id. at 2.

<sup>16</sup> See Joy Howard Letter at 8 and Nathan Howard Letter at 1.

<sup>17</sup> See Nathan Howard Letter at 1.

<sup>18</sup> See id. at 1-4.

<sup>19</sup> See GFOA Letter at 2.

<sup>20</sup> See id.

suggested that when the issuer is represented by a financial advisor, this underwriter input should not be seen as violating the intent of Rule G-23.<sup>21</sup> However, when the issuer is not so represented, such input provided by the underwriter becomes the issuer’s sole source of financial advice, and this may cause the underwriter to be the de facto financial advisor to the issuer.<sup>22</sup> The commenter suggested that the latter relationship should be prohibited by Rule G-23.<sup>23</sup> As such, this commenter suggested that the proposed interpretive guidance should at least require the underwriter to disclose that it is not serving as the issuer’s financial advisor, and has no fiduciary obligation to act in the best interest of the issuer.<sup>24</sup> This commenter further stated that “[i]ssuers need to clearly understand that their underwriter is not their financial advisor and that they are not discouraged from hiring a financial advisor because of a loophole in the proposed Guidance that suggests the underwriter can perform both roles.”<sup>25</sup>

Another commenter stated that if the Commission adopts the expansive view of what constitutes “acting as an underwriter” as proposed by the MSRB, the underwriters acting as financial advisors should be required to decide the role they wish to play before they talk with the issuer and affirmatively disclose the conflicts inherent in their underwriting role to the issuer, if that is the role they decide to pursue.<sup>26</sup> Further, this commenter stated that any contract that

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<sup>21</sup> See id.

<sup>22</sup> See id.

<sup>23</sup> See id.

<sup>24</sup> See id.

<sup>25</sup> Id.

<sup>26</sup> See NAIPFA Letter at 7-8. This commenter also noted the extensive affirmative disclosure obligations the MSRB is seeking to impose on municipal advisors, and the lack of similar disclosure required of dealers. See id. As such, this commenter suggested that dealers providing advice should be required to do more than merely state that they are acting as an underwriter to avoid being deemed a financial advisor. See id. at 8.

the underwriter had for acting as an advisor for an issuer must be terminated when the firm is hired or seeks to be hired as an underwriter to the issuer, or in any other role that is inconsistent with the role of a fiduciary.<sup>27</sup> Another commenter stated that a firm should disclose in writing, prior to beginning any work for a municipal issuer, whether it will be working as a broker-dealer or as a municipal advisor so as to allow a municipality to make an informed decision to use a broker-dealer instead of a municipal advisor.<sup>28</sup>

Another commenter generally expressed support for the proposed rule change and the proposed interpretive guidance.<sup>29</sup> With respect to the proposed interpretive guidance, the commenter pointed out that it is possible that a dealer may make representations or engage in conduct at the outset of a relationship that leads a municipal entity to believe that the dealer, even though labeled as “underwriter,” is providing advice in the municipal entity’s best interests.<sup>30</sup> Moreover, the commenter stated that the “advice” offered to a municipal entity may have other functions than being offered in an issuer’s best interests.<sup>31</sup> Further, this commenter pointed out that even if a direct explicit representation is not made, there are a variety of methods to lead a municipal entity to believe that an underwriter’s advice places the entity’s interests first.<sup>32</sup> In addition, this commenter expressed skepticism that merely informing an issuer that a dealer will be an underwriter is sufficient to “whitewash the dealer’s advice to the issuer” because many

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Rather, the commenter suggested that disclosure similar to that proposed for municipal advisors should be required for underwriters. See id.

<sup>27</sup> See NAIPFA Letter at 8.

<sup>28</sup> See Ehlers Letter.

<sup>29</sup> See AGFS Letter at 1.

<sup>30</sup> See id.

<sup>31</sup> See id.

<sup>32</sup> See id.

issuers do not know the difference between an underwriter and a financial advisor.<sup>33</sup> As such, this commenter suggested that the dealer be required to inform the issuer that the advice is not offered in a fiduciary capacity, with an explanation of what that means.<sup>34</sup> Lastly, this commenter suggested that dealers serving as underwriters should engage in discussions with issuers underscoring the non-fiduciary character of the relationship and state in bond purchase agreements atypical facts and circumstances in which underwriters do assume fiduciary roles.<sup>35</sup>

On a similar note, five commenters<sup>36</sup> suggested amending or deleting paragraph (b) of Rule G-23 in order to reduce confusion about the scope of the role of an underwriter and the role of a financial advisor. One of these commenters stated that under the Exchange Act, an individual acts as a municipal advisor if it provides “advice with respect to the structure, timing, terms and other similar matters concerning such financial products or issues,” and a “broker, dealer, or municipal securities dealer serving as an underwriter” is excluded from the definition of a municipal advisor.<sup>37</sup> This commenter then pointed out that “[t]he definition of ‘underwriter’ under Section 2(a)(11) of the Securities Act of 1933 does not include ‘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

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<sup>33</sup> See id. at 2. See also Kidwell Letter at 2-3 (stating that while conflicts of interest may have been disclosed to issuers, many may not fully understand how their interests could be adversely affected by permitting such conflicts of interest to exist).

<sup>34</sup> See AGFS Letter at 2.

<sup>35</sup> See id. at 2-3. The commenter also pointed out that the discussions should occur at the outset of the relationship, and prior to the time that issuers commit themselves to particular courses of action. See id. at 3.

<sup>36</sup> See PFM Letter, Joy Howard Letter, Nathan Howard Letter, NAIPFA Letter and Kidwell Letter.

<sup>37</sup> See Joy Howard Letter at 2.



issues.”<sup>38</sup> As such, the commenter stated that proposed Rule G-23 confuses the distinction between municipal advisors and underwriters, thereby making the market less transparent and more susceptible to conflicts of interest and abuse and that proposed Rule G-23 would be less ambiguous if paragraph (b) was deleted in its entirety.<sup>39</sup> Another commenter suggested that the last sentence of paragraph (b) of proposed Rule G-23 be revised to read: “Notwithstanding the foregoing, for purposes of this rule, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker, dealer or municipal securities dealer provides information to an issuer relating to the sale of the securities to investors such as transactional structures, the underwriter’s capabilities to sell various securities, how particular terms of a security structure may affect rates and yields, and matters incidental to the underwriting of a new issue of municipal securities.”<sup>40</sup>

In response, in Amendment No. 1, the MSRB stated that, in order for a dealer to be considered to be acting as an underwriter under Rule G-23(b), it must clearly identify itself, in writing, as an underwriter and not as a financial advisor from the earliest stages of the relationship and, in the proposed interpretive guidance, as amended by Amendment No. 1, the MSRB provides additional examples of what the earliest stage of a relationship may be. Amendment No. 1 would also amend the proposed interpretive guidance to provide that the required disclosure must make clear that the primary role of an underwriter is to purchase, or arrange 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. Additionally, as amended, the proposed interpretive guidance would

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<sup>38</sup> Id.

<sup>39</sup> See id.

<sup>40</sup> NAIPFA Letter at 6.

provide that the dealer must not engage in a course of conduct that is inconsistent with an arm's length relationship with the issuer in connection with such issue of municipal securities or the dealer will be deemed to be a financial advisor with respect to that issue and precluded from underwriting that issue by Rule G-23(d). The MSRB is of the view that these disclosures would be adequate to alert the issuer to the role of the dealer as an underwriter with respect to an issue, especially when coupled with the requirement that the dealer's course of conduct must not be inconsistent with its disclosures if it is to avoid being considered a financial advisor.

The Commission understands commenters' concerns regarding clarity of the roles of an underwriter and a financial advisor and believes that the requirement under the proposed rule, as amended, that a firm wishing to serve as an underwriter must make a written disclosure of its proposed role with respect to an issuance at the earliest stages of its relationship with the issuer and continue to engage in a course of conduct consistent with that role in connection with such issue, will help achieve that clarity. In addition, the Commission notes that a variety of facts and circumstances, including the presence or absence of another firm serving as a financial advisor with respect to that issuance, may ultimately inform any review of whether or not a dealer has engaged in a course of conduct consistent with the role of an underwriter with respect to that issue.

As discussed above, several commenters expressed concern that the proposed rule conflicted with the provisions of Section 15B(c)(1) of the Exchange Act<sup>41</sup> which provides that "municipal advisors have a fiduciary duty to their municipal entity clients."<sup>42</sup> The Commission notes that the proposed rule, as amended, explicitly does not define "whether provision of the advice permitted by Rule G-23 would cause the dealer to be considered a 'municipal advisor'

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<sup>41</sup> 15 U.S.C. 78o-4(c)(1)

<sup>42</sup> See, e.g., PFM Letter, Joy Howard Letter, NAIPFA Letter and Kidwell Letter.

under the Exchange Act.” In addition, the proposed interpretive guidance, as amended, clarifies that “Rule G-23 is only a conflicts-of-interest rule and does not set normative standards for dealer conduct. In particular, Rule G-23, as amended, would not address whether the provision of any of the advice permitted by Rule G-23 would subject the dealer to a fiduciary duty as a ‘municipal advisor.’”<sup>43</sup> The Commission further notes that although it shall not be a violation of Rule G-23(d) for a dealer acting as an underwriter to give advice with respect to the investment of the proceeds of the issue, municipal derivatives integrally related to the issue or other similar matters concerning the issue, as proposed in the Municipal Advisor Registration Proposing Release, such dealer would be required by the Commission to register as a municipal advisor with respect to such advice.<sup>44</sup> Since October 1, 2010, municipal advisors, and any persons associated with a municipal advisor, have had a fiduciary duty to any municipal entity for whom the municipal advisor acts as a municipal advisor. In addition, the Commission notes that a dealer acting as an underwriter who must also register as a municipal advisor may be subject to additional rules (including, but not limited to, limitations on unmanageable conflicts or additional disclosures regarding compensation and conflicts of interest) based upon fiduciary duty or other laws or rules.

B. Rebuttable Presumption of Financial Advisor Status

Several commenters objected to the rebuttable presumption in the proposed interpretive guidance, which stated that a dealer that provides advice to an issuer with respect to the issuance of municipal securities will be presumed to be a financial advisor with respect to that issue and suggested that the presumption be eliminated. One commenter suggested that the interpretive guidance does not provide any clarity because it states that an underwriter could still be

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<sup>43</sup> See Amendment No. 1 at 4.

<sup>44</sup> See Municipal Advisor Registration Proposing Release, supra note 11.

considered a financial advisor by engaging in certain unspecified subsequent actions.<sup>45</sup> This commenter opined that rather than using presumptions, the rule should be that if a party is engaged by an issuer as a financial advisor, then it is a financial advisor; and if a party is engaged by an issuer as an underwriter, then it is an underwriter.<sup>46</sup> This commenter further stated that if the Commission does not believe issuers can understand the differences between those roles, it can prescribe disclosures to make the differences clear.<sup>47</sup>

Another commenter expressed concerns with the ability of underwriters to advise issuers in connection with an offering in the context of the proposed rebuttable presumption.<sup>48</sup> The commenter stated that, in connection with the solicitation of municipal underwriting business, prospective underwriters are frequently asked by issuers about structuring and strategic alternatives, comparative analyses and general market intelligence, and other relevant ideas, and this dialogue provides an important informational foundation for many issuers in the financing process.<sup>49</sup> As such, this commenter stated that the presumption that dealers are financial advisors would chill or eliminate this pre-engagement exchange, particularly because even if a dealer had properly alerted the issuer that it was acting solely as an underwriter, its subsequent course of conduct may still cause it to be considered a financial advisor and thus be precluded from participating in the underwriting.<sup>50</sup> The commenter stated that this problem is exacerbated because of the proposed deletion of the reference to compensation in Rule G-23(b), which has

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<sup>45</sup> See BDA Letter at 3.

<sup>46</sup> See id.

<sup>47</sup> See id.

<sup>48</sup> See SIFMA Letter at 3.

<sup>49</sup> See id. at 4.

<sup>50</sup> See id.

provided a bright line for determining whether a person is a financial advisor.<sup>51</sup> Consequently, the commenter suggested that the presumption be eliminated, and instead, the interpretive guidance should provide that dealers intending to act solely as underwriters make clear and unambiguous such intentions in their initial communications with the issuer.<sup>52</sup> Another commenter objected to the proposed presumption and stated that underwriter conduct is clearly discernible because such transactions are formally concluded by a bond purchase agreement.<sup>53</sup>

On the other hand, several commenters requested more guidance about the content of the actions necessary to rebut the presumption of financial advisory status.<sup>54</sup> One commenter stated that “[t]o give the Rule any substantive meaning, the timing and content of a rebuttal of a municipal advisory relationship must be well defined... It is particularly important that the rebuttal be clear about the broker-dealer’s role and its limits in the context of a negotiated transaction in which there is no municipal advisor.”<sup>55</sup>

In response, in Amendment No. 1, the MSRB noted that Amendment No. 1 would amend

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<sup>51</sup> See id.

<sup>52</sup> See id. This commenter further suggested that the proposed interpretive guidance should provide that a written agreement between the prospective underwriter and municipal issuer reflecting such understanding would, in fact, establish a presumption that the underwriter will continue to act in such role throughout the pendency of the offering. See id. at 4-5.

<sup>53</sup> See BMO Letter.

<sup>54</sup> See Joy Howard Letter at 5-8 and Fieldman Letter. For example, one commenter raised questions about the meaning of the phrases “in the course of acting as an underwriter” and “clearly identify itself as an underwriter” as they are used in the proposed interpretive guidance. See Joy Howard Letter at 5-8.

<sup>55</sup> Fieldman Letter. This commenter suggested that the rebuttal must state that the underwriter broker-dealer is not serving as a municipal advisor; that the underwriter also represents interests that may conflict with those of the issuer; and that the broker-dealer does not owe a fiduciary duty and duties of loyalty and care to the issuer. See id. This commenter also suggested that the rebuttal must be in writing and acknowledged by the issuer, and must be provided prior to the beginning of any work for the issuer. See id.

the proposed interpretive guidance by removing the rebuttable presumption language and replacing it with language that a financial advisory relationship will be deemed to exist whenever a dealer renders the types of advice provided for in proposed Rule G-23(b), because the revised language is more consistent with the language of proposed Rule G-23(b).

C. Section 23(c): Writing Requirement for Financial Advisors

One commenter recommended that Rule G-23(c) be deleted or revised<sup>56</sup> because it is no longer necessary.<sup>57</sup> This commenter stated that the Dodd-Frank Act provided a definition of “municipal advisor” and the Commission’s proposing release on the registration of municipal advisors made it clear that an individual will be treated as a municipal advisor regardless of whether these services are free.<sup>58</sup> As such, the commenter opined that a written agreement is unnecessary for determining whether the broker-dealer is a financial advisor.<sup>59</sup>

In response, in Amendment No. 1, the MSRB noted that Amendment No. 1 would amend the proposed interpretive guidance to reiterate what Rule G-23 has always provided: it is not necessary to have a writing in order for a financial advisory relationship to exist. Instead, Rule G-23(c) provides that a writing must be entered into prior to, upon or promptly after the inception of the financial advisory relationship. The Commission believes that the change in Amendment No. 1 clarifying that it is not necessary to have a written agreement for a financial advisory relationship to exist is consistent with the provisions of the Exchange Act.

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<sup>56</sup> See Joy Howard Letter at 3-4. This commenter suggested that the rule be modified such that a broker-dealer that intends to serve as an underwriter would be required to submit to the municipal entity a written document that defines the broker-dealer’s role as an underwriter, and indicates that the underwriter is not serving as an advisor and is not serving as a fiduciary. See id. at 4.

<sup>57</sup> See id. at 3.

<sup>58</sup> See id.

<sup>59</sup> See id.

D. Small and/or Infrequent Issuers

Several commenters<sup>60</sup> stated that the proposed amendments to Rule G-23 would harm small and infrequent issuers, with one commenter<sup>61</sup> specifically calling for an exemption for “Small Issue Deals” or “offerings under \$5 million in aggregate principal amount” and another commenter<sup>62</sup> calling for an exemption for “issuances under \$10 million.”

One commenter expressed concern that the proposed rule change will adversely impact small municipal bond transactions because it will eliminate an already limited number of potential underwriters for such transactions, resulting in decreased competition, decreased choice, and increased costs to issuers.<sup>63</sup> Several other commenters expressed similar concerns about decreased competition, decreased choice, and increased costs.<sup>64</sup> Further, one commenter stated that it is unaware of any history of abuse in simple fixed rate bonds that make up most of the small issuances, and that any concern relating to potential abuse by financial advisors is addressed through federal and state fiduciary duties imposed on financial advisors.<sup>65</sup> One commenter suggested that, if the proposed rule change is approved, the MSRB carefully monitor the impact of the rule change on small and/or infrequent issuers and revise the rule if needed to increase market accessibility.<sup>66</sup>

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<sup>60</sup> See e.g., RBC Letter, First Southwest Letter, BDA Letter and SIFMA Letter. See also Eastern Bank Letter.

<sup>61</sup> See First Southwest Letter at 1-2.

<sup>62</sup> See SIFMA Letter at 5.

<sup>63</sup> See First Southwest Letter at 1.

<sup>64</sup> See SIFMA Letter at 5 and BDA Letter at 2.

<sup>65</sup> See SIFMA Letter at 5.

<sup>66</sup> See BDA Letter at 2.

On the other hand, one commenter that supported the proposed amendments to Rule G-23 did not support an exception to the proposed amendments for small and/or infrequent issuers.<sup>67</sup> This commenter noted that small and infrequent issuers will be the primary beneficiaries of the revised Rule G-23 because these issuers are the least likely to understand the conflicts of interest that arise when a financial advisor switches to serving as an underwriter.<sup>68</sup>

In Amendment No. 1, the MSRB stated that it believes that the potential negative impact on fees and market accessibility for small and/or infrequent issuers would be minimal compared to the protections that will be afforded to such issuers. The MSRB stated that it was persuaded by arguments that small and/or infrequent issuers are, in many cases, unable to appreciate the difference in the nature of the roles of a financial advisor and an underwriter and did not believe that exceptions should be provided for smaller offerings as suggested by several commenters. The Commission agrees that it is appropriate to apply the protections of proposed Rule G-23 to small and/or infrequent issuers.

E. Competitive Bid Offerings

Six commenters<sup>69</sup> supported changes to the proposed amendments that would exempt some or all competitively bid transactions from the proposed rule change. Several commenters stated that there has been no history of abuse by dealers that had previously served as financial advisors in competitive bids.<sup>70</sup> One commenter pointed out that the competitive bidding process

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<sup>67</sup> See Joy Howard Letter at 10.

<sup>68</sup> See id.

<sup>69</sup> See Giles Letter, BDA Letter, Baird Letter, RBC Letter, SIFMA Letter and First Southwest Letter. One commenter stated that except for municipal bond transactions under \$5 million, the commenter does not believe there should be an exception for competitively bid transactions. See First Southwest Letter at 1.

<sup>70</sup> See RBC Letter at 2. This commenter stated that there is no evidence that financial advisors structure transactions to give themselves an advantage, or are not diligent in



for municipal issues has become almost exclusively electronic, and the electronic process provides for a completely transparent, highly efficient and tamper proof process.<sup>71</sup> Another commenter stated that the municipal underwriting market is competitive, and competition and transparency resulting from a free and open market would prohibit inappropriate or unethical behavior by financial advisors acting as underwriters.<sup>72</sup> One other commenter stated that financial advisors would have no practical opportunity in these straightforward, simple contexts to structure an offering that might give them any competitive advantage.<sup>73</sup> Several commenters also expressed concern that by prohibiting the bid of financial advisors under the proposed rule change, issuers may end up being locked out of the market, or the lowest bid would be removed from the process, harming particularly the smaller issuers.<sup>74</sup> Moreover, some commenters stated

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seeking other bidders in order to improve their chances of being the successful bidder. See id. See also Baird Letter at 3; SIFMA Letter at 3; and Giles Letter at 1 (stating that the proposed rule change is based on the “specious argument” that “a conflict of interest might exist when a financial advisor acts as an underwriter,” and that there is no tangible proof that an actual conflict of interest exists or that such conflict of interest has resulted in wrongdoing).

<sup>71</sup> See RBC Letter at 2. See also SIFMA Letter at 3 (stating that “competitively bid, non rated, non credit-enhanced, fixed rate municipal debt issuances in which the issuer utilizes an electronic bidding platform” should be exempt from the proposed rule change in order to ensure continued unfettered access to the credit markets for municipal issuers).

<sup>72</sup> See Giles Letter at 2. See also BDA Letter at 2 (stating that potential conflicts of interest for financial advisors who act as underwriters are eliminated in a fairly run, competitively bid offering of securities) and Giles Letter at 1 (stating that “any conflict of interest that might exist would be erased by permitting competitive bidding”).

<sup>73</sup> See SIFMA Letter at 3.

<sup>74</sup> See RBC Letter at 2. This commenter opined that this proposed rule change would create an additional artificial barrier to entry to the market by non-rated competitive issuers because such issuers have historically depended on “bidders that are willing to do their homework in order to bid,” such as financial advisors. See id. at 3. See also SIFMA Letter at 3 and Giles Letter at 2 (stating that the proposed rule change could be economically harmful to taxpayers by eliminating competitive bidders and precluding best execution for the issuer).

that concerns relating to potential abuse by financial advisors would be addressed through their fiduciary duties under federal and state law.<sup>75</sup>

On the other hand, one commenter expressed support for the absence of an exception for competitive sales in the proposed rule change because this would ensure that financial advisors aggressively work to secure the largest number of bids possible.<sup>76</sup> This commenter acknowledged that there could be instances where a small issuer experiences difficulty in obtaining bids.<sup>77</sup> However, the commenter stated that if a financial advisor is allowed to switch roles to become an underwriter, the financial advisor would effectively be allowed to breach its fiduciary duty by structuring and marketing the transaction in a fashion to insure their success as the winning bidder rather than seeking to obtain the largest number of bids possible.<sup>78</sup>

In Amendment No. 1, the MSRB stated that it does not believe that the use of electronic bidding platforms mitigates the conflict of interest posed by a dealer financial advisor's switching to an underwriter role, in part, because such platforms are not necessarily available to all issuers. Further, in the Commission Notice, the MSRB stated its belief that involvement in this process provides a dealer financial advisor with information that can provide an unfair advantage when such dealer participates in a competitive bid transaction. The Commission believes that the MSRB's proposed rule change helps prevent potential conflicts of interest and/or unfair competition issues that could arise when a dealer financial advisor participates in a competitive bid transaction without limiting access to potential purchasers of an issuance of municipal securities.

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<sup>75</sup> See SIFMA Letter at 3. See also RBC Letter at 3.

<sup>76</sup> See Joy Howard Letter at 10.

<sup>77</sup> See id.

<sup>78</sup> See id.

F. Effective Date

Several commenters suggested that the six-month transition period provided in the proposed rule change should be extended. Commenters suggested various transitional timeframes to allow market participants adequate time to comply with any changes.<sup>79</sup> One commenter suggested a transitional period of one year to allow issuers, dealers, and financial advisors sufficient time to take action to comply with the rules.<sup>80</sup> Another commenter expressed concern that the six-month implementation period proposed by the MSRB for the proposed rule change is insufficient to avoid market disruption.<sup>81</sup> One commenter suggested incorporating a grandfather clause that would allow current Rule G-23 to continue to apply to financial advisory relationships that are in place at the time the proposed rule change is adopted.<sup>82</sup>

On the other hand, several commenters suggested that the transition period should be shortened or eliminated. One commenter suggested that in order to clarify and enforce the fiduciary duty of financial advisors, there should not be a transition period for prohibiting role switching from financial advisor to underwriter.<sup>83</sup> Another commenter stated that because municipal advisors had a fiduciary duty under federal law effective October 1, 2010, any role switching that occurred after that date is a violation of the Exchange Act.<sup>84</sup>

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<sup>79</sup> See BDA Letter, Baum Letter and SIFMA Letter.

<sup>80</sup> See BDA Letter at 3.

<sup>81</sup> See SIFMA Letter at 6.

<sup>82</sup> See id.

<sup>83</sup> See Joy Howard Letter at 9. This commenter stated that in MSRB Notice 2010-42, dated October 1, 2010, the MSRB stated that financial advisors are subject to a federal fiduciary duty to their municipal entity clients as of October 1, 2010, even before MSRB rulemaking on the subject. See id. As such, this commenter stated that any broker-dealer that has served as a financial advisor on or after October 1, 2010 and subsequently switched to serving as an underwriter has already violated its fiduciary duty. See id.

<sup>84</sup> See NAIPFA Letter at 8.

In response, in Amendment No. 1, the MSRB stated that it does not recommend changing the current proposal that the rule change be made effective for new issues for which the Time of Formal Award (as defined in MSRB Rule G-34) occurs more than six months after Commission approval. In addition, the MSRB does not recommend a grandfather provision, as the MSRB has determined that the effective date described above provides an ample time period for issuers of municipal securities to finalize any outstanding transactions that might be affected by the proposed rule change. The Commission believes that the proposed effective date for proposed Rule G-23 is appropriate.

G. Other Comments

Several commenters expressed concern that the MSRB never published the proposed interpretive guidance to proposed Rule G-23 for public comment before it was filed with the Commission, as it did with other amendments to Rule G-23.<sup>85</sup> In response, in Amendment No. 1, the MSRB noted that it filed the proposed rule change with the Commission in accordance with the requirements of Section 19(b) of the Exchange Act, which generally provides for a 21-day comment period following publication in the Federal Register of a rule change proposed by a self-regulatory organization.

Two commenters objected to the part of the proposed rule change that would allow for a dealer to serve as a financial advisor on one transaction and serve as the underwriter on a separate transaction for the same issuer.<sup>86</sup> One commenter suggested that proposed Rule G-23 be revised such that it would force the underwriter acting as an advisor to decide which role they will play for the issuer and prohibit the firm from playing both roles at the same time.<sup>87</sup> This

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<sup>85</sup> See e.g., PFM Letter at 1-2 and GFOA Letter at 2.

<sup>86</sup> See NAIPFA Letter at 9 and GFOA Letter at 1.

<sup>87</sup> See NAIPFA Letter at 9.

commenter suggested a one year cooling off period from the time an advisor terminates its role as a municipal advisor and the time the advisor would be allowed to negotiate an issue with the issuer or act in any other role that is inconsistent with the role of a fiduciary.<sup>88</sup> One commenter raised a concern that some broker-dealers serve as financial advisors with the objective of establishing a relationship with the issuer that will ultimately enable the company to serve as the underwriter for subsequent transactions, and that the proposed rule change does not resolve this conflict of interest.<sup>89</sup> As such, this commenter suggested that Rule G-23 require a two-year period after a financial advisory relationship has expired before a broker-dealer serving as a financial advisor can switch to serving as an underwriter.<sup>90</sup>

In response, in Amendment No. 1, the MSRB noted that it has determined to continue to apply Rule G-23 on an issue-by-issue basis. The proposed amendments would not prohibit a dealer financial advisor from providing financial advisory services on one issue and then serving as underwriter on another issue, even if the two issues were in the market concurrently. The Commission believes that applying proposed Rule G-23 on an issue-by-issue basis is consistent with the Exchange Act in light of the requirements in the proposed rule that a dealer clearly identify its role as an underwriter and engage in a course of conduct not inconsistent with that role.

Another commenter expressed concern about the requirement that a dealer may not act as a remarketing agent with respect to an issue for one year following the termination of an advisory relationship in connection with such issue.<sup>91</sup> This commenter opined that the one-year

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<sup>88</sup> See id.

<sup>89</sup> See Joy Howard Letter at 9.

<sup>90</sup> See id. at 10.

<sup>91</sup> See SIFMA Letter at 5-6.

period is arbitrary and unnecessarily long, and should be no longer than three months.<sup>92</sup> In response, the MSRB noted in Amendment No. 1 that it has previously stated that it does consider it to be appropriate to impose a one-year cooling off period during which a dealer financial advisor could not serve as remarketing agent for the same issue of municipal securities. The MSRB stated that the one year period is a significant timeframe that would more adequately address any potential or actual conflicts of interest than the three month timeframe. The Commission agrees with the MSRB that a one-year cooling off period is appropriate.

One commenter stated that current Rule G-23 has provided balanced guidance to financial advisors who seek to act as underwriters without any history of abuse.<sup>93</sup> As such, the commenter suggested that the Commission consider sunsetting the proposed rule change two years after its implementation, which would allow the MSRB to assess the impact of the proposed rule change and would ensure reconsideration of the actual need for its continuance at such time.<sup>94</sup> In response, the MSRB stated in Amendment No. 1 that it does not recommend a sunset provision, as the MSRB and Commission comment periods have provided ample opportunity for public comment and considerations of those comments on the proposed rule change. The Commission agrees with the MSRB that a sunset provision is not appropriate. In particular, the Commission notes the importance of the protections that will be provided by proposed Rule G-23, as amended, and believes it is appropriate to have those protections on a going-forward basis and not to sunset the Rule after a specified period of time.

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<sup>92</sup> See id.

<sup>93</sup> See id. at 6.

<sup>94</sup> See id. See also BMO Letter.

### III. Discussion and Commission's Findings

The Commission has carefully considered the proposed rule change, the comment letters received, and Amendment No.1 and finds that the proposed rule change, as amended, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the MSRB.<sup>95</sup>

In particular, the Commission finds that the proposed rule, as amended, does not conflict with Section 15B(e)(4)(A) of the Exchange Act,<sup>96</sup> which defines the term “municipal advisor,” because the proposed rule, as amended, explicitly does not state whether provision of the advice permitted by proposed Rule G-23, as amended, would cause the dealer to be considered a “municipal advisor” under the Exchange Act.

The Commission also finds that the proposed rule, as amended, does not conflict with the provisions of Section 15B(c)(1) of the Exchange Act,<sup>97</sup> which provides that “[a] municipal advisor... shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor” because, as the MSRB notes in Amendment No. 1, the proposed rule, as amended, does not set normative standards for dealer conduct. The Commission notes that other laws or rules may set the normative standards for the activities allowed by the proposed rule, as amended.

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<sup>95</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

<sup>96</sup> 15 U.S.C. 78o-4(e)(4)(A).

<sup>97</sup> 15 U.S.C. 78o-4(c)(1).

The Commission believes that the proposed rule, as amended, is consistent with Section 15B(b)(2) of the Exchange Act<sup>98</sup> and, in particular, Section 15B(b)(2)(C) of the Exchange Act,<sup>99</sup> which provides that the rules of the MSRB shall:

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.

The proposed rule change, as amended, is consistent with Section 15B(b)(2) of the Exchange Act because it will help prevent potentially fraudulent and manipulative acts and practices caused by a dealer financial advisor serving as underwriter or placement agent for an issue of municipal securities for which it provided financial advisory services. Accordingly, the proposed rule change, as amended, will help protect municipal entities and help to perfect the mechanism of a free and open market in municipal securities to the benefit of investors, municipal entities, and the public interest.

Furthermore, the Commission finds that the proposed rule, as amended, is consistent with Section 15B(b)(2)(L)(iv) of the Exchange Act,<sup>100</sup> which requires that rules adopted by the MSRB:

not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, municipal entities, and obligated persons, provided that there is robust protection of investors against fraud.

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<sup>98</sup> 15 U.S.C. 78o-4(b)(2).

<sup>99</sup> 15 U.S.C. 78o-4(b)(2)(C).

<sup>100</sup> 15 U.S.C. 78o-4(b)(2)(L)(iv).



The Commission believes that the proposed rule, as amended, would principally affect dealer financial advisors that are not small municipal advisors. Furthermore, it is likely that those dealer financial advisors that are small municipal advisors primarily serve as financial advisors to issuers of municipal securities that do not access the capital markets frequently and, when they do so, issue securities in small principal amounts. Those issuers may be less likely than larger, more frequent issuers to understand the conflict presented when their financial advisors also underwrite their securities. The Commission believes it is appropriate for the prohibitions in the proposed rule, as amended, to also apply to those dealer financial advisors that are small municipal advisors.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-MSRB-2011-03 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-MSRB-2011-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2011-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause for approving the proposed rule change, as modified by Amendment No. 1, before the 30th day after the date of publication in the Federal Register. The Commission notes that the proposal was published for notice and comment, and the Commission received eighteen comment letters, which comments have been discussed in detail above.

The Commission believes that Amendment No.1 is consistent with the requirements of the Exchange Act and finds good cause, consistent with Section 19(b)(2) of the Act,<sup>101</sup> to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

VI. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the MSRB, and in particular, Sections 15B(b)(2),<sup>102</sup> 15B(c)(1),<sup>103</sup> and 15B(e)(4)(A)<sup>104</sup> of the Exchange Act. The proposal will become effective for new issues for which the Time of Formal Award (as defined in MSRB Rule G-34(a)(ii)(C)(1)(a)) occurs more than six months after the date of this order.

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<sup>101</sup> 15 U.S.C. 78s(b)(2).

<sup>102</sup> 15 U.S.C. 78o-4(b)(2).

<sup>103</sup> 15 U.S.C. 78o-4(c)(1).

<sup>104</sup> 15 U.S.C. 78o-4(e)(4)(A).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,<sup>105</sup> that the proposed rule change (SR-MSRB-2011-03), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>106</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>105</sup> 15 U.S.C. 78s(b)(2).

<sup>106</sup> 17 CFR 200.30-3(a)(12).