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March 10, 2014

Ronald W. Smith, Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

Re: MSRB Regulatory Notice 2014-01
Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors

Dear Mr. Smith:

We are submitting this comment letter in response to Regulatory Notice 2014-01 (the "***Notice***") issued by the Municipal Securities Rulemaking Board (the "***MSRB***")[1] because of our firm's representation of a number of municipal advisors. We appreciate the opportunity to submit our comments in response to the Notice. However, as discussed below, we have a number of concerns regarding the Notice's proposal relating to MSRB Rule G-42 (the "***Proposal***").

I. OVERVIEW OF THE PROPOSAL

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "***Dodd-Frank Act***") to, among other things, provide for the regulation by the U.S. Securities and Exchange Commission (the "***SEC***") and the MSRB of municipal advisors. In the Notice, the MSRB notes that the Dodd-Frank Act establishes that a fiduciary duty is owed by a municipal advisor to its municipal entity clients.[2] To effectuate that end, the MSRB has proposed to define the standards of conduct and duties of non-solicitor municipal advisors. The Proposal includes, among other things:

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[1] *See Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors*, MSRB Notice 2014-01 (Jan. 9, 2014), *available at* http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-01.ashx.

[2] *See* § 15B(c)(1) of the Securities Exchange Act of 1934, as amended (the "***Exchange Act***"). The Notice acknowledges, however, that the Dodd-Frank Act does not impose a fiduciary duty with respect to a municipal advisor's obligated person clients.

- Disclosure requirements for municipal advisors;
- A requirement to document the terms and extent of the municipal advisor's relationship with each municipal client;
- A prohibition on recommending a municipal securities transaction or product unless the municipal advisor has a reasonable basis for believing that it is suitable for the client;
- A requirement that municipal advisors, upon request of a client, review another party's recommendation to the client;
- A prohibition of principal transactions, except in limited circumstances;
- A prohibition of specified conduct; and
- Supplementary Material containing additional guidance on the provisions of proposed Rule G-42, including Supplementary Material .10, which provides that proposed Rule G-42 would apply to municipal advisors to sponsors or trustees of 529 Plans.

As explained in further detail below, while we applaud the MSRB's goal of ensuring the protection of clients of municipal advisors, we believe that the Proposal is overly burdensome, duplicative of certain existing requirements and would lead to unintended consequences. In addition, we believe that the Notice's cost-benefit analysis does not adequately address the costs that the Proposal will create for municipal advisors.

II. COMMENTS ON THE PROPOSAL

We believe that the Proposal is overly burdensome because it (i) imposes a "one-size fits all approach" for all municipal advisors and does not account for the various business models utilized by municipal advisors, (ii) imposes substantial costs that will be passed on to the municipalities sought to be protected by the Proposal; and (iii) exceeds the scope of the fiduciary duty that was defined by Congress in the Dodd-Frank Act.

In addition, we believe that the Proposal is duplicative of existing requirements because (i) many of the proposed disclosures already are found in the publicly available disclosures municipal advisors make in Form MA, and (ii) there already exists a body of law applicable to fiduciaries, including municipal advisors.

Finally, we offer a number of miscellaneous comments relating to the Proposal.

A. The Proposal is Overly Burdensome

The Rigidity of the Proposal. Municipal advisors take a variety of forms and provide a variety of services. By imposing a single set of standards on all municipal advisors, regardless of the services provided, we believe the Proposal does not properly account for the diversity that exists in the marketplace and will, in many instances, result in the imposition of costly burdens that provide little in the way of investor protection. The Proposal appears to have been drafted with a particular municipal advisor in mind. What about the instances where an entity meets the definition of municipal advisor but is

providing a limited set of services? We believe that the Proposal is not flexible enough to accommodate the many variations that we believe exist today (as well as those that may develop in the future) because it is overly prescriptive in nature. The Proposal's rigidity is at odds with the principles-based regime of fiduciary law as developed in the common law. The Proposal's rules-based approach also is at odds with other regulatory regimes governing the provision of advice, such as the regulatory regime developed under the Investment Advisers Act of 1940, as amended the ("***Advisers Act***"). We urge the MSRB to take a principles-based approach to the regulation of municipal advisors so as to not: effectively codify a single or a limited number of business models; create winners and losers in the industry; inhibit experimentation and dynamism in the industry; limit the ability of municipal entities to contract to receive an "a la carte" set of services; or drive up the cost of compliance so as to stifle competition or to raise the costs to municipal entities of receiving municipal advisory services.

For example, in the context of state-sponsored 529 college savings plans ("***529 Plans***"), the Proposal would be impractical or unworkable in the following ways:

- Proposed Supplementary Material .01 provides that "a municipal advisor must undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information." In the context of 529 Plans, municipal advisors receiving information from the trustees and sponsors of such plans would not be in a position to verify the accuracy or completeness of information provided by authorized state employees and officials.

- Proposed Supplementary Material .02 would require, among other things, that a municipal advisor "investigate and consider other reasonably feasible alternatives to any recommended municipal securities transaction or municipal financial product that might also or alternatively serve the municipal entity client's objectives." It is not clear how this requirement would apply in the context of a municipal advisor advising a 529 Plan, as the municipal advisor would be providing advice to the issuer regarding the design of the 529 Plan so as to meet stated needs and requirements of the state and complies with applicable laws governing the plan's operations. In such a context, the recommendation of another "securities transaction or municipal financial product" would not be applicable. In this respect, the quoted language above does not account for the fact that 529 Plans do not involve a particular transaction but instead are constantly being offered. It is not clear how various aspects of the Proposal apply in the context of a security that does not have a set end to the underwriting period.

- Subsection (b) of proposed Rule G-42 lists nine different disclosures that a municipal advisor must make to its client at or prior to the inception of a municipal advisory relationship, but many of these disclosures could be

inapplicable in the context of an advisory relationship with a 529 Plan.

- Proposed Supplementary Material .07 requires, among other things, the provision of written disclosure to investors of certain affiliations. As a result of the structure of 529 Plans, the services provided to 529 Plan issuers and Federal and state restrictions on the ability of financial institutions to share their customers' non-public personal information, a municipal advisor generally will not have access to information about the 529 Plan's investors or how to contact them and would therefore be unable to provide the required disclosure. In this respect, municipal advisors to 529 Plans do not generally interact with investors.

- Subsection (d) of proposed Rule G-42 imposes a suitability standard that seems unworkable in the 529 Plan context. Subsection (d), as well as Supplementary Material .08, which require consideration of such things as "the client's financial situation and needs, objectives, tax status, risk tolerance," etc., do not have much utility in the context of someone that is advising a 529 Plan issuer. In large measure, this is because Section 529 of the Internal Revenue Code and regulations thereunder dictate the relevant tax structure. Subsection (d) of proposed Rule G-42, as well as the other proposed provisions, ignore the fact that 529 Plans, unlike traditional municipal securities, do not involve a "financing" by a municipal entity. Instead, as recognized by the SEC in the municipal advisor adopting release[3] 529 Plans are funded by individual participants' contributions. In addition, a municipal advisor working with a 529 Plan issuer generally provides advice with regard to the plan's investment options that will be available to investors; in this context, the concept of suitability for the client (i.e., the state issuer) has little meaning since the municipal entity's funds will not be at risk. It is thus unclear how the suitability requirement would apply in the context of a municipal advisor advising a state on the design of a 529 Plan.

Although the stated goal of the Proposal is to provide guidance on how to apply the fiduciary duty that Congress imposed on municipal advisors, the rigidity of the Proposal creates many interpretive issues for municipal advisors that do not fit the paradigm envisioned by the Proposal; such municipal advisors will find it difficult, if not impossible, to comply with the various requirements in the Proposal. In this respect, we note that while the above examples relate to 529 Plans, the same types of issues will be faced by any municipal advisor that does not fit the traditional mold envisioned by the Proposal.

The Substantial Costs of the Proposal. As explained above, municipal advisors take many forms and will incur substantial costs when attempting to apply the Proposal's various requirements to their particular business models. These costs are likely to be

[3] *Registration of Municipal Advisors*, SEC Release No. 34-70462 (Sept. 20, 2013), *available at* http://www.sec.gov/rules/final/2013/34-70462.pdf (the "***Municipal Advisor Adopting Release***").

passed onto the clients of the municipal advisors. Furthermore, it is possible that a substantial number of municipal advisors will discontinue services that they provide to municipalities in order to avoid the Proposal's requirements or to be able to comply with the Proposal's requirements. In this respect, we believe that one of the results of the Proposal will be that municipal entities will find a more narrow menu of services and business models available to them. Accordingly, we believe the Proposal will end up harming municipalities by limiting the availability of advisory services that they need or desire. In many ways, the Proposal is rather paternalistic and assumes municipal advisors are unable to intelligently contract for advisory services. We recognize and appreciate the multitude of harms that befell various municipal entities that relied on unscrupulous or incompetent financial advisors. At the same time, we do not believe the answer to such harms lies in the prescriptive, rigid set of rules contained in the Proposal. We believe municipal entities can be protected by a broad-based set of fiduciary principles that are vigorously enforced, along with a set of complementary rules governing licensing, registration, and books and records.

The Excessive Scope of the Proposal. Although Congress imposed a fiduciary duty on municipal advisors, it did not specifically mandate any rulemaking to define the scope of such fiduciary duty. In the Notice, the MSRB justifies the Proposal by citing to Section 15B(b)(2)(L)(i) of the Exchange Act, which authorizes the MSRB to adopt rules "prescrib[ing] 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." This grant of authority does not evidence Congress's intent for the MSRB to propose a detailed and granular set of rules defining what it means to serve as a fiduciary.

In addition, in the Notice the MSRB asks whether it should subject municipal advisors to the fiduciary duty when providing advice to obligated persons, but the MSRB has no authority for this. In fact, the Notice itself acknowledges that § 15B(c)(1) of the Exchange Act does not impose a fiduciary duty with respect to a municipal advisor's obligated person clients.

B. The Proposal is Duplicative of Existing Requirements

Disclosure of Conflicts of Interest and Other Information. Subsection (b) of Proposed Rule G-42 would require a municipal advisor to fully and fairly disclose to its clients all material conflicts of interest, and to do so at or prior to the inception of a municipal advisory relationship. We question why the disclosures that would already be made publicly available to clients through the Form MA would be insufficient, especially when the Municipal Advisor Adopting Release stated that "the information provided on Form MA and Form MA-I will expand the amount of publicly available information about municipal advisors, including conflicts of interest and disciplinary history."[4] In this respect, Form MA requires municipal advisors to disclose the following information concerning the municipal advisor's conflicts of interest:

[4] *See* Municipal Advisor Adopting Release, at p. 425 (emphasis supplied).

- Its affiliated business entities (Item 1.K.);
- Compensation arrangements, including whether the municipal advisor receives compensation from anyone other than clients in the context of its municipal advisory activities (Items 4.H. to 4.J.);
- Proprietary interests in municipal advisory client transactions, sales interests in client transactions, and investment or brokerage discretion (Item 7); and
- The municipal advisor's disciplinary history and the disciplinary history of all associated persons of the municipal advisor (Item 9).

Much of the disclosure called for by subsection (b) of proposed Rule G-42 would duplicate disclosure provided in the Form MA. For example, subsection (b)(v) of proposed Rule G-42 would require disclosure of fee-splitting arrangements, but this disclosure would already be provided pursuant to Item 4.J of Form MA. In addition, section (b)(ix) of proposed Rule G-42 would require disclosure of disciplinary events, but Item 9 of Form MA and the corollary disclosure reporting pages would already make full disclosure of these events.

Laws Applicable to Fiduciaries. The Proposal is repetitive in that there already exists a body of law applicable to fiduciaries, including municipal advisors. In addition, many municipal advisors are already subject to a fiduciary duty because of other business that they engage in, and the requirements applicable in those contexts could be sufficient to ensure that fiduciary obligations are being met.

Furthermore, because the fiduciary duty is, by its very nature, principles-based, we would suggest that the MSRB allow the fiduciary duty applicable to municipal advisors to develop organically through a principles-based approach. The SEC has adopted such an approach in developing the fiduciary duties applicable to investment advisers and that industry now has well-defined standards that are workable, practical and understandable.

C. Miscellaneous Comments

We would also offer the following miscellaneous comments regarding the Proposal:

- The Notice states, in part, that "If engaged to do so by its client, a municipal advisor also would be required to undertake a review of a recommendation made by a third party regarding a municipal securities transaction or municipal financial product." Why is this provision necessary? If engaged to provide a legal and ethical service, a municipal advisor would be obligated to do it. Why specify one out of the countless services a municipal advisor may be asked to provide?

- If a given principal transaction is truly in the best interests of a client, the client is provided full and fair written disclosure of the conflicts of interest

and costs associated with the principal transaction and the client provides prior consent to the principal transaction, then why should there be a virtual prohibition on engaging in such transactions. If the foregoing criteria are satisfied, then how it is inconsistent with a municipal advisor's fiduciary duty under Section 975 of the Dodd-Frank-Act? In this respect, we note that under the Advisers Act, investment advisers are not prohibited from engaging in principal transactions. Accordingly, the MSRB should explain why it believes "[i]t is questionable whether, given the high potential for self-dealing in such situations, a client consent following any amount of disclosure should be considered to be valid."

- In the context of 529 Plans, what does the MSRB expect from a municipal advisor in order to satisfy the proposed obligation to undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information? In the 529 Plan context it may well be that the only entity from which a municipal advisor obtains information is the issuer (or its representative) itself. Does the MSRB expect municipal advisors to obtain a representation from the issuer that the information it provides does not contain any material misstatements or omissions?

- Under the Proposal, a municipal advisor engaged by a client in connection with an issuance of municipal securities must undertake a thorough review of the official statement for that issue, unless otherwise directed by the client and so documented in writing. Why? Why is the MSRB inserting itself into the relationship between a municipal entity and a municipal advisor and requiring (unless the municipal entity expressly directs otherwise), at risk of violating an MSRB Rule, that the municipal advisor provide a service and that the municipal entity pay for such service? What is the basis for the MSRB to decide that every municipal advisor must (unless the municipal entity expressly directs otherwise), as a matter of law, provide a service prescribed by the MSRB? What is the basis for the MSRB's decision to set default contract rules for an entire industry? We note that this proposal is paternalistic, imposes, by default, costs on municipal entities and disregards the needs and desires of such entities. We believe that municipal entities should decide for themselves what services they wish to receive. We fail to see how this proposed provision supports the fiduciary duty of municipal advisors. We think it is detrimental to municipal entities, municipal advisors, and the industry and sets a dangerous precedent. Securities regulators should not be dictating contractual terms for registrants.

- Proposed Rule G-42(b) requires disclosure of the amount and scope of coverage of professional liability insurance that the municipal advisor carries (e.g., coverage for errors and omissions, improper judgments, or

negligence), deductible amounts, and any material limitations on such coverage, or a statement that the advisor does not carry any such coverage. We fail to understand why this is a proposed disclosure item. The MSRB needs to explain the connection between the level of insurance maintained and a municipal advisor's fiduciary duty and why such information is treated under proposed Rule G-42(b) as involving a conflict of interest.

- Under proposed Rule G-42(c), municipal advisors must evidence each of their municipal advisory relationships by a writing entered into prior to, upon or promptly after the inception of the municipal advisory relationship. The documentation would be required to include certain terms and conditions. Why is it necessary for the municipal advisory relationship to be reduced to a writing or to contain certain terms? We note that the Advisers Act does not require a written investment advisory agreement. What is unique about the services provided by a municipal advisor that requires a writing and that the writing contain certain designated terms? We believe that this is another example of regulatory overreaching into a relationship that should be established by the parties to the agreement.

III. THE BENEFITS VS. THE COSTS

Before proceeding with its efforts to adopt proposed Rule G-42, the MSRB should undertake a more rigorous analysis of the costs and benefits associated with the Proposal. Such an analysis would be consistent with the MSRB's recently announced *Policy on the Use of Economic Analysis in MSRB Rulemaking* (the "***Policy***") and would help ensure that any rule's costs and burdens are balanced with its expected benefits.[5] We note that the Policy establishes four elements of a proper regulatory economic analysis:

1. Identifying the need for a proposed rule and explaining how the rule will meet that need;

2. Articulating a baseline against which to measure the likely economic impact of the proposed rule;

3. Identifying and evaluating alternative regulatory approaches; and

4. Assessing the benefits and costs, both quantitative and qualitative, of the proposed rule and the main reasonable alternative regulatory approaches

[5] *See MSRB Adopts Policy for Integrating Economic Analysis into Rulemaking Process*, MSRB Press Release (Sept. 26, 2013) (announcing the MSRB's new *Policy on the Use of Economic Analysis in MSRB Rulemaking* (the "***MSRB's Economic Policy***") which is available at: http://www.msrb.org/About-MSRB/Financial-and-Other-Information/Financial-Policies/Economic-Analysis-Policy.aspx.)

The Notice is not consistent with the Policy because it does not include a discussion of the quantitative costs associated with the Proposal. The Proposal's quantitative costs must be established and compared against the expected benefits to ensure there is a legitimate basis for the Proposal.

IV. CONCLUSION

The Proposal is overly burdensome because it is inflexible, imposes costs that will be passed on to municipalities, is duplicative of existing requirements and is not supported by a rigorous cost-benefit analysis. We urge the MSRB to address these comments and to re-propose the Proposal.

I would be pleased to provide additional information or discuss these comments at your convenience.

Very truly yours,

Michael Koffler

Michael Koffler