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Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 176

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2011 - * 14

Amendment No. (req. for Amendments *)

Proposed Rule Change by Municipal Securities Rulemaking Board

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal
☒	☐	☐

Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
☒	☐	☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule

☐ 19b-4(f)(1)	☐ 19b-4(f)(4)
☐ 19b-4(f)(2)	☐ 19b-4(f)(5)
☐ 19b-4(f)(3)	☐ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

Proposed Rule G-36, on fiduciary duty of municipal advisors, and a proposed interpretive notice concerning the application of proposed Rule G-36 to municipal advisors

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * Peg Last Name * Henry

Title * General Counsel, Market Regulation

E-mail * phenry@msrb.org

Telephone * (703) 797-6600 Fax (703) 797-6700

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

Municipal Securities Rulemaking Board

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 08/23/2011

By Ronald W. Smith

(Name *)

Corporate Secretary

(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Ronald Smith, rsmith@msrb.org

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information (required)

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change (required)

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule and Interpretive Notice

(a) The Municipal Securities Rulemaking Board (the "MSRB" or "Board") is hereby filing with the Securities and Exchange Commission (the "SEC" or "Commission") a proposed rule change consisting of proposed Rule G-36 (on fiduciary duty of municipal advisors) and a proposed interpretive notice (the "Notice") concerning the application of proposed Rule G-36 to municipal advisors. The MSRB requests that the proposed rule change be made effective on the date that rules defining the term "municipal advisor" under the Securities Exchange Act of 1934 (the "Exchange Act") are first made effective by the Commission or such later date as the proposed rule change is approved by the Commission.

The text of the proposed rule change is set forth below:[1]

* * * *

Rule G-36 (on fiduciary duty of municipal advisors)

In the conduct of its municipal advisory activities on behalf of municipal entity clients, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care.

* * * * *

INTERPRETIVE NOTICE ON RULE G-36 FIDUCIARY DUTY OF A MUNICIPAL ADVISOR

Section 15B(c)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") provides that:

> A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the Board.[1]

Section 15B(b)(2)(L)(i) of the Exchange Act provides that the Municipal Securities Rulemaking Board ("MSRB") shall establish rules with respect to municipal advisors that "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."

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[1] Underlining indicates additions.

In furtherance of this statutory directive, the MSRB promulgated MSRB Rule G-36, on fiduciary duty of municipal advisors, which provides:

> In the conduct of its municipal advisory activities on behalf of municipal entity clients, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care.

The terms "municipal advisor" and "municipal entity" are defined in Sections 15B(e)(4) and (e)(8), respectively, of the Exchange Act and the rules and regulations promulgated thereunder. The term "municipal advisory activities" is defined by MSRB Rule D-13 to mean the activities described in Section 15B(e)(4)(A)(i) and (ii) of the Exchange Act, whether conducted by a broker, dealer, or municipal securities dealer ("dealer") that is a municipal advisor within the meaning of Section 15B(e)(4) of the Exchange Act or by a municipal advisor that is not a dealer.

This notice also provides interpretive guidance on the meaning of "fiduciary duty" for purposes of Rule G-36 and describes conduct that would or could breach that Rule G-36 fiduciary duty.[2]

The Rule G-36 fiduciary duty to municipal entity clients goes beyond and encompasses the obligation under MSRB Rule G-17 for municipal advisors, in the conduct of their municipal advisory activities, to deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice.[3] A violation of Rule G-17 with respect to a municipal entity client, therefore, would necessarily be a violation of Rule G-36.

DUTY OF LOYALTY

As provided in Rule G-36, a municipal advisor's fiduciary duty to its municipal entity client includes a duty of loyalty. That duty requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor.

Conflicts of Interest

Disclosure Obligations. Under Rule G-36, a municipal advisor must disclose all material conflicts of interest of which it is aware after reasonable inquiry, such as those that might impair its ability to satisfy the duty of loyalty to its municipal entity client.[4] Such conflicts of interest include those existing at the time the engagement is entered into, and those discovered or arising during the course of the engagement. A municipal entity will be considered to be a client of the municipal advisor from the time that the advisor has been engaged to provide municipal advisory services (either pursuant to a written agreement or by informal arrangement) until the time that the agreed upon engagement ends. All disclosures of conflicts, including those discovered or arising during the course of the engagement, must be made in writing to an official of the municipal entity the municipal advisor reasonably believes has the authority to bind the

municipal entity by contract with the municipal advisor in a manner sufficiently detailed to inform the municipal entity of the nature and implications of the conflict. The following are examples of the types of conflicts that must be disclosed by the municipal advisor, but this list is not intended to be exhaustive:

(i) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business;[5]

(ii) payments from third parties to the municipal advisor in relation to the municipal advisory engagement;[6]

(iii) payments from third parties to enlist the municipal advisor's recommendation of their services to the municipal entity;[7]

(iv) whether the municipal advisor or an affiliate of the municipal advisor is acting as a principal in matters concerning the municipal advisory engagement;[8]

(v) the form of compensation for the municipal advisory engagement;[9] and

(vi) other engagements or relationships that might impair the municipal advisor's ability to act in the best interests of its municipal entity client.

See, however, "Unmanageable Conflicts" for a description of certain conflicts that would preclude a municipal advisor from undertaking an engagement with a municipal entity and with respect to which disclosure of such conflicts would not be effective in permitting such engagement to be undertaken.

Informed Consent. Under Rule G-36, the municipal advisor must receive written consent to its conflicts by an official of the municipal entity that the municipal advisor reasonably believes has the authority to bind the municipal entity by contract with the municipal advisor before the municipal advisory engagement begins or, in the case of conflicts discovered or arising after the municipal advisory engagement has begun, before the municipal advisor may continue to provide such services. For purposes of Rule G-36, a municipal entity will be deemed to have consented to conflicts that are clearly described in its engagement letter or other written contract with the municipal advisor, if the municipal entity expressly acknowledges the existence of such conflicts. If the official of the municipal entity agrees to proceed with the municipal advisory engagement after receipt of the conflicts disclosure but will not provide written acknowledgement of such conflicts, the municipal advisor may proceed with the engagement after documenting with specificity why it was unable to obtain such written acknowledgement.

Disclosure of conflicts, coupled with written consent, will not satisfy the requirements of Rule G-36 in instances in which the municipal advisor has reason to believe that such consent is not informed. In such cases, a municipal advisor must make additional efforts reasonably designed to inform the official of the municipal entity of the

nature and implications of the municipal advisor's conflicts. Additionally, disclosures to an official who is a party to the conflict of interest (such as recipients of payments from municipal advisors) will not satisfy the requirements of Rule G-36.

Unmanageable Conflicts. Pursuant to its duty of loyalty under Rule G-36, a municipal advisor must not engage in municipal advisory activities with respect to a municipal entity client if it cannot manage its conflicts in a manner that will permit it to act in the municipal entity's best interests. Some conflicts are not manageable because, when fully informed of the nature and potential consequences of the conflicts, an official of a municipal entity could not provide informed consent.[10] The following are examples of conflicts that fall into this category, but this list is not intended to be exhaustive:

(i) kickback arrangements, or certain fee-splitting arrangements, with the providers of investments or services to municipal entities,[11]

(ii) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor described in Section 15B(e)(9) of the Exchange Act,[12] and

(iii) except as provided below, acting as a principal in matters concerning the municipal advisory engagement.[13]

In most cases under Rule G-36, a municipal advisor that acts as a principal with its municipal entity client on the same transaction will be considered to have an unmanageable conflict. This will also be the case if an affiliate of the municipal advisor acts as a principal with the municipal entity on the same transaction. Notwithstanding the foregoing, a municipal advisor will not violate Rule G-36 solely because it acts as principal under any of the following circumstances:

(i) it provides investments to a municipal entity on a temporary basis to ensure the delivery of such securities on the closing date for a bond issue, provided that its compensation attributable to the provision of the securities is limited to the reimbursement of its cost of carry (not including any opportunity cost);

(ii) it engages in an activity permitted under Rule G-23;

(iii) it is a municipal advisor solely because it recommends investments or municipal financial products provided or offered by it to a municipal entity as a counterparty, but is not described in (iv) below; or

(iv) it serves as a counterparty to a municipal entity with respect to a swap or security-based swap transaction in which the municipal entity is represented by an "independent representative" as that term is defined in section 4s(h)(5) of the Commodity Exchange Act or section 15F(h)(5) of

the Exchange Act, respectively, and the rules and regulations promulgated thereunder.

Compensation

Excessive Compensation. The MSRB recognizes that what is considered reasonable compensation for a municipal advisor will vary according to the municipal advisor's expertise, the complexity of the financing, whether the fee is contingent upon the closing of the transaction, and the length of time spent on the engagement, among other factors. However, in certain cases and depending upon the specific facts and circumstances of the engagement, a municipal advisor's compensation may be so disproportionate to the nature of the municipal advisory services performed as to indicate that the municipal advisor is not acting in the municipal entity's best interests as required by Rule G-36. Such excessive compensation would constitute a violation of the municipal advisor's duty of loyalty, even if such compensation has been disclosed.[14]

Forms of Compensation. The manner in which municipal advisors are compensated varies according to the nature of the engagement and applicable state and local laws and policies. Pursuant to Rule G-36, a municipal advisor must provide written disclosure to its municipal entity client of what the amount (in dollars and to the extent it can be quantified) of its direct compensation and indirect compensation (*e.g.*, amounts paid to affiliates) from the engagement will be, or is projected to be, as well as the scope of services to be provided for that compensation. Additionally, except as provided below, the municipal advisor must provide written disclosure to its client of the conflicts of interest associated with various forms of compensation, including the form of compensation applicable to its engagement. One way in which a municipal advisor may satisfy its obligation to provide written disclosure of the conflicts with various forms of compensation is to provide its client with the document entitled "Disclosure of Conflicts of Interest With Various Forms of Compensation," attached as Appendix A to this notice (the "Compensation Disclosure Document"). The disclosures described in this paragraph must be provided as described above under "Duty of Loyalty/Conflicts of Interest/Disclosure Obligations." Provision by the municipal advisor to its client of the Compensation Disclosure Document will not satisfy the municipal advisor's obligation to disclose conflicts of interest not addressed in the Compensation Disclosure Document, such as payments from third parties. Notwithstanding the foregoing, if the municipal entity client has required that a particular form of compensation be used, the compensation conflicts disclosure provided by the municipal advisor need only address that particular form of compensation.

A municipal advisor's duty of loyalty under Rule G-36 requires it to manage any conflicts of interest that may result from its form of compensation so that it acts in the best interests of its municipal entity client. For example, except as discussed below under "Permissible Limitations on Scope of Engagement," a municipal advisor that reasonably believes that a proposed financing or product is not in its municipal entity client's best interests must so advise the municipal entity pursuant to its duty of loyalty, even if such advice could adversely affect the municipal advisor's compensation.

DUTY OF CARE

As provided in Rule G-36, a municipal advisor's fiduciary duty to its municipal entity client also includes a duty of care. That is, under Rule G-36, a municipal advisor must exercise due care in performing its responsibilities.

Necessary Qualifications

Pursuant to that duty of care required by Rule G-36, the municipal advisor must not undertake a municipal advisory engagement for which the advisor does not possess the degree of knowledge and expertise needed to provide the municipal entity with informed advice.[15] For example, a municipal advisor must not undertake a swap advisory engagement or security-based swap advisory engagement for a municipal entity unless it has sufficient knowledge to evaluate the transaction and its risks, as well as the pricing and appropriateness of the transaction.[16]

Consideration of Alternatives

Unless that duty has been expressly disclaimed as provided below, under Rule G-36, a municipal advisor has a duty to investigate and advise the municipal entity of alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity.[17]

Duty of Inquiry

Under Rule G-36, a municipal advisor must make a reasonable inquiry as to the facts that are relevant to a municipal entity's determination of whether to proceed with a course of action (*e.g.*, the issuance of municipal securities, entering into a derivative contract, or making an investment). Similarly, when asked to provide a certificate that will be relied upon by the municipal entity or by investors in the municipal entity's securities, the municipal advisor must make a reasonable inquiry as to the pertinent facts.[18] Furthermore, when a municipal advisor participates in the preparation of an official statement for a municipal securities issue, the municipal advisor owes a duty to the municipal entity to make reasonable inquiries in order to help ensure the appropriate disclosures are made in the official statement.[19]

Advisor Not a Guarantor

The duty of care under Rule G-36 requires only that the municipal advisor act competently and provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to the financings or products proposed that might better serve the interests of its municipal entity client. However, a municipal advisor's duty of care does not make the municipal advisor a guarantor of a successful financing or a

guarantor that there are no facts material to a municipal entity's decisionmaking process other than the ones known by the municipal advisor and disclosed to the municipal entity.

PERMISSIBLE LIMITATIONS ON SCOPE OF ENGAGEMENT

Municipal advisors may be retained by municipal entity clients for limited engagements and may, accordingly, limit the scope of the engagement to which their fiduciary duty applies.[20] In some cases, a municipal entity may have already reached a decision that a particular type of financing or financial product is appropriate for it and not find it necessary for the advisor to advise it on appropriateness. In that case, under Rule G-36 the advisor's engagement must reflect the limitations on its role. If there is no engagement letter, the advisor must be specific about that limitation in a written communication to the municipal entity. In either case, these limitations must be disclosed prior to the commencement of the engagement. If the advisor has taken these steps and does not by course of conduct cause the municipal entity to expect that the advisor will be advising on appropriateness,[21] the fact that the transaction thereafter proves to have been inappropriate for the municipal entity will not mean that the advisor has breached its fiduciary duty to the municipal entity under Rule G-36.

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[1] The fiduciary duty in Section 15B(c)(1) of the Exchange Act is in addition to any state or other fiduciary duty laws.

[2] This notice cites cases and administrative proceedings involving breach of fiduciary duty under the Investment Advisers Act (the "Advisers Act") and state fiduciary duty laws, as well as violations of Section 17(a) of the Securities Act of 1933 (the "Securities Act") and Section 10(b) of the Exchange Act concerning the fraudulent behavior of fiduciaries. These citations are included only for purposes of illustration of the conduct that would be considered a breach by a municipal advisor of its Rule G-36 fiduciary duty, which is an independent duty created by Section 15B(c)(1) of the Exchange Act.

[3] The MSRB notes that the Commission has brought enforcement actions concerning financial advisors for violations of Rule G-17. *See, e.g., In the Matter of Lazard Freres and Merrill Lynch*, SEC Rel. No. 34-36419 (Oct. 26, 1995) (settlement in connection with alleged violation of Rule G-17 for failure of underwriter and financial advisor to disclose payments made by underwriter to financial advisor); *In re Wheat, First Securities, Inc.*, SEC Initial Dec. Rel. No. 155 (Dec. 17, 1999) (administrative law judge found violation of Rule G-17 and Florida fiduciary duty law for financial advisor's false disclosure to municipal entity that it had not employed a lobbyist to secure its advisory contract with the county and that it had not entered into an arrangement with a third party to make payments contingent upon its securing the advisory contract); *In re Pryor, McClendon, Counts & Co., Inc. et al.*, Exchange Act Release No. 48095 (Jun. 26, 2003) (settlement in connection with alleged violation of Rule G-17 for financial

advisor's failure to disclose payment to government official made to secure advisory assignment).

[4] *See, e.g., Securities and Exchange Commission v. Capital Gains*, 375 U.S. 180 (1963) (adviser breached fiduciary duty under Advisers Act by failing to act in his clients' best interests and failing to disclose the short-term profits it made, and the impact of his actions on the clients, by recommending certain securities to his clients after purchasing them for his own account, a practice known as "scalping").

[5] *See, e.g., Monetta Financial Services, Inc. v. Securities and Exchange Commission*, 390 F.3d 952 (7th Cir. 2004) (investment adviser breached fiduciary duty under Advisers Act by failing to disclose allocation of valuable IPO shares to directors of its investment company clients); *In re Wheat, First Securities, Inc.* and *In re Pryor, McClendon, Counts & Co., Inc., supra*.

[6] *See, e.g., In re O'Brien Partners, Inc.*, Exchange Act Release No. 7594 (Oct. 27, 1998) (settlement in connection with alleged breach of fiduciary duty under Advisers Act, California law, Wisconsin law, and New York law by investment adviser for failure to disclose to state and municipal clients that it received "referral fees" from a finder that assisted in the reinvestment of municipal bond proceeds in guaranteed investment contracts, repurchase agreements and forwards; referral fees allegedly totaled $450,000 and represented 50-60% of finder commission); *In the Matter of Mark S. Ferber*, Exchange Act Release No. 38102 (Dec. 31, 1996) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose to state and municipal clients payments from broker-dealer totaling almost $6 million over two years in exchange for recommendations that his clients select that broker-dealer as underwriter or provider of other financial services, including interest rate swaps); *In the Matter of Arthurs Lestrange & Co., Inc. and Michael Bova*, SEC Release Nos. 33-7775, 34-42148 (Nov. 17, 1999) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose true nature of fee splitting arrangement; financial advisor allegedly contributed its financial advisory fee of $210,000 to pool of advisory and brokerage service compensation, received $1.5 million from the investment broker, and paid $500,000 to a finder); *In the Matter of William R. Hough & Co.*, SEC Release Nos. 33-7826, 34-42632 (Apr. 6, 2000) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose excessive mark-ups and fee-splitting with investment providers; in one case, financial advisor allegedly received $35,000 for its financial advisory services and $400,000 from the investment provider; in the other, financial advisor allegedly received $300,000 from a forward supply contract provider for "developing a forward supply assignment program"); *In the Matter of John S. Reger and Business & Financial Advisors, Inc.*, SEC Rel. No. 33-7973 (Apr. 23, 2001) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose to issuer that it received $129,000 kickback from escrow securities provider, representing 40% of escrow

provider's profit; financial advisor also participated in preparation of official statement and allegedly violated Sections 17(a)(2) and (3) of the Securities Act by failing to disclose the payments).

[7] *See, e.g.*, *Securities and Exchange Commission v. DiBella*, 587 F.3d 553 (2d Cir. 2009) (investment adviser breached fiduciary duty under Advisers Act by failing to disclose payment to state senator on state pension fund investment advisory board made to influence state treasurer's decision to invest state pension fund moneys with adviser); *U.S. v. deVegter*, 198 F. 3d 1324 (11th Cir. 1999) (financial advisor breached fiduciary duty to issuer by accepting payments from underwriter to manipulate competitive bidding process for refunding of bonds; financial advisor incorporated underwriter's comments in order to make request for proposals more favorable for underwriter, sent bids of other competitors to underwriter, and ordered bids to be re-ranked so underwriter was highest ranked bidder).

[8] *See, e.g.*, *Securities and Exchange Commission v. Rauscher Pierce Refsnes, Inc.*, 17 F. Supp. 2d 985 (D. Ariz. 1998) (financial advisor breached its fiduciary duty under Arizona law by making false statements in tax certificate for advance refunding bonds, failing to disclose that its government securities desk was acting as a principal in the provision of escrow securities, and failing to disclose excessive mark-ups).

[9] *See* "Compensation/Forms of Compensation" herein.

[10] *See, e.g.*, Prohibition on the Use of Brokerage Commissions to Finance Distribution, SEC Rel. No. 26591 (Sept. 2, 2004), at Section VII.E (explaining that the Commission's adoption in 2004 of Investment Company Act Rule 12b-1(h), which, among other things, prohibits a fund from using brokerage commissions to pay for the distribution of the fund's shares, was based on a conclusion that the practice of trading brokerage business for sales of fund shares poses conflicts of interest that the Commission believed to be "largely unmanageable").

[11] *See, e.g.*, the cases at note 6, *supra*. Rule G-36 does not preclude a municipal advisor from receiving payment for its municipal advisory services from a third party, as long as the municipal advisor discloses, and the municipal entity provides its informed written consent to, such payment arrangement and the amount of such payment. As with the disclosure of other conflicts of interest, such disclosure must be made before the municipal advisory engagement is entered into, or at the time the conflict is discovered or arises, if later.

[12] *See* the cases at note 5, *supra*. Municipal advisors that are described in Section 15B(e)(9) of the Exchange Act because they solicit business from municipal entities on behalf of other municipal advisors are subject to all MSRB rules for

municipal advisors.

[13] *See, e.g., Securities and Exchange Commission v. Rauscher Pierce Refsnes, Inc., supra*; *In the Matter of Lazard Freres & Co.*, SEC Rel. Nos. 33-7671, 34-41318 (Apr. 21, 1999) (settlement in connection with financial advisor alleged to have failed to disclose excessive mark-ups on escrow securities it provided as principal; financial advisor alleged to have received $700,000 on the sale of the Treasuries, in addition to its $200,000 advisory fee).

[14] Payments from third parties are included in determining whether compensation is excessive. *See*, *e.g.*, the cases at note 6, *supra*, for examples of excessive compensation arrangements. Municipal advisors subject to hourly billing arrangements must not submit bills that do not accurately reflect the nature of the services performed and the personnel performing them. Similarly, municipal advisors must not submit inflated expenses.

[15] *See*, *e.g.*, the cases at note 18, *infra*.

[16] Section 4s(h)(5) of the Commodity Exchange Act requires that a swap dealer with a special entity client (including states, local governments, and public pension funds) must have a reasonable basis to believe that the special entity has an independent representative that satisfies these criteria, among others. Section 15F(h)(5) of the Exchange Act imposes the same requirements with respect to security-based swaps.

[17] *See, e.g.*, *O'Brien Partners*, *supra* (duty to advise issuer on whether to invest bond proceeds and whether to invest in securities); *In re* Lazard Freres, *supra* (duty to investigate whether advisory client could obtain a more favorable price than the one offered by financial advisor for escrow securities).

[18] *See*, *e.g.*, *In the Matter of Dwight Allen*, SEC Rel. Nos. 33-7456, 34-39122 (Sept. 24, 1997) (settlement in connection with independent financial consultant alleged to have violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act by acting recklessly in certifying that certain municipal obligations met a "minimum credit requirement" based on the value to lien ratio calculated on the value of land; lacking experience with these types of obligations, calculating the value to lien ratio, or the land appraisal process, he allegedly simply relied on one appraisal of the land, which was based on the estimated build-out value if the land was fully developed and did not reflect current market value); *In re Milbrodt*, SEC Rel. Nos. 33-7455, 34-39121 (Sept. 24, 1997) (settlement in connection with financial advisor alleged to have certified that land-based bonds to be acquired by pool bond issuer met minimum credit requirements despite the lack of an independent appraisal of the current market value of the land and without reviewing the governing documents, the governing test for investments of pool bond issuers, or the official statements of land-based bond issuers); *In the Matter of the County of Nevada (McKay)*, SEC Rel. Nos. 33-7556, 34-40225 (July 17,

1998) (settlement in connection with appraiser in *Dwight Allen* and *Milbrodt* cases alleged to have failed to exercise due care in its appraisals used in official statements and violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act).

[19] *See, e.g., In the Matter of County of Nevada (Virginia Horler)*, SEC Init. Dec. Rel. No. 153 (Oct. 29, 1999) (administrative law judge found financial advisor tasked with preparation of official statement for Mello-Roos issue stepped into the shoes of the underwriter and violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act by failing to exercise due diligence and inquire into the finances or personal financial condition of developers and financial condition of development company, which was experiencing negative cash flow and failed to pay taxes in 1990, ultimately leading to bankruptcy).

[20] *See, e.g., Joyce v. Morgan Stanley*, 538 F. 3d 797 (10th Cir. 2008) (claim by shareholder denied because financial advisor had limited its fiduciary duty to the corporation itself and its engagement letter had expressly disclaimed the duty to advise on the possible change in value of stock of the acquiring corporation in the period between announcement of the merger and the closing).

[21] *See, e.g., In re Daisy Systems Corp.* (97 F. 3d 1171 (9th Cir. 1996) (financial advisor's engagement letter not dispositive of scope of financial advisory relationship because it did not expressly limit the nature of the advice to be provided).

* * * * * *

APPENDIX A

DISCLOSURE OF CONFLICTS OF INTEREST WITH VARIOUS FORMS OF COMPENSATION

The Municipal Securities Rulemaking Board requires us, as your municipal advisor, to provide written disclosure to you about the actual or potential conflicts of interest presented by various forms of compensation. We must provide this disclosure unless you have required that a particular form of compensation be used. You should select a form of compensation that best meets your needs and the agreed upon scope of services.

Forms of compensation; potential conflicts. The forms of compensation for municipal advisors vary according to the nature of the engagement and requirements of the client, among other factors. Various forms of compensation present actual or potential conflicts of interest because they may create an incentive for an advisor to recommend one course of action over another if it is more beneficial to the advisor to do so. This document discusses various forms of compensation and the timing of payments to the advisor.

Fixed fee. Under a fixed fee form of compensation, the municipal advisor is paid a fixed amount established at the outset of the transaction. The amount is usually based upon an analysis by the client and the advisor of, among other things, the expected duration and complexity of the transaction and the agreed-upon scope of work that the advisor will perform. This form of compensation presents a potential conflict of interest because, if the transaction requires more work than originally contemplated, the advisor may suffer a loss. Thus, the advisor may recommend less time-consuming alternatives, or fail to do a thorough analysis of alternatives. There may be additional conflicts of interest if the municipal advisor's fee is contingent upon the successful completion of a financing, as described below.

Hourly fee. Under an hourly fee form of compensation, the municipal advisor is paid an amount equal to the number of hours worked by the advisor times an agreed-upon hourly billing rate. This form of compensation presents a potential conflict of interest if the client and the advisor do not agree on a reasonable maximum amount at the outset of the engagement, because the advisor does not have a financial incentive to recommend alternatives that would result in fewer hours worked. In some cases, an hourly fee may be applied against a retainer (*e.g.,* a retainer payable monthly), in which case it is payable whether or not a financing closes. Alternatively, it may be contingent upon the successful completion of a financing, in which case there may be additional conflicts of interest, as described below.

Fee contingent upon the completion of a financing or other transaction. Under a contingent fee form of compensation, payment of an advisor's fee is dependent upon the successful completion of a financing or other transaction. Although this form of compensation may be customary for the client, it presents a conflict because the advisor may have an incentive to recommend unnecessary financings or financings that are disadvantageous to the client. For example, when facts or circumstances arise that could cause the financing or other transaction to be delayed or fail to close, an advisor may have an incentive to discourage a full consideration of such facts and circumstances, or to discourage consideration of alternatives that may result in the cancellation of the financing or other transaction.

Fee paid under a retainer agreement. Under a retainer agreement, fees are paid to a municipal advisor periodically (*e.g.*, monthly) and are not contingent upon the completion of a financing or other transaction. Fees paid under a retainer agreement may be calculated on a fixed fee basis (*e.g.*, a fixed fee per month regardless of the number of hours worked) or an hourly basis (*e.g.*, a minimum monthly payment, with additional amounts payable if a certain number of hours worked is exceeded). A retainer agreement does not present the conflicts associated with a contingent fee arrangement (described above).

Fee based upon principal or notional amount and term of transaction. Under this form of compensation, the municipal advisor's fee is based upon a percentage of the principal amount of an issue of securities (*e.g.*, bonds) or, in the case of a derivative, the present value of or notional amount and term of the derivative. This form of

compensation presents a conflict of interest because the advisor may have an incentive to advise the client to increase the size of the securities issue or modify the derivative for the purpose of increasing the advisor's compensation.

[If applicable, describe other form of compensation for the engagement and associated conflicts with a comparable level of specificity].

Acknowledgement

The undersigned hereby acknowledges that he/she has received this disclosure and that he/she has been given the opportunity to raise questions and discuss the foregoing matters with the advisor.

_____ [name of client]
By: _____
Name: _____
Title: _____
Date: _____

* * * * * *

(b) Not applicable.

(c) Not applicable

2. Procedures of the Self-Regulatory Organization

The proposed rule change was adopted by the MSRB at its May 19-20, 2011 and July 27-29, 2011 meetings. Questions concerning this filing may be directed to Peg Henry, General Counsel, Market Regulation, at 703-797-6600 or Karen Du Brul, Associate General Counsel, at 703-797-6600.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule and Interpretative Notice

(a) With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[2] the MSRB was expressly directed by Congress to protect municipal entities. Accordingly, the MSRB is proposing Rule G-36 and an interpretive notice thereunder to address the fiduciary duty of municipal advisors to their municipal entity clients.

A more-detailed description of the provisions of the Notice follows:

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[2] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Duty of Loyalty. The Notice would provide that the Rule G-36 duty of loyalty would require the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor. It would require a municipal advisor to make clear, written disclosure of all material conflicts of interest, such as those that might impair its ability to satisfy the duty of loyalty, and to receive the written, informed consent of officials of the municipal entity the municipal advisor reasonably believes have the authority to bind the municipal entity by contract with the municipal advisor. Such disclosure would be required to be made before the municipal advisor could provide municipal advisory services to the municipal entity or, in the case of conflicts discovered or arising after the municipal advisory relationship has commenced, before the municipal advisor could continue to provide such services.

The Notice would provide that a municipal advisor may not undertake an engagement if certain unmanageable conflicts exist, including (i) kickbacks and certain fee-splitting arrangements with the providers of investments or services to municipal entities, (ii) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor for solicitation activities regulated by the MSRB, and (iii) acting as a principal in matters concerning the municipal advisory engagement (except when providing investments to the municipal entity on a temporary basis to ensure timely delivery for closing; when engaging in activities permitted under Rule G-23; when it is a municipal advisor solely because it recommends investments or municipal financial products provided or offered by it to a municipal entity as a counterparty (other than a swap or security-based swap counterparty); or when acting as a swap or security-based counterparty to a municipal entity represented by an "independent representative," as defined in the Commodity Exchange Act or the Exchange Act, respectively.

The Notice would provide that, in certain cases, the compensation received by a municipal advisor could be so disproportionate to the nature of the municipal advisory services performed that it would be inconsistent with the proposed Rule G-36 duty of loyalty and would represent an unmanageable conflict. The Notice would also provide that a municipal advisor would be required to disclose conflicts associated with various forms of compensation (except where the form of compensation has been required by the municipal entity client), in which case the disclosure need only address that form of compensation. The Notice would also include a form of disclosure of conflicts relating to the forms of compensation to aid advisors in preparing their disclosure. Use of the form would not be required.

Duty of Care. The Notice would provide that the proposed Rule G-36 duty of care would require that a municipal advisor act competently and provide advice to the municipal entity after inquiry into reasonably feasible alternatives to the financings or products proposed (unless the engagement is of a limited nature). The Notice would also require the advisor to make reasonable inquiries into facts necessary to determine the basis for the municipal entity's chosen course of action, as well facts necessary to prepare

certificates and to help ensure appropriate disclosures for official statements. The Notice would also permit the municipal advisor to limit the scope of its engagement.

(b) The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2) of the Exchange Act, which provides, in pertinent part, that:

> The Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.

Section 15B(c)(1) of the Exchange Act also provides, in pertinent part, that:

> A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the Board.

Section 15B(b)(2)(L) of the Exchange Act provides, in pertinent part, that:

> [The rules of the Board, at a minimum, shall,] with respect to municipal advisors— (i) 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 proposed rule change is consistent with Section 15B(c)(1) of the Exchange Act and Section 15B(b)(2)(L) of the Exchange Act because it incorporates the fiduciary duty, imposed by the Exchange Act, into a proposed rule that would articulate the principal duties that comprise a municipal advisor's fiduciary duty to a municipal entity client (a duty of loyalty and a duty of care), although such duties would not be exclusive. The proposed rule change also would provide guidance on what conduct would be inconsistent with a duty of loyalty (principally failing to deal honestly and in good faith with the municipal entity and failing to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor) and the conflicts of interest that would be inconsistent with a duty of loyalty (including certain third-party payments and receipts and, in general, acting as a principal in matters concerning the municipal advisory engagement). It would also provide guidance on what conduct would be inconsistent with a duty of care (principally failing to act competently and to provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to

the financings or products proposed that might better serve the interests of the municipal entity).

Section 15B(b)(2)(L)(iv) of the Exchange Act requires that rules adopted by the Board:

> 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.

All municipal advisors, regardless of their size, have a fiduciary duty to their municipal entity clients. Because the protection of their clients is paramount, in this context, the MSRB has concluded that it is appropriate to impose the same rules on small municipal advisors as it imposes on larger municipal advisors. However, the MSRB recognizes that there are costs of compliance. That is the reason the MSRB has included Appendix A to the Notice. By using Appendix A to provide disclosure concerning compensation conflicts, small municipal advisors will satisfy the compensation disclosure requirement of the Notice without having to retain legal counsel to assist them in the preparation of such disclosure.

4. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, since it would apply equally to all municipal advisors with municipal entity clients.

5. Self-Regulatory Organization's Statement on Comments Received on the Proposed Rule Change by Members, Participants, or Others.

On February 14, 2011, the MSRB requested comment on a draft of Rule G-36 ("draft Rule G-36") and a draft of the Notice (the "draft Notice").[3] The MSRB received comment letters from: the American Bankers Association ("ABA"); the American Council of Engineering Companies ("ACEC"); the American Federation of State, County and Municipal Employees ("AFSCME"); American Governmental Financial Services ("AGFS"); B-Payne Group ("B-Payne Group"); the Education Finance Council ("EFC"); Fi360; Lewis Young Robertson & Burningham, Inc. ("Lewis Young"); the Michigan Bankers Association ("Michigan Bankers"); Municipal Regulatory Consulting LLC ("MRC"); the National Association of Independent Public Finance Advisors ("NAIPFA"); Not for Profit Capital Strategies ("Capital Strategies"); Phoenix Advisors, LLC ("Phoenix Advisors"); Public Financial Management ("PFM"); the Securities

[3] See MSRB Notice 2011-14 (February 14, 2011).

Industry and Financial Markets Association ("SIFMA"); and the Wisconsin Bankers Association ("Wisconsin Bankers").[4]

SCOPE OF THE RULE

- **Comment: Delay Interpretive Notice until SEC Rule on Municipal Advisors Finalized.** Many commenters[5] requested that the MSRB withdraw or delay some or all of the provisions of the Notice until the SEC has defined "municipal advisor," after which time they asked that the MSRB afford commenters an additional opportunity to comment on the Notice. Other comments were outside the scope of the request for comment on draft Rule G-36 (e.g., suggested modifications to the definition of "municipal advisor") and are not summarized here.

- **MSRB Response:** Because the fiduciary duty applicable to municipal advisors was effective as of October 1, 2010, the MSRB feels it is important to provide guidance on basic fiduciary duties applicable to municipal advisors. The MSRB has requested that the proposed rule change be made effective on the date that rules defining the term "municipal advisor" under the Exchange Act are first made effective by the SEC or such later date as the proposed rule change is approved by the SEC. At that time, the MSRB may propose additional guidance, if necessary.

- **Comment: References to Duty of Loyalty and Duty of Care Too Limiting.** Lewis Young suggested said that the MSRB should delete the clause "which shall include a duty of loyalty and a duty of care" from the text of draft Rule G-36 on the theory that it is too limiting and that there is a substantial body of state and federal law governing fiduciary duty that includes more than these two duties.

- **MSRB Response:** The MSRB has determined not to make this change to these provisions in proposed Rule G-36. Proposed Rule G-36 would provide that a municipal advisor's fiduciary duty to its municipal entity client includes a duty of loyalty and a duty of care. While the duties of loyalty and care are generally recognized as the principal components of a fiduciary duty, the MSRB recognizes that certain state fiduciary duty laws address other duties. The use of the word "includes" permits the MSRB to articulate other duties in the future. Therefore the MSRB has determined not to make this change.

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4 See Exhibit 2.

5 ABA; SIFMA; Wisconsin Bankers; Michigan Bankers; NAIPFA; MRC; AFSCME; EFC; Phoenix Advisors; and ACEC.

- **Comment: Clarification of Relationship to Duty of Fair Dealing.** NAIPFA requested that the MSRB clarify its statement that the duties of fair dealing under Rule G-17 are subsumed within the municipal advisor's fiduciary duty, and that the fair dealing duties under Rule G-17 are applicable to municipal advisors when advising municipal entities.

- **MSRB Response:** The Notice would provide that, "The Rule G-36 fiduciary duty to municipal entity clients goes beyond and encompasses the obligation under MSRB Rule G-17 for municipal advisors, in the conduct of their municipal advisory activities, to deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice. A violation of Rule G-17 with respect to a municipal entity client, therefore, would necessarily be a violation of Rule G-36." Endnote 3 to the Notice provides examples of conduct by financial advisors with respect to issuers of municipal securities that has been found to violate Rule G-17. The MSRB would consider such conduct to also be a violation of proposed Rule G-36.

- **Comment: Application of Draft Rule G-36 to Broker-Dealers.** PFM suggested that the MSRB clarify that draft Rule G-36 applies to broker-dealers who engage in municipal advisory activities (except in the course of underwriting under Section 2(a)(11) of the Securities Act).

- **MSRB Response:** The Notice would provide that: "The term "municipal advisory activities" is defined by MSRB Rule D-13 to mean the activities described in Section 15B(e)(4)(A)(i) and (ii) of the Exchange Act, whether conducted by a broker, dealer, or municipal securities dealer ("dealer") that is a municipal advisor within the meaning of Section 15B(e)(4) of the Exchange Act or by a municipal advisor that is not a dealer."

- **Comment: Duty When Advising Obligated Person.** Capital Strategies requested that the MSRB clarify the municipal advisor's duty when a financing alternative for a municipal advisor's obligated person client is not in the best interests of a municipal entity.

- **MSRB Response:** The Exchange Act does not impose a fiduciary duty on municipal advisors with obligated person clients. Accordingly, the MSRB has determined not to make this change in the Notice relating to proposed Rule G-36. The obligations of a municipal advisor to an obligated person client would be set forth in a companion MSRB notice relating to Rule G-17. That notice would provide (in endnote 7): "Although a municipal advisor advising an obligated person does not have a fiduciary duty to the municipal entity that is the conduit issuer for the obligated person, it still has a fair dealing duty to the municipal entity." Thus, when a municipal advisor is advising an obligated person, its primary obligation of fair dealing is to its client. The municipal advisor would not required to act in the best interest of the municipal entity acting as a conduit

issuer, although the advisor would be prohibited from acting in a deceptive, dishonest or unfair manner.

- **Comment: Limitations on Fiduciary Duty.** SIFMA requested that the MSRB clarify that a municipal advisor's fiduciary duty only applies in connection with a specific transaction or during the course of a specific engagement and does not apply to solicitation activities of a municipal advisor, to activities concerning obligated persons, or when a municipal advisor solicits a municipal entity on its own behalf. SIFMA requested that the MSRB clarify that the municipal advisor's fiduciary duty will not apply to those entities exempt from the definition of municipal advisor (i.e., underwriters, investment advisors providing investment services, etc.).

  MSRB Response: Proposed Rule G-36 would provide that a municipal advisor's fiduciary duty applies when the advisor has a municipal entity client. A companion MSRB notice relating to Rule G-17 would specifically provide that a municipal advisor does not have a fiduciary duty under proposed Rule G-36 to an obligated person client or a municipal entity it solicits on behalf of a third-party client. The MSRB also determined to clarify when a municipal entity is determined to be a client and has revised the Notice so that it would provide: "A municipal entity will be considered to be a client of the municipal advisor from the time that the advisor has been engaged to provide municipal advisory services (either pursuant to a written agreement or by informal arrangement) until the time that the agreed upon engagement ends."

DUTY OF LOYALTY

Conflicts of Interest; Disclosure.

- **Comment: Certain Conflicts Not Waiveable.** Lewis Young suggested removing the examples of the types of conflicts that must be disclosed because this is not necessary and because certain of the conflicts concerning third-party payments should be considered not to be waiveable.

- **MSRB Response:** The MSRB has determined not to revise the Notice to remove the examples of conflicts, because it is important to provide this guidance to municipal advisors. However, the revised Notice would clarify that disclosures of conflicts and consent by the recipient would not suffice to allow a municipal advisor to undertake a municipal advisory engagement if the conflicts are so significant that they are unmanageable.

- **Comment: Substitute Term "Engagement" for "Relationships."** Lewis Young suggested that, because the term "relationships" was vague and overbroad, the term "engagement" should be used instead, because such term was clear and measurable. It said that this substitution would also avoid the suggestion that municipal advisors were subject to a higher standard than that applicable to

attorneys. It also said that only those relationships that the advisor reasonably feels will cloud its judgment should be required to be disclosed; otherwise, it said, important relationships may get lost in the disclosure of a long list of items.

- **MSRB Response:** The MSRB does not agree with this comment and therefore has determined not to make the changes suggested. The cases cited in the endnotes to the Notice include examples of informal relationships of which issuers should have been made aware. Furthermore, if a relationship is so significant that it would materially impair an advisor's duty to act in the best interests of its client, the municipal advisor would be precluded from entering into the engagement. Disclosure and informed consent would not suffice.

- **Comment: Disclosure of Conflicts of Interest.** SIFMA said that disclosure of conflicts should be based on reasonableness and upon actual knowledge of personnel who are specifically involved in municipal advisory activities. It said that requiring large organizations to centralize and maintain information would be costly and could also risk compromising confidentiality barriers.

- **MSRB Response:** The MSRB has addressed these concerns and has revised the Notice so that it would provide that the advisor must disclose all material conflicts "of which it is aware after reasonable inquiry." The MSRB has also determined to apply this standard to conflicts "existing at the time the engagement is entered into, as well those discovered or arising during the course of the engagement."

  The MSRB recognizes the issues concerning compromising confidentiality barriers when making inquiries about other relationships with municipal entities. Nevertheless, the MSRB believes that actual knowledge of only those persons involved in the municipal advisory activity is not sufficient. Section 15B(e)(4) of the Exchange Act does not limit the term "municipal advisor" to natural persons. A municipal entity client retains a municipal advisor firm, not an individual that works for the firm. Accordingly, it is the conflicts of the firm that must be disclosed. The revised Notice would clarify that persons preparing the conflicts disclosure must make a reasonable inquiry into the activities of their firm to determine what conflicts may exist. This may include inquiry of persons in addition to those specifically engaged in the municipal advisory activity. In addition, the revised Notice would provide that reasonable inquiry will continue to apply during the course of the engagement to address conflicts discovered or arising after the engagement has been entered into.

- **Comment: Disclose Only General Conflicts of Interest.** SIFMA said that generalized disclosure of conflicts, rather than disclosure tailored to the individual client, should be permitted, allowing the municipal entity to request additional disclosure. SIFMA argued that requiring a municipal advisor to undertake an individualized investigation relating to conflicts applicable to the specific municipal entity, or analyzing the exact implications of the conflict applicable to the municipal entity client, would be time consuming and expensive. It said that

the municipal entity could request more information and decide if the expense was worth it.

SIFMA also said that a municipal advisor should be required to disclose the applicable conflicts only once, in a brochure disclosing material conflicts, and not be required to re-disclose or reconfirm on a transaction by transaction basis unless new material conflicts were discovered. SIFMA said that the municipal advisor should not be required to re-disclose conflicts previously disclosed in a request for proposal ("RFP").

- **MSRB Response:** The MSRB has determined not to make the suggested changes in the Notice. Generalized disclosure, without a discussion of the specific conflicts that may relate to the municipal entity client, is not sufficient to alert a municipal entity client to specific conflicts and is an insufficient basis for informed consent. The Notice would not require disclosures to be made more than once per issue. An RFP response may be an appropriate place to make required disclosures as long as the proposed structure of the financing is adequately developed at that point to permit the specific disclosures required by the Notice.

- **Comment: Conflicts of Interest Should be Addressed in Rule G-23.** MRC suggested that the requirements to disclose conflicts and to obtain informed consent would be more appropriately addressed in MSRB Rule G-23, and that the requirements should be removed from the Notice.

- **MSRB Response:** The MSRB disagrees with this comment and has therefore determined not to make the suggested changes. Rule G-23 only concerns financial advisory activities of dealers. It also does not impose a fiduciary duty.

- **Comment: Rule Recognizes Essential Duties of Loyalty and Due Care.** Fi360 applauded the MSRB for recognizing the duties of loyalty and due care as essential obligations under the fiduciary standard of care. It also said the Notice amply captured key principles that underlie the duties of loyalty and care. AFSCME also applauded the efforts of the MSRB to protect municipal entities from self-dealing and other deceptive practices, and said that strong protections were required for municipal entities.

- **MSRB Response.** The MSRB appreciates these comments.

- **Comment: Due Diligence To Determine Authority of Municipal Official.** SIFMA requested that the MSRB clarify the level of due diligence required to determine if an official has the authority to bind the municipal entity by contract, and suggested that a representation by the official that it had the requisite authority to execute should be sufficient, absent actual knowledge by the municipal advisor that such representation was false.

- **MSRB Response:** The MSRB has revised the Notice so that it would provide that a municipal advisor is only required to have a reasonable belief that it is making required disclosures to officials with the authority to bind the issuer. This change would also be made to the informed consent provisions of the Notice.

Conflicts of Interest; Unmanageable Conflicts.

- **Comment: Principal Transactions.** ABA and SIFMA suggested that principal transactions should not be prohibited as unmanageable conflicts because other federal and state laws permit entities subject to a fiduciary duty to effect principal transactions with clients after disclosure and informed consent. They said that traditional banking activities, including accepting deposits and foreign exchange transactions, should be permitted, arguing that not permitting municipal advisors to engage in these transactions would create an unfair advantage for investment advisors and swap dealers, among others, that have the ability to effect these types of transactions. They said that such a ban would also effectively limit municipal entities' access to critical products and services. SIFMA also proposed that the prohibition on principal transactions not prohibit a municipal advisor or affiliate from serving as a trustee and that the prohibition should not apply to advisory transactions if the principal transactions were effected by "distant cousin" affiliates of a municipal advisor. ABA suggested that the MSRB propose exceptions for associated persons, similar to the exception provided in a 1978 interpretation[6] of MSRB Rule D-11, which excludes, solely for purposes of the fair practice rules, persons who are associated "solely by reason of a control relationship," unless the affiliate is otherwise engaged in municipal advisory activities.

  MSRB Response: The revised Notice would provide that a municipal advisor will not be considered to have an unmanageable conflict as a result of acting as principal when: (i) providing investments to the municipal entity on a temporary basis to ensure timely delivery for closing; (ii) engaging in activities permitted under Rule G-23; (iii) it is a municipal advisor solely because it recommends investments or municipal financial products provided or offered by it to a municipal entity as a counterparty, but is not described in (iv); or (iv) acting as a swap or security-based counterparty to a municipal entity represented by an "independent representative," as defined in the Commodity Exchange Act or the Exchange Act, respectively. Once the SEC has completed its rulemaking on the definition of "municipal advisor," the MSRB will consider whether additional exceptions are appropriate.

- **Comment: Engineers as Municipal Advisors.** ACEC said that, under certain circumstances, some engineers, if subject to a fiduciary duty by reason of being included in the definition of "municipal advisor," may have direct conflicts with

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[6] The ABA's citation is actually to the SEC's order approving Rule D-11, a portion of which is reprinted in the MSRB Rule Book.

their municipal entity clients because of the engineers' professional and ethical duties. It said that an engineer's ethical duties require it to hold the safety, health, and welfare of the public paramount and that an engineer's duty to render independent judgments might in some cases conflict with its duty of loyalty to its municipal entity client, particularly if the expectations of its client differed from the engineer's independent judgment.

- **MSRB Response:** The MSRB has determined not to make any changes to the Notice with respect to this comment. The MSRB recognizes that members of other professions that also serve as municipal advisors may have concurrent professional duties and standards and the MSRB agrees that an advisor is required to exercise its independent professional skill and judgment in performing its role. The rule does not require that the advisor abandon its professional standards in order to render opinions consistent with the client's expectations.

Fee Splitting; Prohibited Payments

- **Comment: Compensation for Related Services.** SIFMA and ABA requested further clarification about fee-splitting and related compensation arrangements, and suggested that compensation for certain traditional banking services (relating to corporate trust and mutual funds), such as shareholder servicing fees and 12b-1 fees, be permitted with full disclosure and informed consent.

- **MSRB Response.** Endnote 6 to the Notice provides examples of fee-splitting arrangements. The Notice also provides exceptions to the general rule that a municipal advisor that serves as a principal has an unmanageable conflict. Depending upon the SEC's definition of "municipal advisor," the MSRB may propose additional exceptions, but the MSRB is unwilling to do so at this time.

- **Comment: Prohibited Payments to Affiliated Solicitors.** SIFMA also requested further guidance on prohibited payments by municipal advisors to solicitors and argued that payments to affiliated solicitors should not be prohibited because the definition of municipal advisor adopted by the Dodd Frank Act only restricts payments to independent solicitors.

- **MSRB Response:** The MSRB has determined not to make the suggested changes. The cases cited in the endnotes to the Notice demonstrate the inappropriate role that third-party payments have played in many municipal securities financings. The exceptions made by the Notice would only concern issuer-permitted payments and payments to parties that are themselves regulated by the MSRB.

Compensation; Excessive Compensation.

- **Comment: Definition of Excessive Compensation**. NAIPFA, SIFMA, and B-Payne Group requested further clarification on the definition of "excessive compensation." NAIPFA suggested certain criteria, including, among other

things, the time and labor required, the novelty and difficulty of the issue involved, and the skill requisite to perform the municipal advisory services properly; the fee customarily charged in the locality for similar municipal advisory services; the amount involved and the results obtained; the nature and length of the professional relationship with the client; the experience, reputation, and ability of the municipal advisor or municipal advisors performing the services; and whether the fee is fixed or contingent. B-Payne Group objected to any evaluation of whether its fees were excessive, arguing that no regulator was in a position to evaluate the reasonableness of the municipal advisor's fee. SIFMA suggested that a fully disclosed and negotiated agreement, absent fraud, was sufficient to guard against excessive compensation.

- **MSRB Response:** The MSRB has revised the Notice so that it would incorporate some of the factors noted in the comment letters. The revised Notice would describe excessive compensation as compensation that is so disproportionate to the nature of the municipal advisory services performed as to indicate that the municipal advisor is not acting in the best interests of its municipal advisory client. Further, the revised Notice would provide that "the MSRB recognizes that what is considered reasonable compensation for a municipal advisor will vary according to the municipal advisor's expertise, the complexity of the financing, and the length of time spent on the engagement, among other factors." As this language recognizes, many factors may appropriately affect the amount of the fee, and the specific factors listed in the Notice would not be exclusive. Thus, it may be that the various other factors noted by commenters could have an impact on the compensation paid to a municipal advisor. In all cases, the municipal advisor must be able to support the legitimacy of its fees.

Compensation; Forms of Compensation.

- **Comment: Disclosure of Conflicts Confusing and Unnecessary.** Several commenters[7] suggested that the MSRB delete Appendix A to the Notice (Disclosure of Conflicts with Various Forms of Compensation) and the requirement of the Notice that municipal advisors disclose the conflicts with various forms of compensation. Commenters argued that: (i) such disclosure was unnecessary and that including it would detract from the importance of the rest of the rule; (ii) statements about imbedded conflicts in compensation would be confusing to municipal entities because underwriters (who, they said, have inherent conflicts as both purchasers and distributors of the municipal entity's securities) are not required to disclose this information, whereas municipal advisors, who do not have these inherent conflicts, are nevertheless required to disclose such possible conflicts; and (iii) contingent fees do not affect professional performance. Other commenters argued that the fiduciary duty applicable to municipal advisors was sufficient to guard against excessive compensation. NAIPFA requested that, if this requirement were retained, a

[7] B-Payne Group, Lewis Young, MRC, NAIPFA, PFM, and SIFMA.

similar requirement be applicable to underwriters. B-Payne Group agreed that fees of all participants, including bond lawyers, should be disclosed. MRC suggested that any disclosure requirements were more appropriately addressed in Rule G-23.

AGFS said that, among other things, the proposal to require that firms clarify for clients the advantages and disadvantages of various forms of advisor compensation was excellent. It said that too many municipal issuers are gullible regarding the use of contingent compensation payable only after transactions are completed and that they do not think through the long-term costs and other relevant implications of contingent compensation that can place advisors, upon whom the issuers rely heavily, in the unfortunate position of sacrificing months of work without compensation when it becomes apparent (or should be apparent to a market financial professional) that a transaction is not in the issuers' best interests. AGS said that, unfortunately, there are advisors who would plow ahead in order to avoid substantial financial loss, rather than informing the issuer clients either (1) not to proceed or (2) to alter the structure or approach.

- **MSRB Response:** The MSRB has determined not to eliminate Appendix A from the Notice. Because municipal advisors are fiduciaries with respect to their municipal entity clients, the MSRB considers it essential that they disclose all material conflicts to their clients. Appendix A was included in the Notice for the benefit of small municipal advisors to help them avoid the need to hire an attorney to prepare such compensation conflicts disclosure. Use of Appendix A would not be mandatory and municipal advisors would be free to draft their own disclosure addressing these conflicts.

  Pursuant to Section 15B(e)(4)(C) of the Exchange Act, dealers are not municipal advisors when they are serving as underwriters. Even so, MSRB Rule G-17 (on fair dealing) would apply to them when they engage in municipal securities activities with issuers of municipal securities. The MSRB recognizes that underwriters would not be subject to the same requirement to disclose conflicts associated with various forms of compensation under Rule G-17. It is appropriate to interpret Rule G-17 differently for arm's-length counterparty relationships on the one hand (such as underwriters appropriately maintain with issuers) and advisory relationships on the other.

  The MSRB notes that it does not have jurisdiction over bond lawyers, unless they are functioning as municipal advisors, and, therefore, in most cases, may not require them to disclose compensation conflicts.

- **Comment: Limit Disclosure of Conflicts to Form of Compensation Mandated by Issuer.** NAIPFA suggested that disclosure of conflicts be limited to the conflicts applicable to the form of compensation methodology at the time the compensation methodology was proposed. NAIPFA also suggested that "pitches" or other discussions of ideas with municipal entities prior to engagement should

not require delivery of the disclosure. NAIPFA suggested that the disclosures should not be required when the municipal entity dictated the form of compensation, arguing that discussion of conflicts in this instance would not advance the duty of loyalty to the municipal entity client.

- **MSRB Response:** The MSRB has determined to revise the Notice so that it would require that conflicts disclosures, including those regarding compensation, need only be delivered before the engagement of the municipal advisor, unless a conflict is discovered or arises later. Furthermore, the revised Notice would provide that "if the municipal entity client has required that a particular form of compensation be used, the compensation conflicts disclosure provided by the municipal advisor need only address that particular form of compensation." If the form of compensation is not required by the municipal entity, however, the municipal advisor would be required to disclose and discuss the conflicts associated with various forms of compensation.

- **Comment: Authority of Municipal Entity Officials to Consent to Disclosures.** Several commenters suggested that, in determining the authority of a municipal entity official to enter into a contract, to receive various disclosures, and to deliver informed consent, a municipal advisor should be permitted to rely on the apparent authority of an official to acknowledge the conflicts disclosure. NAIPFA suggested that the municipal advisor be able to rely on the designation by the municipal entity of the primary contact for the engagement as evidence of its authority unless the municipal advisor has reason to believe that the official does not have the requisite authority. SIFMA suggested that the municipal advisor be able to rely on a representation of the official as to its apparent authority.

- **MSRB Response:** As noted above under "Conflicts of Interest; Disclosure," the MSRB determined to revise the Notice so that it would provide that a municipal advisor is only required to have a reasonable belief that it is making required disclosures to, and receiving informed consent from, officials with the authority to bind the issuer.

- **Comment: Consent Presumed With Receipt of Written Agreement.** NAIPFA suggested that a municipal advisor be permitted to presume consent to compensation conflicts disclosure if it receives an executed contract, or verbal agreement that a written engagement letter (or similar document) has been accepted, or written or verbal acknowledgement that the advisor has been selected following an RFP process in which the form of compensation was appropriately disclosed.

- **MSRB Response:** The MSRB had determined not to make changes to the Notice in response to this comment because the following provisions of the Notice would address this comment: "The disclosures described in this paragraph must be provided as described above under "Duty of Loyalty/Conflicts of Interest/Disclosure Obligations." That section of the Notice would provide: "For

purposes of proposed Rule G-36, a municipal entity will be deemed to have consented to conflicts that are clearly described in its engagement letter or other written contract with the municipal advisor, if the municipal entity expressly acknowledges the existence of such conflicts. If the officials of the municipal entity agree to proceed with the municipal advisory engagement after receipt of the conflicts disclosure but will not provide written acknowledgement of such conflicts, the municipal advisor may proceed with the engagement after documenting with specificity why it was unable to obtain their written acknowledgement."

DUTY OF CARE

Necessary Qualifications.

- **Comment: Restrictions on Undertaking Engagements Are Unnecessary.** Lewis Young suggested that the requirement that the "municipal advisor should not undertake a municipal advisory engagement for which the advisor does not possess the degree of knowledge and expertise needed to provide the municipal entity with informed advice" be removed, arguing that it was unnecessary and it left out many other aspects of the general fiduciary duty of care and "unbalanced" the implications of the general duty.

- **MSRB Response:** The MSRB has determined not to make any changes to the Notice in response to this comment. The MSRB disagrees with this comment because it considers the requisite knowledge and expertise to be an essential element of the duty of care. The cases cited in endnote 20 to the Notice provide examples of instances in which financial advisors violated this duty.

Consideration of Alternatives.

- **Comment: Requirement Unnecessary.** Lewis Young suggested that this requirement should be removed as it was unnecessary.

- **MSRB Response:** The MSRB disagrees with this comment and considers this requirement to be a fundamental distinction between a fiduciary and an arm's length counterparty, such as an underwriter.

- **Comment: Limit Obligations to Terms of Contract.** SIFMA argued that a municipal advisor should be required to do only what the municipal entity contracts for and that imposing other duties will impose additional costs and will cause extensive negotiation on the limitations clauses in contracts. Further, SIFMA argued that an implied duty to review alternatives should not apply where the form of engagement letter is non-negotiable because the inability to negotiate a limited engagement clause will reduce the number of municipal advisors who offer services.

- **MSRB Response:** The MSRB has determined not to make any changes to the Notice in response to this comment. The MSRB expects that municipal advisors that wish to limit their engagements with municipal entities will do so in writings (whether as part of engagement letters or separately) that limit the scope of their engagements to particularly enumerated items or which state that any services not specified in the writing will not be provided by the advisor. This should impose no measurable additional cost on the advisor or the municipal entity.

Duty of Inquiry.

- **Comment: Scope of Inquiry.** Lewis Young said that the requirement to conduct reasonable inquiry regarding representations set forth in a certificate should be governed by the terms of the certificate, which should show the scope of inquiry. SIFMA requested more guidance on the required scope of a factual investigation and on the nature and scope of any permitted qualifications, and whether a municipal advisor could disclaim the duty altogether in its engagement letter or later, noting that it would be impossible to anticipate all limitations on this duty at outset of engagement. NAIPFA suggested that the MSRB clarify its statements about a municipal advisor's duty of inquiry under G-36 and G-17 to form a reasonable basis for its recommendations.

- **MSRB Response:** The MSRB has determined not to make the suggested changes. The Notice would not permit the waiver of duties imposed by proposed Rule G-36, as interpreted by the Notice, if they are within the scope of the municipal advisor's engagement. If it is within the scope of the municipal advisor's engagement to prepare a certificate that will be relied upon by the issuer, the municipal advisor would be required to conduct a reasonable inquiry into the facts that underlie the certificate. For example, review of the official books of the issuer and other factual information within the municipal advisor's control might assist the municipal advisor in forming a reasonable basis for its certificate. However, if the certificate relies on the representations of others or facts not within the municipal advisor's control, additional inquiry on the part of the municipal advisor might be required.

  The MSRB notes that some certificates that municipal advisors provide already have the potential to subject the advisor to penalties under Section 6700 of the Internal Revenue Code. An Internal Revenue Service publication on Section 6700 [8] provides: "Participants [in a bond financing] can rely on matters of fact or material provided by other participants necessary to make their own statements or draw their own conclusions, unless they have actual knowledge or a reason to know of its inaccuracy or the statement is not credible or reasonable on its face."

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[8] See Office of Chief Counsel, Internal Revenue Service, Memorandum No. 200610018, Application of Section 6700 Penalty with Respect to Various Participants in Tax-Exempt Bond Issuance (Feb. 3, 2006).

The Internal Revenue Service summarized the legislative history of Section 6700. See H. Conf. Rep. No. 101-247, 101st Cong., 1st Sess. 1397.

With respect to clarifying the statements in the Notice concerning the municipal advisor's duty to form a reasonable basis for any recommendation, the MSRB has determined not to make any changes to the Notice other than those directed to specific circumstances in the Notice (e.g. Duty of Inquiry, Consideration of Alternatives, etc.) . The MSRB notes that each recommendation, and the basis for such recommendation, will be dependent on facts and circumstances and that the statements in the Notice are intended as general guidelines.

- **Comment: Due Diligence.** Lewis Young and SIFMA said that the requirement for a municipal advisor to use due diligence when preparing an official statement suggested that the municipal advisor (whose duties are to an issuer) had the duties of an underwriter (whose duties are to investors). Lewis Young said that this requirement is inconsistent with an advisor's obligation, which is to advise "in a secondary role to the issuer as principal as to disclosure duties, as well as duplicating the duties of an underwriter." Lewis Young also noted that a municipal advisor owes a duty to the municipal entity, not to investors, and the municipal advisor's obligations in respect of the disclosure process are to explain the process to the issuer, to make recommendations on the structure and content of the disclosure document, and to recommend competent counsel to prepare.

- **MSRB Response:** The MSRB has determined to revise the Notice so that it would address these concerns. The language in the Notice upon which this comment is based covers the situation in which the municipal advisor prepares all, or substantially all, of the official statement, exercising discretion as to the content of disclosures. This is often true in the case of competitive underwritings. Under these circumstances, the advisor owes a duty to the municipal entity to make reasonable inquiries in order to help ensure the appropriate disclosures are made in the official statement. The revised Notice would no longer require that the advisor exercise due diligence, and would further provide that the municipal advisor "owes a duty to the municipal entity to make reasonable inquiries in order to help ensure the appropriate disclosures are made in the official statement."

PERMISSIBLE LIMITATIONS ON SCOPE OF ENGAGEMENT

Limitations.

- **Comment: Outline Scope of Duties in Engagement.** Both SIFMA and NAIPFA suggested that municipal advisors should be permitted to outline the scope of their duties in an engagement, rather than outlining the exclusions and limitations. NAIPFA noted that it would be unreasonable to subject a municipal advisor to a fiduciary duty with respect to services that were beyond the scope of the parties' agreement. Further, it said that an issuer had no reason to assume that services not specified in writing would be performed. The municipal advisor

should be held to the duties it had agreed to undertake, and be able to include a blanket statement relating to the matters excluded from the engagement.

- **MSRB Response:** The MSRB has determined not to make any changes to the Notice in response to this comment. The MSRB expects that municipal advisors that wish to limit their engagements with municipal entities will do so in writings (whether as part of engagement letters or separately) that limit the scope of their engagements to particularly enumerated items or which state that any services not specified in the writing will not be provided by the advisor. This should impose no measurable additional cost on the advisor or the municipal entity.

Disclosure of Pre-Formed Judgment on Appropriateness of Transaction or Product.

- **Comment: Remove Requirement to Disclose Advisor's Pre-Formed Opinion.** SIFMA suggested that the MSRB reconsider its position on permitting the municipal advisor to limit the scope of its engagement while requiring it to disclose any pre-formed opinion it has on matters not within the scope of the engagement. SIFMA said that this was burdensome, detracted from the scope of the limitations, and would effectively require the municipal advisor to consider the appropriateness of the financing or product (which it had excluded from its engagement) to counter any hindsight judgment.

- **MSRB Response:** The MSRB has determined to revise the Notice so that it would no longer include this requirement. While the Notice would not require the municipal advisor to conduct reasonable inquiry to form such an opinion, the MSRB realizes that some municipal advisors might feel obliged to do so to avoid being questioned in hindsight about whether they had, in fact, formed an opinion on appropriateness before being retained.

Scope of Engagement.

- **Comment: Define Term of Engagement.** SIFMA suggested that the Notice include a definition of "engagement," and define when the municipal advisor's obligation will commence and terminate pursuant to a written engagement letter. Absent a written engagement letter, SIFMA suggested that an engagement should terminate on the reasonable expectations of the parties, or when the related transaction has been concluded.

- **MSRB Response:** By the use of the word "engagement," the MSRB means the municipal advisory assignment or other scope of work for which the municipal entity has retained the municipal advisor. When a municipal advisor is engaged or retained by the municipal entity, the municipal entity would become the client of the municipal advisor and the fiduciary duty under proposed Rule G-36 would begin to apply. It would continue to apply until the engagement is complete.

- **Comment: Incorporate Requirements of Advisory Contracts in Rule G-23.** MRC suggested that any requirements relating to the content of advisory contracts be incorporated into existing rules such as Rule G-23, rather than by interpretation. MRC also suggested clarification of the various statements relating to appropriateness and incorporation of such statements in MSRB Rule G-19 (on suitability).

- **MSRB Response:** The MSRB disagrees with this comment and has therefore determined not to make the suggested changes. As noted above, Rule G-23 only concerns financial advisory activities of broker-dealers. It also does not impose a fiduciary duty. Rule G-19 only imposes a duty of suitability upon dealers and, even then, only in connection with transactions in municipal securities recommended to customers. [9] The MSRB has determined not to amend that rule at this time.

OTHER COMMENTS

- **Comment: Other Rules May Impose Conflicting Standards.** Various commenters[10] noted that several regulatory agencies either have in place or are currently promulgating rules that concern parties that might be subject to draft Rule G-36 and that lack of coordination with these agencies could lead to conflicting standards applicable to such parties. They said that the MSRB and other regulatory agencies need to coordinate their respective guidance and AFSCME suggested that these agencies offer informal guidance such as webinars to aid market participants.

- **MSRB Response:** The MSRB has been coordinating with other regulators in areas of overlap. For example, the provisions of the Notice concerning the provision of swap advice use the same language as found in Title VII of Dodd-Frank and the proposed Commodity Trading Futures Commission ("CFTC") business conduct rule for swap dealers and major swap participants.[11] Further, the MSRB has conducted and will continue to conduct webinars and various outreach events to explain its rulemaking efforts.

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9 Under MSRB Rule D-9:

> Except as otherwise specifically provided by rule of the Board, the term "customer" shall mean any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities.

10 ABA; AFSCME; Michigan Bankers; SIFMA; and EFC.

11 See Federal Register Vol. 75, No. 245 (December 22, 2010).

- **Comment: Manner of Regulation and Cost of Compliance.** B-Payne Group expressed the view that the MSRB should regulate municipal advisors by getting "experienced personnel on the ground in regional markets and charge them with staying on top of situations," rather than regulating municipal advisors as the MSRB regulates dealers. It argued for exemptions from MSRB rules for small municipal advisors and said the cost of compliance for such advisors would outweigh the regulatory benefit. Other parts of the comment letter addressed matters that were outside the scope of the request for comment on draft Rule G-36 (e.g., professional qualifications testing, training for local finance officials) and are not summarized here.

- **MSRB Response:** For regulation of municipal advisors to be fair, all municipal advisors must know what rules apply to them. The Exchange Act itself imposes a fiduciary duty on municipal advisors and the proposed rule change provides guidance to municipal advisors on what it means to have a fiduciary duty so they can tailor their conduct accordingly. Without such guidance, "experienced personnel on the ground" would likely enforce the Exchange Act in an inconsistent manner, which the MSRB doubts that B-Payne Group would consider fair.

  As stated above, all municipal advisors, regardless of their size, have a fiduciary duty to their municipal entity clients. Because the protection of their clients is paramount, in this context, the MSRB has concluded that it is appropriate to impose the same rules on small municipal advisors as it imposes on larger municipal advisors. However, the MSRB recognizes that there are costs of compliance. That is the reason the MSRB has included Appendix A to the Notice. By using Appendix A to provide disclosure concerning compensation conflicts, small municipal advisors would be able to satisfy the compensation disclosure requirement of the Notice without having to retain legal counsel to assist them in the preparation of such disclosure.

- **Comment: Implementation Period.** SIFMA suggested that because Rule G-36 would subject municipal advisors to rules they are not currently subject to, the MSRB should consider providing for an implementation period of no less than one year.

- **MSRB Response.** The MSRB recognizes that some municipal advisors may be subject to rules that are not currently applicable. However, the appropriate implementation period will depend upon the provisions of the SEC's rule relating to municipal advisors.

6. Extension of Time Period of Commission Action

The MSRB declines to consent to an extension of the time period specified in Section 19(b)(2) of the Exchange Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2).

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Federal Register Notice

2. Notice Requesting Comment and Comment Letters

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(RELEASE NO. 34- ; File No. SR-MSRB-2011-14)

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Proposed Rule G-36, on Fiduciary Duty of Municipal Advisors, and a Proposed Interpretive Notice Concerning the Application of Proposed Rule G-36 to Municipal Advisors

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("the Exchange Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on August 23, 2011, the Municipal Securities Rulemaking Board ("Board" or "MSRB") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The MSRB is filing with the SEC a proposed rule change consisting of proposed Rule G-36 (on fiduciary duty of municipal advisors) and a proposed interpretive notice (the "Notice") concerning the application of proposed Rule G-36 to municipal advisors. The MSRB requests that the proposed rule change be made effective on the date that rules defining the term "municipal advisor" under the Exchange Act are first made effective by the Commission or such later date as the proposed rule change is approved by the Commission.

The text of the proposed rule change is available on the MSRB's website at www.msrb.org/Rules-and-Interpretations/SEC-Filings/2011-Filings.aspx, at the MSRB's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[3] the MSRB was expressly directed by Congress to protect municipal entities. Accordingly, the MSRB is proposing Rule G-36 and an interpretive notice thereunder to address the fiduciary duty of municipal advisors to their municipal entity clients.

A more-detailed description of the provisions of the Notice follows:

Duty of Loyalty. The Notice would provide that the Rule G-36 duty of loyalty would require the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor. It would require a municipal advisor to make clear, written disclosure of all material conflicts of interest, such as those that might impair its ability to satisfy the duty of loyalty, and to receive the written, informed consent of officials of the municipal entity the municipal advisor reasonably believes have the authority to bind the municipal entity by contract with the municipal advisor. Such disclosure would be required to be made before the municipal advisor could provide municipal advisory services to the municipal entity or, in the case of

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[3] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

conflicts discovered or arising after the municipal advisory relationship has commenced, before the municipal advisor could continue to provide such services.

The Notice would provide that a municipal advisor may not undertake an engagement if certain unmanageable conflicts exist, including (i) kickbacks and certain fee-splitting arrangements with the providers of investments or services to municipal entities, (ii) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor for solicitation activities regulated by the MSRB, and (iii) acting as a principal in matters concerning the municipal advisory engagement (except when providing investments to the municipal entity on a temporary basis to ensure timely delivery for closing; when engaging in activities permitted under Rule G-23; when it is a municipal advisor solely because it recommends investments or municipal financial products provided or offered by it to a municipal entity as a counterparty (other than a swap or security-based swap counterparty); or when acting as a swap or security-based counterparty to a municipal entity represented by an "independent representative," as defined in the Commodity Exchange Act or the Exchange Act, respectively.

The Notice would provide that, in certain cases, the compensation received by a municipal advisor could be so disproportionate to the nature of the municipal advisory services performed that it would be inconsistent with the proposed Rule G-36 duty of loyalty and would represent an unmanageable conflict. The Notice would also provide that a municipal advisor would be required to disclose conflicts associated with various forms of compensation (except where the form of compensation has been required by the municipal entity client), in which case the disclosure need only address that form of compensation. The Notice would also include a

form of disclosure of conflicts relating to the forms of compensation to aid advisors in preparing their disclosure. Use of the form would not be required.

Duty of Care. The Notice would provide that the proposed Rule G-36 duty of care would require that a municipal advisor act competently and provide advice to the municipal entity after inquiry into reasonably feasible alternatives to the financings or products proposed (unless the engagement is of a limited nature). The Notice would also require the advisor to make reasonable inquiries into facts necessary to determine the basis for the municipal entity's chosen course of action, as well facts necessary to prepare certificates and to help ensure appropriate disclosures for official statements. The Notice would also permit the municipal advisor to limit the scope of its engagement.

2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2) of the Exchange Act, which provides, in pertinent part, that:

> The Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.

Section 15B(c)(1) of the Exchange Act also provides, in pertinent part, that:

> A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the Board.

Section 15B(b)(2)(L) of the Exchange Act provides, in pertinent part, that:

> [The rules of the Board, at a minimum, shall,] with respect to municipal advisors— (i) 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 proposed rule change is consistent with Section 15B(c)(1) of the Exchange Act and Section 15B(b)(2)(L) of the Exchange Act because it incorporates the fiduciary duty, imposed by the Exchange Act, into a proposed rule that would articulate the principal duties that comprise a municipal advisor's fiduciary duty to a municipal entity client (a duty of loyalty and a duty of care), although such duties would not be exclusive. The proposed rule change also would provide guidance on what conduct would be inconsistent with a duty of loyalty (principally failing to deal honestly and in good faith with the municipal entity and failing to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor) and the conflicts of interest that would be inconsistent with a duty of loyalty (including certain third-party payments and receipts and, in general, acting as a principal in matters concerning the municipal advisory engagement). It would also provide guidance on what conduct would be inconsistent with a duty of care (principally failing to act competently and to provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to the financings or products proposed that might better serve the interests of the municipal entity).

Section 15B(b)(2)(L)(iv) of the Exchange Act requires that rules adopted by the Board:

> 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.

All municipal advisors, regardless of their size, have a fiduciary duty to their municipal entity clients. Because the protection of their clients is paramount, in this context, the MSRB has concluded that it is appropriate to impose the same rules on small municipal advisors as it imposes on larger municipal advisors. However, the MSRB recognizes that there are costs of compliance. That is the reason the MSRB has included Appendix A to the Notice. By using Appendix A to provide disclosure concerning compensation conflicts, small municipal advisors will satisfy the compensation disclosure requirement of the Notice without having to retain legal counsel to assist them in the preparation of such disclosure.

B. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, since it would apply equally to all municipal advisors with municipal entity clients.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On February 14, 2011, the MSRB requested comment on a draft of Rule G-36 ("draft Rule G-36") and a draft of the Notice (the "draft Notice").[4] The MSRB received comment letters from: the American Bankers Association ("ABA"); the American Council of Engineering Companies ("ACEC"); the American Federation of State, County and Municipal Employees ("AFSCME"); American Governmental Financial Services ("AGFS"); B-Payne Group ("B-Payne Group"); the Education Finance Council ("EFC"); Fi360; Lewis Young Robertson & Burningham, Inc. ("Lewis Young"); the Michigan Bankers Association ("Michigan Bankers"); Municipal Regulatory Consulting LLC ("MRC"); the National Association of Independent Public Finance Advisors ("NAIPFA"); Not for Profit Capital Strategies ("Capital Strategies");

[4] See MSRB Notice 2011-14 (February 14, 2011).

Phoenix Advisors, LLC ("Phoenix Advisors"); Public Financial Management ("PFM"); the Securities Industry and Financial Markets Association ("SIFMA"); and the Wisconsin Bankers Association ("Wisconsin Bankers").

SCOPE OF THE RULE

- Comment: Delay Interpretive Notice until SEC Rule on Municipal Advisors Finalized. Many commenters[5] requested that the MSRB withdraw or delay some or all of the provisions of the Notice until the SEC has defined "municipal advisor," after which time they asked that the MSRB afford commenters an additional opportunity to comment on the Notice. Other comments were outside the scope of the request for comment on draft Rule G-36 (e.g., suggested modifications to the definition of "municipal advisor") and are not summarized here.
- MSRB Response: Because the fiduciary duty applicable to municipal advisors was effective as of October 1, 2010, the MSRB feels it is important to provide guidance on basic fiduciary duties applicable to municipal advisors. The MSRB has requested that the proposed rule change be made effective on the date that rules defining the term "municipal advisor" under the Exchange Act are first made effective by the SEC or such later date as the proposed rule change is approved by the SEC. At that time, the MSRB may propose additional guidance, if necessary.
- Comment: References to Duty of Loyalty and Duty of Care Too Limiting. Lewis Young suggested said that the MSRB should delete the clause "which shall include a duty of loyalty and a duty of care" from the text of draft Rule G-36 on the theory that it is too

[5] ABA; SIFMA; Wisconsin Bankers; Michigan Bankers; NAIPFA; MRC; AFSCME; EFC; Phoenix Advisors; and ACEC.

limiting and that there is a substantial body of state and federal law governing fiduciary duty that includes more than these two duties.

- MSRB Response: The MSRB has determined not to make this change to these provisions in proposed Rule G-36. Proposed Rule G-36 would provide that a municipal advisor's fiduciary duty to its municipal entity client includes a duty of loyalty and a duty of care. While the duties of loyalty and care are generally recognized as the principal components of a fiduciary duty, the MSRB recognizes that certain state fiduciary duty laws address other duties. The use of the word "includes" permits the MSRB to articulate other duties in the future. Therefore the MSRB has determined not to make this change.
- Comment: Clarification of Relationship to Duty of Fair Dealing. NAIPFA requested that the MSRB clarify its statement that the duties of fair dealing under Rule G-17 are subsumed within the municipal advisor's fiduciary duty, and that the fair dealing duties under Rule G-17 are applicable to municipal advisors when advising municipal entities.
- MSRB Response: The Notice would provide that, "The Rule G-36 fiduciary duty to municipal entity clients goes beyond and encompasses the obligation under MSRB Rule G-17 for municipal advisors, in the conduct of their municipal advisory activities, to deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice. A violation of Rule G-17 with respect to a municipal entity client, therefore, would necessarily be a violation of Rule G-36." Endnote 3 to the Notice provides examples of conduct by financial advisors with respect to issuers of municipal securities that has been found to violate Rule G-17. The MSRB would consider such conduct to also be a violation of proposed Rule G-36.

- Comment: Application of Draft Rule G-36 to Broker-Dealers. PFM suggested that the MSRB clarify that draft Rule G-36 applies to broker-dealers who engage in municipal advisory activities (except in the course of underwriting under Section 2(a)(11) of the Securities Act).
- MSRB Response: The Notice would provide that: "The term "municipal advisory activities" is defined by MSRB Rule D-13 to mean the activities described in Section 15B(e)(4)(A)(i) and (ii) of the Exchange Act, whether conducted by a broker, dealer, or municipal securities dealer ("dealer") that is a municipal advisor within the meaning of Section 15B(e)(4) of the Exchange Act or by a municipal advisor that is not a dealer."
- Comment: Duty When Advising Obligated Person. Capital Strategies requested that the MSRB clarify the municipal advisor's duty when a financing alternative for a municipal advisor's obligated person client is not in the best interests of a municipal entity.
- MSRB Response: The Exchange Act does not impose a fiduciary duty on municipal advisors with obligated person clients. Accordingly, the MSRB has determined not to make this change in the Notice relating to proposed Rule G-36. The obligations of a municipal advisor to an obligated person client would be set forth in a companion MSRB notice relating to Rule G-17. That notice would provide (in endnote 7): "Although a municipal advisor advising an obligated person does not have a fiduciary duty to the municipal entity that is the conduit issuer for the obligated person, it still has a fair dealing duty to the municipal entity." Thus, when a municipal advisor is advising an obligated person, its primary obligation of fair dealing is to its client. The municipal advisor would not required to act in the best interest of the municipal entity acting as a

conduit issuer, although the advisor would be prohibited from acting in a deceptive, dishonest or unfair manner.

- Comment: Limitations on Fiduciary Duty. SIFMA requested that the MSRB clarify that a municipal advisor's fiduciary duty only applies in connection with a specific transaction or during the course of a specific engagement and does not apply to solicitation activities of a municipal advisor, to activities concerning obligated persons, or when a municipal advisor solicits a municipal entity on its own behalf. SIFMA requested that the MSRB clarify that the municipal advisor's fiduciary duty will not apply to those entities exempt from the definition of municipal advisor (i.e., underwriters, investment advisors providing investment services, etc.).
- MSRB Response: Proposed Rule G-36 would provide that a municipal advisor's fiduciary duty applies when the advisor has a municipal entity client. A companion MSRB notice relating to Rule G-17 would specifically provide that a municipal advisor does not have a fiduciary duty under proposed Rule G-36 to an obligated person client or a municipal entity it solicits on behalf of a third-party client. The MSRB also determined to clarify when a municipal entity is determined to be a client and has revised the Notice so that it would provide: "A municipal entity will be considered to be a client of the municipal advisor from the time that the advisor has been engaged to provide municipal advisory services (either pursuant to a written agreement or by informal arrangement) until the time that the agreed upon engagement ends."

DUTY OF LOYALTY

Conflicts of Interest; Disclosure.

- Comment: Certain Conflicts Not Waiveable. Lewis Young suggested removing the examples of the types of conflicts that must be disclosed because this is not necessary and because certain of the conflicts concerning third-party payments should be considered not to be waiveable.
- MSRB Response: The MSRB has determined not to revise the Notice to remove the examples of conflicts, because it is important to provide this guidance to municipal advisors. However, the revised Notice would clarify that disclosures of conflicts and consent by the recipient would not suffice to allow a municipal advisor to undertake a municipal advisory engagement if the conflicts are so significant that they are unmanageable.
- Comment: Substitute Term "Engagement" for "Relationships." Lewis Young suggested that, because the term "relationships" was vague and overbroad, the term "engagement" should be used instead, because such term was clear and measurable. It said that this substitution would also avoid the suggestion that municipal advisors were subject to a higher standard than that applicable to attorneys. It also said that only those relationships that the advisor reasonably feels will cloud its judgment should be required to be disclosed; otherwise, it said, important relationships may get lost in the disclosure of a long list of items.
- MSRB Response: The MSRB does not agree with this comment and therefore has determined not to make the changes suggested. The cases cited in the endnotes to the Notice include examples of informal relationships of which issuers should have been made aware. Furthermore, if a relationship is so significant that it would materially impair an advisor's duty to act in the best interests of its client, the municipal advisor

would be precluded from entering into the engagement. Disclosure and informed consent would not suffice.

- Comment: Disclosure of Conflicts of Interest. SIFMA said that disclosure of conflicts should be based on reasonableness and upon actual knowledge of personnel who are specifically involved in municipal advisory activities. It said that requiring large organizations to centralize and maintain information would be costly and could also risk compromising confidentiality barriers.
- MSRB Response: The MSRB has addressed these concerns and has revised the Notice so that it would provide that the advisor must disclose all material conflicts "of which it is aware after reasonable inquiry." The MSRB has also determined to apply this standard to conflicts "existing at the time the engagement is entered into, as well those discovered or arising during the course of the engagement."

  The MSRB recognizes the issues concerning compromising confidentiality barriers when making inquiries about other relationships with municipal entities. Nevertheless, the MSRB believes that actual knowledge of only those persons involved in the municipal advisory activity is not sufficient. Section 15B(e)(4) of the Exchange Act does not limit the term "municipal advisor" to natural persons. A municipal entity client retains a municipal advisor firm, not an individual that works for the firm. Accordingly, it is the conflicts of the firm that must be disclosed. The revised Notice would clarify that persons preparing the conflicts disclosure must make a reasonable inquiry into the activities of their firm to determine what conflicts may exist. This may include inquiry of persons in addition to those specifically engaged in the municipal advisory activity. In addition, the revised Notice would provide that reasonable inquiry will continue to apply

during the course of the engagement to address conflicts discovered or arising after the engagement has been entered into.

- Comment: Disclose Only General Conflicts of Interest. SIFMA said that generalized disclosure of conflicts, rather than disclosure tailored to the individual client, should be permitted, allowing the municipal entity to request additional disclosure. SIFMA argued that requiring a municipal advisor to undertake an individualized investigation relating to conflicts applicable to the specific municipal entity, or analyzing the exact implications of the conflict applicable to the municipal entity client, would be time consuming and expensive. It said that the municipal entity could request more information and decide if the expense was worth it.

  SIFMA also said that a municipal advisor should be required to disclose the applicable conflicts only once, in a brochure disclosing material conflicts, and not be required to re-disclose or reconfirm on a transaction by transaction basis unless new material conflicts were discovered. SIFMA said that the municipal advisor should not be required to re-disclose conflicts previously disclosed in a request for proposal ("RFP").

- MSRB Response: The MSRB has determined not to make the suggested changes in the Notice. Generalized disclosure, without a discussion of the specific conflicts that may relate to the municipal entity client, is not sufficient to alert a municipal entity client to specific conflicts and is an insufficient basis for informed consent. The Notice would not require disclosures to be made more than once per issue. An RFP response may be an appropriate place to make required disclosures as long as the proposed structure of the financing is adequately developed at that point to permit the specific disclosures required by the Notice.

- Comment: Conflicts of Interest Should be Addressed in Rule G-23. MRC suggested that the requirements to disclose conflicts and to obtain informed consent would be more appropriately addressed in MSRB Rule G-23, and that the requirements should be removed from the Notice.
- MSRB Response: The MSRB disagrees with this comment and has therefore determined not to make the suggested changes. Rule G-23 only concerns financial advisory activities of dealers. It also does not impose a fiduciary duty.
- Comment: Rule Recognizes Essential Duties of Loyalty and Due Care. Fi360 applauded the MSRB for recognizing the duties of loyalty and due care as essential obligations under the fiduciary standard of care. It also said the Notice amply captured key principles that underlie the duties of loyalty and care. AFSCME also applauded the efforts of the MSRB to protect municipal entities from self-dealing and other deceptive practices, and said that strong protections were required for municipal entities.
- MSRB Response. The MSRB appreciates these comments.
- Comment: Due Diligence To Determine Authority of Municipal Official. SIFMA requested that the MSRB clarify the level of due diligence required to determine if an official has the authority to bind the municipal entity by contract, and suggested that a representation by the official that it had the requisite authority to execute should be sufficient, absent actual knowledge by the municipal advisor that such representation was false.
- MSRB Response: The MSRB has revised the Notice so that it would provide that a municipal advisor is only required to have a reasonable belief that it is making required

disclosures to officials with the authority to bind the issuer. This change would also be made to the informed consent provisions of the Notice.

Conflicts of Interest; Unmanageable Conflicts.

- Comment: Principal Transactions. ABA and SIFMA suggested that principal transactions should not be prohibited as unmanageable conflicts because other federal and state laws permit entities subject to a fiduciary duty to effect principal transactions with clients after disclosure and informed consent. They said that traditional banking activities, including accepting deposits and foreign exchange transactions, should be permitted, arguing that not permitting municipal advisors to engage in these transactions would create an unfair advantage for investment advisors and swap dealers, among others, that have the ability to effect these types of transactions. They said that such a ban would also effectively limit municipal entities' access to critical products and services. SIFMA also proposed that the prohibition on principal transactions not prohibit a municipal advisor or affiliate from serving as a trustee and that the prohibition should not apply to advisory transactions if the principal transactions were effected by "distant cousin" affiliates of a municipal advisor. ABA suggested that the MSRB propose exceptions for associated persons, similar to the exception provided in a 1978 interpretation[6] of MSRB Rule D-11, which excludes, solely for purposes of the fair practice rules, persons who are associated "solely by reason of a control relationship," unless the affiliate is otherwise engaged in municipal advisory activities.
- MSRB Response: The revised Notice would provide that a municipal advisor will not be considered to have an unmanageable conflict as a result of acting as principal when: (i)

[6] The ABA's citation is actually to the SEC's order approving Rule D-11, a portion of which is reprinted in the MSRB Rule Book.

providing investments to the municipal entity on a temporary basis to ensure timely delivery for closing; (ii) engaging in activities permitted under Rule G-23; (iii) it is a municipal advisor solely because it recommends investments or municipal financial products provided or offered by it to a municipal entity as a counterparty, but is not described in (iv); or (iv) acting as a swap or security-based counterparty to a municipal entity represented by an "independent representative," as defined in the Commodity Exchange Act or the Exchange Act, respectively. Once the SEC has completed its rulemaking on the definition of "municipal advisor," the MSRB will consider whether additional exceptions are appropriate.

- Comment: Engineers as Municipal Advisors. ACEC said that, under certain circumstances, some engineers, if subject to a fiduciary duty by reason of being included in the definition of "municipal advisor," may have direct conflicts with their municipal entity clients because of the engineers' professional and ethical duties. It said that an engineer's ethical duties require it to hold the safety, health, and welfare of the public paramount and that an engineer's duty to render independent judgments might in some cases conflict with its duty of loyalty to its municipal entity client, particularly if the expectations of its client differed from the engineer's independent judgment.
- MSRB Response: The MSRB has determined not to make any changes to the Notice with respect to this comment. The MSRB recognizes that members of other professions that also serve as municipal advisors may have concurrent professional duties and standards and the MSRB agrees that an advisor is required to exercise its independent professional skill and judgment in performing its role. The rule does not require that the advisor

abandon its professional standards in order to render opinions consistent with the client's expectations.

Fee Splitting; Prohibited Payments

- Comment: Compensation for Related Services. SIFMA and ABA requested further clarification about fee-splitting and related compensation arrangements, and suggested that compensation for certain traditional banking services (relating to corporate trust and mutual funds), such as shareholder servicing fees and 12b-1 fees, be permitted with full disclosure and informed consent.
- MSRB Response. Endnote 6 to the Notice provides examples of fee-splitting arrangements. The Notice also provides exceptions to the general rule that a municipal advisor that serves as a principal has an unmanageable conflict. Depending upon the SEC's definition of "municipal advisor," the MSRB may propose additional exceptions, but the MSRB is unwilling to do so at this time.
- Comment: Prohibited Payments to Affiliated Solicitors. SIFMA also requested further guidance on prohibited payments by municipal advisors to solicitors and argued that payments to affiliated solicitors should not be prohibited because the definition of municipal advisor adopted by the Dodd Frank Act only restricts payments to independent solicitors.
- MSRB Response: The MSRB has determined not to make the suggested changes. The cases cited in the endnotes to the Notice demonstrate the inappropriate role that third-party payments have played in many municipal securities financings. The exceptions made by the Notice would only concern issuer-permitted payments and payments to parties that are themselves regulated by the MSRB.

Compensation; Excessive Compensation.

- Comment: Definition of Excessive Compensation. NAIPFA, SIFMA, and B-Payne Group requested further clarification on the definition of "excessive compensation." NAIPFA suggested certain criteria, including, among other things, the time and labor required, the novelty and difficulty of the issue involved, and the skill requisite to perform the municipal advisory services properly; the fee customarily charged in the locality for similar municipal advisory services; the amount involved and the results obtained; the nature and length of the professional relationship with the client; the experience, reputation, and ability of the municipal advisor or municipal advisors performing the services; and whether the fee is fixed or contingent. B-Payne Group objected to any evaluation of whether its fees were excessive, arguing that no regulator was in a position to evaluate the reasonableness of the municipal advisor's fee. SIFMA suggested that a fully disclosed and negotiated agreement, absent fraud, was sufficient to guard against excessive compensation.
- MSRB Response: The MSRB has revised the Notice so that it would incorporate some of the factors noted in the comment letters. The revised Notice would describe excessive compensation as compensation that is so disproportionate to the nature of the municipal advisory services performed as to indicate that the municipal advisor is not acting in the best interests of its municipal advisory client. Further, the revised Notice would provide that "the MSRB recognizes that what is considered reasonable compensation for a municipal advisor will vary according to the municipal advisor's expertise, the complexity of the financing, and the length of time spent on the engagement, among other factors." As this language recognizes, many factors may appropriately affect the

amount of the fee, and the specific factors listed in the Notice would not be exclusive. Thus, it may be that the various other factors noted by commenters could have an impact on the compensation paid to a municipal advisor. In all cases, the municipal advisor must be able to support the legitimacy of its fees.

Compensation; Forms of Compensation.

- Comment: Disclosure of Conflicts Confusing and Unnecessary. Several commenters[7] suggested that the MSRB delete Appendix A to the Notice (Disclosure of Conflicts with Various Forms of Compensation) and the requirement of the Notice that municipal advisors disclose the conflicts with various forms of compensation. Commenters argued that: (i) such disclosure was unnecessary and that including it would detract from the importance of the rest of the rule; (ii) statements about imbedded conflicts in compensation would be confusing to municipal entities because underwriters (who, they said, have inherent conflicts as both purchasers and distributors of the municipal entity's securities) are not required to disclose this information, whereas municipal advisors, who do not have these inherent conflicts, are nevertheless required to disclose such possible conflicts; and (iii) contingent fees do not affect professional performance. Other commenters argued that the fiduciary duty applicable to municipal advisors was sufficient to guard against excessive compensation. NAIPFA requested that, if this requirement were retained, a similar requirement be applicable to underwriters. B-Payne Group agreed that fees of all participants, including bond lawyers, should be disclosed. MRC suggested that any disclosure requirements were more appropriately addressed in Rule G-23.

[7] B-Payne Group, Lewis Young, MRC, NAIPFA, PFM, and SIFMA.

AGFS said that, among other things, the proposal to require that firms clarify for clients the advantages and disadvantages of various forms of advisor compensation was excellent. It said that too many municipal issuers are gullible regarding the use of contingent compensation payable only after transactions are completed and that they do not think through the long-term costs and other relevant implications of contingent compensation that can place advisors, upon whom the issuers rely heavily, in the unfortunate position of sacrificing months of work without compensation when it becomes apparent (or should be apparent to a market financial professional) that a transaction is not in the issuers' best interests. AGS said that, unfortunately, there are advisors who would plow ahead in order to avoid substantial financial loss, rather than informing the issuer clients either (1) not to proceed or (2) to alter the structure or approach.

- MSRB Response: The MSRB has determined not to eliminate Appendix A from the Notice. Because municipal advisors are fiduciaries with respect to their municipal entity clients, the MSRB considers it essential that they disclose all material conflicts to their clients. Appendix A was included in the Notice for the benefit of small municipal advisors to help them avoid the need to hire an attorney to prepare such compensation conflicts disclosure. Use of Appendix A would not be mandatory and municipal advisors would be free to draft their own disclosure addressing these conflicts.

  Pursuant to Section 15B(e)(4)(C) of the Exchange Act, dealers are not municipal advisors when they are serving as underwriters. Even so, MSRB Rule G-17 (on fair dealing) would apply to them when they engage in municipal securities activities with issuers of municipal securities. The MSRB recognizes that underwriters would not be subject to the

same requirement to disclose conflicts associated with various forms of compensation under Rule G-17. It is appropriate to interpret Rule G-17 differently for arm's-length counterparty relationships on the one hand (such as underwriters appropriately maintain with issuers) and advisory relationships on the other.

The MSRB notes that it does not have jurisdiction over bond lawyers, unless they are functioning as municipal advisors, and, therefore, in most cases, may not require them to disclose compensation conflicts.

- Comment: Limit Disclosure of Conflicts to Form of Compensation Mandated by Issuer. NAIPFA suggested that disclosure of conflicts be limited to the conflicts applicable to the form of compensation methodology at the time the compensation methodology was proposed. NAIPFA also suggested that "pitches" or other discussions of ideas with municipal entities prior to engagement should not require delivery of the disclosure. NAIPFA suggested that the disclosures should not be required when the municipal entity dictated the form of compensation, arguing that discussion of conflicts in this instance would not advance the duty of loyalty to the municipal entity client.
- MSRB Response: The MSRB has determined to revise the Notice so that it would require that conflicts disclosures, including those regarding compensation, need only be delivered before the engagement of the municipal advisor, unless a conflict is discovered or arises later. Furthermore, the revised Notice would provide that "if the municipal entity client has required that a particular form of compensation be used, the compensation conflicts disclosure provided by the municipal advisor need only address that particular form of compensation." If the form of compensation is not required by the

municipal entity, however, the municipal advisor would be required to disclose and discuss the conflicts associated with various forms of compensation.

- Comment: Authority of Municipal Entity Officials to Consent to Disclosures. Several commenters suggested that, in determining the authority of a municipal entity official to enter into a contract, to receive various disclosures, and to deliver informed consent, a municipal advisor should be permitted to rely on the apparent authority of an official to acknowledge the conflicts disclosure. NAIPFA suggested that the municipal advisor be able to rely on the designation by the municipal entity of the primary contact for the engagement as evidence of its authority unless the municipal advisor has reason to believe that the official does not have the requisite authority. SIFMA suggested that the municipal advisor be able to rely on a representation of the official as to its apparent authority.
- MSRB Response: As noted above under "Conflicts of Interest; Disclosure," the MSRB determined to revise the Notice so that it would provide that a municipal advisor is only required to have a reasonable belief that it is making required disclosures to, and receiving informed consent from, officials with the authority to bind the issuer.
- Comment: Consent Presumed With Receipt of Written Agreement. NAIPFA suggested that a municipal advisor be permitted to presume consent to compensation conflicts disclosure if it receives an executed contract, or verbal agreement that a written engagement letter (or similar document) has been accepted, or written or verbal acknowledgement that the advisor has been selected following an RFP process in which the form of compensation was appropriately disclosed.

- MSRB Response: The MSRB had determined not to make changes to the Notice in response to this comment because the following provisions of the Notice would address this comment: "The disclosures described in this paragraph must be provided as described above under "Duty of Loyalty/Conflicts of Interest/Disclosure Obligations." That section of the Notice would provide: "For purposes of proposed Rule G-36, a municipal entity will be deemed to have consented to conflicts that are clearly described in its engagement letter or other written contract with the municipal advisor, if the municipal entity expressly acknowledges the existence of such conflicts. If the officials of the municipal entity agree to proceed with the municipal advisory engagement after receipt of the conflicts disclosure but will not provide written acknowledgement of such conflicts, the municipal advisor may proceed with the engagement after documenting with specificity why it was unable to obtain their written acknowledgement."

DUTY OF CARE

Necessary Qualifications.

- Comment: Restrictions on Undertaking Engagements Are Unnecessary. Lewis Young suggested that the requirement that the "municipal advisor should not undertake a municipal advisory engagement for which the advisor does not possess the degree of knowledge and expertise needed to provide the municipal entity with informed advice" be removed, arguing that it was unnecessary and it left out many other aspects of the general fiduciary duty of care and "unbalanced" the implications of the general duty.
- MSRB Response: The MSRB has determined not to make any changes to the Notice in response to this comment. The MSRB disagrees with this comment because it considers the requisite knowledge and expertise to be an essential element of the duty of care. The

cases cited in endnote 20 to the Notice provide examples of instances in which financial advisors violated this duty.

Consideration of Alternatives.

- Comment: Requirement Unnecessary. Lewis Young suggested that this requirement should be removed as it was unnecessary.
- MSRB Response: The MSRB disagrees with this comment and considers this requirement to be a fundamental distinction between a fiduciary and an arm's length counterparty, such as an underwriter.
- Comment: Limit Obligations to Terms of Contract. SIFMA argued that a municipal advisor should be required to do only what the municipal entity contracts for and that imposing other duties will impose additional costs and will cause extensive negotiation on the limitations clauses in contracts. Further, SIFMA argued that an implied duty to review alternatives should not apply where the form of engagement letter is non-negotiable because the inability to negotiate a limited engagement clause will reduce the number of municipal advisors who offer services.
- MSRB Response: The MSRB has determined not to make any changes to the Notice in response to this comment. The MSRB expects that municipal advisors that wish to limit their engagements with municipal entities will do so in writings (whether as part of engagement letters or separately) that limit the scope of their engagements to particularly enumerated items or which state that any services not specified in the writing will not be provided by the advisor. This should impose no measurable additional cost on the advisor or the municipal entity.

Duty of Inquiry.

- Comment: Scope of Inquiry. Lewis Young said that the requirement to conduct reasonable inquiry regarding representations set forth in a certificate should be governed by the terms of the certificate, which should show the scope of inquiry. SIFMA requested more guidance on the required scope of a factual investigation and on the nature and scope of any permitted qualifications, and whether a municipal advisor could disclaim the duty altogether in its engagement letter or later, noting that it would be impossible to anticipate all limitations on this duty at outset of engagement. NAIPFA suggested that the MSRB clarify its statements about a municipal advisor's duty of inquiry under G-36 and G-17 to form a reasonable basis for its recommendations.
- MSRB Response: The MSRB has determined not to make the suggested changes. The Notice would not permit the waiver of duties imposed by proposed Rule G-36, as interpreted by the Notice, if they are within the scope of the municipal advisor's engagement. If it is within the scope of the municipal advisor's engagement to prepare a certificate that will be relied upon by the issuer, the municipal advisor would be required to conduct a reasonable inquiry into the facts that underlie the certificate. For example, review of the official books of the issuer and other factual information within the municipal advisor's control might assist the municipal advisor in forming a reasonable basis for its certificate. However, if the certificate relies on the representations of others or facts not within the municipal advisor's control, additional inquiry on the part of the municipal advisor might be required.

  The MSRB notes that some certificates that municipal advisors provide already have the potential to subject the advisor to penalties under Section 6700 of the Internal Revenue

Code. An Internal Revenue Service publication on Section 6700 [8] provides: "Participants [in a bond financing] can rely on matters of fact or material provided by other participants necessary to make their own statements or draw their own conclusions, unless they have actual knowledge or a reason to know of its inaccuracy or the statement is not credible or reasonable on its face." The Internal Revenue Service summarized the legislative history of Section 6700. See H. Conf. Rep. No. 101-247, 101st Cong., 1st Sess. 1397.

With respect to clarifying the statements in the Notice concerning the municipal advisor's duty to form a reasonable basis for any recommendation, the MSRB has determined not to make any changes to the Notice other than those directed to specific circumstances in the Notice (e.g. Duty of Inquiry, Consideration of Alternatives, etc.) . The MSRB notes that each recommendation, and the basis for such recommendation, will be dependent on facts and circumstances and that the statements in the Notice are intended as general guidelines.

- Comment: Due Diligence. Lewis Young and SIFMA said that the requirement for a municipal advisor to use due diligence when preparing an official statement suggested that the municipal advisor (whose duties are to an issuer) had the duties of an underwriter (whose duties are to investors). Lewis Young said that this requirement is inconsistent with an advisor's obligation, which is to advise "in a secondary role to the issuer as principal as to disclosure duties, as well as duplicating the duties of an underwriter." Lewis Young also noted that a municipal advisor owes a duty to the municipal entity, not

[8] See Office of Chief Counsel, Internal Revenue Service, Memorandum No. 200610018, Application of Section 6700 Penalty with Respect to Various Participants in Tax-Exempt Bond Issuance (Feb. 3, 2006).

to investors, and the municipal advisor's obligations in respect of the disclosure process are to explain the process to the issuer, to make recommendations on the structure and content of the disclosure document, and to recommend competent counsel to prepare.

- MSRB Response: The MSRB has determined to revise the Notice so that it would address these concerns. The language in the Notice upon which this comment is based covers the situation in which the municipal advisor prepares all, or substantially all, of the official statement, exercising discretion as to the content of disclosures. This is often true in the case of competitive underwritings. Under these circumstances, the advisor owes a duty to the municipal entity to make reasonable inquiries in order to help ensure the appropriate disclosures are made in the official statement. The revised Notice would no longer require that the advisor exercise due diligence, and would further provide that the municipal advisor "owes a duty to the municipal entity to make reasonable inquiries in order to help ensure the appropriate disclosures are made in the official statement."

PERMISSIBLE LIMITATIONS ON SCOPE OF ENGAGEMENT

Limitations.

- Comment: Outline Scope of Duties in Engagement. Both SIFMA and NAIPFA suggested that municipal advisors should be permitted to outline the scope of their duties in an engagement, rather than outlining the exclusions and limitations. NAIPFA noted that it would be unreasonable to subject a municipal advisor to a fiduciary duty with respect to services that were beyond the scope of the parties' agreement. Further, it said that an issuer had no reason to assume that services not specified in writing would be performed. The municipal advisor should be held to the duties it had agreed to

undertake, and be able to include a blanket statement relating to the matters excluded from the engagement.

- MSRB Response: The MSRB has determined not to make any changes to the Notice in response to this comment. The MSRB expects that municipal advisors that wish to limit their engagements with municipal entities will do so in writings (whether as part of engagement letters or separately) that limit the scope of their engagements to particularly enumerated items or which state that any services not specified in the writing will not be provided by the advisor. This should impose no measurable additional cost on the advisor or the municipal entity.

Disclosure of Pre-Formed Judgment on Appropriateness of Transaction or Product.

- Comment: Remove Requirement to Disclose Advisor's Pre-Formed Opinion. SIFMA suggested that the MSRB reconsider its position on permitting the municipal advisor to limit the scope of its engagement while requiring it to disclose any pre-formed opinion it has on matters not within the scope of the engagement. SIFMA said that this was burdensome, detracted from the scope of the limitations, and would effectively require the municipal advisor to consider the appropriateness of the financing or product (which it had excluded from its engagement) to counter any hindsight judgment.
- MSRB Response: The MSRB has determined to revise the Notice so that it would no longer include this requirement. While the Notice would not require the municipal advisor to conduct reasonable inquiry to form such an opinion, the MSRB realizes that some municipal advisors might feel obliged to do so to avoid being questioned in hindsight about whether they had, in fact, formed an opinion on appropriateness before being retained.

Scope of Engagement.

- Comment: Define Term of Engagement. SIFMA suggested that the Notice include a definition of "engagement," and define when the municipal advisor's obligation will commence and terminate pursuant to a written engagement letter. Absent a written engagement letter, SIFMA suggested that an engagement should terminate on the reasonable expectations of the parties, or when the related transaction has been concluded.
- MSRB Response: By the use of the word "engagement," the MSRB means the municipal advisory assignment or other scope of work for which the municipal entity has retained the municipal advisor. When a municipal advisor is engaged or retained by the municipal entity, the municipal entity would become the client of the municipal advisor and the fiduciary duty under proposed Rule G-36 would begin to apply. It would continue to apply until the engagement is complete.
- Comment: Incorporate Requirements of Advisory Contracts in Rule G-23. MRC suggested that any requirements relating to the content of advisory contracts be incorporated into existing rules such as Rule G-23, rather than by interpretation. MRC also suggested clarification of the various statements relating to appropriateness and incorporation of such statements in MSRB Rule G-19 (on suitability).
- MSRB Response: The MSRB disagrees with this comment and has therefore determined not to make the suggested changes. As noted above, Rule G-23 only concerns financial advisory activities of broker-dealers. It also does not impose a fiduciary duty. Rule G-19 only imposes a duty of suitability upon dealers and, even then, only in connection with

transactions in municipal securities recommended to customers. [9] The MSRB has determined not to amend that rule at this time.

OTHER COMMENTS

- Comment: Other Rules May Impose Conflicting Standards. Various commenters[10] noted that several regulatory agencies either have in place or are currently promulgating rules that concern parties that might be subject to draft Rule G-36 and that lack of coordination with these agencies could lead to conflicting standards applicable to such parties. They said that the MSRB and other regulatory agencies need to coordinate their respective guidance and AFSCME suggested that these agencies offer informal guidance such as webinars to aid market participants.
- MSRB Response: The MSRB has been coordinating with other regulators in areas of overlap. For example, the provisions of the Notice concerning the provision of swap advice use the same language as found in Title VII of Dodd-Frank and the proposed Commodity Trading Futures Commission ("CFTC") business conduct rule for swap dealers and major swap participants.[11] Further, the MSRB has conducted and will continue to conduct webinars and various outreach events to explain its rulemaking efforts.

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9 Under MSRB Rule D-9:

> Except as otherwise specifically provided by rule of the Board, the term "customer" shall mean any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities.

10 ABA; AFSCME; Michigan Bankers; SIFMA; and EFC.

11 See Federal Register Vol. 75, No. 245 (December 22, 2010).

- Comment: Manner of Regulation and Cost of Compliance. B-Payne Group expressed the view that the MSRB should regulate municipal advisors by getting "experienced personnel on the ground in regional markets and charge them with staying on top of situations," rather than regulating municipal advisors as the MSRB regulates dealers. It argued for exemptions from MSRB rules for small municipal advisors and said the cost of compliance for such advisors would outweigh the regulatory benefit. Other parts of the comment letter addressed matters that were outside the scope of the request for comment on draft Rule G-36 (e.g., professional qualifications testing, training for local finance officials) and are not summarized here.
- MSRB Response: For regulation of municipal advisors to be fair, all municipal advisors must know what rules apply to them. The Exchange Act itself imposes a fiduciary duty on municipal advisors and the proposed rule change provides guidance to municipal advisors on what it means to have a fiduciary duty so they can tailor their conduct accordingly. Without such guidance, "experienced personnel on the ground" would likely enforce the Exchange Act in an inconsistent manner, which the MSRB doubts that B-Payne Group would consider fair.

  As stated above, all municipal advisors, regardless of their size, have a fiduciary duty to their municipal entity clients. Because the protection of their clients is paramount, in this context, the MSRB has concluded that it is appropriate to impose the same rules on small municipal advisors as it imposes on larger municipal advisors. However, the MSRB recognizes that there are costs of compliance. That is the reason the MSRB has included Appendix A to the Notice. By using Appendix A to provide disclosure concerning compensation conflicts, small municipal advisors would be able to satisfy the

compensation disclosure requirement of the Notice without having to retain legal counsel to assist them in the preparation of such disclosure.

- Comment: Implementation Period. SIFMA suggested that because Rule G-36 would subject municipal advisors to rules they are not currently subject to, the MSRB should consider providing for an implementation period of no less than one year.
- MSRB Response. The MSRB recognizes that some municipal advisors may be subject to rules that are not currently applicable. However, the appropriate implementation period will depend upon the provisions of the SEC's rule relating to municipal advisors.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether 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. Please include File Number SR-MSRB-

2011-14 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-2011-14. 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 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 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the MSRB's offices. 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-2011-14 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[12]

Elizabeth M. Murphy
Secretary

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[12] 17 CFR 200.30-3(a)(12).

EXHIBIT 2

MSRB
Municipal Securities
Rulemaking Board

MSRB NOTICE 2011-14 (FEBRUARY 14, 2011)

REQUEST FOR COMMENT ON DRAFT MSRB RULE G-36 (ON FIDUCIARY DUTY OF MUNICIPAL ADVISORS) AND DRAFT INTERPRETIVE NOTICE

The Municipal Securities Rulemaking Board ("MSRB") is requesting comment on draft Rule G-36 concerning the fiduciary duty of municipal advisors, and a draft interpretive notice under Rule G-36.

Comments should be submitted no later than April 11, 2011. Comments should be sent via e-mail to CommentLetters@msrb.org. Please indicate the notice number in the subject line of the e-mail. To submit comments via regular mail, please send them to Ronald W. Smith, Corporate Secretary, MSRB, 1900 Duke Street, Alexandria, VA 22314. Written comments will be available for public inspection on the MSRB's web site.[1] The MSRB will hold an informational webinar on draft Rule G-36 and the draft interpretive notice on March 1 at 3:00 p.m. The webinar will also address MSRB Notice 2011-13 (February 14, 2011) on the application of Rule G-17 to municipal advisors advising obligated persons and municipal advisors soliciting business from municipal entities on behalf of others. **Register** for the webinar.

Questions about this notice should be directed to Peg Henry, Deputy General Counsel, or Karen Du Brul, Associate General Counsel, at 703-797-6600.

BACKGROUND

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. Law No. 111-203) ("Dodd-Frank Act") amended Section 15B(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act") to provide that municipal advisors[2] have a fiduciary duty to their municipal entity[3] clients. Section 15B(b)(2)(L)(i) of the Exchange Act directs the MSRB to establish rules with respect to municipal advisors that "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."

REQUEST FOR COMMENT

Accordingly, the MSRB requests comment on draft Rule G-36 and the draft interpretive notice.

Draft Rule G-36 (on fiduciary duty of municipal advisors) provides:

> In the conduct of its municipal activities on behalf of municipal entities, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care.

The interpretive notice provides that the Rule G-36 duty of loyalty requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor. It requires a municipal advisor to make clear, written disclosure of all material conflicts of interest, such as those that might impair its ability to satisfy the duty of loyalty, and to receive the written, informed consent of officials of the municipal entity with the authority to bind the municipal entity by contract with the municipal advisor. Such disclosure must

be made before the municipal advisor may provide municipal advisory services to the municipal entity or, in the case of conflicts arising after the municipal advisory relationship has commenced, before the municipal advisor may continue to provide such services.

The notice provides that under Rule G-36 a municipal advisor may not undertake an engagement if certain unmanageable conflicts exist, including (i) kickbacks and certain fee-splitting arrangements with the providers of investments or services to municipal entities, (ii) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor for solicitation activities regulated by the MSRB, and (iii) acting as a principal in matters concerning the municipal advisory engagement (except when Internal Revenue Service competitive bidding guidelines for establishing fair market value are satisfied). The notice also provides that, in certain cases, the compensation received by a municipal advisor may be so disproportionate to the nature of the municipal advisory services performed that it is inconsistent with the Rule G-36 duty of loyalty and represents an unmanageable conflict.

The notice provides that the Rule G-36 duty of care requires that a municipal advisor act competently and provide advice to the municipal entity after inquiry into reasonably feasible alternatives to the financings or products proposed (unless the engagement is of a limited nature).

Commenters should note that the interpretive notice is based upon the statutory definition of municipal advisor set forth in the Dodd-Frank Act without regard to any interpretation of that term proposed by the Securities and Exchange Commission (“SEC”) in its proposed permanent registration rule for municipal advisors (Securities Exchange Act Release No. 34-63576 (December 20, 2010). If the SEC’s permanent registration rule is adopted in its current form, the MSRB may request comment on revisions to the draft interpretive notice. For example, should certain brokerage activities be construed to be the provision of advice on investment strategies and, therefore, make the brokers municipal advisors, the Board would reconsider the provisions of the notice concerning limitations on principal transactions.

TEXT OF DRAFT RULE G-36

MSRB Rule G-36 (on fiduciary duty of municipal advisors)

In the conduct of its municipal advisory activities on behalf of municipal entities, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care.

TEXT OF DRAFT INTERPRETIVE NOTICE

FIDUCIARY DUTY OF A MUNICIPAL ADVISOR

Section 15B(c)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”) provides that:

> A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor’s fiduciary duty or that is in contravention of any rule of the Board.

Section 15B(b)(2)(L)(i) of the Exchange Act provides that the Municipal Securities Rulemaking Board (“MSRB”) shall establish rules with respect to municipal advisors that “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.”

In furtherance of this statutory directive, the MSRB promulgated MSRB Rule G-36, on fiduciary duty of municipal advisors, which provides:

> In the conduct of its municipal advisory activities[1] on behalf of municipal entities,[2] a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care.

In addition, this notice provides interpretive guidance on the meaning of "fiduciary duty" for purposes of Rule G-36 and describes conduct that would or could breach that Rule G-36 fiduciary duty. This duty is derived from Exchange Act Section 15B(c)(1), which imposes a fiduciary duty on municipal advisors.[3]

In addition to its Rule G-36 fiduciary duty to its municipal entity clients, MSRB Rule G-17 requires that municipal advisors, in the conduct of their municipal advisory activities, deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice.[4] In the case of its municipal entity clients, this Rule G-17 duty of fair dealing is subsumed within the municipal advisor's fiduciary duty, and a violation of Rule G-17 with respect to a municipal entity client would necessarily be a violation of Rule G-36.

DUTY OF LOYALTY

As provided in Rule G-36, a municipal advisor's fiduciary duty to its municipal entity client includes a duty of loyalty. That duty requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor.

Conflicts of Interest

Disclosure Obligations. Under Rule G-36, a municipal advisor must disclose all material conflicts of interest, such as those that might impair its ability to satisfy the duty of loyalty to its municipal entity client.[5] All disclosures of conflicts must be made in writing to officials of the municipal entity with the authority to bind the municipal entity by contract with the municipal advisor in a manner sufficiently detailed to inform the municipal entity of the nature and implications of the conflict. The following are examples of the types of conflicts that must be disclosed by the municipal advisor, but this list is not intended to be exhaustive:

> (i) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business;[6]
>
> (ii) payments from third parties to the municipal advisor in relation to the municipal advisory engagement;[7]
>
> (iii) payments from third parties to enlist the municipal advisor's recommendation of their services to the municipal entity;[8]
>
> (iv) whether the municipal advisor or an affiliate of the municipal advisor is acting as a principal in matters concerning the municipal advisory engagement;[9]
>
> (v) form of compensation;[10] and
>
> (vi) other engagements or relationships that might impair the municipal advisor's ability to act only in the best interests of its municipal entity client.

Informed Consent. Under Rule G-36, the municipal advisor must receive written consent to its conflicts by officials of the municipal entity with the authority to bind the municipal entity by contract with the municipal advisor before the municipal advisor may provide municipal advisory services to the municipal entity or, in the case of conflicts arising after the municipal advisory

relationship has commenced, before the municipal advisor may continue to provide such services. For purposes of Rule G-36, a municipal entity will be deemed to have consented to conflicts that are clearly described in its engagement letter or other written contract with the municipal advisor, if the municipal entity expressly acknowledges the existence of such conflicts. If the officials of the municipal entity agree to proceed with the municipal advisory engagement after receipt of the conflicts disclosure but will not provide written acknowledgement of such conflicts, the municipal advisor may proceed with the engagement after documenting with specificity why it was unable to obtain their written acknowledgement. *See, however*, "Unmanageable Conflicts" for a description of certain conflicts that will preclude a municipal advisor from undertaking an engagement with a municipal entity, despite disclosure and consent.

Disclosure of conflicts, coupled with written consent, will not satisfy the requirements of Rule G-36 in instances in which the municipal advisor has reason to believe that such consent is not informed. In such cases, a municipal advisor should make additional efforts reasonably designed to inform the officials of the municipal entity of the nature and implications of the municipal advisor's conflicts. Additionally, disclosures to officials who are themselves parties to the conflict of interest (such as recipients of payments from municipal advisors) will not suffice to satisfy the requirements of Rule G-36.

Unmanageable Conflicts. Pursuant to its duty of loyalty under Rule G-36, a municipal advisor must not engage in municipal advisory activities with respect to a municipal entity client if it cannot manage its conflicts in a manner that will permit it to act only in the municipal entity's best interests. Some conflicts are not manageable because, when fully informed of the nature and potential consequences of the conflicts, an official of a municipal entity could not provide informed consent.[11] The following are examples of conflicts that fall into this category, but this list is not intended to be exhaustive:

> (i) kickback arrangements, or certain fee-splitting arrangements, with the providers of investments or services to municipal entities,[12]
>
> (ii) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor described in Section 15B(e)(9) of the Exchange Act,[13] and
>
> (iii) except as provided below, acting as a principal in matters concerning the municipal advisory engagement.[14]

In most cases under Rule G-36, a municipal advisor that acts as a principal with its municipal entity client on the same transaction will be considered to have an unmanageable conflict. This will also be the case if an affiliate of the municipal advisor acts as a principal with the municipal entity on the same transaction. However, Rule G-36 does permit a municipal advisor or its affiliate to act as a principal in the following limited situation. A municipal advisor to an issuer of municipal securities or its affiliate may provide investments of bond proceeds as a principal if it is the lowest cost provider and the fair market value of the investments has been determined in a bidding process that satisfies the Internal Revenue Service safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield-restricted defeasance escrow.[15] Neither the municipal advisor, nor its affiliate may provide any of the minimum number of bids required by that safe harbor.

Compensation

Excessive Compensation. While the MSRB recognizes that what is considered reasonable compensation for a municipal advisor will vary according to the municipal advisor's expertise and the nature of the financing, in certain cases, a municipal advisor's compensation may be so disproportionate to the nature of the municipal advisory services performed as to indicate that the municipal advisor is not acting in the municipal entity's best interests as required by Rule G-36. Such excessive compensation would constitute a violation of the municipal advisor's duty of loyalty, even if such compensation has been disclosed.[16]

Forms of Compensation. The manner in which municipal advisors are compensated varies according to the nature of the engagement and applicable state and local laws and policies. Pursuant to Rule G-36, a municipal advisor must provide written disclosure to its municipal entity client of what the amount (in dollars and to the extent it can be quantified) of its direct compensation and indirect compensation (*e.g.*, amounts paid to affiliates) from the engagement will be, or is projected to be, as well as the scope of services to be provided for that compensation. Additionally, the municipal advisor must provide written disclosure to its client of the conflicts of interest with various forms of compensation, including the form of compensation applicable to its engagement, even if the client has required that a particular form of compensation be used. One way in which a municipal advisor may satisfy its obligation to provide written disclosure of the conflicts with various forms of compensation is to provide its client with the document entitled "Disclosure of Conflicts of Interest With Various Forms of Compensation," attached as Appendix A to this notice (the "Compensation Disclosure Document"). The disclosures described in this paragraph must be provided as described above under "Duty of Loyalty/Conflicts of Interest/Disclosure Obligations." Provision by the municipal advisor to its client of the Compensation Disclosure Document will not satisfy the municipal advisor's obligation to disclose conflicts of interest not addressed in the Compensation Disclosure Document, such as payments from third parties.

A municipal advisor's duty of loyalty under Rule G-36 requires it to manage any conflicts of interest that may result from its form of compensation so that it acts in the best interests of its municipal entity client. For example, except as discussed below under "Permissible Limitations on Scope of Engagement," a municipal advisor that reasonably believes that a proposed financing or product is not in its municipal entity client's best interests, must so advise the municipal entity pursuant to its duty of loyalty, even if such advice adversely affects the municipal advisor's compensation.

DUTY OF CARE

As provided in Rule G-36, a municipal advisor's fiduciary duty to its municipal entity client also includes a duty of care. That is, under Rule G-36 a municipal advisor should exercise due care in performing its responsibilities.

Necessary Qualifications

Pursuant to that duty of care required by Rule G-36, the municipal advisor should not undertake a municipal advisory engagement for which the advisor does not possess the degree of knowledge and expertise needed to provide the municipal entity with informed advice.[17] For example, a municipal advisor should not undertake a swap advisory engagement unless it has sufficient knowledge to evaluate the transaction and its risks, as well as the pricing and appropriateness of the transaction.[18]

Consideration of Alternatives

Unless that duty has been expressly disclaimed as provided below, under Rule G-36 a municipal advisor has a duty to investigate and advise the municipal entity of alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity.[19]

Duty of Inquiry

Under Rule G-36, a municipal advisor must make a reasonable inquiry as to the facts that are relevant to a municipal entity's determination of whether to proceed with a course of action (*e.g.*, the issuance of municipal securities, entering into a derivative contract, or making an investment). Similarly, when asked to provide a certificate that will be relied upon by the municipal entity or by investors in the municipal entity's securities, the municipal advisor must make a reasonable inquiry as to the pertinent facts.[20] Furthermore, when a municipal advisor undertakes the preparation of an official statement for a municipal securities issue, the municipal advisor must exercise due diligence as to the facts that are material to the offering.[21]

Advisor Not a Guarantor

The duty of care under Rule G-36 requires only that the municipal advisor act competently and provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to the financings or products proposed that might better serve the interests of its municipal entity client. However, a municipal advisor's duty of care does not make the municipal advisor a guarantor of a successful financing or a guarantor that there are no facts material to a municipal entity's decisionmaking process other than the ones known by the municipal advisor and disclosed to the municipal entity.

PERMISSIBLE LIMITATIONS ON SCOPE OF ENGAGEMENT

Municipal advisors may be retained by municipal entity clients for limited engagements and may, accordingly, limit the scope of the engagement to which their fiduciary duty applies.[22] In some cases, a municipal entity may have already reached a decision that a particular type of financing or financial product is appropriate for it and not find it necessary for the advisor to advise it on appropriateness. In that case, under Rule G-36 the advisor's engagement should reflect the limitations on its role. If there is no engagement letter, the advisor should be specific about that limitation in a written communication to the municipal entity. In either case, these limitations must be disclosed prior to the commencement of the engagement. If the advisor has already formed a judgment that the financing or product is not appropriate for the municipal entity, it should inform the municipal entity in a written communication. If the advisor has taken these steps and does not by course of conduct cause the municipal entity to expect that the advisor will be advising on appropriateness,[23] the fact that the transaction thereafter proves to have been inappropriate for the municipal entity will not mean that the advisor has breached its fiduciary duty to the municipal entity under Rule G-36.

APPENDIX A

DISCLOSURE OF CONFLICTS OF INTEREST WITH VARIOUS FORMS OF COMPENSATION

The Municipal Securities Rulemaking Board (MSRB) requires us, as your municipal advisor, to provide written disclosure to you about the actual or potential conflicts of interest presented by

various forms of compensation. We must provide this disclosure even if you have already chosen a particular form of compensation. The municipal advisor's client should select a form of compensation that best meets its needs and the agreed upon scope of services.

Forms of Compensation; Potential Conflicts. The forms of compensation for municipal advisors vary according to the nature of the engagement and requirements of the client, among other factors. Various forms of compensation present actual or potential conflicts of interest because they may create an incentive for an advisor to recommend one course of action over another if it is more beneficial to the advisor to do so. This document discusses various forms of compensation and the timing of payments to the advisor.

Fixed fee. Under a fixed fee form of compensation, the municipal advisor is paid a fixed amount established at the outset of the transaction. The amount is usually based upon an analysis by the client and the advisor of, among other things, the expected duration and complexity of the transaction and the agreed-upon scope of work that the advisor will perform. This form of compensation presents a potential conflict of interest because, if the transaction requires more work than originally contemplated, the advisor may suffer a loss. Thus, the advisor may recommend less time-consuming alternatives, or fail to do a thorough analysis of alternatives. There may be additional conflicts of interest if the municipal advisor's fee is contingent upon the successful completion of a financing, as described below.

Hourly fee. Under an hourly fee form of compensation, the municipal advisor is paid an amount equal to the number of hours worked by the advisor times an agreed-upon hourly billing rate. This form of compensation presents a potential conflict of interest if the client and the advisor do not agree on a reasonable maximum amount at the outset of the engagement, because the advisor does not have a financial incentive to recommend alternatives that would result in fewer hours worked. In some cases, an hourly fee may be applied against a retainer (*e.g.*, a retainer payable monthly), in which case it is payable whether or not a financing closes. Alternatively, it may be contingent upon the successful completion of a financing, in which case there may be additional conflicts of interest, as described below.

Fee contingent upon the completion of a financing or other transaction. Under a contingent fee form of compensation, payment of an advisor's fee is dependent upon the successful completion of a financing or other transaction. Although this form of compensation may be customary for the client, it presents a conflict because the advisor may have an incentive to recommend unnecessary financings or financings that are disadvantageous to the client. For example, when facts or circumstances arise that could cause the financing or other transaction to be delayed or fail to close, an advisor may have an incentive to discourage a full consideration of such facts and circumstances, or to discourage consideration of alternatives that may result in the cancellation of the financing or other transaction.

Fee paid under a retainer agreement . Under a retainer agreement, fees are paid to a municipal advisor periodically (*e.g.*, monthly) and are not contingent upon the completion of a financing or other transaction. Fees paid under a retainer agreement may be calculated on a fixed fee basis (*e.g.*, a fixed fee per month regardless of the number of hours worked) or an hourly basis (*e.g.*, a minimum monthly payment, with additional amounts payable if a certain number of hours worked is exceeded). A retainer agreement does not present the conflicts associated with a contingent fee arrangement (described above).

Fee based upon principal or notional amount and term of transaction. Under this form of compensation, the municipal advisor's fee is based upon a percentage of the principal amount of an issue of securities (*e.g.*, bonds) or, in the case of a derivative, the present value of or notional

amount and term of the derivative. This form of compensation presents a conflict of interest because the advisor may have an incentive to advise the client to increase the size of the securities issue or modify the derivative for the purpose of increasing the advisor's compensation.

[If applicable, describe other form of compensation for the engagement and associated conflicts with a comparable level of specificity].

Acknowledgement

The undersigned hereby acknowledges that he/she has received this disclosure and that he/she has been given the opportunity to raise questions and discuss the foregoing matters with the advisor.

_____ [name of client]

By: _____

Name: _____

Title:_____

Date:_____

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[1] The term "municipal advisory activities" is defined by MSRB Rule D-13 to mean the activities described in Section 15B(e)(4)(A)(i) and (ii) of the Exchange Act.

[2] The term "municipal entity" is defined by Section 15B(e)(8) of the Exchange Act as: "any State, political subdivision of a State, or municipal corporate instrumentality of a State, including -- (A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities."

[3] This fiduciary duty in Exchange Act Section 15B(c)(1) is in addition to any state or other fiduciary duty laws. This notice cites cases and administrative proceedings involving breach of fiduciary duty under the Investment Advisers Act (the "Advisers Act") and state fiduciary duty laws, as well as violations of Section 17(a) of the Securities Act of 1933 (the "Securities Act") and Section 10(b) of the Exchange Act concerning the fraudulent behavior of fiduciaries. These citations are included only for purposes of illustration of the conduct that would be considered a breach by a municipal advisor of its Rule G-36 fiduciary duty, which is an independent duty created by Section 15B(c)(1) of the Exchange Act.

[4] The MSRB notes that the Commission has brought enforcement actions concerning financial advisors for violations of Rule G-17. *See, e.g., In the Matter of Lazard Freres and Merrill Lynch*, SEC Rel. No. 34-36419 (Oct. 26, 1995) (settlement in connection with alleged violation of Rule G-17 for failure of underwriter and financial advisor to disclose payments made by underwriter to financial advisor); *In re Wheat, First Securities, Inc.*, SEC Initial Dec. Rel. No. 155 (Dec. 17, 1999) (administrative law judge found violation of Rule G-17 and Florida fiduciary duty law for financial advisor's false disclosure to municipal entity that it had not employed a lobbyist to secure its advisory contract with the county and that it had not entered into an arrangement with

a third party to make payments contingent upon its securing the advisory contract); *In re Pryor, McClendon, Counts & Co., Inc. et al.*, Exchange Act Release No. 48095 (Jun. 26, 2003) (settlement in connection with alleged violation of Rule G-17 for financial advisor's failure to disclose payment to government official made to secure advisory assignment).

[5] *See, e.g.*, *Securities and Exchange Commission v. Capital Gains*, 375 U.S. 180 (1963) (adviser breached fiduciary duty under Advisers Act by failing to act in his clients' best interests and failing to disclose the short-term profits it made, and the impact of his actions on the clients, by recommending certain securities to his clients after purchasing them for his own account, a practice known as "scalping").

[6] *See, e.g., Monetta Financial Services, Inc. v. Securities and Exchange Commission*, 390 F.3d 952 (7th Cir. 2004) (investment adviser breached fiduciary duty under Advisers Act by failing to disclose allocation of valuable IPO shares to directors of its investment company clients); *In re Wheat, First Securities, Inc.* and *In re Pryor, McClendon, Counts & Co., Inc*., *supra*.

[7] *See, e.g., In re O'Brien Partners, Inc.,* Exchange Act Release No. 7594 (Oct. 27, 1998) (settlement in connection with alleged breach of fiduciary duty under Advisers Act, California law, Wisconsin law, and New York law by investment adviser for failure to disclose to state and municipal clients that it received "referral fees" from a finder that assisted in the reinvestment of municipal bond proceeds in guaranteed investment contracts, repurchase agreements and forwards; referral fees allegedly totaled $450,000 and represented 50-60% of finder commission); *In the Matter of Mark S. Ferber*, Exchange Act Release No. 38102 (Dec. 31, 1996) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose to state and municipal clients payments from broker-dealer totaling almost $6 million over two years in exchange for recommendations that his clients select that broker-dealer as underwriter or provider of other financial services, including interest rate swaps); *In the Matter of Arthurs Lestrange & Co., Inc. and Michael Bova*, SEC Release Nos. 33-7775, 34-42148 (Nov. 17, 1999) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose true nature of fee splitting arrangement; financial advisor allegedly contributed its financial advisory fee of $210,000 to pool of advisory and brokerage service compensation, received $1.5 million from the investment broker, and paid $500,000 to a finder); *In the Matter of William R. Hough & Co*., SEC Release Nos. 33-7826, 34-42632 (Apr. 6, 2000) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose excessive mark-ups and fee-splitting with investment providers; in one case, financial advisor allegedly received $35,000 for its financial advisory services and $400,000 from the investment provider; in the other, financial advisor allegedly received $300,000 from a forward supply contract provider for "developing a forward supply assignment program"); *In the Matter of John S. Reger and Business & Financial Advisors, Inc.,* SEC Rel. No. 33-7973 (Apr. 23, 2001) (settlement in connection with alleged breach of fiduciary duty by financial advisor for failure to disclose to issuer that it received $129,000 kickback from escrow securities provider, representing 40% of escrow provider's profit; financial advisor also participated in preparation of official statement and allegedly violated Sections 17(a)(2) and (3) of the Securities Act by failing to disclose the payments).

[8] *See, e.g.*, *Securities and Exchange Commission v. DiBella*, 587 F.3d 553 (2d Cir. 2009) (investment adviser breached fiduciary duty under Advisers Act by failing to disclose payment to state senator on state pension fund investment advisory board made to influence state treasurer's decision to invest state pension fund moneys with adviser); *U.S. v. deVegter*, 198 F. 3d 1324 (11th Cir. 1999) (financial advisor breached fiduciary duty to issuer by accepting payments from underwriter to manipulate competitive bidding process for refunding of bonds;

financial advisor incorporated underwriter's comments in order to make request for proposals more favorable for underwriter, sent bids of other competitors to underwriter, and ordered bids to be re-ranked so underwriter was highest ranked bidder).

[9] *See, e.g., Securities and Exchange Commission v. Rauscher Pierce Refsnes, Inc*., 17 F. Supp. 2d 985 (D. Ariz. 1998) (financial advisor breached its fiduciary duty under Arizona law by making false statements in tax certificate for advance refunding bonds, failing to disclose that its government securities desk was acting as a principal in the provision of escrow securities, and failing to disclose excessive mark-ups).

[10] *See* "Compensation/Forms of Compensation" herein.

[11] *See, e.g., Prohibition on the Use of Brokerage Commissions to Finance Distribution*, SEC Rel. No. 26591 (Sept. 2, 2004), at Section VII.E (explaining that the Commission's adoption in 2004 of Investment Company Act Rule 12b-1(h), which, among other things, prohibits a fund from using brokerage commissions to pay for the distribution of the fund's shares, was based on a conclusion that the practice of trading brokerage business for sales of fund shares poses conflicts of interest that the Commission believed to be "largely unmanageable").

[12] *See, e.g.*, the cases at note 7, *supra*. Rule G-36 does not preclude a municipal advisor from receiving payment for its municipal advisory services from a third party, as long as the municipal advisor discloses, and the municipal entity provides its informed written consent to, such payment arrangement and the amount of such payment. As with the disclosure of other conflicts of interest, such disclosure should be made before the municipal advisory engagement is entered into, or at the time the conflict arises, if later.

[13] *See* the cases at note 6, *supra*. Municipal advisors that are described in Section 15B(e)(9) of the Exchange Act because they solicit business from municipal entities on behalf of other municipal advisors are subject to all MSRB rules for municipal advisors.

[14] *See, e.g., Securities and Exchange Commission v. Rauscher Pierce Refsnes, Inc*., *supra*; *In the Matter of Lazard Freres & Co*., SEC Rel. Nos. 33-7671, 34-41318 (Apr. 21, 1999) (settlement in connection with financial advisor alleged to have failed to disclose excessive mark-ups on escrow securities it provided as principal; financial advisor alleged to have received $700,000 on the sale of the Treasuries, in addition to its $200,000 advisory fee).

[15] Treas. Reg. § 1.148-5(d)(6). In addition, a municipal advisor will not violate Rule G-36 solely because it provides investments to a municipal entity on a temporary basis to ensure the delivery of such securities on the closing date for a bond issue, provided that its compensation attributable to the provision of the securities is limited to the reimbursement of its cost of carry, such arrangement and compensation is disclosed to the municipal entity, and the municipal entity provides its informed written consent.

[16] Payments from third parties are included in determining whether compensation is excessive. *See, e.g.,* the cases at note 7, *supra*, for examples of excessive compensation arrangements. Municipal advisors subject to hourly billing arrangements must not submit bills that do not accurately reflect the nature of the services performed and the personnel performing them. Similarly, municipal advisors should not submit inflated expenses.

[17] *See, e.g*., the cases at note 20, *infra*.

[18] Section 4s(h)(5) of the Dodd-Frank Act requires that a swap dealer with a special entity client (including states, local governments, and public pension funds) must have a reasonable

basis to believe that the special entity has an independent representative that satisfies these criteria, among others.

[19] *See, e.g., O'Brien Partners, supra* (duty to advise issuer on whether to invest bond proceeds and whether to invest in securities); *In re Lazard Freres, supra* (duty to investigate whether advisory client could obtain a more favorable price than the one offered by financial advisor for escrow securities).

[20] *See, e.g*., *In the Matter of Dwight Allen*, SEC Rel. Nos. 33-7456, 34-39122 (Sept. 24, 1997) (settlement in connection with independent financial consultant alleged to have violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act by acting recklessly in certifying that certain municipal obligations met a "minimum credit requirement" based on the value to lien ratio calculated on the value of land; lacking experience with these types of obligations, calculating the value to lien ratio, or the land appraisal process, he allegedly simply relied on one appraisal of the land, which was based on the estimated build-out value if the land was fully developed and did not reflect current market value); *In re Milbrodt*, SEC Rel. Nos. 33-7455, 34-39121 (Sept. 24, 1997) (settlement in connection with financial advisor alleged to have certified that land-based bonds to be acquired by pool bond issuer met minimum credit requirements despite the lack of an independent appraisal of the current market value of the land and without reviewing the governing documents, the governing test for investments of pool bond issuers, or the official statements of land-based bond issuers); *In the Matter of the County of Nevada (McKay)*, SEC Rel. Nos. 33-7556, 34-40225 (July 17, 1998) (settlement in connection with appraiser in *Dwight Allen* and *Milbrodt* cases alleged to have failed to exercise due care in its appraisals used in official statements and violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act).

[21] *See, e.g.*, *In the Matter of County of Nevada (Virginia Horler)*, SEC Init. Dec. Rel. No. 153 (Oct. 29, 1999) (administrative law judge found financial advisor tasked with preparation of official statement for Mello-Roos issue stepped into the shoes of the underwriter and violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act by failing to exercise due diligence and inquire into the finances or personal financial condition of developers and financial condition of development company, which was experiencing negative cash flow and failed to pay taxes in 1990, ultimately leading to bankruptcy).

[22] *See, e.g., Joyce v. Morgan Stanley*, 538 F. 3d 797 (10th Cir. 2008) (claim by shareholder denied because financial advisor had limited its fiduciary duty to the corporation itself and its engagement letter had expressly disclaimed the duty to advise on the possible change in value of stock of the acquiring corporation in the period between announcement of the merger and the closing).

[23] *See, e.g., In re Daisy Systems Corp*. (97 F. 3d 1171 (9th Cir. 1996) (financial advisor's engagement letter not dispositive of scope of financial advisory relationship because it did not expressly limit the nature of the advice to be provided).

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[1] All comments received will be made publicly available without change. Personal identifying information, such as names or e-mail addresses, will not be edited from submissions. Therefore, commenters should submit only information that they wish to make publicly available.

[2] "Municipal advisor" is defined in Section 15B(e)(4) of the Exchange Act as "a person (who is not a municipal entity or an employee of a municipal entity) that: (i) 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 issues; or (ii) undertakes a solicitation of a municipal entity.

[3] The term “municipal entity” is defined by Section 15B(e)(8) of the Exchange Act as: “any State, political subdivision of a State, or municipal corporate instrumentality of a State, including -- (A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities.”

Alphabetical List of Comment Letters on MSRB Notice 2011-14 (February 14, 2011)

1. American Bankers Association: Letter from Cristeena G. Naser, Senior Counsel, dated April 11, 2011

2. American Council of Engineering Companies: Letter from David A. Raymond, President and CEO, dated April 11, 2011

3. American Federation of State, County and Municipal Employees: Letter from Gerald W. McEntee, International President, dated April 11, 2011

4. American Governmental Financial Services: E-mail from Robert Doty, dated April 11, 2011

5. B-Payne Group: Letter from John B. Payne, Principal, dated March 28, 2011

6. Education Finance Council: Letter from Vince Sampson, President, dated April 11, 2011

7. Fi360: Letter from Blaine F. Aikin, CEO, and Kristina A. Fausti, Director of Legal and Regulatory Affairs, dated April 11, 2011

8. Lewis Young Robertson & Burningham, Inc.: Letter from Scott J. Robertson, Principal, dated April 11, 2011

9. Michigan Bankers Association: Letter from Richard C. Lavolette, General Counsel

10. Municipal Regulatory Consulting LLC: Letter from David Levy, Principal, dated April 11, 2011

11. National Association of Independent Public Finance Advisors: Letter from Colette J. Irwin-Knott, President, dated April 11, 2011

12. Not for Profit Capital Strategies: E-mail from Ed Crouch, dated February 14, 2011

13. Phoenix Advisors, LLC: E-mail from Peter G. Egan, Managing Director, dated March 3, 2011

14. Phoenix Advisors, LLC: E-mail from Peter G. Egan, Managing Director, dated March 4, 2011

15. Public Financial Management: Letter from Joseph J. Connolly, General Counsel, dated April 8, 2011

16. Securities Industry and Financial Markets Association: Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, dated April 11, 2011

17. Wisconsin Bankers Association: Letter from Rose Oswald Poels, Interim CEO/President, dated April 11, 2011

American Bankers Association
Building Success. Together.

202-663-5332
cnaser@aba.com

BY ELECTRONIC MAIL

April 11, 2011

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Re: MSRB Notice 2011-14 – Draft MSRB Rule G-36 (On Fiduciary Duty of Municipal Advisors) and Draft Interpretive Notice (February 14, 2011)

Dear Mr. Smith:

The American Bankers Association (ABA)[1] appreciates this opportunity to comment on draft Rule G-36 and the related draft Interpretive Notice of the Municipal Securities Rulemaking Board (MSRB) concerning the fiduciary duty of municipal advisors. Section 975 of the Dodd-Frank Wall Street and Consumer Protection Act (Dodd-Frank Act)[2] newly requires the registration of municipal advisors with both the Securities and Exchange Commission (Commission) and the MSRB and imposes on municipal advisors a fiduciary duty to their municipal entity clients. Our members provide a wide array of products and services to municipal entities, some of which may be determined to involve advice for purposes of Section 975.

ABA appreciates the efforts of the MSRB to provide guidance on the required fiduciary duty. However, as discussed more fully below, we strongly believe that the MSRB should await a final determination from the Commission on the scope of its rule establishing those activities that require registration as a municipal advisor. Absent that critical determination, our members cannot ascertain which, if any, of their services to municipal entities require registration and, therefore, provide a fully informed response with respect to the impact of the draft Interpretive Notice on those services.

BACKGROUND

Draft Rule G-36 provides simply:

> In the conduct of its municipal activities on behalf of municipal entities, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and duty of care.

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[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. Learn more at www.aba.com.

[2] Pub. L. No. 111-203.

Duty of Loyalty

The Interpretive Notice provides that the Rule G-36 duty of loyalty requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor. It requires a municipal advisor to make clear, written disclosure of all material conflicts of interest, such as those that might impair its ability to satisfy the duty of loyalty, and to receive the written, informed consent of officials of the municipal entity with the authority to bind the municipal entity by contract with the municipal advisor. Such disclosure must be made before the municipal advisor may provide municipal advisory services to the municipal entity or, in the case of conflicts arising after the municipal advisory relationship has commenced, before the municipal advisor may continue to provide such services.

The Interpretive Notice further provides that under Rule G-36 a municipal advisor may not undertake an engagement if certain unmanageable conflicts exist, including (1) kickbacks and certain fee-splitting arrangements with the providers of investments or services to municipal entities, (2) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor for solicitation activities regulated by the MSRB, and (3) generally acting as principal in matters concerning the municipal advisory engagement.

The Notice also provides that, in certain cases, the compensation received by a municipal advisor may be so disproportionate to the nature of the municipal advisory services performed that it is inconsistent with the Rule G-36 duty of loyalty and represents an unmanageable conflict.

Finally, the Interpretive Notice provides that the Rule G-36 duty of care requires that a municipal advisor act competently and provide advice to the municipal entity after inquiry into reasonably feasible alternatives to the financings or products proposed (unless the engagement is of a limited nature).

Duty of Care

A municipal advisor's fiduciary duty to its municipal entity client also requires that a municipal advisor exercise due care in performing its responsibilities. This duty requires a municipal advisor to consider alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity. It also requires a municipal advisor to make a reasonable inquiry as to the facts that are relevant to a municipal entity's determination of whether to proceed with a course of action.

DISCUSSION

1. The MSRB should hold its rulemaking in abeyance until the SEC defines the activities that require registration as a municipal advisor.

As the MSRB is aware, the Commission issued a proposal[3] seeking input on a proposed permanent registration system for municipal advisors. The proposal espoused a broad interpretation of Section 975 to cover a wide array of activities, including "advice" (an undefined term) with respect to funds "held" by a municipal entity, a proposition with which the MSRB itself is not in full agreement.[4] Indeed, the Chairman and staff of the Commission have acknowledged that the scope of its proposal has been cast broadly.[5]

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[3] *See,* Exchange Act Release No. 63576 (Dec. 20, 2010).

[4] *See* Comment Letter from Michael G. Bartolotta, MSRB, to Elizabeth M. Murphy, SEC, (Feb. 22, 2011) at 4–6, *available at* http://sec.gov/comments/s7-45-10/s74510-586.pdf.

[5] The Chairman and staff of the SEC have each indicated that they are looking closely at the scope of their proposal, including potential regulatory overlap, in light of significant comments received. *See Budget Hearing – Securities and Exchange Commission:*

As a result of this broad interpretation, the proposal included numerous questions about the scope of activities which would require registration. Key among those questions was whether certain traditional activities of banks should be exempted from the registration requirement. In our comment letter, ABA strongly asserted that such activities are outside the scope of Section 975 and, additionally, sought an exclusion from the registration requirement for banks that would be exempt under the statute but for the statutory bank exemption from the Investment Advisers Act of 1940.[6]

Given that the Commission's proposal could potentially require the registration of thousands of banks and their employees, we believe the MSRB should await final action by the Commission so that the banks that actually will be required to register may realistically assess the impact of a fiduciary duty on covered municipal advisory activities. For example, if custody accounts are, in a final rule, subject to the municipal advisor registration requirement, then the prohibition on principal transactions could prohibit foreign exchange transactions with respect to such accounts.

Virtually all of our members interact with municipal entities in numerous areas throughout their institutions, including with respect to deposit taking, lending and cash management services, to name but a few. We are aware that a number of our larger members have not yet completed an assessment of all the areas in which they interact with municipal entities. Accordingly, ABA believes the wiser course is to await action by the Commission. Indeed, the MSRB itself has indicated that the proposed Interpretive Guidance may require refinement once the Commission's proposal is finalized. Therefore, we strongly urge the MSRB to hold in abeyance its Interpretive Notice until that time.

2. The MSRB should coordinate its fiduciary duty standard with other regulators.

In addition to the MSRB's proposed guidance, a number of other agencies are currently considering the imposition of a fiduciary standard on various participants in the capital markets that may serve municipal entity customers. For example, registered investment advisers have long been subject to a heightened standard of care established under the Investment Advisers Act, and the Commission is actively considering whether a similar standard should be applied to broker-dealers. In addition, both the Commission and the Commodity Futures Trading Commission are similarly considering a heightened standard of care that may be applicable to a securities-based swap dealer or a swap dealer respectively when advising municipal entities.[7] Moreover, the Department of Labor is considering a fiduciary duty for certain advisors to employee benefit plans under the Employee Retirement Income Security Act. In addition, to the extent products and services are provided through bank trust departments to municipal entities such as pension plans, those activities are subject to the most stringent fiduciary duties under common law and state trust law. Such activities are also comprehensively regulated and supervised by federal bank regulators.

Because our members may serve in all these capacities, it would be wholly unworkable for them to attempt to comply with differing – and possibly competing – fiduciary duties while providing the same services.[8]

Hearing Before the House Committee on Appropriations, Subcommittee on Financial Services and General Government, 112th Cong. (Mar. 15, 2011) (testimony of Mary Schapiro, Chairman, SEC) ("[W]e're looking very carefully at whether we may have cast the net too widely and taking the comments very, very seriously"); *see also Oversight of the Securities and Exchange Commission's Operations, Activities, Challenges and FY 2012 Budget Request: Hearing Before the House Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government- Sponsored Enterprises,* 112th Cong. (Mar. 10, 2011) (testimony of Robert Cook, Director, SEC Division of Trading and Markets).

[6] A copy of ABA's comment letter is attached.

[7] *See,* Exchange Act § 15F(h)(4)(B) (added by Section 764 of the Dodd-Frank Act); Commodity Exchange Act § 4s(h)(4)(B) (added by Section 731 of the Dodd-Frank Act).

[8] We note that the Commission's municipal advisor proposal contemplates registration for a broker-dealer engaging in principal transactions with a municipal entity, while the MSRB's Interpretive Notice would prohibit such activity as an unmanageable conflict of interest.

3. The proposed fiduciary duty should not apply to affiliates of the municipal advisor.

Section 975 defines the term "person associated with a municipal advisor" to include "any person directly or indirectly controlling, controlled by, or *under common control* with such municipal advisor."[9] [Emphasis added.] This definition would appear to impose the draft Rule G-36 fiduciary duty on an affiliate of a municipal advisor, despite the fact that the affiliate is not engaged in municipal advisory activities. It would further appear to encompass a registered investment adviser affiliate of a municipal advisor notwithstanding the fact that the former is expressly exempted under Section 975.

We note that under Rule D-11, the term "municipal advisor" also includes the advisor's "associated persons," including entities under common control. However, for purposes of its fair practice rules, the MSRB has interpreted "associated persons" under Rule D-11 to exclude persons who are associated "solely by reason of a control relationship."[10] ABA believes such an interpretation would be appropriate in the context of draft Rule G-36. We believe that imposing a fiduciary duty on all entities under common control with a municipal advisor would be both unnecessary and burdensome, particularly for large financial institutions whose affiliates do not actually coordinate their activities.

Therefore, we urge the MSRB to clarify that the affiliates of a municipal advisor are not subject to draft Rule G-36 unless the affiliate is independently engaged in activities that would require registration as a municipal advisor.

4. Principal transactions should not be prohibited as unmanageable conflicts.

Draft Rule G-36 would prohibit a municipal advisor from ever acting as principal in a transaction with its municipal entity client, notwithstanding disclosure by the advisor of potential conflicts and informed consent by the client. The MSRB bases this prohibition on its belief that a municipal entity could never give informed consent based on disclosure of the conflict in such transactions. ABA strongly disagrees with this position.

Indeed, common trust law, state fiduciary law and the Employee Retirement Income Security Act all which incorporate the highest, strictest form of true "fiduciary duty", do not flatly prohibit such principal transactions. Rather, principal transactions may be permitted depending on whether the adviser has discretion as well as on the provisions of the governing documents. Under ERISA, an independent fiduciary may permit another fiduciary to engage in principal transactions. Similarly, registered investment advisers are permitted to act as principal in transactions with advisory clients so long as the adviser obtains the client's consent after disclosure of (1) the adviser's capacity, (2) any compensation to be received by the adviser and (3) any other relevant facts.[11]

Yet, despite this relevant common and statutory law, the MSRB has provided no support for its position that municipal entities, regardless of sophistication, are incontrovertibly unable to provide informed consent to principal transactions. Rather, its position would result in the wholly unacceptable position that a bank advising a municipal entity would not be able to provide deposit products or similar traditional banking services to that client because it would be a prohibited transaction. However, registered investment advisers who are exempt from Section 975 *would* be able to engage in appropriate principal transactions with municipal entities, while municipal advisers could not, resulting in a competitive disadvantage for the latter.

ABA urges the MSRB to reconsider this prohibition in light of common law and state fiduciary law and permit principal transactions with appropriate disclosure and client consent.

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[9] Exchange Act § 15B(e)(7).
[10] *See* Interpretive Notice, Approval of Fair Practice Rules (Oct. 24, 1978).
[11] *See*, Investment Advisers Act of 1940 § 206(3).

5. Shareholder servicing fees and 12b-1 fees should not be deemed to be impermissible fee-splitting arrangements.

The MSRB should clarify that payments to municipal advisers by means of shareholder servicing fees and 12b-1 fees do not constitute impermissible fee-splitting arrangements. Banks have long received payment for corporate trust services to municipal entities by means of shareholder servicing fees or 12b-1 fees through fully disclosed arrangements with clients.[12] In addition, banks that provide services to ERISA pension plans are typically compensated through 12b-1 fees. We are not aware that these traditional forms of compensation have been the subject of concerns with bank regulators; nor have they been deemed to be inappropriate.

To assure that such compensation programs remain available to municipal entities, ABA urges the MSRB to clarify affirmatively that this form of compensation is permissible.

CONCLUSION

For the reasons stated above, ABA strongly urges the MSRB to await Commission action finalizing the proposal on a permanent registration regime for municipal advisors. Until industry participants can determine with certainty whether or not their activities require registration as municipal advisors and therefore provide informed comments about the potential impact of a fiduciary duty on those activities, we believe the MSRB's efforts are premature. In addition, because other regulators are also considering the imposition of heightened standards of care on related activities, any efforts by the MSRB to devise an appropriate duty for municipal advisors should be undertaken only in consultation with those bodies. We further believe any such duty should not apply to affiliates of municipal advisors. Nor should principal transactions or traditional compensation programs be flatly prohibited.

If you have any questions about the foregoing, please do not hesitate to contact the undersigned.

Sincerely,

Cristeena G. Naser

[12] We note that existing agreements with mutual funds may denominate trustee fees as 12b-1 fees, when, in fact, they are for the provision of shareholder servicing fees. This inclusion of this example does not mean that ABA believes that the provision of corporate trust services to municipal entities would trigger municipal advisor registration. To the contrary, we strongly believe that corporate trustees do *not* provide advice to such clients, but rather are directed by those clients.

ACEC
American Council of Engineering Companies
100 Years of Excellence

David A. Raymond
President & CEO

April 11, 2011

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Re: Draft Rule G-36

Dear Mr. Smith:

On behalf of the American Council of Engineering Companies (ACEC) – the national voice of America's engineering industry – I appreciate the opportunity to provide our comments on the Municipal Securities Rulemaking Board's (MSRB) proposed rule concerning the fiduciary duty of municipal advisors pursuant to Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

ACEC members – numbering more than 5,000 firms representing hundreds of thousands of engineers and other specialists throughout the country – are engaged in a wide range of engineering works that propel the nation's economy, and enhance and safeguard America's quality of life. Many of our member firms work with municipal clients and could potentially be affected by the proposed rule.

As you know, Section 975 of the Act requires "municipal advisors" to register with the Securities and Exchange Commission (SEC) and the MSRB. The statute also includes an exemption from registration for "engineers providing engineering advice."

The SEC has issued a proposed rule providing interpretation of what constitutes engineering advice. ACEC believes that this understanding of the engineering exemption is too narrow and does not reflect congressional intent in specifying the need for an engineering exemption from the definition of municipal advisor. In our comments to the SEC, we highlighted our concerns about the specific exclusion of cash-flow modeling from the engineering exemption, and the reference to feasibility studies. We have asked the SEC for the opportunity to work with them to refine the agency's interpretation of the engineering exemption to the municipal advisor registration regime so that it more clearly reflects congressional intent and the nature of professional engineering work.

Depending on the interpretation of the engineering exemption in the SEC's final rule, certain engineers and engineering firms may need to register as municipal advisors. There is a potential conflict for engineers that register as municipal advisors and must

T 202-347-7474 F 202-898-0068 draymond@acec.org
1015 15th Street, NW, 8th Floor Washington, DC 20005-2605 www.acec.org

therefore assume the fiduciary duties outlined in MSRB draft rule G-36. The draft rule states: "In the conduct of its municipal activities on behalf of municipal entities, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care." A duty of loyalty requires a municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor. While this duty may not, in the normal course of events, cause any conflicts for the engineer, there are circumstances when such duties could come into direct conflict with the engineer's professional and ethical responsibilities.

The ethical duty of engineers to hold paramount the safety, health, and welfare of the public is delineated in the regulations of the various state licensing boards for professional engineers. For example, the Commonwealth of Virginia's Board for Architects, Professional Engineers, Land Surveyors, Certified Interior Designers, and Landscape Architects' current regulations provide as follows:

> *The primary obligation of the professional is to the public. The professional shall recognize that the health, safety, and welfare of the public are dependent upon professional judgments, decisions, and practices. If the professional judgment of the professional is overruled under circumstances when the health, safety, and welfare, or any combination thereof, of the public are endangered, the professional shall inform the employer and client of the possible consequences and notify appropriate authorities.*

The same obligation is reflected in the codes of ethics of private professional associations such as ACEC and the National Society of Professional Engineers (NSPE), as well as related professional associations such as the American Institute of Architects (AIA).

In the course of providing professional engineering services to a client, it is conceivable that circumstances could arise in which a professional engineer would find himself or herself facing a conflict between breaching the fiduciary obligations of a municipal advisor and violating the ethical obligations imposed upon the professional engineer under applicable state licensing board regulations. By failing to address such a conflict, MSRB draft rule G-36 does not serve the interests of the public, which looks to professional engineers to solve many of society's problems.

In addition to conflicts related to engineering codes of ethics, the same fiduciary and duty of loyalty provisions can be in conflict with normal expectations when engineering firms are involved in demand and revenue forecasting. An example would be traffic and revenue forecasts for a toll facility. In that role, the engineer is expected to operate independently of the client as he or she prepares estimates of revenue. These forecasts may be at odds with client expectations, and this "arm's length" relationship is essential to the credibility of the study product. In this role, engineers are not actually serving as 'advisors' to the client but rather as independent forecasters providing a critical component to the design process.

We respectfully request that the MSRB consider these issues and advise ACEC and the engineering industry how such conflicts can and should be managed. Thank you for your

consideration of our comments. We look forward to working with the MSRB on these issues as the rulemaking process moves forward.

Sincerely,

David A. Raymond
President & CEO

AFSCME
We Make America Happen

April 11, 2011

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Re: MSRB Notice 2011-14 Fiduciary Duty of Municipal Advisors
MSRB Notice 2011-13 Fair Dealing Obligations of Municipal Advisors
MSRB Notice 2011-12 Underwriters of Municipal Securities

Dear Mr. Smith:

The American Federation of State, County and Municipal Employees ("AFSCME") is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan (the "Plan") is a long-term shareholder that manages $850 million in assets for its participants, who are staff members of AFSCME and its affiliates.

AFSCME is pleased to have the opportunity to voice support for the rules proposed by the Municipal Securities Rulemaking Board ("MSRB") which delineate the fiduciary duty of municipal advisors with respect to their municipal entity clients, the obligations of municipal advisors to deal fairly with their current or prospective clients, and the requirements that underwriters have towards issuers of municipal securities. We applaud the efforts of the MSRB to protect municipal entities from self-dealing and other deceptive practices. Strong protections are required for municipal entities.

During consideration of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), AFSCME strongly supported the inclusion of provisions establishing the strongest possible market reforms, oversight and transparency for the "shadow markets" and other major provisions addressing corporate governance and investor protection. Investor protections important to AFSCME members include new market reforms addressing the sale of derivatives products and strategies, duties owed by firms and individuals offering investment advice, greater transparency for the

American Federation of State, County and Municipal Employees, AFL-CIO
TEL (202) 429-1000 **FAX** (202) 429-1293 **TDD** (202) 659-0446 **WEB** www.afscme.org 1625 L Street, NW, Washington, DC 20036-5687

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advisors to hedge funds and private equity investments, and improved safeguards for municipal markets.

In each of these rulemaking contexts, vendors of various investment products and services have raised concerns that new obligations of disclosure or other investor protection remedies are not workable. Perhaps unsurprisingly, many Wall Street firms and their different lobbying entities argue that new investor protections under Dodd Frank may also trigger obligations under federal pension law. The implementation of market reforms requires both coordinated rulemaking designed to facilitate the operation of well-functioning markets that deserve investor confidence, and a big picture view that prevents evasion by those who would delay and dilute market reforms. We urge the MSRB to keep both of these in mind.

One of the areas targeted by tactics of delay and misdirection is the definition of "investment advice." During passage of Dodd-Frank, workers, seniors, consumers, savers, and investors joined together to urge that the law be strengthened regarding the responsibilities of those who give investment advice, that it be "clarified" where doubt had been raised, and that it be expanded to areas – for example, over-the-counter derivatives – where it has become painfully clear that restrictions on sound market requirements were ill-advised, to say the least.

Entities that give investment advice sell both advice and products (or products and services) bundled together. These firms and their subsidiaries or affiliates sell advice, and products to "implement" that advice, in more than one market. Distinguishing advice from the products it recommends is hard to do. Identifying the accountable provider – the firm with the household name or the call center employee who answers the phone – is hard to do. Distinguishing the price of advice from the price of the product or service – and further distinguishing those prices from the amount "at work in the market" – is hard to do. Distinguishing who got paid what and works under what incentives is hard to do. Distinguishing when the worker or pension plan trustee or buyer responsible for other people's money is talking to an advisor, or another kind of provider, is hard to do. Knowing which hat is being worn by which affiliate is hard to do.

After reviewing the comments submitted by large financial firms to the different regulators, and the efforts to create cover for rolling back reforms one more time through the same old tricks of deregulating and defunding, it is hard to imagine that this difficulty is not exactly their goal. Regulators must be steadfast in order to cut through the smokescreen which permits financial firms to continue operating with serious conflicts of interest, to the detriment of investors.

In spite of the great overlap in the entities that provide advice and products (or strategies) in different markets, Wall Street firms argue that the differences are

huge and that any potential overlap in duties must be avoided. They prefer to redefine – or not define – "advice" anew in every market and every context. They limit the definition of the recipients eligible to receive the duty that comes with providing advice. They work to limit the types of products and strategies to which any advice-related duty could apply. They work to craft language limiting the application of any duty.

The harms to be avoided are always alleged to be these: too much disclosure risks seller liability; sellers withdrawing from the market; competition forces diminishing; investor choice narrowing; and prices rising. So, the argument goes, too much disclosure is bad for investors. We find this difficult to believe, and we urge you to take a very hard look at this logic.

When pension assets are involved, firms that seek to avoid their obligations warn that too much information disclosed by service providers may result in misunderstandings and promote bad decisions. It may intrude on proprietary information (meaning they have no obligation to tell clients), it certainly will cost sellers to disclose more, and they certainly would have to bill investors for that.

The challenges around implementing effective fiduciary duties are clearly present in the ongoing efforts at the MSRB. Dodd-Frank directs the MSRB to establish rules with respect to municipal advisors that "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." And MSRB Notice 2011-14 requesting comment on draft guidance on a fiduciary duty of municipal advisors attempts to do that.

Yet the text itself warns that this guidance was developed based on the statutory language of Dodd-Frank, and that it was developed "without regard to any interpretation of that term proposed by the SEC in its proposed permanent registration rule for municipal advisors", and that MSRB may revise its own proposed guidance and may seek additional comment. Furthermore, the SEC proposal does not define exactly what constitutes the "provision of advice" though it gives examples of the types of "advice" that would trigger "municipal advisor" status and a duty to register under the proposal. At this time there is little that appears definitive. Careful review of the whole record – and continued input - will be very important.

MSRB noted several very important issues in the comment it submitted to the SEC regarding the definition of municipal advisor for purposes of SEC registration. Given the importance of these issues to AFSCME members, and the interplay with the scope of the fiduciary duty on municipal advisors addressed in this rulemaking proposal, we would like to address them here.

First, the MSRB noted that the SEC's proposed rule would benefit from a wording change to narrow the exclusion from municipal advisor registration for CFTC-Registered Commodity Trading Advisors in order to clarify that the exclusion "is available only when the registered commodity trading advisor is providing advice relating to swaps (as defined in Section 1a(47) of the Commodity Exchange Act and Section 3(a)(69) of the Exchange Act, and the rules and regulations thereunder." In other words, "the exclusion would not be available to such registered commodity trading advisors engaged in any other municipal advisory activities, including providing advice relating to any municipal derivative other than a swap".

The MSRB also provides several additional comments that show the complexity of the connection among investment advice obligations:

> The MSRB notes that Section 913 of Dodd-Frank and the effort to hold brokers to a fiduciary standard when giving advice comes into play in this marketplace and that "the Commission may, by rule, provide that the legal standard for securities transactions effected by broker-dealers with municipal entities shall be the same as the standard applicable to investment advisers under the Investment Advisers Act and, pursuant thereto, could replace the existing suitability standard with a fiduciary standard." SIFMA and others have urged that the SEC be given time to act first.
>
> The MSRB further noted its belief that public defined contribution pension plans fall squarely within the description of "investment strategies" and investment activities that trigger SEC registration of municipal advisors. The MSRB also "believes it would be appropriate to include public defined benefit pension plans as well, since they share many of the same potential direct or indirect impact on third-party beneficiaries and generally are exempt from the protections afforded by the Employee Retirement Income Security Act (ERISA) to private pension funds. Thus, in general, investment strategies would include such strategies relating to investments by all types of public pension funds other than broker-dealer recommendations "about a transaction such broker-dealer itself effects that is subject to federal broker-dealer suitability and related business conduct standards."
>
> Finally, the MSRB notes its reading of the language and legislative history of Dodd-Frank as "strongly indicative of a Congressional intent that advice by advisors to municipal entities, particularly in but not necessarily limited to the context of a municipal securities offering, was intended to be regulated under a single comprehensive municipal advisor regulatory construct", under which CFTC would be responsible for "comprehensive regulation . . . of the swap activities of swap dealers and major swap participants (including advice on swaps provided to special entities)", and MSRB would provide for

> "comprehensive regulation . . . of most typical non-dealer advisors to municipal entities (including advisors, other than swap dealers and major swap participants, providing advice on municipal derivatives).'

The MSRB says that strengthened coordination among the MSRB, the SEC and the CFTC would promote a more efficient and effective implementation of the Dodd-Frank Act and would reduce the compliance burden on market participants. This includes small municipal advisors who might provide advice to an issuer on a variable rate demand offering (VRDO) involving an interest rate swap which could be subject to MSRB rules as a municipal advisor in connection with advice on the new issue offering, while simultaneously becoming subject to distinct CFTC rules as a commodity trading advisor in connection with the swap. We again encourage such coordination among the agencies.

Another danger to avoid is that some sellers will carve themselves out of disclosure duties, that they will succeed in scaling back the reach of market reforms and staggering the effective dates, and fall artfully between the cracks. This would leave investors in a "buyer beware" bind, which might be filled by small independent advisors. These small firms would end up stepping into the disclosure breach and facing potential responsibility for unearthing the truth that sellers did not reveal.

The MSRB strongly recommends coordination. That is essential – not delay but real coordinated rulemaking. As a part of that process, both during rule development and after specifics are finalized, the MSRB, the SEC and the CFTC should undertake a series of efforts – similar to those typical of the Department of Labor's ERISA regulators - to issue not only clear explanations of their formal guidance but also informal guidance in the form of Frequently Asked Questions, regional meetings and internet webinars and other forms of explanation that help the market participants – including workers, pension participants, investors, and pension trustees – make informed decisions, knowing both the players and the rules.

Another MSRB Notice, 2011-12, requests comments on proposed interpretive guidance regarding the duty of dealers in their interactions with municipal entities as underwriters of municipal securities, "including integrally-related activities, such as interest rate swap transactions and purchases of defeasance escrow securities". The MSRB states that this duty to deal fairly requires, among other things, disclosure of all material risks and characteristics of the financing of complex municipal securities (such as a VRDO with a swap), as well as disclosure of any incentives for the underwriter to recommend the financing (e.g., third-party payments, certain credit default swaps, and profit-sharing arrangements with investors).

The duty of fair dealing here is also defined as including "an implied representation that the price an underwriter pays to an issuer bears a reasonable relationship to the prevailing market price of the securities. An underwriter's direct and indirect compensation for a new issue must not be excessive (i.e., disproportionate to the nature of the underwriting and related services performed)."

It seems reasonable to anticipate that this notice, too, will require coordination to ensure effective implementation and investor protection. Only that kind of coordinated implementation will fulfill the promise of Dodd-Frank and build back greater trust in the integrity of the financial markets and greater stability in the economy overall.

* * *

We appreciate the opportunity to express our views on this matter. Should you have questions regarding our comments, please contact Lisa Lindsley at (202) 429-1275.

Sincerely,

GERALD W. McENTEE
International President

From: Robert Doty
Sent: Monday, April 11, 2011 7:18 PM
To: Peg Henry
Subject: Comments on Drafts Proposals Relating to Rules G-17 and G-36

Thank you for this opportunity to comment on the Board's draft proposals to issue a new Rule G-36 and interpretative notices relating to Rule G-17 and G-36.

I do not have extensive comment regarding these proposals because I believe that the Board has made sound proposals.

In particular, I appreciate the Board's sensitivity to the subtleties of the fiduciary duty and its inclusive recognition of the duty of loyalty and the duty of care owed by municipal advisors to their clients. For too long, some advisors, purporting to serve municipal issuers, have focused excessively on the closing of the "deal," rather than on the provision of appropriate advice to their clients. The potential for explicit limitations on the scope of the relationships should alleviate concerns that some may have.

Among other things, the proposal to require that firms clarify for clients the advantages and disadvantages of various forms of advisor compensation is excellent. Too many municipal issuers are gullible regarding the use of contingent compensation payable only after transactions are completed. They do not think through the long-term costs and other relevant implications of contingent compensation that can place advisors, upon whom the issuers rely heavily, in the unfortunate position of sacrificing months of work without compensation when it becomes apparent (or should be apparent to a market financial professional) that a transaction is not in the issuers' best interests. Unfortunately, there are advisors who would plow ahead in order to avoid substantial financial loss, rather than informing the issuer clients either (1) not to proceed or (2) to alter the structure or approach.

I commend the Board for its awareness of these issues for market professionals who have a fiduciary duty, and am hopeful that the Board will continue to act with that awareness and sensitivity as it moves forward with the implementation of the fiduciary duty, fair dealing concepts, professional standards and other aspects of municipal advisor regulation.

Robert Doty
AGFS

AGFS CONTACT INFORMATION:
Email: *robert.doty@agfs.com*
Telephone: (916) 483-7378
Fax: (916) 483-7565
Website: *www.agfs.com*

1721 Eastern Avenue, Suite 4
Sacramento, CA 95864-1745

171 Montclair Ave.
Circleville, Ohio 43113
bpaynegroup.com

B-Payne Group Financial Advisors

March 28, 2011

To: Securities & Exchange Commission and Municipal Securities Rulemaking Board Regulators,

Re: Proposed Regulations for Independent Municipal Financial Advisors

OVERVIEW:

I have long intended to comment on the MSRB's proposed regulations for independent municipal financial advisors, "FAs". I spent a few hours reading and thinking about the over two-hundred pages of proposed and "explained" regulations, but never got around to commenting for the record. Nevertheless, earlier this week I found your email address in an article by The Bond Buyer, and, as it was convenient to do so, I decided to submit my recommendations through that channel. Please understand that I am not a securities lawyer, so my comments are of a general nature and intended to help all parties understand the impact of this measure on my small business.

Before commenting, I'll summarize my experience. I began my career as a State Budget Analyst with the State of Ohio in 1983. I soon was assigned to assist the legendary Herb Kruse manage and track all state debt issuances that were controlled by the Governor's office. I moved on from there in 1989 to Ehrlich Bober, where I began my career as a public finance investment banker. On Ehrlich's departure from the business in 1991, I moved to A.G. Edwards and built a business and highly respected career for 14 ½ years. My next move was to Robert W. Baird to manage and build a "traditional" public finance operation in Ohio to complement its existing group of Ohio "structured" finance experts. I stayed at Baird for 4 ½ years and left in February 2009 to create my own advisory business. My clients are primarily the least understood in the marketplace – small- to medium-sized school districts, counties, and cities - and my client base is extensive. I believe I am very well known in state circles and that my reputation is excellent. (At least no one has told me otherwise, and I have never had even the smallest complaint about my work.) To further understand my business, please visit my website at bpaynegroup.com.

The bullet points below summarize my thoughts. Details and recommendations follow.

- Regulatory Framework – Using the financial advisor/stock broker regulatory framework to regulate a small handful of FAs in Ohio is impractical. It's like building a billion dollar damn to

John B. Payne
jp@bpaynegroup.com
614.497-4555

Lorelei L. Roush
lr@bpaynegroup.com
614.570.0631

Jerry K. Buccilla
jb@bpaynegroup.com
740.507.4866

regulate Old Mill Creek. Unlike the damn, however, this overkill is difficult to see, as is the eventual fallout for the small operations like mine that simply fade away under the burden. Keeping emails and correspondence is relatively painless, but the vast number of forms and required procedures are punitive. There is a much more practical and cost efficient way to do this, which I will recommend herein.

- Compliance Costs: I don't pretend to understand the regulators guesses at my compliance costs. The fact is, cost estimates published in the proposed regulations are wild guesses and were obviously generated by analysts who know absolutely nothing about my business. I estimate my costs to be a minimum of fifty thousand dollars or as much as hundreds of thousands of dollars. That would be fine if I employed twenty or more professionals including a lawyer and systems professional. I don't. The paperwork, seminars, lawyer bills, supervisory red tape and excessive opportunity costs in the proposed regulations are a small advisor death sentence in my opinion. Add to this the burden of record keeping for the tax filings I have to make to federal, state, and local levels and you have a regulatory burden with a potential cost of well over a half million dollars a year in cost and lost opportunities.
- Real-life Impact: I have one full-time employee whose job is seriously threatened by the cost of these regulations. She is a single mother who has been with me for years, and she plays a critical part of my business model. I have one part-time employee with good experience in the business, who supplements his education-related income by providing FA services to a select group of issuers, and I have another limited-time (12 hours per week) employee who is in his first job, doing a great job, and trying to build a resume. Not a single one of these jobs is safe now.

DETAILS:

Regulatory Framework Is Flawed - The basic premise of the regulations is tragically flawed. The premise of the FA regulations seems to be that government finance officers and legislative bodies will benefit from the same level of protection and protective procedures that "Sam the retired grocer" needs when dealing with retail stock brokers and his life savings. Using the same regulatory "architecture" for independent FA's and retail brokerage clients is a mistake and an example of extreme regulatory overkill. FAs are much different from registered stock brokers in three very important ways that also make us easier to regulate: 1) there are a relatively small number of FAs and a sea of brokers; 2) brokers manage and have access to clients' accounts and FAs do not, serving almost exclusively as advisor middlemen; 3) FA clients are mostly sophisticated industry professionals who realize that they have a duty of care to the

public, just as we have to them – broker clients are often quite defenseless and have only themselves as a final check.

I ask you to seriously compare my clients' situations to Sam above who may not know the difference between an annuity and a football and who is working with one of possibly thousands of random brokers in the state. I don't touch my clients' money and never have access to their accounts even if I wanted it, yet my clients have the qualifications necessary to know exactly what I'm doing, while Sam is quite defenseless. I realize that many of the perceived FA problems in the business over the past years are the result of poor decision making at the government level, due to lack of oversight and budgetary discipline. Therefore, local issuers should be prodded to recognize that they have a duty of care in this area to choose their advisors and bankers carefully. Federal regulators shouldn't try to "back door" this oversight through the FAs just because they can't get to the government officials. Figure out another method. Work with the states to increase local-finance-officer training and regulation or something along those lines, but don't expect to get better behavior from local government finance officers and elected officials by smothering me with regulations. It won't work.

To be fair to the legislators and regulators, I have asked myself this question: do I have issuer clients who are ill prepared to understand and make sensible decisions about debt issuance? Of course I do. I don't expect any of them to understand what it has taken me twenty-five years to learn simply because I try to explain it to them in a few visits. Therefore, I am intensely aware of my fiduciary responsibility. Are there bad FA apples out there who don't always deal "honestly" and "fairly" (at least as a group of knowledgeable and sensible people would define those two words)? I am saddened to say, perhaps there are. Unfortunately, email tracking, testing, and so on will have no effect whatsoever on FA actions. Those bureaucratic nuisances simply kill private jobs and hurt efficiency. Sure, we could use some oversight. However, the FA world is small and thus can be reviewed much more simply than the brokerage world can. For example, I can name only four active and well-known independent FAs working the Ohio local government market. If you want to find out who among us may need some guidance, if any, get someone on the ground here in Ohio who can ask around. Perform an occasional random transaction review. The point is, you can't prevent abusive behavior with burdensome, irrelevant paperwork, but you can certainly discourage such behavior with occasional inquiries handled by someone on the ground who actually knows the neighborhood. Otherwise, we are simply creating another federally-mandated paper jungle that fails to accomplish its intended goal. To be clear, I am

recommending that you hire an expert for each state or region that you define, one who has an impeccable reputation for fairness and quality, to explore and discourage sloppy or unfair work among the area's FAs. Then, you could discard the bulk of your regulations, needless testing, and paperwork. The standard fraud and fairness laws would be enough.

Compliance Costs – Over my 20 years as an investment banker and independent financial advisor, 70% of my revenue has come from approximately 25% of my clients. Finding and retaining that 25% is critical to survival. The challenge is knowing when and where you will find that opportunity. Therefore, I have to be on the street, at conferences, and on the phone more than I really have time to be. And whenever I am taken away from those activities for regulatory administrative work, the more likely I am to fail. This is particularly worrisome in my position because the bulk of my clients are very small, as are my fees. Unfortunately, transaction work for small governments can be more time consuming and demanding than for larger governments, and the required degree of care is often higher.

Therefore, I expect my compliance costs, including opportunity cost, to be far in excess of my income in any year. I feel like a small business poster child for the crippling effects of onerous federal regulations. Believe me when I say that I am on the very edge of closing my doors rather than confronting this federal attack. And it's the small issuers, who need my services most, who will suffer for that. This will be bad for Ohio's small government issuers, bad for me, and good for the big boys. I'm sure that was the intention of some in Washington, but I doubt it was the intention of Congress.

If you have any interest in helping start-up advisors like me survive this process, I recommend being explicit about exemptions for small independent advisors. I can manage and support fee and conflict disclosures and outgoing email and client file retention, but that is it. And I could write rules to that effect in a sentence or two. Two-hundred and thirty pages seems a bit much.

Fees and Fair Dealing - The regulations focus a great deal on "fair dealing" and fees. I agree that our government finance officers are responsible for managing the fees they pay. They should know what they are agreeing to pay up front when possible, if a fixed fee or percentage fee, and get a cap if an hourly fee. The proposed regulations on fee disclosure are manageable and sensible – perhaps long overdue for all professionals in the public finance business. Rather than just FAs, however, all parties - FAs, bond lawyers, and underwriters - should be required to disclose any and all fees that they or any

partner may charge prior to the engagement. That's where the regulation must stop, however. Judging the "reasonableness" of fees is an impossible duty for any out-of-state regulator, due to the vast differences in required services for unique issues and clients. There isn't a regulator alive, of whom I am aware, who knows enough to tell my clients if my fees are reasonable or not. Please do not misunderstand me, though. If the news reports on fees for the swaps and swaptions executed for certain Pennsylvania schools are true, those who charged those fees and achieved such miserable results should be called out. However, I need fee flexibility not tied to a regulator's uninformed opinion about what the fee should be. Not to be able to charge more for some and less for others will achieve the exact opposite result intended by the regulations; the small issuers most in need of the very best services and expertise will be left to the amateurs; that is, the least experienced and skilled "advisors" on the staffs of the large firms.

Again, my recommendation is to get experienced personnel on the ground in regional markets and charge them with staying on top of situations. They will know where there might be problems and their presence alone will encourage all parties to act in their clients' best interests. It's very difficult to define fairness or fair dealing for this work because the work is so different for each client, but we know what's right as a group of professionals in Ohio (FAs, underwriters, and counsel), and when someone is suspected of violating what's considered right, word gets around quickly. Having a qualified and respected person on the ground in the region would bring things into focus for the long-term benefit of all of us, including the issuers. Again, I am recommending creating an ombudsmen sort of position by local region and filling it with a known and respected individual, then discarding specific regulations in favor of much broader guidance and much less paperwork and bureaucracy.

Testing - Testing is another area I fear will be managed poorly by the regulators if history is any guide. Years ago, I was required to pass the Series 7 Registered Securities Representative test to be a public finance investment banker. The funny thing was that it had nothing to do with my job. Besides that, the test questions were so basic and irrelevant that the tests served no purpose other than to waste an entire day. Likewise, the thinking that bi-annual continuing education and initial licensing tests will help regulate public financial advisors is well-meaning, but Pollyanna. Over the years in the public finance world, testing and continuing education sessions were laughed at as absolute wastes of productive time. I have no suggested alternative other than to just totally discard them.

Summary - The proposed FA regulations are well-intentioned, I'm sure. On the whole, however, they are a perfect example of well meaning but destructive government officials creating significant barriers to business and job growth. Worse yet, they will have absolutely no positive impact. The good news is that it doesn't have to be this way. Please, resist creating another massive bureaucracy with stultifying mounds of paperwork and administrative overkill. Back off and take a close look at who you are regulating before finalizing any rules and procedures. I believe you will realize you can do this much more efficiently simply by hiring an effective employee or two.

After reading the regulations, I had a long conversation with my staff and wife about closing my doors. Those conversations are ongoing and unsettled. It would be a shame to close, because my clients need my help badly and trust me implicitly, and they would be the first to tell you so.

Respectfully submitted for consideration,

John B. Payne

Principal (and serving as cfo, compliance officer, marketing vice president, vice president of accounting, and independent financial advisor)

Copies to:

Securities & Exchange Commission
Municipal Securities Rulemaking Board
Honorable Sherrod Brown
Honorable Rob Portman
Honorable Steve Austria

April 11, 2011

Ronald W. Smith
Corporate Secretary
MSRB
1900 Duke Street
Alexandria, VA 22314

RE: MSRB NOTICE 2011-14 (FEBRUARY 14, 2011)

The Education Finance Council (EFC) is the association representing the nation's state agency and nonprofit student loan providers. We are pleased to submit the following comments on Proposed Rule Notice 2011-14 which creates draft Rule G-36 and interpretive guidance (the "draft Rule"). EFC believes that the draft Rule creates an unnecessary disclosure requirement for members of boards of directors of nonprofit and state agency student loan providers.[1] Many student loan providers, particularly those who are instrumentalities of a state, have boards of directors who are appointed by a state legislature or executive. Those serving as directors are already subject to state laws that create duties of loyalty and care effectively similar to those created by the draft Rule.

The draft rule proposes to subject "municipal advisors" to a "fiduciary duty, which shall include a duty of loyalty and duty of care." The draft Rule incorporates the definition of "municipal advisor" found in section 15B(e)(4) of the Securities and Exchange Act of 1933.[2] The definition of "municipal advisor" referenced by the draft Rule would cover many of the individuals that currently serve on the boards of directors of municipal student loan providers. Clearly, these boards would be covered because they are not employees of the municipal student loan issuer and they control the key strategic decisions of the provider - including types of and amounts of issuances. However, the input and direction these boards of directors provide are not analogous to the activities provided by municipal advisors that the MSRB is seeking to regulate in the draft Rule. Moreover, to treat members of the board of municipal entities, such as student loan providers, as municipal advisors is inconsistent with the reality of how these boards function. The boards of municipal student loan providers are the governing body for the provider and as such cannot be an "advisor."

This unnecessary registration of board members of state agency student loan providers, as proposed by the draft Rule, will inhibit people from serving on boards of directors at precisely the time these entities need them most. Recent changes to federal law eliminated a historic business line for state-based student loan providers. Access to individuals with the capabilities and expertise is critical so that municipal student loan providers make the critical decisions that will allow them to navigate through

[1] See e.g., draft Rule, Appendix A.

[2] In footnote 1 of the preamble, the draft Rule states: "'Municipal advisor' is defined in Section 15B(e)(4) of the Exchange Act as "a person (who is not a municipal entity or an employee of a municipal entity) that: (i) 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 issues; or (ii) undertakes a solicitation of a municipal entity."

this time of transition and continue meeting the needs of students and families. Unnecessary registration and disclosure will, in many instances, result in significant attrition of individuals currently serving on boards.

In many states, individuals serving on boards of municipal entities such as student loan providers, are subject to ethics boards and operate under state "open meetings" laws. In some cases, while board appointees are not “employees” of the municipal entity in the strictest sense, they are considered by states to be public officers and thus subject to strict state financial disclosure statues. Therefore, those serving on boards of municipal student loan providers already have a fiduciary duty to act in the best interest of the citizens of a particular state.

Finally, due to the municipal advisor rulemakings underway at both the MSRB and the Securities and Exchange Commission (SEC), there could be conflicting standards for defining who would be considered and disclosure requirements for municipal advisors.[3] Therefore, the MSRB should coordinate with the SEC to determine a consistent standard for disclosure requirements.

For the reasons stated above, EFC believes the draft rule will not provide investors with additional substantive information and will have the damaging effect of driving interested and qualified board members away from municipal student loan providers. We are hopeful that MSRB does not require appointed or elected board members to be subject to the disclosure rules for “municipal advisors.”

Sincerely,

Vince Sampson
President

[3] See, draft Rule: “Commenters should note that the interpretive notice is based upon the statutory definition of municipal advisor set forth in the Dodd-Frank Act without regard to any interpretation of that term proposed by the Securities and Exchange Commission (“SEC”) in its proposed permanent registration rule for municipal advisors (Securities Exchange Act Release No. 34-63576 (December 20, 2010).”

April 11, 2011

DELIVERED VIA E-MAIL TO CommentLetters@msrb.org

Ronald W. Smith, Corporate Secretary
MSRB
1900 Duke Street
Alexandria, VA 22314

RE: Draft MSRB Rule G-36 (on Fiduciary Rule of Municipal Advisors) and Draft Interpretative Notice under Rule G-36

Dear Mr. Smith,

Fi360 [1] appreciates the opportunity to comment on draft MSRB Rule G-36 and the related draft interpretative notice setting rules for and providing guidance on municipal advisors' fiduciary duty established under the Dodd-Frank Act.[2]

Fi360 applauds the MSRB on its efforts to provide clarity on municipal advisors' fiduciary obligations to their municipal entity clients. In particular, we commend the MSRB on recognizing in draft Rule G-36 the duty of loyalty and the duty of care, which have long been recognized by the SEC as essential obligations under the fiduciary standard of care.[3] Moreover, we believe that the MSRB's draft interpretative notice has amply captured key principles that underly the duties of the loyalty and care.

For a fiduciary to fulfill its obligations in good faith, it must at a minimum: (1) put the client's best interest first; (2) act with the skill, care, diligence and good judgment of a professional; (3)

[1] Fi360 offers a full circle approach to investment fiduciary education, practice management, and support. Our mission is to promote a culture of fiduciary responsibility and improve the decision making processes of investment fiduciaries, including investment advisors, managers, and stewards. With legally substantiated Practices as our foundation, we offer training, tools, and resources in support of that mission. We also manage the Accredited Investment Fiduciary® (AIF®) and Accredited Investment Fiduciary Analyst™ (AIFA®) designation programs. AIF designees receive training that provides a unique comprehensive overview of fiduciary standards of excellence, asset allocation, preparation of investment policy statements, manager search and due diligence, performance measurement, and other related subjects. AIFA designee training builds on that foundation and prepares students to provide Fiduciary Assessments to institutions. At present, there are over 4,800 active AIF and AIFA designees.

[2] Sec. 975(c)(2), Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. Law No. 111-203.

[3] *See*, *e.g.*, Staff of the U.S. Securities and Exchange Commission, "Study on Investment Advisers and Broker-Dealers," January 2011 ("SEC Fiduciary Study"), *at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf .

not mislead clients and provide conspicuous, full and fair disclosure of all important facts; (4) avoid conflicts of interest; and (5) fairly manage unavoidable conflicts in the client's favor.[4] We believe that the MSRB not only has fully recognized these principles in its proposal, but has also provided strong safeguards that will protect municipal entity clients by requiring municipal advisors to disclose conflicts, obtain written informed consent, avoid unmanageable conflicts, act competently, and make reasonable inquiry into transactions and alternatives. Moreover, we commend the MSRB for recognizing that the fair dealing requirements under MSRB Rule G-17 are subsumed within the advisor's fiduciary duty under draft Rule G-36.

Fiduciary obligations are hugely important to protecting the trust that clients place in their advisors because the advisor's duties maintain the integrity of advice that is provided to clients and promote strong investor protection. We applaud the MSRB for setting a high benchmark for municipal advisors' fiduciary conduct and hope that benchmark will serve as an example of the high standard that should be exemplified in all advisory services and the legislative and regulatory requirements that affect those services.

We truly appreciate the opportunity to provide our views on these important issues. Please do not hesitate to contact us at (412) 221-0292 if you have any questions or would like additional information.

Sincerely,

Blaine F. Aikin
CEO

Kristina A. Fausti
Director of Legal and Regulatory Affairs

[4] We note that the Committee for the Fiduciary Standard has recognized and advocated for these five fiduciary principles in the legislative and regulatory context. *See* "The Committee for the Fiduciary Standard: Five Fundamental Principles," *at* http://thefiduciarystandard.org/images/Summary_5Principles.pdf.

LEWIS YOUNG
ROBERTSON & BURNINGHAM, INC.
AN INDEPENDENT MUNICIPAL FINANCIAL ADVISORY
AND CONSULTING FIRM

Via E-Mail [CommentLetters@msrb.org]
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

April 11, 2011

Re: MSRB Notice 2011-14, Request for Comment on Draft MSRB Rule G-36 and Draft Interpretative Notice

Ladies and Gentlemen:

Lewis Young Robertson & Burningham ("LYRB") is pleased to submit comments on the above-referenced Notice.

LYRB is an independent financial advisory firm which has elected, since its inception 15 years ago, to be regulated as a broker dealer and, therefore, has been and remains subject to MSRB regulation. We are now also registered as a municipal advisor with the Securities and Exchange Commission and the MSRB pursuant to Rule 15Ba2-6T of the Commission.

LYRB does not underwrite or purchase securities for our own account or for sale to others nor do we carry customer accounts of any kind. We do not participate as a co-manager or member of selling groups and do not act as a remarketing agent. For the year 2010, we were ranked by The Bond Buyer as the number two financial advisor in the State of Utah, measured by volume. LYRB has acted as financial advisor on hundreds of transactions with a volume of well over $5 billion. These transactions run the gamut from small to large, and include general obligation bonds, various types of revenue and tax backed bonds, revenue and bond anticipation notes, and taxable and tax-exempt (including Build America Bonds) bonds in both fixed rate and variable rate structures.

Proposed Rule G-36 imposes a general fiduciary duty connected with the services provided to a municipal entity by a municipal advisor, with specific attention to a duty of loyalty and a duty of care. While we have always and do presently acknowledge the fiduciary duty we owe our financial advisory clients, we are concerned with some aspects of the basic approach taken in the proposed rule and the draft interpretive notice.

As to the rule text itself, we recommend the deletion of the phrase ", which shall include a duty of loyalty and a duty of care". There is a substantial body of state and federal law on the duties of fiduciaries. While the duties of loyalty and care are important aspects of the overall duties they are by no means the only duties.

As to the draft interpretive notice, we offer the following for your consideration:

First, we recommend that the "Conflicts of Interest" material beginning "The following are examples…" and ending prior to "Informed Consent" be deleted. The matters discussed are largely subsumed in the chief paragraph and, to the extent they are not, are best moved or left out altogether. In particular, we note that the third party compensation matters discussed under "Unmanageable Conflicts" and listed as the first three items in the material we suggest be deleted are almost always problematic and should be considered unwaiveable. This might be addressed under its own separate heading, rather than

GATEWAY PLAZA BUILDING
41 NORTH RIO GRANDE, SUITE 101
SALT LAKE CITY, UTAH 84101
TELEPHONE 801.596.0700
TOLL FREE 800.581.1100
FAX 801.596.2800
WWW.LEWISYOUNG.COM

as a part of Conflicts of Interest. Further, the reference to "other…relationships that might impair the municipal advisor's ability to act only in the best interests of its…client" is both vague and overbroad. Without further definition, the term "relationships" can be construed narrowly or expansively, and can result in entirely appropriate relationships being open to second guessing by persons in hindsight. Actual engagements are concrete, clear and measurable. Personal, past, or other "relationships" should only need to be disclosed when the advisor reasonably feels its judgment may be clouded. Otherwise, very real risks are run of not being sufficiently comprehensive in a conflict disclosure communication or, more to the point, of including in the disclosure so many cautionary items that matters of real concern are lost in the "chatter" of the overbroad disclosure. There is also a concern that this reference to "relationships" may require a standard considerably higher than that applicable to attorneys. We cannot believe this is intended or desirable.

The provisions relating to disclosure of conflicts in forms of compensation is a solution in search of a problem. While the method and amount of compensation, together with conditions, if any, should be disclosed in writing, the material in Appendix A is unnecessary and its inclusion in the rule gives it an importance it does not merit, thus detracting from the gravity the rest of the subject matter and purpose of the rule. Most municipal entities will find the statements that most forms of compensation have embedded conflicts of interest to be confusing at best.

Second, as to the duty of care, the first paragraph is sufficient. While the references to qualifications and consideration of alternatives are interesting, mention of these, while leaving unmentioned the many other aspects of the general fiduciary duty and the more specific duty of care, unbalances the implications of the general duty.

Other objections exist to the language under "Duty of Inquiry". The first sentence is a mere truism. The second should be governed by the language of the certificate, showing the scope of inquiry, if any, made.

The final sentence under "Duty of Inquiry" is misplaced entirely. The use of the phrase "due diligence" appears to impose the duty of an underwriter (who acts for investors) on a financial advisor (who acts for an issuer, and only advises in a secondary role to the issuer, as principal, as regards to its disclosure duties). The imposition of such a duty on a financial advisor is not only inconsistent with its basic role and its fiduciary duty to its client, but is unnecessarily duplicative of the responsibilities of an underwriter. This adds unnecessarily to the expense of an already complex process. A municipal advisor's duty of care must run to the issuer (and in this context may include advice such as urging retention of disclosure counsel if no reputable underwriter's counsel is involved or explanation of the issuer's disclosure duties), not to investors. The phrase "due diligence" in the context of the securities law is a term of art applicable solely to underwriters and not to issuers and their agents. Under the general fiduciary duty, the responsibility of a municipal advisor in connection with the disclosure process would include an explanation of the disclosure obligations of the issuer and/or obligated person, recommendations as to the structuring and contents of the disclosure document and the retention of experienced counsel to assist in the disclosure process.

Sincerely,

Lewis Young Robertson & Burningham, Inc.

Scott J. Robertson
Principal

507 S. Grand Ave.
Lansing, MI 48933
www.mibankers.com

517-485-3600
Fax 517-485-3672

By electronic delivery to CommentLetters@msrb.org

Ronald W. Smith
Corporate secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Subject: MSRB Notice 2011-14 – Draft MSRB Rule G-36 and Draft interpretative Notice

Dear Mr. Smith:

On behalf of the Michigan banking industry, I appreciate the opportunity to comment on the MSRB Notice 2011-14 – Draft Rule G-36 and Draft Interpretative Notice regarding the fiduciary duty of municipal advisors. Section 975 of the Dodd-Frank Wall Street and Consumer Protection Act requires that municipal advisors register with both the Securities Exchange Commission and the Municipal Securities Rulemaking Board and imposes a fiduciary duty upon municipal advisors to their municipal clients.

The Michigan Bankers Association joins the American Bankers Association in urging the MSRB to hold in abeyance its Draft Rule G-36 until the SEC finalizes its action on a permanent registration regimen for municipal advisors. We further join the ABA in encouraging the MSRB to coordinate its rulemaking with other federal agencies including the Commodity Futures Trading Commission, and the Department of Labor.

Like all banks across the nation, Michigan banks provide a wide array of routine products and services to local municipalities including deposit-taking, lending, and cash management, along with numerous other services, some of which may be managed by bank's trust department. Any number of these products and services might be deemed to constitute advice pursuant to Section 975.

Draft Rule G-36 could result in mandated registration for a large number of Michigan banks, not to mention thousands of other banks across the nation, with a subsequent exemption from registration following the SEC's determination.

It makes the most sense for the MSRB to have the benefit of the SEC's determination prior to implementing its own rules.

Additionally, other federal agencies are considering the imposition of a fiduciary standard on participants in the capital markets that may provide services to municipalities including the Commodity Futures trading Commission regarding swap activities and the Department of Labor regarding ERISA activities. We strongly encourage agencies coordinate their regulatory authority to ensure consistent regulations that do not work at cross purposes.

Further, many banks provide services to municipalities through the bank's trust department. Fiduciary activities provided by bank trust departments to municipalities are already subject to extremely thorough regulation by state and federal bank regulatory agencies. Yet another layer of regulation serves no meaningful purpose.

For these reasons and others, we strongly urge the MSRB hold in abeyance its Draft Rule G-36 until the SEC issues its determinations under Dodd-Frank and we urge the MSRB to coordinate its rulemaking with that of other federal agencies.

On behalf of the banking industry in Michigan, I thank you for your consideration of these comments.

Respectfully submitted,

Richard D. Lavolette
General Counsel

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com

6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

April 11, 2011

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Sent via email to CommentLetters@msrb.org

Re: MSRB Notice No. 2011-12: 2011-13; 2011-14

Dear Mr. Smith:

Thank you for the opportunity to comment on the various matters included within the Requests for Comment on MSRB's Rules G-36 and G-17. Municipal Regulatory Consulting LLC is a professional consulting firm serving the municipal securities industry. In providing regulatory advice to municipal advisors and broker-dealers, I am sometimes called upon to interpret rules of the MSRB and other agencies or SROs. More to the point, my clients often seek advice how to apply those rules in the context of their business.

If anything is clear at this point in the rulemaking process spurred by the Dodd-Frank Act, it is that nothing is clear. Virtually all the rules and guidance proposed by the MSRB in 2011 come with the following explicit or implicit caveat: "Until the SEC settles on a definition that everyone can understand, even we (the MSRB) aren't certain what specific activities qualify as municipal advisory activities, nor do we know for certain when they begin. If we don't know which activities are advisory, we also don't know exactly who the advisors are. But we've been told we have to propose rules, so here they are." Market participants may have sympathy for the position in which the MSRB finds itself, but they have to react to what has been proposed, and many wonder given the circumstances why the MSRB has not chosen to be more circumspect.

I believe the proposals as written do not resolve but exacerbate confusion among market participants, including issuers, and create potential compliance nightmares. The MSRB would do the municipal securities community – including the issuers it is now mandated to protect – a great service if it scales back its proposals, moderates some of its positions and clarifies others.

1. The MSRB Should Do No More than Establish Guiding Principles

The MSRB does well by taking a minimalist approach to Rule G-36. "In the conduct of its municipal advisory activities on behalf of municipal entities, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care." It is obviously modeled after Rule G-17, which reads, "In the conduct of its municipal securities or municipal

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com
6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

Unfortunately, the MSRB goes too far and too deep in its efforts to address as many different aspects of the duties of loyalty, care and fair dealing as it can. The goal at this stage in the regulatory cycle, with certain market participants subject to rules and regulations for the first time, should be to promulgate rules everyone can understand and with which they can readily comply. Now is a time for establishing guiding principles. There will be plenty of time later for crawling in the weeds.

For example, the MSRB appropriately addresses the duty of loyalties and care by stating its view of the general principles underlying each. The duty of loyalty "requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor." The duty of care requires a municipal advisor to "exercise due care in performing its responsibilities."

The MSRB also does the regulated community a service by aggregating in a series of footnotes a variety of cases in which individuals or firms were found to have violated their fiduciary duty or fair dealing obligations under federal and state law and/or securities regulation. It would be reasonable for the MSRB to state that the activities with which the defendants in those cases were charged would violate Rule G-36 and/or Rule G-17. At least for now, however, the MSRB should stop there.[1]

2. If the MSRB Wishes to Regulate Specific Market Activities, It Should Do So In Rules Designed Specifically to Address that Activity

a. Issues Relating to Advisory Contracts Should Be Addressed in Rule G-23

In my view, the MSRB unreasonably intrudes on the commercial relationship between issuers and advisors when it specifies exactly who needs to say what to whom and when. The error is compounded because the MSRB fails to allow for variance when the facts and circumstances suggest that another approach would better accomplish the stated goals. Indeed, the MSRB's rigid requirements might even have the (presumably) unintended consequences of confusing issuers and creating an unlevel playing field between advisors and underwriters.

[1] An argument can be made that going one step further, *i.e.,* stating as a general proposition that material conflicts of interest should be disclosed, would not be one step too far, but stepping on that slippery slope led to the MSRB sliding all the way down the hill. Micromanaging the disclosure requirements – especially the ones relating to compensation - as the MSRB does would be difficult to justify even after time has passed; at this stage of the process, it makes no sense at all.

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com

6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

For many years, the MSRB had a straightforward approach to when and under what circumstances a financial advisory relationship existed between an issuer and a dealer firm. In Rule G-23, it said

> (b) *Financial Advisory Relationship.* For purposes of this rule, a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services. Notwithstanding the foregoing, 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 renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities.
> (c) *Basis of Compensation*. Each financial advisory relationship shall be evidenced by a writing entered into prior to, upon or promptly after the inception of the financial advisory relationship (or promptly after the creation or selection of the issuer if the issuer does not exist or has not been determined at the time the relationship commences). Such writing shall set forth the basis of compensation for the financial advisory services to be rendered, including provisions relating to the deposit of funds with or the utilization of fiduciary or agency services offered by such broker, dealer, or municipal securities dealer or by a person controlling, controlled by, or under common control with such broker, dealer, or municipal securities dealer in connection with the rendering of such financial advisory services.

For some reason, the MSRB did not extend Rule G-23 to non-dealer municipal advisors and/or modify Rule G-23 to address what it views as shortcomings in the contents of advisory contracts. Instead, the MSRB chose to make the content and context of written disclosures a subject of interpretive guidance under the rubric of fiduciary duty and fair dealing. If the MSRB feels so strongly that it needs to specify what goes in contracts, I submit that it should do so by rule and not by interpretation, and subject that proposal to the usual scrutiny and process that apply to rule changes.

b. Issues Relating to Appropriateness or Suitability Should Be Addressed in Rule G-19

The MSRB also has a rule that relates to the obligations of dealers when they recommend transactions to customers. The rule even distinguishes among (i) institutional accounts and non-institutional accounts and (ii) discretionary accounts[2] and non-discretionary accounts. Rule

[2] It is generally accepted that firms have a fiduciary duty with respect to discretionary accounts, though the term fiduciary does not appear anywhere in Rule G-19.

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com
6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

G-19 imposes obligations on dealers to obtain certain information about its customers and about the products it offers before making any recommendations to customers.

As was the case with contracts, for some reason the MSRB chose not to address recommendations to municipal entity or obligated person clients by amending Rule G-19. Instead, the MSRB proposes to address these issues by issuing interpretive guidance under Rules G-36 and G-17. What is worse, it uses language utterly foreign to municipal regulation. Thus, depending on the circumstances and whether the client is a municipal entity or an obligated person, an advisor might have one or more of the following duties:

- To investigate and advise the municipal entity of alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity.
- To make a reasonable inquiry as to the facts that are relevant to a municipal entity's determination of whether to proceed with a course of action.
- To act competently and provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to the financings or products proposed that might better serve the interests of its municipal entity client.
- To recommend a transaction or product only if it has concluded, in its professional judgment, that the transaction or product is appropriate for the client, given its financial circumstances, objectives, and market conditions, and advise the client of material risks and characteristics of the structure or product.

If the MSRB believes that municipal advisors have an obligation to municipal entity and obligated person clients to "know their customer," and to have a "reasonable basis" for recommending transactions, products or courses of action, the MSRB should abandon the multiple and confusing formulations quoted above.[3] The MSRB should simply say what it means in Rule G-19 and it should use terminology the industry already understands.[4]

3. The MSRB Should Abandon Appendix A Altogether

Even if the MSRB accepts my suggestion and chooses to address advisor compensation directly in Rule G-23 instead of in interpretive guidance under fiduciary duty or fair dealing, it should get rid of its inappropriate and ill-conceived attempt to demonstrate that all compensation

[3] The same principle applies to the MSRB's disclosure requirements in the context of "complex municipal securities financings," although it does not appear that the MSRB has imposed upon underwriters any suitability or appropriateness obligations when recommending any financing, complex or otherwise. Whatever the requirements, they should be set forth in Rule G-19.

[4] Among the advantages of using Rule G-19 is that there is a wealth of existing interpretive guidance relating to the concept of suitability and what is required to have a reasonable basis for making a recommendation.

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com
6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

creates conflicts between advisors and issuers. The MSRB does indeed have a mandate to protect issuers, but it seems to me that there are many more important things to worry about than whether an advisor being paid by the hour is padding her bill. And there are better ways to do it than requiring a senior issuer official to attest in writing that he understands this "conflict" and is OK with going ahead anyway.

Conclusion

Writing guidance to establish the parameters of fiduciary duty and fair dealing is not easy. The MSRB should not make the task more difficult than it is by trying to fit so many things into boxes not designed to hold them. Instead, it should concentrate on establishing guiding principles and use the existing regulatory structure where possible to address specific concerns.

Very truly yours,

David Levy, Principal

cc: Martha Haines, SEC

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

April 11, 2011

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Re: MSRB Notice No. 2011-14; No. 2011-13

Dear Mr. Smith:

The National Association of Independent Public Financial Advisors ("NAIPFA") appreciates this opportunity to provide comments to the Municipal Securities Rulemaking Board ("MSRB") on proposed Rule G-36 and related interpretations (the "G-36 Notice") as well as the MSRB's proposed interpretation of Rule G-17 as it would apply to municipal advisors (the "MA Guidance"). NAIPFA addresses the MSRB's proposed interpretation of Rule G-17 as it would apply to underwriters (the "UW Guidance") in a separate letter also filed today.

NAIPFA, founded 21 years ago, is a professional organization composed of independent public finance advisory firms located across the nation. Our member firms solely and actively represent the interests of issuers of municipal securities.

PRELIMINARY STATEMENT:

Congress delegated to the SEC and the MSRB the responsibility to protect the interests of issuers, investors, and the public trust. NAIPFA believes these proposals must be read in light of and together with the various other proposals made by the SEC and the MSRB to meet that responsibility. In prior comment letters addressing (i) the registration of municipal advisors proposed by the SEC and (ii) Rule G-23 and related guidance proposed by the MSRB, NAIPFA has expressed concern that the proposals fail to recognize the realities of the marketplace and the lessons of the past. NAIPFA believes the rules proposed would impose significant regulatory burdens on firms that did not contribute in any meaningful way to the financial crisis or cause harm to issuers. At the same time, firms that directly caused or contributed significantly to the crisis will be largely free to continue the practices that led many issuers to enter into transactions that were not in their best interests but were very lucrative for the firms that recommended them.

Finally, NAIPFA is very concerned that the scope and tenor of MSRB proposed rules relating to municipal advisors reflects the desire of the MSRB's primary constituency, investment banks and

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

broker-dealers, to limit the participation and influence of municipal advisors. Independent financial advisors recognize that many broker-dealers consider financial advisors to be a nuisance to the conduct of their business and regularly seek to exclude financial advisors from public finance transactions. The MSRB's proposed rules reflect this perspective by imposing relatively heavier burdens on municipal advisors than on broker-dealers.

The proposals and guidance we address in this comment letter suffer from the same flaws. They do not implement Congressional intent. They inappropriately and unnecessarily intrude on the relationship between advisors and their clients. And, most unconscionably, they fail to constrain the broker-dealers and investment banks. In short, the MSRB has placed shackles on the shepherds and told the wolves they should be nice to the sheep.

The Congressional Mandate:

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. Law No. 111-203) ("Dodd-Frank Act") amended Section 15B(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act") to provide that municipal advisors have a fiduciary duty to their municipal entity clients. Section 15B(b)(2)(L)(i) of the Exchange Act directs the MSRB to establish rules with respect to municipal advisors that "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."

Securities and Exchange Commission Release Number 34-63576; File S7-45-10 states Section 15B(e)(4)(A) of the Exchange Act, as amended by the Dodd-Frank Act, defines the term Municipal Advisor to mean a person (who is not a municipal entity or employee of a municipal entity) (i) 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, or other similar matters concerning such financial products or issues, or (ii) that undertakes a solicitation of a municipal entity. The Release further states the definition of a Municipal Advisor explicitly excludes "a broker, dealer, or municipal securities dealer serving as an underwriter," as well as attorneys offering legal advice or providing services that are of a traditional legal nature and engineers providing engineering advice.

The Dodd-Frank Act defined municipal advisor activities to mean advising issuers and borrowers with respect to the structure, timing, terms, and similar matters concerning a municipal bond issue and defined underwriting activities to be purchasing and distributing securities. At this point the law and historical and legal distinction between advisory activities and underwriting activities are in accord. Advisors sit on the same side of the table as the issuer with all of the legal responsibilities that go

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

along with being an advisor and underwriters sit on the opposite side of the table negotiating an arm's length transaction to purchase bonds.

The Dodd-Frank Act expanded the responsibilities of the MSRB to include the protection of municipal entities. It also required the MSRB to change the composition of its Board to one that is composed of a majority of members not affiliated with regulated entities. Accordingly, the MSRB amended its stated mission to include protection of the interests of issuers, as well as the interests of investors and the public trust. It also brought on new Board members.

The mission of the MSRB implies the duty of a fiduciary to the interests it protects. Changing the composition of the MSRB Board gave hope to issuers and independent advisors that the rules the MSRB promulgates would be less biased in favor of investment banks and broker dealers. Those hopes were dashed on February 9, 2011 when the MSRB filed with the SEC a proposed amendment to MSRB Rule G-23 and related interpretative guidance. That proposal would undermine the rule of law and subject municipal issuers to the same types of conflicts of interest the Dodd-Frank Act was enacted to prevent.

NAIPFA addressed the concerns of the organization regarding proposed Rule G-23 and interpretative guidance in its letter to the SEC dated March 11, 2011, a copy of which is attached to this correspondence. We reiterate those concerns. Furthermore, NAIPFA believes any rules regarding fair dealing, conflicts of interest, and fiduciary duty, or others for that matter, should:

1. Protect the interests of issuers, investors, and the public trust;
2. Avoid inconsistencies that place public interests at risk;
3. Be clear and easily understood by the parties that have to follow them;
4. Minimize the potential for public confusion regarding the law; and
5. Safeguard against the potential for firms to avoid the intent of the Dodd-Frank Act.

NAIPFA believes that the rules and guidance proposed by the MSRB thus far would, taken together, create a body of law which falls far short of providing the protections intended by the Dodd-Frank Act, places issuers, investors, and the public trust at risk to the types of actions the law intended to eliminate, and subjects issuers and the public to confusion and machinations of firms desiring to subvert the law.

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

COMMENT:

A. Proposed Rule G-36

NAIPFA supports the proposed rule, as written. However, in view of the dynamic nature of the rulemaking process, and the fact that so much of what is being proposed is subject to the SEC's ultimate definition of "municipal advisory activity," NAIPFA expressly requests that the MSRB provide further opportunities to comment as the SEC's position crystallizes and the implications of that position become more clear.

B. The G-36 Notice and the MA Guidance

1. NAIPFA Seeks Clarification of the Relationship Between Rule G-36 and Rule G-17

The MSRB states in the G-36 Notice that advisors have both a fiduciary duty under G-36 and a responsibility under Rule G-17 to deal fairly with municipal entity clients. The MSRB goes on to note that "this Rule G-17 duty of fair dealing is subsumed within the municipal advisor's fiduciary duty, and a violation of Rule G-17 with respect to a municipal entity client would necessarily be a violation of Rule G-36." NAIPFA notes that the MSRB addresses certain matters in the MA Guidance that are not addressed, or are addressed differently, in the G-36 Notice.[1] NAIPFA notes further that the MA Guidance is, by its terms, applicable to the interactions between advisors and obligated persons. It is unclear, therefore, if the MSRB intended the obligations and/or duties of advisors to obligated persons also to be applicable to municipal entities. Accordingly, NAIPFA requests that the MSRB clarify its intent.

2. NAIPFA Objects to the MSRB's Compensation Disclosure Requirements

There is perhaps no greater example of the MSRB's misplaced zeal to "protect" issuers than its requirement that advisors warn issuers that each and every payment arrangement they enter into with an advisor is fraught with conflicts. The MSRB stated the eminently reasonable proposition that the duty of loyalty owed by an advisor to its municipal entity client "requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best

[1] For example, the MSRB in the MA Guidance cautions advisors that responses to RFPs "must fairly and accurately describe the municipal advisor's capacity, resources, and knowledge to perform the proposed municipal advisory engagement as of the time the proposal is submitted." It cites this as an example of the G-17 duty not to misrepresent or omit material facts in any representation made to an obligated person client. This example is not included in the G-36 Notice.

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

interests without regard to financial or other interests of the municipal advisor." Had it stopped there, NAIPFA would happily have supported the principle.

However, the MSRB then goes on to state that "a municipal advisor must disclose all material conflicts of interest, such as those that might impair its ability to satisfy the duty of loyalty to its municipal entity client." The MSRB lists five particular "examples of the types of conflicts that must be disclosed by the municipal advisor:"

(i) Payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business;
(ii) Payments from third parties to the municipal advisor;
(iii) Payments from third parties to enlist the municipal advisor's recommendation of their services to the municipal entity;
(iv) whether the municipal advisor or an affiliate of the municipal advisor is acting as a principal in matters concerning the municipal advisory engagement; and
(v) form of compensation.

For each of the first four of these examples, the MSRB cites in footnotes various cases in which firms – virtually all of which were multi-service financial institutions – were found to have acted inappropriately and in violation of applicable federal or state law. The only category for which the MSRB did ***not*** cite an example of misconduct was with regard to the form of compensation. That is not surprising, as NAIPFA is aware of no instance in which an independent financial advisor was found to have acted to the detriment of an issuer in order to maximize its compensation under any standard compensation arrangement.

The MSRB's position is that a material conflict exists in fact through virtually any compensation arrangement. This ignores the reality that the conflict ***only*** exists if the municipal advisor is violating its fiduciary duty. Indeed, the MSRB apparently believes that even the most basic forms of compensation, *e.g.*, being paid by the hour, pose a threat to issuers. The MSRB could have highlighted the issue, warned advisors to take care not to allow any compensation arrangement to influence their recommendations to municipal entity clients, and moved on. But that was apparently not sufficient. Instead, the MSRB proposes that advisors be required to disclose these conflicts to issuers. But advisors apparently can't be trusted to do that properly either, so the MSRB wrote the disclosure for them![2] It took the form of a document entitled *Disclosure of Conflicts of Interest With*

[2] Compare the MSRB's approach with to rules put forth by the American Bar Association ("ABA") that deal with the ethical conduct of lawyers, a group of individuals who, like municipal advisors, have fiduciary duties to their clients. Rule 1.5 of the ABA Model Rules of Professional Conduct specifically addresses fees. In particular, Rule 1.5 addresses (i) unreasonable or excessive fees and provides factors for determining reasonableness, (ii) an attorney's ability to limit the scope of his representation, and (iii) contingent fees. At no point in either the rule

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

Various Forms of Compensation (referred to in the G-36 Notice and this comment letter as "Appendix A"). [3]

Appendix A clearly and concisely states that every form of compensation paid by a municipal entity client to a municipal advisor creates a conflict of interest. Fixed fees, hourly fees, fees contingent on completion of a financing and fees based upon amount financed are all identified by the MSRB as problematic in their own way. It is functionally equivalent to saying "The Surgeon General has determined that using a financial advisor may be hazardous to your health." Thus, whether intended or not, the effect of providing the disclosure in the form "suggested" by the MSRB may well be to make issuers wary of financial advisors, when in fact their interests are most likely to be better served by retaining financial advisors.

The absurdity of the MSRB's approach is highlighted by – and its continued bias towards firms that underwrite bonds is evidenced by – the fact that those parties with whom the issuers deal that have real and actual (as opposed to potential) conflicts not only don't have an Appendix A of their own, but are for all intents and purposes absolved of even the need to disclose the conflicts they have. Burdensome disclosure duties are imposed upon municipal advisors who are accountable for the advice and services provided to municipal entities regarding the structure, terms, timing and other similar matters regarding the issuance of municipal securities. No similar disclosure requirements are placed on dealers serving as underwriters even though they are not accountable for the services they provide with regard to the structure, terms, timing and other similar matters regarding the issuance of municipal securities.

This is important to consider when viewed in conjunction with proposed Rule G-23, which proposes that underwriters are allowed to provide "advice" without having to comply with a fiduciary duty. The result is that an underwriter, who has an inherent conflict of interest by virtue of its role as purchaser and distributor of securities in an arm's length commercial transaction with a municipal entity, does not have to disclose that its compensation creates a conflict of interest. What is more, although municipal advisors are required to disclose matters, in writing, that do not in and of themselves create conflicts of interest, such as compensation, underwriters are not required to disclose anything in writing, even the inherent conflict of interest that exists when an underwriter

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itself or in the interpretive guidance is it required that an attorney disclose that his fee, even if contingent, may create a conflict of interest.

[3] NAIPFA appreciates that the MSRB is not directly mandating use of Appendix A, but it surely realizes – and we believe fully intends – that few firms would choose not to use it.

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

provides advice to a municipal entity regarding the structure, terms, timing and similar matters with regard to the issuance of municipal securities.

NAIPFA believes that this double-standard is unacceptable. The MSRB's regulatory framework can be summarized as follows: If an individual **can** be held accountable for the services it provides regarding the structure, timing, terms and other similar matters regarding the issuance of municipal securities, the individual **must disclose**, in writing, certain matters that do **not** in and of themselves create conflicts of interest, such as the form of compensation. However, if the individual **cannot** be held accountable for the services it provides to municipal entities, the individual **may** have to make disclosures, such as those found in G-23, but these disclosures are **never** required to be in writing, even if the matter does create a material conflict of interest, such as where the underwriter is simultaneously serving as financial advisor on one transaction with an issuer and as underwriter on a different transaction with that same issuer.

Although such a regulatory framework may have been acceptable pre-Dodd-Frank, the MSRB's new mandate requires it to protect the interest of municipal entities. Therefore, the test for proposed Rule G-36, and others, is whether the rule adequately protects the interest of municipal entities. Proposed Rule G-36 as interpreted by the MSRB fails to meet this test and therefore the guidance must be amended.

The Rule, when viewed within the broader regulatory framework put forth since the enactment of Dodd-Frank, leads to the conclusion that municipal entities will be unaware as to who is protecting their interest. Based on the disclosure requirements of proposed Rule G-36 and proposed Rule G-23, will municipal entities understand that municipal advisors, who have to disclose conflicts of interest, in writing, act in their best interest, or will municipal officials believe that underwriters, who do not have to disclose anything in writing, are acting in their best interest? NAIPFA believes that the latter is more likely to occur. Rather than placing strong disclosure requirements on unaccountable underwriters, the MSRB has instead placed these requirements on municipal advisors. Doing so gives the impression that municipal advisors, not underwriters, possess the conflicts of interest. This is inconsistent with reality.

NAIPFA respectfully suggests that the G-36 Notice (and the MA Guidance) be amended to no longer require disclosures regarding "conflicts with various forms of compensation" and that Appendix A be eliminated in its entirety. Alternatively, if the MSRB determines that disclosures regarding compensation are required, NAIPFA strongly suggests that, because these disclosures are equally, if

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

not more applicable to dealers serving as underwriters, similar disclosures should be required of them.[4]

At first blush, one might be tempted to argue that underwriters are not fiduciaries, and without the duty of loyalty there is no basis to compel underwriters to disclose their conflicts or their compensation. However, the MSRB in its MA Guidance imposes on municipal advisors the same duty to disclose compensation to obligated person clients under Rule G-17 as it does under G-36. It seems that fair dealing means one thing if you are a municipal advisor and something else entirely if you are an underwriter.

3. If Compensation Disclosure is Required, NAIPFA Suggests a Better Way to Do It

As noted above, NAIPFA asserts that the Appendix A requirement is unnecessary because the advisor's fiduciary duty will require that it not put its own financial interests before its client. Furthermore, the MSRB's requirement will confuse issuers because it addresses a problem that doesn't exist and inappropriately intrudes on the relationship between the advisor and its potential client. Leaving the wisdom of the requirement aside, the logistical issues raised by the disclosure proposal are themselves significant.

The MSRB would require that the disclosure be made

(i) In writing;
(ii) To officials of the municipal entity (or obligated person) with the authority to bind the municipal entity (or obligated person) by contract; and
(iii) receive written consent back;
(iv) before the municipal advisor may provide municipal advisory services.

The MSRB apparently assumes that all municipal advisory activity is undertaken only at such time as an issuer formally retains a municipal advisor to perform an agreed upon set of tasks. However, if the SEC's proposal on permanent registration is adopted, a variety of activities that typically occur prior to being retained would qualify as municipal advisory activities. Indeed, one could be deemed an advisor without ever being retained or compensated or ever having even discussed compensation.

For example, it may well be that any one of the following qualifies as municipal advisory activity:

- Meeting the executive director of a non-profit hospital at a conference and discussing with her how they plan to finance a new wing on the hospital;

[4] See NAIPFA's Comment Letter dated March 11, 2011 related to the Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities, submitted together with this Comment Letter.

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
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- Sending to an issuer official on an unsolicited basis a financing idea for a convention center the city is considering; or
- Responding to an RFP seeking a municipal advisor where the RFP identifies the project(s) to be financed and seeks ideas.

In which of these scenaria would it be remotely practical or even possible to have not only provided Appendix A but have received written consent to the "conflicts" back from the potential client? Obviously, the answer is none of them.

Perhaps the more appropriate way to think about this is that there can be no conflict between an advisor and its client relating to compensation before the advisor is retained for compensation. Indeed, some advisors may offer certain services absolutely free of charge and there can be no compensation-related conflict when there is no compensation. NAIPFA is prepared to accept that a fiduciary duty may attach to those services, but there is no possible benefit to be gained from - or protection afforded to an issuer by - providing Appendix A to the "client" in this circumstance.

NAIPFA also takes issue with the MSRB's overly restrictive definition of which individual(s) at the municipal entity or obligated person is required to receive and acknowledge the compensation disclosure. How is the advisor to know if the individual qualifies? What diligence is required to find out? What happens if it turns out the advisor gets it wrong?

NAIPFA believes a rational alternative to the disclosure requirement proposed by the MSRB would involve disclosure (i) of the conflicts that are actually applicable to a compensation methodology being proposed by a municipal advisor to a municipal entity client (ii) made at the time the compensation methodology is being proposed (iii) to the representative of the municipal entity designated by the municipal entity as the primary contact for the engagement.

This regime would make disclosure more meaningful, because it would relate to what is actually being proposed, when it is being proposed and to whom it is being proposed. Issuers would be free to solicit ideas from advisors and advisors would be free to offer ideas to potential clients. Only at such time as the parties actually consider engagement, and the terms of that engagement are being discussed would the disclosures need to be made, and no disclosure would be made when there is no compensation. Additionally, advisors would be permitted to rely on the apparent authority of an issuer representative when making the disclosure, provided the advisor has no reason to believe the individual with whom it is dealing lacks the requisite authority. Finally, the advisor may presume that consent to the compensation arrangement is granted if it either (a) receives an executed contract (or similar document) or a verbal acknowledgment that the terms of a written engagement letter (or similar document) have been accepted; or (b) receives written or verbal acknowledgment that it has been selected following an RFP process in which the form of compensation was disclosed and the applicable disclosure provided.

4. *The MSRB Should Clarify What it Means By Excessive Compensation*

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P.O. Box 304
Montgomery, Illinois 60538.0304
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The MSRB states that excessive compensation violates both the duty of loyalty under G-36 and G-17's requirement to deal fairly. What the MSRB does not do is provide any guidance as to how a municipal advisor is to determine at what point compensation becomes excessive. The MSRB should provide that guidance. NAIPFA suggests that the following (or similar) criteria or considerations would be appropriate in making a determination about the reasonableness of compensation:

a. the time and labor required, the novelty and difficulty of the issue involved, and the skill requisite to perform the municipal advisory services properly;
b. the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the municipal advisory; (i.e., if you take job A, does it limit your ability to obtain job B; if so, your fee can reflect that reality);
c. the fee customarily charged in the locality for similar municipal advisory services;
d. the amount involved and the results obtained;
e. the time limitations imposed by the client or by the circumstances;
f. the nature and length of the professional relationship with the client;
g. the experience, reputation, and ability of the municipal advisor or municipal advisors performing the services; and
h. whether the fee is fixed or contingent.

5. *NAIPFA Objects to the Presumption that Only Services Specifically Disclaimed Are Outside the Scope of Services Subject to a Fiduciary Duty*

The MSRB recognizes that not all advisory engagements are alike and that some are limited by the express wishes of the client. Nevertheless, the MSRB implies that only those services that an advisor specifically states in writing it is not performing or for which it is not responsible are exempt from the fiduciary duty. As noted above, there are any number of situations in which a municipal advisor may be providing municipal advisory services either without compensation or prior to being formally engaged. Indeed, the potential client may never actually engage this advisor or any advisor with regard to the matter or project that was the subject of discussion between the potential client and the advisor. In such instances, it would be obviously unreasonable for the advisor to be deemed to have had a fiduciary duty that extended beyond the limited boundaries of what the parties discussed. Accordingly, the MSRB should withdraw or clarify its statement that, unless the duty has been "expressly disclaimed . . . a municipal advisor has a duty to investigate and advise the municipal entity of alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity."

NAIPFA believes the presumption should be reversed, particularly in cases in which there is a writing that describes the services being performed. The issuer has no reason to assume that services will be performed by an advisor that are not specified in a writing when that document purports to set forth

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Montgomery, Illinois 60538.0304
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the services being requested or provided. At the very least, a municipal advisor should be permitted to make a blanket statement such as "only those services specifically set forth herein are within the scope of this engagement" without having to enumerate – even if it could identify - every other possible service that it is not performing.

6. *The MSRB Should Clarify the Various Due Diligence Requirements Set Forth Under Both the Fiduciary Duty of Care and the Fair Dealing Rule*

The MSRB states in various places and using different language several requirements that can be described as due diligence obligations. One, noted above, is the fiduciary "duty to investigate and advise the municipal entity of alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity." Another is the fiduciary duty to "make a reasonable inquiry as to the facts that are relevant to a municipal entity's determination of whether to proceed with a course of action." In a section titled *Advisor Not a Guarantor*, the MSRB states that the fiduciary duty of care "requires only that the advisor act competently and provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to the financings or products proposed that might better serve the interests of its municipal client." And the fair dealing rules require that an advisor recommend a transaction or product to an obligated person client only if it has "concluded, in its professional judgment, that the transaction or product is appropriate for the client, given its financial circumstances, objectives, and market conditions, and must advise the client of material risks and characteristics of the structure or product."

NAIPFA believes these different formulations are unnecessarily obtuse. If, as we believe, the purpose of the guidance is to establish the general principle that an advisor must have a reasonable basis for recommending a course of action, whether because it has a fiduciary duty or under the rubric of fair dealing, the MSRB should simply say so. Similarly, if the MSRB believes that an advisor can only have a reasonable basis if it has obtained certain essential facts about the client and its objectives, it should say that, too. And, finally, if the MSRB believes that any recommendation of a course of action should include a description of the risks of that course of action, it should be equally clear about that.

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CONCLUSION:

NAIPFA believes the MSRB's entire approach to its new mission to protect issuers is wrong as a matter of law. It simply does not further and in some cases runs counter to the express provisions of the Dodd-Frank Act. The approach is also misguided because it focuses less on real-world problems than on those that the MSRB imagines issuers care about. By seeking to impose significant disclosure and other requirements on independent advisors while conspicuously exempting underwriters from similar requirements, the MSRB creates the patently false impression that independent advisors pose a greater threat to an issuer's health than underwriters do. For the reasons stated above and in NAIPFA's prior comment letters, we respectfully request that the MSRB re-think these and other rule proposals and develop a comprehensive regime that fulfills its mission.

Sincerely,

Colette J. Irwin-Knott, CIPFA
President, National Association of Independent Public Finance Advisors

cc: The Honorable Mary L. Schapiro, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Michael Coe, Counsel to Commissioner Aguilar
Martha Haines, Assistant Director and Chief, Office of Municipal Securities
Lynnette Hotchkiss, Executive Director, Municipal Securities Rulemaking Board

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

March 21, 2011

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

Re: File Number SR-MSRB-2011-03

Dear Ms. Murphy:

The National Association of Independent Public Finance Advisors ("NAIPFA") appreciates this opportunity to provide comments to the Securities and Exchange Commission ("SEC") on proposed Rule G-23 and the accompanying interpretive notice submitted for consideration by the Municipal Securities Rulemaking Board ("MSRB").

NAIPFA, founded 21 years ago, is a professional organization of independent public finance advisory firms that provide public finance advice to municipal and non-profit entities. NAIPFA comprises thirty two member firms serving all fifty states from locations in twenty–six states. Independent public finance advisors offer a wide variety of consulting services to issuers and obligated persons. In 2009, NAIPFA members represented clients on over 2,800 separate bond issues with approximately $75 billion in proceeds.

Preliminary Statement

Since its adoption in 1977, MSRB Rule G-23 has been the subject of much discussion within the industry and in the financial press. The Rule has been modified - or ***not*** modified - several times. The concerns raised primarily related to the conflicts of interest inherent in permitting broker-dealers to serve as financial advisors then later resign to become the underwriter of the issue they helped structure. It is problematic because the firm in its role as advisor sets out to and does, in fact, gain the trust and confidence of its client. When a broker-dealer advisor suddenly resigns and shifts its role to that of an underwriter, the firm's interests are then at odds with its former municipal entity client (the issuer), because it is negotiating to purchase the bonds with a goal to resell them to investors for a profit.

On several occasions, NAIPFA has asked the MSRB to consider whether it was appropriate for a broker-dealer to provide the kind of advice that financial advisors typically provide, *i.e.*, advice with regard to the structure, timing and similar matters related to a financing, and then switch roles.[1] Among the concerns raised were that broker-dealer firms were developing relationships of trust and confidence through their actions and statements, but disclaimed legal responsibility when their municipal clients sought under local law to hold them to the fiduciary standards that others who provided similar advice were held.

In 2010, having seen that numerous municipalities suffered significant losses in connection with sometimes extremely complex financial transactions promoted by underwriters or underwriters acting as financial advisors, Congress determined that some issuers were not sophisticated enough to make

[1] See, *e.g.*, letters from NAIPFA dated October 28, 2005 and May 18, 2007, copies of which are attached.

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
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informed financial decisions or were taken advantage of by unscrupulous market participants. Through passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), and particularly Section 975 thereof, Congress created a new class of regulated entity – the municipal advisor – and directed the SEC and the MSRB, among others, to adopt rules to protect issuers and obligated persons. Understanding Congressional concerns and SEC initiatives, the MSRB in August 2010 proposed for comment changes to its Rule G-23. It received 73 comments, including a letter from NAIPFA supporting changes to the Rule.[2] In its current filing with the SEC, the MSRB proposes to modify Rule G-23 (the "Proposed Rule") and also to issue interpretive guidance (the "Guidance").

NAIPFA commends the MSRB for revisiting this issue. The proposed Rule takes some steps in eliminating conduct that NAIPFA and others have long recognized puts issuers and the public at risk. NAIPFA supports those changes that prohibit firms from acting as advisors and then switching roles. NAIPFA agrees with the following MSRB responses set forth in SEC Exchange Act Release No. 34-63946:

- The MSRB does not believe the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act;
- The MSRB believes current Rule G-23 permits inherent conflicts of interest, which are not cured by disclosure and waiver provisions of the Rule;
- The MSRB 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 issuer;
- The MSRB does not believe that exceptions should be provided for smaller offerings;
- The MSRB does not believe the use of electronic bidding platforms mitigates the conflict of interest posed by a dealer financial advisor's switching to an underwriter role;
- The MSRB does not believe requiring advance notice of competitive sale would provide adequate protections against conflicts of interest;
- The MSRB agrees that the role and interests of the dealer financial advisor are "significantly different" from the role and interests of a dealer acting as the underwriter for the same governmental unit; and
- The MSRB agrees that the issuer does not fully understand the implications of the ending of the financial advisory relationship with the issuer (which ends the dealer's fiduciary obligation to the issuer) and the arm's length relationship that is necessary due to the dealer's financial advisor becoming the underwriter of the transaction.

Unfortunately, notwithstanding clear direction from Congress, the MSRB failed to recognize the important distinction between providing advice and acting as an underwriter. Accordingly, NAIPFA objects to the Proposed Rule and Guidance to the extent it exempts from the definition of a municipal advisor all 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." Underwriters would still be able to provide the same advice as a municipal advisor without a fiduciary duty to the issuer.

As NAIPFA understands the purpose of Dodd-Frank, advice is only to be rendered to issuers by licensed municipal advisor professionals, registered with the Commission, who have appropriate expertise. Congress intended that those providing advice with respect to the *issuance of municipal securities,*

[2] See Letter dated September 30, 2010, from Steven F. Apfelbacher (the "2010 Comment Letter"), a copy of which is attached.

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P.O. Box 304
Montgomery, Illinois 60538.0304
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including advice with respect to the structure, timing, terms, and other similar matters concerning such issues would be deemed fiduciaries with a duty to act in the best interests of the issuer client. This MSRB proposal is at variance with the purpose of the Act because the one party with potentially the most significant conflicts of interest - the underwriter – would still be permitted to give issuers advice with respect to the *issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such issues* without a corresponding fiduciary duty.

NAIPFA therefore reiterates its request set forth in the 2010 Comment Letter that the final sentence of section (b) of Rule G-23 be amended 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.*

In addition, the Guidance should make clear that the phrase "in the course of acting as an underwriter" means that the firm has either been retained by an issuer to purchase and distribute its securities, or is responding to requests for proposals or requests for qualifications from a potential issuer seeking an underwriter and has requested that such information be provided by the responding firms. In all other instances, providing "advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities" would constitute financial advisory activities for purposes of Rule G-23.

NAIPFA's suggested changes to proposed Rule G-23 are consistent with the law, and consistent with the views we expressed in our comment letter to the SEC relating to municipal advisor registration.[3] Should the SEC disagree with our views and construe the underwriter's exception under §15B(e)(4)(C) of the Exchange Act to permit underwriters to provide advice to municipal entities regarding the issuance of municipal securities without either having to register or act with a fiduciary duty, NAIPFA urges the SEC to compel the MSRB to include in either Rule G-23 or the Guidance:

- Underwriters must decide prior to communicating with an issuer whether the underwriter will offer its services as an advisor or underwriter. The underwriter should not be allowed to rebut the role of municipal advisor "if the dealer clearly identifies itself as an underwriter from the earliest stages of the relationship with the issuer with respect to that issue."

- Brokers, dealers and municipal securities dealers ("underwriters") providing advice to issuers must disclose in no uncertain terms – in a document similar to Appendix A proposed within the MSRB's Proposed Rule G-36 and Rule G-17 Guidance to Municipal Advisors - that they:

[3] See letter dated February 22, 2011 from Colette Irwin-Knott, a copy of which is attached.

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- Are not acting as advisors but as underwriters;
- Are not fiduciaries to the issuer but rather counterparties dealing at arm's length;
- Have conflicts with issuers because they represent the interests of the investors or other counterparties which may result in benefits to other transaction participants at direct cost to the issuer;
- Seek to maximize their profitability and such profitability may or may not be transparent or disclosed to the issuer; and
- Have no continuing obligation to the issuer following the closing of transactions.

NAIPFA further urges that the rule changes be effective immediately upon SEC approval and not in six months as proposed. Additionally, underwriters should be prohibited from serving as municipal advisor and underwriter for an issuer at the same time. Last, changes to Rule G-23 should be considered only after the market has absorbed all regulatory changes and regulators can review objective evidence to assess any impact due only to Rule G-23.

Discussion

1. **NAIPFA objects to the MSRB's expansive view of the advisory activities in which dealers can engage without being deemed financial advisors.**

Congress was very clear about the activities that it considers to be advisory in nature. These changes are to be made in the municipal market and not within other markets. A municipal advisor is a person

> *who 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 issues; or undertakes a solicitation of a municipal entity.*

Congress also drafted its legislation to specifically include certain market participants and exempt others, at least when they are acting in certain defined and limited capacities. Thus, in the Exchange Act, Congress states that a "broker, dealer or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933) is not a municipal advisor. Section 2(a)(11) provides that an "underwriter" is

> *any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.*

In short, Congress has clearly defined municipal advisory activities to mean advising issuers and borrowers with respect the structure, timing, terms and similar matters concerning a municipal bond issue. At the same time, it has defined underwriting activities to mean purchasing and distributing securities.

The distinction between advisory activities and underwriting activities has always had legal significance. Advisors sit on the same side of the table with the issuer, with all the legal responsibilities that go along with being an advisor, while the underwriter sits at arm's length on the other side of the table, negotiating

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the terms pursuant to which it will purchase the bonds with the end goal of making a profit when they are resold.[4] This distinction is further confirmed within the standard form of Bond Purchase Agreement developed by the industry. The purchase agreement makes it clear the underwriter is in an arm's length relationship with the underwriter.

The MSRB acknowledges the provisions in the law set forth above, but tries to draw lines that are inappropriate in concept and likely unworkable in practice. In the Guidance, the MSRB states 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." However, it goes on to say that the

> *presumption may be rebutted if the dealer clearly identifies itself as the underwriter from the earliest stages of its relationship with the issuer with respect to that issue. Thus, a dealer providing advice to the issuer with respect to the issuance of municipal securities (including the structure, timing and terms of the issue . . .) generally will not be viewed as a financial advisor for purposes of Rule G-23, if such advice is rendered in its capacity as underwriter for such issue. Thus, a dealer providing advice to an issuer with respect to the issuance of municipal securities (including the structure, timing and terms of the issue and other similar matters, such as the investment of bond proceeds, a municipal derivative, or other matters integrally related to the issue) generally will not be viewed as a financial advisor for purposes of Rule G-23, if such advice is rendered in its capacity as underwriter for such issue. Nevertheless, a dealer's subsequent course of conduct (e.g., representing to the issuer that it is acting only in the issuer's best interests, rather than as an arm's length counterparty, with respect to that issue) may cause the dealer to be considered a financial advisor with respect to such issue. In that case, the dealer will be precluded from underwriting that issue by Rule G-23(d).*

As a result of the way business is conducted today, the Guidance is unworkable in most situations. However, one plausible scenario in which the Guidance can work is a scenario in which the issuer has retained a financial advisor to represent its interests in connection with a contemplated financing. The advisor recommends and the issuer agrees that the best course of action is to pursue a negotiated financing. The issuer (with the assistance of the advisor) then conducts an RFP/RFQ process for the purpose of selecting the underwriter. The RFP solicits, among other things, ideas about the "structure, timing and other terms of the issue" being proposed. NAIPFA posits that providing information in that context should not cause the potential underwriter – whether it is ultimately selected or not – to be an advisor. Nor, after it is selected, should the underwriter be deemed an advisor for providing ideas about the "structure, timing and other terms of the issue." In this scenario, the issuer can readily distinguish between the roles of the advisor and the underwriter because it has engaged one of each. Where the Guidance becomes problematic is in the much more frequent scenario, the one where a potential issuer does not yet have – and may never have – an independent advisor working with it.

Issuers are routinely contacted by independent financial advisors, by firms that act only as underwriters and by firms that provide both advisory and underwriting services. Sometimes, but not always, the issuers have a prior relationship with a firm that has or is soliciting them for the purpose of obtaining their business. These contacts are often in writing but are just as likely to be oral. Topics addressed are likely to include the issuer's current financial situation and opportunities that may exist to accomplish one or more of what the firm knows or supposes to be the objectives of the issuer. The firm's communication

[4] For detailed discussions and analysis on this point, see, *e.g.,* submissions to the SEC relating to Exchange Act Release No. 34-63576 (File No. S7-45-10) from Robert Doty and Nathan R. Howard.

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P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
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with the issuer may well suggest that a particular transaction, described generally or in detail, might be advantageous to the issuer. In addition, the firm may offer to discuss the financial matters of a particular transaction more fully at a later time. Assuming that the communications described above – or an ensuing discussion – contains "advice with respect to the structure, timing, terms or other similar matters concerning the issuance of municipal securities," then, based on the Guidance as proposed, if the firm that contacted the issuer was a dealer, that firm would be presumed at that time to be a financial advisor unless it expressly identified that it was acting as an underwriter. However, the firm could *not* be acting as an underwriter at that time, because no such role would then exist.[5] **The only possible role that could exist at such a preliminary stage is that of advisor.**

In the normal course, the issuer may have discussions with several firms, some of which may be independent financial advisors who only provide financial advice and others may be dealers who sometimes serve as financial advisors and sometimes as underwriters. At the time these conversations are taking place, the issuer may not have even decided whether to pursue a transaction, let alone made any of the decisions about whether it will pursue a private loan or similar financing, a private placement or a public offering of bonds and, if the latter, whether the offering will be a competitive or negotiated bond sale. How is the dealer firm to indicate what role it is playing at such a preliminary stage? More importantly, what is the issuer supposed to think? The opportunity for confusion is great, as is the possibility that the issuer might decide to pursue a transaction using the dealer firm and never retain a financial advisor to provide the independent advice that it may have believed it already received.[6]

Congress intended to insulate municipalities from obtaining advice from individuals whose interests are contrary to those of the issuer. Therefore, NAIPFA respectfully suggests that this intent can only be realized if the exemption for underwriters under §15B(e)(4)(C) of the Exchange Act applies only when the underwriter has made clear what role it is playing in the transaction and thereafter does not influence the decision making process by providing advice or by providing information in a manner that could be perceived as advice. Notably, however, proposed Rule G-23 fails to accomplish this intent. Accordingly, we suggest, as we did in September 2010, that the final sentence of section (b) of Rule G-23 be amended 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.*

Proposed Rule G-23 only perpetuates the *status quo.* This will frustrate Congress' intent as it will leave the most vulnerable issuers open to the same abuses Congress sought to prevent with the passage of Dodd-Frank. What is more, when proposed Rule G-23 is taken together with proposed rules G-17 and G-

[5] *See* Letter from Nathan R. Howard, Esq., Municipal Advisor, WM Financial Strategies, to the Securities and Exchange Commission, dated February 22, 2011.

[6] As the MSRB itself states in its submission to the SEC supporting the proposed Rule changes, "[s]mall and infrequent issuers are, in many cases, unable to appreciate the nature of the conflict they are being asked to waive by the very dealer financial advisor that will benefit from the waiver."

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P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

36, the potential for underwriters to wield dangerous levels of influence over municipal entities becomes clear, a result unequivocally contrary to the purpose of Dodd-Frank. As NAIPFA reads proposed Rule G-36, municipal advisors would have duties of loyalty and care to their municipal entity clients, which would include requirements that they take steps to learn the essential facts about the client's financial circumstances and objectives, only undertake assignments which they have the expertise and resources to perform, agree on the services to be performed and the compensation to be paid, disclose all conflicts, including any applicable to their compensation arrangement, and provide advice about all the feasible financing options then reasonably available. At all times the advisor must act in the best interests of the client without regard to its own financial and other interests.

Conversely, underwriters will not be bound by the dictates of proposed Rule G-36, and will be bound instead by the limited duties imposed by Rule G-17. Under proposed Rule G-17, underwriters would merely have a duty to deal fairly with the issuer, which the MSRB states is akin to a 10b-5 duty. In other words, an underwriter may not misrepresent the facts but its obligations do not include any affirmative duty to inquire into the financial circumstances and objectives of the issuer, to disclose the risks associated with a transaction it recommends or even to have any basis – reasonable or otherwise – for any transaction it recommends.[7]

Given the very limited duties the MSRB believes underwriters owe to municipal issuers, NAIPFA would argue that it not only contravenes Congressional intent but is affirmatively dangerous to extend to firms acting as underwriter the right to provide advice to issuers. Instead, as NAIPFA has stated on numerous occasions, an issuer should have the benefit of advice provided by a regulated municipal advisor whose interests are, and always will be, to do what is best for the client.

2. **NAIPFA objects to the notion of a rebuttable presumption when dealers provide advice but, if the presumption is rebuttable, dealers should be required to make affirmative disclosures of the conflicts inherent in their role as underwriter.**

For the reasons set forth above, NAIPFA asserts that the exemption from the definition of financial advisor in Rule G-23 is contrary to Dodd-Frank. However, should the SEC adopt the expansive view of what constitutes "acting as an underwriter" advanced by the MSRB, we believe that underwriters acting as financial advisors should be required to decide which role they will play with the issuer 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 purse. The MSRB highlights the conflict at the heart of the issue:

> *While underwriters have a duty of fair dealing to issuers under Rule G-17, they also have a duty to investors, whose interests are generally adverse to those of issuers.*

The MSRB also recognizes that the opportunity for confusion on the part of those issuers dealing with firms that provide a variety of services when it stated "that a dealer may not avail itself of the underwriter exception unless it maintains an arm's length relationship with the issuer." Nevertheless, the only affirmative requirement that the MSRB proposes to impose on a dealer providing advice to an issuer regarding matters related to the issuance of municipal securities is that the dealer "clearly identif[y] itself as an underwriter from the earliest stages of its relationship with the issuer with respect to that issue."

NAIPFA notes in this context the MSRB's proposals related to Rules G-36 and G-17. In particular, we note the extensive affirmative disclosure obligations the MSRB would seek to impose on municipal

[7] Underwriters have somewhat greater disclosure obligations when the transaction they recommend is "complex."

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P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
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advisors, and the lack of similar disclosures required of dealers. NAIPFA asserts that dealers providing advice should be required to do more than merely state they are acting as an underwriter to avoid being deemed a financial advisor for purposes of Rule G-23 (and otherwise). Instead, they should be required to state– in a document similar to Appendix A proposed within the MSRB's Proposed Rule G-36 and Rule G-17 Guidance to Municipal Advisors - that they:

- Are not acting as advisors but as underwriters;
- Are not fiduciaries to the issuer but rather counterparties dealing at arm's length;
- Have conflicts with issuers because they represent the interests of the investors or other counter parties which may result in benefits to other transaction participants at direct cost to the issuer;
- Total revenues and profitability may not be transparent or disclosed to the issuer; and
- Have no continuing obligation to the issuer following the closing of transactions.

NAIPFA calls on the SEC to also modify G-23 in a way that requires the underwriter acting as a financial advisor to decide before the underwriter approaches the issuer that the underwriter is presenting its services as an advisor or underwriter. This would avoid confusion on the part of the issuers as to the intentions of the underwriters acting as an advisor. Further similar conflict disclosure to the disclosure proposed for municipal advisors should be required by the underwriter if this is the role they have decided to pursue.

In addition, NAIPFA has seen situations where the underwriter acting as a financial advisor has resigned to purchase the debt issue but its financial advisor contract with the issuer remains in effect. The underwriter would then revert back to its role as financial advisor once the bonds were closed. This contract maneuver does not allow for another firm to assume the role of the financial advisor during the transaction or an opportunity to compete for the financial advisor role. Any regulatory actions should require that any contract the underwriter acting as an advisor had with an issuer be terminated when the dealer firm is hired or seeks to be hired as an underwriter to the issuer, swap counterparty or in any other role that is inconsistent with the role of a fiduciary.

3. NAIPFA objects to the MSRB's proposal that the proposed changes to Rule G-23 be effective for new issues awarded six months following approval of the Rule by the SEC.

The MSRB proposes that "the proposed rule change be made effective for new issues for which the Time of Formal Award . . . occurs more than six (6) months after the SEC approval." The stated reason for this effective date is "to allow issuers of municipal securities time to finalize any outstanding transactions that might be affected by the proposed rule change." NAIPFA believes – as apparently does the MSRB – that the substantive changes to Rule G-23 relating to role-switching are mandated by the imposition of a federal fiduciary duty and accordingly, that dealers acting in the role of advisor breach their fiduciary duty to an issuer when they switch roles to become a financial advisor. Because they had such a fiduciary duty under federal law effective October 1, 2010, NAIPFA asserts that any role-switching that occurred after that date was a violation of the Exchange Act.

Even assuming that issuers and underwriters were waiting for guidance on how the MSRB viewed Rule G-23 in light of Dodd-Frank, they were on notice in August 2010 when the MSRB proposed for comment the very changes it has now formally proposed to the SEC for adoption. The changes should be effective immediately upon approval by the SEC.

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

The MSRB believes that the proposed rule would principally affect dealer financial advisors that are not small municipal advisors. Applying the rule effective on adoption would have provided sufficient time for the underwriter acting as an advisor to determine its appropriate role with an issuer. It would also provide immediate clarity to the issuer who is the party that is to benefit most from Dodd-Frank.

4. NAIPFA believes an underwriter should be prohibited from serving as a municipal advisor and underwriter for an issuer at the same time.

Within the MSRB filing, the MSRB agrees that the role and interests of the dealer financial advisor are "significantly different" from the role and interests of a dealer acting as the underwriter for the same governmental unit. Yet upon review of the comment letters, the MSRB has determined:

- Not to impose a cooling off period between the time a dealer completes a financial advisory engagement with an issuer and the time the dealer may serve as underwriter for a different issue by the same issuer. Rule G-23 is to be applied on an "issue by issue basis" so that the dealer financial advisor could serve as advisor on one issue and then serve as the underwriter on another issue for the same client even if the two issues are in the market at the same time; and
- It is appropriate that there be 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 goes on to state that a one year timeframe would more than adequately address any potential or actual conflicts of interest.

NAIPFA does not understand how there can be a conflict between the advisor/underwriter roles and a need for a cooling off period from the role as dealer financial advisor and yet the modified Rule G-23 change would allow for the underwriter acting as an advisor to undertake both activities at the same time with the same issuer. We all agree there is a conflict between the advisor/underwriter roles. Proposed Rule G-23 should be modified in a way that would force the underwriter acting as an advisor to decide which role they will play for the issuer and not be able to play both roles at the same time. NAIPFA further believes that if the one year cooling off period for remarketing conflicts is appropriate, there should be a one year cooling off period from the time an advisor underwriter terminates its role as municipal advisor and the advisor underwriter would be allowed to negotiate an issue with the issuer, act as swap counterparty or serve in any other role that is inconsistent with the role of a fiduciary. This modification would ensure that Rule G-23 would be fair and consistent in its application.

5. NAIPFA believes future changes to Rule G-23 should be considered only after the market has absorbed all regulatory changes and regulators can definitively assess any impact due only to Rule G-23.

Because the industry is having to react to and incorporate so many changes, NAIPFA respectfully requests that the SEC and MSRB not revisit Rule G-23 changes until sufficient time has elapsed to truly assess whether future changes will have the effect intended. The regulatory changes being discussed are significant and will likely change the current business models of advisors and underwriters. After the final rules of regulation have been established, there will be a period of time for the advisor and underwriters to adjust to the changes. Only when the market has adjusted to these significant changes and objective evidence has been gathered will regulators be able to assess the real impact of G-23.

Summary

We understand the pressure there is to adopt rules that meet the intent of Dodd-Frank. The fact is that Congress has determined to accept that, within the municipal market, there are municipal advisors and

National Association of Independent Public Finance Advisors
P.O. Box 304
Montgomery, Illinois 60538.0304
630.896.1292 • 209.633.6265 Fax
www.naipfa.com

broker-dealers that serve as both municipal advisors and underwriters. In a less complicated scenario, advisors advise issuers and underwriters buy issuer bonds. This is a part of the conflict Congress intended to correct with Dodd-Frank. The MSRB agrees that the role and interests of the broker-dealer financial advisor are "significantly different" from the role and interests of a broker-dealer acting as the underwriter for the same governmental unit; yet the proposed Rule G-23 will allow broker-dealers acting as advisors to continue business as usual. NAIPFA's concern is that broker-dealers would be allowed to provide the same advice as municipal advisors without municipal advisor obligations. Broker-dealers could still be engaged by an issuer and then decide if they want to be the advisor or underwriter. Broker-dealers could work as the advisor and underwriter on different issues at the same time. It is clear that broker-dealers who act as advisors want to continue their lucrative business model. This business model of the past, however, must change if the full intent of Dodd-Frank is executed into regulation.

NAIPFA believes broker-dealers should not be allowed to provide unlimited advice without being an advisor with fiduciary duty to the issuer. As a result NAIPFA believes section (b) of Rule G-23 must be amended to provide guidance on the type of advice an underwriter can provide. Should the SEC believe, however, that underwriters have a broader exemption to provide advice, underwriters must be required to decide before they approach an issuer whether they will present themselves to the issuer as a municipal advisor or an underwriter. NAIPFA believes broker-dealers should be required to decide if they are in the advisor business or underwriting business. The broker-dealer should be able to do both but each role should follow the appropriate rules and regulations. Broker-dealers acting as advisors should not be allowed to confuse issuers as to their true role. Additionally, appropriate conflict disclosure should also be required for either role when they talk with the issuer and the rule should be effective immediately.

NAIPFA once again expresses its appreciation for the opportunity to submit its views on the MSRB's proposed Rule G-23 and interpretive guidance. We would be pleased to discuss any issues or concerns raised in this letter with representatives of the SEC. If we can be of any assistance or answer any questions, please feel free to contact me.

Sincerely,

Colette J. Irwin-Knott, CIPFA
President, National Association of Independent Public Finance Advisors

cc: The Honorable Mary L. Schapiro, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Michael Coe, Counsel to Commissioner Aguilar
Martha Haines, Assistant Director and Chief, Office of Municipal Securities
Lynette Hotchkiss, Executive Director, Municipal Securities Rulemaking Board

From: Ed Crouch
Sent: Monday, February 14, 2011 12:41 PM
To: Comment Letters
Subject: Rule G-17 and Rule G-36 Commentary...

Greetings—

Thank you for the opportunity to provide commentary to the development of Rules G-17 and G-36. As these rules are drafted, finalized and interpreted, it should be clearly stated how these two similar (but distinct) rules interact with one another, and are separately or together applied, in the instance where a municipal advisor's client is an obligated person and the municipal entity is a conduit to a financing. More specifically, I am imagining a circumstance where a non-profit organization engages a municipal advisor to assist it in examining all possible financing scenarios that may be available to the organization including the use of conventional financing and tax-exempt bond financing. In this instance, the municipal advisor's client could become an obligated person, defined under that Act, but in the event that the financing that is ultimately consummated is in the form of a conventional loan, is there a question of whether client would ever be an obligated person if it would ultimately have no relationship to a municipal entity? Clearly defining this grey area is critical for municipal advisors to understand which regulatory construct applies at any given point in time.

Also, a potential conflict could materialize in instances where an obligated person could benefit from a transaction or structure that is not in the interest of the municipal entity. In circumstances where the municipal advisor's client is not the municipal entity but rather an obligated person (or as described above, an entity considering using municipal bonds but perhaps outside the definition of an obligated person at a certain point in time) the municipal advisor may believe that not using the municipal entity is in the client's best interest for a variety of interests. For instance if outstanding municipal bonds could be refinanced with a conventional loan, the municipal entity would receive less (or no) fees and therefore be financially impaired to the benefit of the obligated person. Again, the municipal advisor, its client and the municipal entity should be clearly informed as to the fiduciary and fair dealing duties of the municipal advisor under rules G-17 and G-36.

As I review these rules now, such delineation in these circumstances does not appear clear.

I hope this input is useful as the rules are developed. Please contact me if you would like to discuss this e-mail or need clarification.

Regards,
Ed Crouch

Not For Profit Capital Strategies
1 Lee Street | Marblehead | MA | 01945
e-mail: epc@nfpcs.com
Direct: 781-631-1984 | Mobile: 617-901-4898

From: petee
Sent: Thursday, March 03, 2011 5:54 PM
To: Comment Letters
Subject: MSRB NOTICE 2011-14 (February 14, 2011) - Comment/question

The Notice provides the following definition:

[2] "Municipal advisor" is defined in Section 15B(e)(4) of the Exchange Act as "a person **(who is not a municipal entity or an employee of a municipal entity)** that: (i) 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 issues; or (ii) undertakes a solicitation of a municipal entity.

QUESTION: Does the highlighted exclusion from the definition include Officers, and Board Members of a "Municipal Entity" who routinely deliberate, discuss, and consult with each other on business matters of their "Municipal Entity" that come before them in the performance of their legislative duties? It is hard to imagine that the definition of a "Municipal Advisor" would intentionally include the members of the Municipal Entity's legislative body.

Peter G. Egan, Managing Director
Phoenix Advisors, LLC
12 Krauser Road
Downingtown, PA 19335
(610) 304-3894 cell
(412) 266-8500 cell
(610) 321-0713 fax

.

From: petee
Sent: Friday, March 04, 2011 11:01 AM
To: Comment Letters
Subject: MSRB NOTICE 2011-14 (FEBRUARY 14, 2011)

Ladies and gentlemen:

After previously submitting a question on the 2011-14 Notice definition of a Municipal Advisor, it occurred to me that you might appreciate a suggestion to prevent unintended and undesirable consequences:

The highlighted exemption in the below definition should be modified as follows: **(who is not an elected official, officer, board member, or employee of a municipal entity that is engaged in the performance of their official duties for that municipal entity).** This would eliminate the potential problem of having municipal advisors seek positions on the board of municipal entities, or part time employee positions, and thereby claim exemption from the registration requirements. It illuminates the intentional exclusion of elected officials, officers, board members, and employees of municipal entities from the registration requirement and MSRB oversight, but only when acting in the performance of their official duties. Additionally, it precludes the possibility that elected officials, officers, board members, and employees of municipal entities would be able to serve as municipal advisors to other municipal entities (other than their own) … without registration and MSRB oversight.

The 2011-14 Notice provides the following definition:

[2] "Municipal advisor" is defined in Section 15B(e)(4) of the Exchange Act as "a person **(who is not a municipal entity or an employee of a municipal entity)** that: (i) 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 issues; or (ii) undertakes a solicitation of a municipal entity.

Peter G. Egan, Managing Director
Phoenix Advisors, LLC
12 Krauser Road
Downingtown, PA 19335
(610) 304-3894 cell
(412) 266-8500 cell
(610) 321-0713 fax

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Two Logan Square
Suite 1600
18th & Arch Street
Philadelphia, PA
19103-2770

215 567-6100
215 557-1493 fax
www.pfm.com

Public Financial Management

April 8, 2011

Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314
Attention: Ronald W. Smith
Corporate Secretary

Re: MSRB Notices 2011-13 and 2011-14

Draft Interpretive Notice Applicable to Rule G-17 and
Draft Interpretive Notice to Proposed new Rule G-36

Dear Members:

The Municipal Securities Rulemaking Board ("Board") has requested comments on draft Interpretive Notice Applicable to Rules G-17 and new Rule G-36. Kindly treat this letter, two copies of which are submitted, as a response to each of MSRB Notice 2011-13 and Notice 2011-14.

I serve as General Counsel to Public Financial Management, Inc. ("PFM"), a municipal advisor registered with the Board. The following comments are submitted on behalf of PFM.

PFM has no comment with respect to the substance of Rule G-17 and proposed Rule G-36. PFM recommends, however, as to the final version of the Board's Interpretive Notice which will accompany Rule G-17 and that which will accompany the final version of Rule G-36, that the Board make clear that Rule G-36 applies fully to a broker dealer who engages in municipal advisory activities with a municipal entity exclusive of the purchase of municipal securities, as described in Section 2(a)(11) of the Securities Act. The Board's only reference to the duties of brokers acting as municipal advisors is the obscure comment in Notice 2011-14 that if the Commission revises its position stated in Release No. 34-63576, the Board would "reconsider the provisions of the notice concerning limitations on principal transactions."

PFM objects to the Board's interpretation of Rule G-17 and Rule G-36 to require a financial advisor to rehearse with its obligated person/client (and obtain the client's written waiver to) a litany of hypothetical, potential "conflicts of interest" alleged to be presented by nearly every form of compensation

employed in advisory engagements. That proposed requirement is insulting to both financial advisors and to municipal governments and seems to demean financial advisors as compared with the Board's treatment of underwriters (as we note below). If the Board truly believed that such alleged conflicts of interest were real, rather than speculative, the remedy would be to prohibit the compensation arrangement, rather than put a municipal government to the choice of consenting to something which the Board says is bad for it, or foregoing the financial advice which it desires to improve its negotiating position vis-à-vis the underwriters.

In substantially all of our financial advisory engagements, our client sets the rules for our compensation, without any room for negotiation. We accept that structure, and we perform our job professionally to satisfy our own high standards, which are mirrored in Rules G-17 and G-36. And in substantially all instances, we do not get paid for services relating to a bond offering unless the offering is sold. Prior to the publication of MSRB Notices 2011-13 and 2011-14, it would have been bizarre indeed for PFM to admonish an experienced municipal government financial officer, as the Board demands, to "be careful" because we may be motivated to "fail to do a thorough analysis of alternatives" or because we may urge the government to sell more bonds than it really needs.

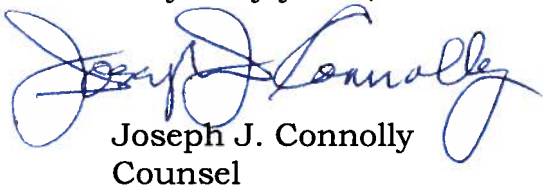
When compared with the treatment of government engagements of underwriters, on the other hand, the Board has shown some confidence in the skill of local financial officials. Municipal dealer underwriters have been subject to Rule G-17 for 35 years, but the Board has never required underwriters to admonish municipal issuers that "we will squeeze every nickel - - your nickels - - out of this deal that we possibly can." That's not a hypothetical, possible conflict of interest. That's a reality that every municipal issuer faces. However, the Board has seen no reason to be sure that the municipal government is on alert - - although, to be sure, we expect that the Board contemplates that the proposed admonitions of potential conflicts of interest will equally be required of brokers who engage in municipal advisory activities with government issuers.

Finally, the requirement that a financial advisor unroll a scroll of Board-conceived "conflicts of interest" to set the table for discussions with a municipal client seems unprecedented. To begin with, in most instances the municipal financial officials set the compensation rules even before a financial advisor is selected. Moreover, we know of nowhere else in the federal securities law in which regulation injects into a private transaction a formality which

necessarily rests on the sole presumption that one of the parties will violate the law. If the federal regulator, as it must, assumes that a financial advisor will observe the fiduciary duties which the law imposes, a regulation requiring an advisor to admonish its client as to situations in which the advisor allegedly might be tempted to subordinate the interests of the client cannot be said to be contemplated by statute. If, on the other hand, the federal regulator assumes that the financial advisor will violate the law, the admonitions to the client invented by the Board that every form of compensation that the client may select can be problematic can do nothing to protect the client from the advisor's invisible self-service - - the "waiver" of the client is, of course, useless. And the enforcement regulator is in exactly the same position as it would be if the admonitions and the waiver had never taken place.

For the foregoing reasons, PFM submits that the provisions of the subject Notices relating to alleged conflicts of interest in the method of computation of compensation of municipal advisors should be deleted.

Very truly yours,



Joseph J. Connolly
Counsel

JJC:plj

April 11, 2011

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22314

Re: MSRB Notice 2011-14 – Draft MSRB Rule G-36 (On Fiduciary Duty of Municipal Advisors) and Draft Interpretive Notice (Feb. 14, 2011)

MSRB Notice 2011-13 – Draft Interpretive Notice Concerning the Application of MSRB Rule G-17 to Municipal Advisors (Feb. 14, 2011)

Dear Mr. Smith:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to comment on the Municipal Securities Rulemaking Board's ("**MSRB**") draft Rule G-36 and related draft interpretive notice (the "**G-36 Proposal**") and the MSRB's draft interpretive notice concerning the application of Rule G-17 to municipal advisors (the "**G-17 Proposal**" and together with the G-36 Proposal, the "**Proposals**").

I. Executive Summary

SIFMA supports the MSRB's desire to provide guidance to municipal advisors as to the contours of the fiduciary duty owed by municipal advisors to their municipal entity clients (the G-36 Proposal) as prescribed by Section 975

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

New York | Washington
120 Broadway, 35th Floor | New York, NY 10271-0080 | P: 212.313.1200 | F: 212.313.1301
www.sifma.org | www.investedinamerica.org

("**Section 975**") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"),[2] as well as to the contours of the duty of fair dealing owed by municipal advisors to obligated person clients in the context of advisory engagements and owed to municipal entities solicited by municipal advisors on behalf of others (the G-17 Proposal). However, SIFMA believes that because the Securities and Exchange Commission ("**SEC**") has not yet adopted final rules that would define the scope of activities that trigger municipal advisor registration,[3] and therefore the universe of potential registrants, the Proposals interpreting how a fiduciary duty and duty of fair dealing apply to this as-of-yet undefined universe are premature. Indeed, in each of the Proposals, the MSRB itself acknowledged that the proposal did not take into account the Pending SEC Proposal and would, in fact, require revision if the Pending SEC Proposal was adopted. Of first importance, we believe the Proposals are unworkable if the Pending SEC Proposal were adopted. Therefore, SIFMA is unable to fully and meaningfully comment on the Proposals without knowing to whom, and during what activities, the duties would apply. Therefore SIFMA requests an opportunity to provide further comments once the SEC has completed its rulemaking defining the scope of activities subject to municipal advisor registration.

In addition to the question of ripeness of the Proposals in light of the Pending SEC Proposal, there are numerous interpretive positions contained in the Proposals that SIFMA believes the MSRB should reconsider. Specifically, with regard to the G-36 Proposal, it is critically important that the MSRB not adopt a ban on principal dealing by advisors to municipal entities; such a ban is not required to protect investors and is not consistent with Congressional intent or similar regulatory regimes. The imposition of such a ban would effectively limit many municipal entities' access to critical products and services, including the ability to purchase securities out of inventory. There is no justification for imposing a more restrictive fiduciary standard in the municipal advisor context.

The MSRB should also not view itself as regulating in a vacuum. Municipal advisors, as currently defined, will often be subject to regulation by other regulators that are also currently considering rules for fiduciary or fiduciary-like duties that would apply to providers of financial services in various contexts. These include the Commodity Futures Trading Commission ("**CFTC**") and SEC business conduct rules for swap dealers and security-based swap dealers, respectively, Department of Labor ("**DOL**") proposed fiduciary duties for

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[2] *See* Securities Exchange Act of 1934 ("**Exchange Act**") § 15B(b)(2)(L)(i).

[3] *See* Exchange Act Release No. 63576 (Dec. 20, 2010) (the "**Pending SEC Proposal**").

providers of investment advice to retirement plans, and the SEC's consideration of a fiduciary standard for broker-dealers providing personalized investment advice to retail customers. The MSRB should coordinate its interpretation with these other regulators to make sure that municipal advisors are not subject to inconsistent and irreconcilable standards.

In addition, many of the duties imposed by the Proposals are only applicable to one narrow form of municipal advisor—the traditional independent municipal advisor formally engaged by the municipal entity, which was largely unregulated prior to the adoption of Section 975. But Section 975 sweeps in other entities as municipal advisors to whom many of the proposed duties would not reasonably apply.

Further, many affirmative obligations that the Proposals would impose on municipal advisors appear to be merely paperwork exercises that add little value for a municipal entity or obligated person, but impose great costs on municipal advisors that will be passed along to their clients in higher fees. Municipal advisors and obligated persons should be permitted to contract for those services that they want, and not have other services mandated to them, presumably, at an additional cost.

Finally, the G-17 Proposal imposes many fiduciary duty-like obligations on a municipal advisor even though Section 975 did not specifically apply a fiduciary duty except when advising a municipal entity. The G-17 Proposal does so by interpreting a municipal advisor's duty of fair dealing with obligated persons. The G-17 Proposal's affirmative obligations go far beyond the common understanding of "fair dealing" and beyond what the MSRB has previously interpreted "fair dealing" to require of brokers, dealers and municipal securities dealers.

SIFMA respectfully requests the MSRB to reconsider the Proposals after SEC has adopted final rules governing the scope of municipal advisory activities and to reissue modified proposals after carefully considering the practical consequences the proposals would have on municipal advisors, municipal entities, and obligated persons.

II. G-36 Proposal – Duties to Municipal Entities

A. The MSRB Should Delay Its Rulemaking Until the SEC Determines the Definition of "Municipal Advisor."

The MSRB should delay its rulemaking and interpretive guidance regarding municipal advisors and their duties until the SEC adopts final rules defining what activities require registration as a "municipal advisor" and reopen

its comment period on the G-36 Proposal at that time. The Pending SEC Proposal would interpret the scope of activities covered by Section 975 very broadly, particularly in the definition of "investment strategies," that the MSRB itself believes is greater than Congress intended.[4] Indeed, the Chairman and staff of the SEC have each indicated that the scope of the Pending SEC Proposal is perhaps broader than even the SEC had intended.[5] For example, the Pending SEC Proposal contemplates that a broker-dealer transacting with a municipal entity as principal may be required to register as a municipal advisor.[6] At the same time, the G-36 Proposal would prohibit outright acting as principal with a municipal entity client as an unmanageable conflict of interest.

While SIFMA appreciates the MSRB's attempt to provide guidance as to the statutory fiduciary duty currently owed, it seems ultimately unproductive to propose rules and interpretations that would apply to an unknown group of persons engaged in unknown activities. The MSRB is effectively proposing rules and interpretations for a moving target. Such an approach is unfair to municipal advisors, including those who do not yet know they fall into that definition, as they cannot possibly consider and provide meaningful comments on the Proposals until they know to whom, and during what activities, the proposals will apply.

As the MSRB acknowledged in the Proposals, the Proposals would almost certainly need to be reconfigured depending on how the SEC ultimately defines municipal advisor activities. Because it is impossible at this time to predict what the SEC's final rules will look like, the MSRB should not, in the meantime, attempt to adopt rules and interpretations that in all likelihood will not reflect the regime being implemented. Once the SEC has issued its final rules, the MSRB should reopen the comment period on the G-36 Proposal so that SIFMA and

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[4] *See* Comment Letter from Michael G. Bartolotta, MSRB, to Elizabeth M. Murphy, SEC, (Feb. 22, 2011) at 4–6, *available at* http://sec.gov/comments/s7-45-10/s74510-586.pdf.

[5] In fact, the Chairman and staff of the SEC have each indicated that they are looking closely at the scope of their proposal, including potential regulatory overlap, in light of significant comments received. *See Budget Hearing – Securities and Exchange Commission: Hearing Before the House Committee on Appropriations, Subcommittee on Financial Services and General Government*, 112th Cong. (Mar. 15, 2011) (testimony of Mary Schapiro, Chairman, SEC) ("[W]e're looking very carefully at whether we may have cast the net too widely and taking the comments very, very seriously"); *see also Oversight of the Securities and Exchange Commission's Operations, Activities, Challenges and FY 2012 Budget Request: Hearing Before the House Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises*, 112th Cong. (Mar. 10, 2011) (testimony of Robert Cook, Director, SEC Division of Trading and Markets).

[6] *See* Pending SEC Proposal at 53.

others may more completely consider the implications of the G-36 Proposal in light of what activities will require municipal advisor registration.

B. The Scope of the Fiduciary Duty Under the Proposal Should be Reconsidered.

1. Fiduciary Duty Should Apply to Municipal Entity Clients Only.

The MSRB should clarify that the fiduciary duty of a municipal advisor applies only to a municipal entity client in the context of providing municipal advisory services, and does not apply to the solicitation activities of a municipal advisor (which are covered by MSRB Rule G-17) or to activities with respect to obligated persons. This appears to have been the MSRB's intention,[7] although draft Rule G-36, as proposed, may not be consistent with that intent.

Under its terms, draft Rule G-36 applies to a municipal advisor's conduct of "municipal advisory activities." The term "municipal advisory activities" is not defined in draft Rule G-36, but is defined in MSRB Rule D-13, which states that "'[m]unicipal advisory activities' means the activities described in Section 15B(e)(4)(A)(i) and (ii) of the [Exchange Act]." This section of the Exchange Act describes both the "advisory" and "solicitation" prongs of the definition of "municipal advisor." As currently proposed, draft Rule G-36 might be read to include a municipal advisor's solicitation of a municipal entity on behalf of a third party within the scope of activities that are subject to the fiduciary duty. The MSRB should clarify draft Rule G-36 to clearly only apply to a municipal advisor's conduct in providing advice to its municipal entity client.

In addition, the MSRB should further clarify that the fiduciary duty under draft Rule G-36 does not apply when a municipal advisor solicits a municipal entity on its own behalf—rather than on behalf of a third party. A fiduciary duty should not apply to this solicitation, because at the time of the solicitation, the municipal entity is not yet the municipal advisor's client. Instead, Rule G-17's fair dealing standard should apply until such time as the municipal entity actually engages the municipal advisor to provide its services.

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[7] *See* MSRB Webinar, *MSRB Fiduciary Duty and Fair Dealing Requests for Comment* (Mar. 1, 2011) at slides 3, 6 and 16 (indicating the fiduciary duty applies where the client is a municipal entity and not where a municipal advisor solicits on behalf of third parties).

2. The MSRB Should Coordinate its Fiduciary Duty Standard with Other Regulators.

The MSRB should coordinate with the SEC, CFTC and the DOL regarding the various fiduciary duties and similar obligations that may be applicable to a person that is also a municipal advisor. For example, a municipal advisor may also (i) be an investment adviser already subject to a fiduciary duty, (ii) provide advice to a retirement fund subject to a DOL fiduciary standard, (iii) be a swap dealer or security-based swap dealer required to act in the "best interests" of a client when advising a "Special Entity" (which includes municipal entities),[8] or (iv) be a broker-dealer that may become subject to a fiduciary standard when providing personalized investment advice to retail customers. It would be unworkable for one entity to be subject to competing and different standards imposed by different regulatory schemes while engaged in the same or similar activities.

C. Activities Subject to the Fiduciary Duty; Duration of the Fiduciary Duty.

1. The MSRB Should Define "Engagement."

Many of the obligations imposed by the G-36 Proposal (*e.g.*, when the fiduciary duty will be deemed to apply, disclosure of payments a municipal advisor will receive, and prohibitions on acting as principal) are triggered by, or are related to the existence of an "engagement." However, the G-36 Proposal does not actually define the contours of when an engagement is deemed to exist, when it begins or when it is considered to have ended.

Because of the significant obligations and restrictions that are triggered by the existence of an engagement, municipal advisors must have clarity as to when they must conform their conduct to these requirements. To this end, the MSRB should clarify that a municipal advisory engagement is only deemed to exist once a written engagement letter is entered into between the municipal advisor and the municipal entity. This clarity would align Rule G-36 with Rule G-23, which requires that the commencement of a financial advisory relationship be evidenced in a writing. The engagement letter may itself specify the term of the engagement, and may set clear terminating events, so that all parties can agree and have certainty regarding whether an engagement is in effect. Absent a written

[8] *See* Commodity Exchange Act § 4s(h)(4)(B) (added by Section 731 of the Dodd-Frank Act); Exchange Act § 15F(h)(4)(B) (added by Section 764 of the Dodd-Frank Act).

engagement letter, the engagement should terminate based on the reasonable expectations of the parties.

If the MSRB declines to interpret the beginning and end of the engagement to be based on the parties' engagement letter, it should nonetheless clarify that the fiduciary duty does not continue in perpetuity, but ends once the particular transaction to which it related had concluded.

2. Fiduciary Duty Should Apply to Specific Engagements Only.

The MSRB should clarify that, absent documentation to the contrary, a person that is a municipal advisor has a fiduciary duty to its municipal entity client only with respect to individualized advisory services rendered pursuant to, or in the context of, a specific engagement, transaction or assignment, and not with respect to non-advisory, ancillary or unrelated activities or other dealings with the municipal entity, even if the same personnel are involved in the activities. For example, even if there is a limitation on principal activities by advisors to municipal entities (which we comment on in Section II.F.1 below), a municipal advisor and its affiliates should be permitted to continue to act as principal in relation to transactions with the municipal entity that are unrelated to the municipal advisor's advisory engagement. Similarly, a municipal advisor's fiduciary obligations should end upon the termination of the engagement, unless agreed otherwise.

3. Fiduciary Duty Should Not Apply to Any Affiliates of the Municipal Advisor.

The MSRB should confirm that, notwithstanding the definition of "person associated with a municipal advisor" under Section 975, which includes "any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor,"[9] the fiduciary duty owed by a municipal advisor is not also owed by any of such advisor's affiliates, unless such an affiliate is itself otherwise engaged in municipal advisory activities and independently qualifies as a municipal advisor with respect to the municipal entity (in which case the affiliate will have an independent fiduciary duty to its municipal entity client).

SIFMA notes that under Rule D-11, "municipal advisor" is defined to include its "associated persons," as that term is defined in Section 3(a)(18) of the Exchange Act (which also includes entities under common control). For purposes

[9] Exchange Act § 15B(e)(7).

of its fair practice rules, the MSRB has nonetheless interpreted "associated persons" under Rule D-11 to *not* include persons who are associated "solely by reason of a control relationship."[10] This interpretation is sensible in the context of a municipal advisor's fiduciary duty to its municipal entity clients as well. While the individual natural persons associated with a municipal advisor should be subject to the fiduciary duty owed by the municipal advisor to its municipal entity clients, extending this duty to all entities under common control would be unworkable and burdensome, especially in the context of large financial institutions that have various entities which, while technically under common control, do not actually coordinate their activities.[11]

4. Activities Excepted from the Definition of "Municipal Advisor" Should not be Subject to a Fiduciary Duty.

The MSRB should clarify that the fiduciary duty under draft Rule G-36 does not extend to those activities that are excluded or exempted from the definition of "municipal advisor," whether by statute, rule or interpretation, (*e.g.*, the underwriter exception).

Draft Rule G-36 provides that a municipal advisor is subject to a fiduciary duty "[i]n the conduct of its municipal advisory activities on behalf of municipal entities." As noted above, Rule D-13 defines "municipal advisory activities" as those activities described in Section 15B(e)(4)(A)(i) and (ii) of the Exchange Act. However, these provisions do not refer to the statutory exceptions from being considered a municipal advisor under Section 15B(e)(4)(C) of the Exchange Act, for example, for underwriters, registered investment advisers or registered commodity trading advisors.

As proposed, draft Rule G-36 could therefore be read to apply a fiduciary duty to an underwriter whenever the underwriter engages in the activities described in Section 15B(e)(4)(A)(i) and (ii). Clearly, by exempting certain activities from municipal advisor registration, Congress also intended the persons engaging in those activities to be exempted from being subject to the duties specific to municipal advisors, including the fiduciary duty.

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[10] *See* Interpretive Notice, Approval of Fair Practice Rules (Oct. 24, 1978).

[11] *C.f.* By-Laws of FINRA, art. I, § (rr) (defining "associated person of a member" as limited to natural persons, rather than any entity under common control).

The MSRB should clarify that a potential underwriter, registered investment adviser or registered commodity trading advisor, or other person that would be eligible for an exception from the definition of "municipal advisor," either by statute or rule, is not required to comply with MSRB Rule G-36 or any aspect of the G-36 Proposal by virtue of that activity.

D. Disclosure of Conflicts and Informed Consent.

1. Only *Actually Known* Conflicts Should be Disclosed.

The G-36 Proposal would require a municipal advisor to provide written disclosure to its municipal entity client of its conflicts of interest and obtain written informed consent.

The MSRB should clarify that the obligation to disclose conflicts and obtain informed consent is not subject to a strict liability standard, but is rather based on reasonableness and relates only to the *actual* knowledge of the personnel of a municipal advisor who are specifically involved in municipal advisory activities.

SIFMA believes that any other standard would be unworkable and burdensome, requiring the creation of massive information gathering systems without any corresponding benefit to municipal entities. For example, a large financial institution could have many potential conflicts of interest, of which the institution's municipal advisory personnel are not even aware. In order to provide organization-wide disclosures, large firms would be required to develop detailed information-gathering processes across the organization to gather information regarding transactions and relationships that could be seen as raising a potential conflict for the organization as a whole. Without undertaking this massive centralization of information, it would be impossible for such a firm to be able to identify every possible conflict of interest that exists. Worse, attempting to do so could itself risk compromising information barriers and the firm's client confidentiality obligations.

Therefore, the municipal advisor should be permitted to disclose generally expected conflicts and disclose only those additional specific conflicts about which at least one member of the firm's municipal advisory group has actual knowledge. This limitation is sensible, as a conflict of interest that is not actually known to the individuals providing the advisory services to the municipal entity could not, in fact, color their judgment or impact the advice or services they provide.

2. Non-Individualized Disclosures Should Be Permitted.

The MSRB should make clear that its requirement that disclosures be "sufficiently detailed to inform the municipal entity of the nature and implications of the conflict" can be satisfied by disclosing conflicts through disclosures that are not individualized to the municipal entity. Many types of conflicts of interest will be common to many engagements, such as a municipal advisor that has an affiliate that engages in principal transactions in securities of the issuer. Generalized disclosure would be sufficient to alert the municipal entity to such conflicts. However, imposing on municipal advisors an obligation to undertake an individualized investigation and consideration of the exact implications of the conflict to that particular municipal entity would be time consuming and expensive, causing delays and increased costs, which will ultimately be borne by the municipal entity client. Of course, once non-individualized disclosures were provided, a municipal entity could request more detailed and individualized information before entering the engagement. The municipal entity would then itself be able to decide whether the costs and delay of such individualized analysis were warranted in its particular situation.

In addition, the MSRB should clarify that a municipal advisor is permitted to disclose conflicts to a municipal entity only once, at the outset of its first municipal advisory engagement, such as by providing a brochure that outlines its material conflicts of interest. Thereafter, the municipal advisor would not be required to re-deliver these disclosures and re-obtain informed consent on a periodic, transaction-by-transaction, or assignment-by-assignment basis, unless a new, material conflict were discovered. This clarification would reduce the paperwork burden on both municipal advisor and the municipal entity that frequently deal with each other, without any loss of protection for the municipal entity.

3. Disclosures Need Not be Repeated.

The MSRB should confirm that, with respect to any conflicts of interest required to be disclosed and informed consent to be obtained under the G-36 Proposal, a municipal advisor need not re-disclose such information if the information was contained in the municipal advisor's response to a municipal entity's request for proposals or otherwise provided to the municipal entity before the municipal advisor was formally engaged. In such a case, the municipal entity's engagement of the municipal advisor after receipt of such disclosures would provide evidence the municipal entity's informed consent.

4. Official Providing Informed Consent.

The G-36 Proposal would require a municipal advisor to obtain written informed consent to conflicts of interest from its municipal entity client prior to providing (or continuing to provide) municipal advisory services to the municipal entity. This informed consent would need to be provided by an official with the authority to bind a municipal entity.

The MSRB should clarify what level of diligence a municipal advisor would be required to undertake in order to determine whether the official providing the consent has the "authority to bind the municipal entity by contract with the municipal advisor." A municipal advisor should not be viewed as having breached its fiduciaries duties simply because it erred in its understanding of the signing authority of a municipal entity's official. Instead, SIFMA suggests that a municipal advisor's reasonable belief that the official has such authority should satisfy its duty. A representation to this effect by the signing official should be a sufficient basis for the municipal advisor to form this reasonable belief, absent the advisor's actual knowledge that such representation is false.

E. Compensation Conflicts and Disclosure.

The G-36 Proposal would require municipal advisors, as part of their duty of loyalty, to provide their municipal entity clients with disclosures regarding the municipal advisor's compensation and the conflicts inherent in various forms of compensation.

In implementing the fiduciary duty that municipal advisors owe to municipal entities they advise, the MSRB should ensure that its guidance does not restrict the choices available to municipal entities. Municipal entities should be free to choose among various compensation models, including fee-based and commission-based compensation. MSRB rules should not intentionally or effectively foreclose any particular mode of compensation.

SIFMA believes the MSRB should reconsider its proposed requirement that, in order to comply with its fiduciary duty, a municipal advisor disclose conflicts that arise from the municipal advisor's form of compensation. Even if the required disclosures were limited to the general disclosures in the form of Appendix A to the interpretive notice (Disclosure of Conflicts of Interest With Various Forms of Compensation), they should not be required.[12] The conflicts

[12] If the disclosure is to be required at all, it certainly should not be required when the municipal entity requires that a particular manner of compensation be used. Providing a form disclosure that is of no interest to the municipal entity cannot be said to further the municipal (…continued)

described in Appendix A are well understood by municipal entities, and the only meaningful effect of requiring this disclosure will be to obscure more pertinent disclosures and create risks of non-compliance by unwary municipal advisors.

F. Unmanageable Conflicts.

The G-36 Proposal would deem certain conflicts of interest to be "unmanageable." Unmanageable conflicts would be prohibited, even when fully disclosed and consented to by the municipal entity. This policy is based on the MSRB's view that a municipal entity is incapable of actually providing informed consent due to the nature of certain conflicts, even with full and complete disclosure and notwithstanding the sophistication of the municipal entity.

1. Principal Transactions Should Not be Prohibited.

The MSRB should reconsider its position that it is an unmanageable conflict for a municipal advisor to "act[] as a principal in matters concerning the municipal advisory engagement" (with a limited exception for a qualified competitive bid situation). Reasonable disclosure of, and informed consent to, potential conflicts associated with principal activities should be sufficient.

Even investment advisers, which have long been recognized as owing a fiduciary duty and the utmost good faith in dealings with their clients,[13] are not subject to an immutable prohibition on transacting with a client as principal. Rather, consistent with its fiduciary duty, an investment adviser 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.[14]

Similarly, the Dodd-Frank Act requires that swap dealers and security-based swap dealers, when acting as advisors to "Special Entities" (which include

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advisor's duty of loyalty. Rather, such a requirement risks reducing the entire disclosure and consent process to a pure paperwork exercise divorced from any practical purpose or benefit to municipal entities.

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

[14] *See* Investment Advisers Act of 1940 (the "**Advisers Act**") § 206(3). *See also* SEC Staff Study on Investment Advisers and Broker-Dealers (Jan. 2011) ("**SEC Staff Study**") at 24–26.

municipal entities), have a duty to act in the best interests of the Special Entity.[15] Requiring that these dealers act in the best interest of Special Entities reflects a congressional view that acting as both an advisor and a principal on the same transaction is not an unmanageable conflict of interest.

In fact, in another instance where the Dodd-Frank Act contemplated the imposition of a fiduciary duty, it did not prohibit principal transactions. Section 913 of the Dodd-Frank Act permits the SEC to promulgate rules subjecting broker-dealers to a fiduciary duty when providing personalized investment advice about securities to retail customers. However, Congress instructed the SEC that any such fiduciary duty rule should require disclosure and consent of any material conflicts of interest, rather than an outright prohibition on principal transactions. If Congress believed that broker-dealers could, consistent with a fiduciary duty, transact as principal with *retail* investors, surely it did not intend for municipal entities to be subject to greater protection.

There seems to be no logical distinction why a principal transaction would not be an unmanageable conflict of interest when it occurs between an investment adviser and its client, a swap dealer or security-based swap dealer and a client, or a broker-dealer providing personalized investment advice to a retail client, but the same transaction would be unmanageable when it occurs between a municipal advisor and a municipal entity client. Indeed, because registered investment advisers engaged in municipal advisory activities are exempt from the definition of "municipal advisor,"[16] the effect of the G-36 Proposal would be to impose stricter standard on municipal advisors than investment advisers when each are engaged in the exact same municipal advisory activity.

Congress could not have intended a municipal advisor's fiduciary duty to include a absolute prohibition on principal transactions. Rather, the MSRB should look to the example of existing fiduciary duty regimes, which permit principal transactions with appropriate disclosure and consent.

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[15] *See* Commodity Exchange Act § 4s(h)(4)(B) (added by Section 731 of the Dodd-Frank Act).

[16] *See* Exchange Act § 15B(e)(4)(C).

2. If Principal Transactions are Prohibited, the MSRB Should Limit the Scope of the Prohibition.

Even if principal transactions are generally considered to be unmanageable conflicts in some municipal advisor contexts, municipal advisors should not be generally prohibited from principal transactions, nor should their affiliates.[17] A complete prohibition on municipal advisors transacting as principal with their municipal entity clients would deprive the municipal entity of access to certain financial products, such as fixed income products the municipal advisor sells in its brokerage capacity, or swaps the municipal advisor enters into in its swap dealer capacity. Instead, the MSRB should consider limiting those principal transactions that are considered unmanageable to those few narrow instances where disclosure and consent may actually be ineffective.

In particular, the ban should not apply to common principal activities of persons that, in addition to being a municipal advisor, conduct other principal-based regulated businesses, such as banks taking deposits; broker-dealers selling fixed income securities; swap dealers or security-based swap dealers entering into swaps or security-based swaps that comply with applicable CFTC or SEC business conduct rules; or foreign exchange transactions. These activities are already subject to comprehensive oversight and regulation by their respective regulators.[18]

A complete prohibition on principal transactions would harm, rather than protect municipal entities. For example, if deposit-taking and other traditional banking services are not excluded from the prohibition on principal transactions, it will greatly restrict municipal entities from obtaining banking services from banks that are also municipal advisors, harming municipal entities' ability to obtain necessary and beneficial financial products and services. Similarly, if a municipal advisor that is also a broker-dealer is prohibited from selling securities out of inventory to its municipal entity client, the municipal entity will face increased costs to obtain those securities.[19]

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[17] *See also* Section II.C.3 above.

[18] For example, SEC and FINRA rules permit broker-dealers to transact as principal, but they may only do so consistent with "best execution" obligations and may not charge excessive markups or markdowns.

[19] *See*, *e.g.*, SEC Staff Study at 159–60 (noting that "costs associated with purchasing certain securities, particularly less liquid securities, as agent, may increase execution costs for (…continued)

The MSRB should also reconsider the extension of this ban to affiliates of the municipal advisor that act as a principal with the municipal entity on the same transaction. Such a prohibition would prove burdensome and unworkable in a large financial institution engaged in the provision of multiple services to municipal entities through a number of related affiliates. In any case, this ban should be measured by a reasonableness rather than strict liability standard, such that one person would not be prohibited from acting as principal on a transaction because a distant corporate cousin that is nominally, but not practically, under common control acts as the municipal entity's municipal advisor. Instead, the prohibition should only apply to those personnel of the municipal advisor who actually deal directly with the municipal entity and have actual knowledge of the facts of the engagement giving rise to the prohibition. Requiring persons to conduct an investigation of what relationships all of its affiliates and their personnel have with a municipal entity before transacting as principal with that municipal entity would create great expense and delay, while providing little, if any, additional protection to the municipal entity.

The MSRB should also clarify that this prohibition on principal transactions would not bar a municipal advisor or its affiliates from performing other *services* for a municipal entity (*e.g.*, acting as a trustee, collateral agent, calculation agent or broker).

3. Further Guidance is Needed Regarding Kickbacks and Fee-Splitting Arrangements.

Among conflicts that are "unmanageable," the G-36 Proposal highlights "kickback arrangements, or certain fee-splitting arrangements, with the providers of investments or services to municipal entities." Because of the variety of legitimate compensation arrangements that may exist, the MSRB should provide additional clarification of how it would define impermissible "kickbacks" and "fee splitting," or confirm that these impermissible arrangements are limited to the types of referral fees, excessive mark-ups and fee splitting described in footnote 7 to the G-36 Proposal.

The MSRB should also take care not to classify common and generally accepted arrangements as "unmanageable conflicts," thereby disrupting legitimate business arrangements. For example, financial institutions that hold funds of municipal entities often sweep cash balances into money market mutual funds. In

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some investors, namely those customers of broker-dealers who otherwise had maintained inventories of such securities").

a fully disclosed arrangement, to which the municipal entity provides informed consent, the financial institution may receive a 12b-1 fee or a revenue sharing fee from the fund or its adviser.[20] This and similar common arrangements do not present an unmanageable conflict—when full disclosure is provided, municipal entities are capable of considering the conflict and providing informed consent. To assure that these types of programs—which provide benefits to municipal entities—remain available, the MSRB should provide specific guidance as to which "certain" fee-splitting arrangements are proscribed. Otherwise, municipal advisors will be forced to curtail their offerings and municipal entities will be faced with fewer investment options.

4. Further Guidance is Needed Regarding Prohibited Payments to Solicitors.

Under the G-36 Proposal, it would be an unmanageable conflict for a municipal advisor to make a payment "for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor described in Section 15B(e)(9) of the Exchange Act" (defining solicitation). As an initial matter, to the extent that the MSRB intends for this provision to serve to regulate pay-to-play activity, SIFMA believes that the MSRB should instead address pay-to-play issues through its pay-to-play rules, and not in an indirect manner by classifying pay-to-play activity as an unmanageable conflict.

SIFMA has separately commented on MSRB and SEC pay-to-play proposals, and does not believe that it is appropriate to reiterate its comments here.[21] However, we note that any prohibition on payments to *affiliated* solicitors is highly problematic in the context of multi-service financial institutions and contrary to the apparent intent of Section 975, which defines solicitation of a municipal entity as certain solicitations undertaken for one of certain types of

[20] Although not reflected in the G-36 Proposal, a bank that advises a municipal entity to invest its cash deposit balances in a money market mutual fund may be considered municipal advisor if the Pending SEC Proposal is adopted. *See, e.g.*, Pending SEC Proposal at 42 .

[21] *See* Comment Letter from Leslie M. Norwood, SIFMA, to Ronald W. Smith, MSRB (Feb. 25, 2011), *available at* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/~/media/Files/RFC/2011/2011-04/SIFMA.ashx; Comment Letter from Leslie M. Norwood, SIFMA, to Elizabeth M. Murphy, SEC (Feb. 25, 2011), *available at* http://www.sec.gov/comments/s7-45-10/s74510-657.pdf.

entities "that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation…"[22]

Additionally, the MSRB should clarify that any provision governing payments for solicitation does not apply to activities that are not regulated by the MSRB, such as when a person that is also a municipal advisor makes payments to a third party, whether affiliated or unaffiliated, in connection with a commodity futures or even a non-financial transaction.

G. Prohibition on Excessive Compensation.

1. Further Guidance is Required on When Compensation will be Considered "Excessive."

The G-36 Proposal states that a municipal advisor violates its duty of loyalty to the municipal entity if its compensation is "so disproportionate" to the services performed such that it is "excessive." While the proposed interpretation acknowledges that what constitutes reasonable compensation will vary depending on many factors, the proposal gives no guidance as to where the line between reasonable and excessive lies.

Without further guidance, municipal advisors are at risk of having a standard established only in hindsight. Consider a situation where, after full disclosure, a municipal entity agrees to an hourly fee for advice relating to the issuance of municipal securities. Due to various factors unrelated to the municipal advisor's services, the transaction does not close. In hindsight, the municipal advisor's fee may appear to have been excessive in light of the services performed on a failed offering. Although this may not be the MSRB's intent, municipal advisors will need to be constantly concerned that their compensation could be deemed "excessive" at a later date, which may cause them to limit the services or compensation arrangements they offer to municipal entities.

Instead, a fully disclosed and negotiated compensation arrangement, absent fraud, should not be subject to hindsight review for potentially being "excessive" or "disproportionate" unless the MSRB provides clear objective measures that can be applied prospectively.

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[22] Exchange Act § 15B(e)(9).

H. Duty to Evaluate Alternatives and to Assess Whether a Transaction Is in a Municipal Entity's Best Interest.

1. Municipal Advisors Should Not be Required to Consider Alternatives Unless Specifically Engaged to Do So.

The G-36 Proposal provides that, as part of a municipal advisor's duty of care, the municipal advisor has a general duty to investigate and advise a municipal entity of alternatives to a proposed financing structure or product that are reasonably feasible based on the issuer's financial circumstances and the prevailing market conditions, if those alternatives would better serve the interests of the municipal entity.

The MSRB should reconsider imposing such implied affirmative obligations. Rather, the presumption of this duty should be reversed, such that a municipal advisor need only do what the municipal entity contracts for it to do, and only undertakes additional investigation and advisory activities at the request of the municipal entity. A municipal entity should not have to pay for services beyond those for which it expressly engaged the municipal advisor. Were the MSRB to retain this duty as drafted, municipal advisors would extensively negotiate the forms of engagement letters in order to fit into the "limited engagement" exception.

In addition, if any duty is to be implied, it should not apply in the context of a request for proposals where the form of engagement letter is non-negotiable. The imposition of such a duty by rule, coupled with the inability to negotiate a limited engagement clause in the engagement letter, would likely cause municipal advisors to limit the services that they offer, which would reduce competition in the marketplace and raise the cost of services.

2. More Guidance is Needed Regarding Duty of Inquiry When Providing a Certificate.

Under the G-36 Proposal, the MSRB would interpret a municipal advisor's fiduciary duty to its municipal entity client to include a duty to "make a reasonable inquiry as to the pertinent facts" when asked to provide a certificate that will be relied on by the municipal entity or by investors in the municipal entity's securities.

If the MSRB retains this requirement, the MSRB should clarify the required scope of a municipal advisor's factual investigation in connection with such municipal advisor's provision of a "certificate." The MSRB should also clarify whether any qualifications on the nature and scope of the investigation will

be permitted, and whether a municipal advisor may limit the scope of its engagement to disclaim such duty in the initial engagement letter or at any point thereafter. Indeed, it is impossible at the outset of an engagement to anticipate all of the limitations on the duty of inquiry that may be relevant in the context of providing a certificate. The examples contained in footnote 20 to the G-36 Proposal illustrate how large this universe of potential duties is (*e.g.*, reckless certifications of compliance with a "minimum credit requirement" and failure to exercise due care in its appraisals used in official statements).

3. The MSRB Should Not Impose New Due Diligence Requirements for Official Statements.

Under the G-36 Proposal, the MSRB would interpret a municipal advisor's fiduciary duty to its municipal entity client, when the municipal advisor undertakes the preparation of an official statement, to include a duty to "exercise due diligence as to the facts that are material to the offering."

The MSRB should reconsider this interpretation. Even where a municipal advisor participates in preparing the official statement, it is but one of many parties—and their counsel—involved in the process. While many parties contribute, it is understood by all that the official statement is the issuer's document and that ultimately, it is the issuer's obligation to ensure that the official statement contains all facts material to the offering. The MSRB should not reverse this fundamental principle under the guise of a duty of care. While the municipal advisor should be responsible for any information it provides, it should not—based on an interpretation of its fiduciary duty to the issuer—have responsibility for the accuracy or completeness of the entire official statement.

If the MSRB concludes to require municipal advisors to conduct this due diligence, the MSRB should clarify how exhaustive a municipal advisor's factual investigation must be. For example, the MSRB should clarify whether the municipal advisor may limit the scope of its engagement and qualify the nature and scope of the investigation, or whether a municipal advisor may contract out of such duty in the initial engagement letter or at any point thereafter. The MSRB should also clarify, where an underwriter assists in the preparation of an official statement, how the underwriter exception interacts with this duty.

In addition, the interpretive notice is ambiguous as to whom this duty of due diligence is owed. The MSRB should clarify that in interpreting a municipal advisor's fiduciary duty to its municipal entity client, the MSRB does not intend to impose on municipal advisors any direct obligations or potential liability to investors. The MSRB should not create due diligence requirements or new liabilities for official statements beyond those already existing under federal

securities laws. The MSRB should not create new sources of liability to investors; rather it should interpret the duty of care owed to the municipal entity. The MSRB should also clarify that any such duty would not be applicable in the case where the municipal entity serves as a conduit issuer for an obligated person, such as a private corporation or other private entity.

4. Municipal Advisors Should Not be Required to Conduct an Inquiry into Counterparty Representations Unless Specifically Engaged to Do So.

The G-36 Proposal would require that the municipal advisor "conduct a reasonable inquiry into representations of a municipal entity's counterparties." This duty would be unprecedented and burdensome and should not be imposed absent a specific request from the municipal entity client for the municipal advisor to do so. This duty seems to view a municipal advisor as an independent advisor to an issuer, rather than the many other roles that could give rise to municipal entity status, such as providing advice as a swap dealer.

At very least, the MSRB should provide clear guidance regarding the scope of a municipal advisor's duty to engage in a "reasonable inquiry." Because the MSRB has recognized that the municipal advisor is "not a guarantor" of the transaction, the MSRB should clarify that the municipal advisor is not required to undertake the type of investigation that would be required of a person that would be strictly liable for the success of the transaction. In addition, the MSRB should clarify that a municipal advisor would not be required to inquire into a counterparty's representations if the advisor's engagement is limited to advising the municipal entity as to the type of transaction in which the municipal entity should engage, and does not include advice regarding the specific counterparty with whom the municipal entity should conduct the transaction.

5. Limited Scope Engagements Should Be Limited in Scope.

Under the G-36 Proposal, the MSRB would permit an engagement to be limited in scope by specifying the limitation in the engagement letter or other written communication.[23] However, even in the face of a limited scope

[23] The MSRB's recognition that engagements may be limited in scope by providing for the limitation in the engagement letter further supports the position that the beginning of an "engagement" should be defined by entering into an engagement letter, as discussed in Section II.C.1 above. Otherwise, the limitations on scope that the Proposal permits would be impossible to implement during what the parties otherwise view as preliminary informal discussions.

engagement that specifically excludes the service, the G-36 Proposal would require a municipal advisor to (i) advise its municipal entity client if it has formed a broader judgment about the appropriateness of a financing or product, or (ii) expand the scope of its engagement based on the "course of conduct."

The MSRB should reconsider these positions, which would, by law, force municipal advisors to perform services that municipal entities contractually declined, thereby raising costs on municipal entities.

Where an engagement is specifically limited in scope to exclude advice regarding the appropriateness of a financing or product, municipal advisors should not nonetheless be required to inform its municipal entity client if it has formed a judgment about the financing or product. Even though, by its terms, this interpretation would only apply where the municipal advisor has actually formed a view, the practical effect of this interpretation would be that municipal advisors, in order to protect themselves from hindsight second-guessing, would be required to affirmatively consider the advisability of a financing or product. Otherwise, were a financing or a product to turn out to have been inappropriate for the municipal entity, the municipal advisor would always be subject to questioning and potential litigation about whether it had failed to disclose a view to the municipal entity.

Instead, where the parties have specifically contracted for a limited engagement that does not cover advising on the appropriateness of a financing or product, MSRB should not force it upon them. Otherwise, the municipal advisor's certification of its competence as part of its registration as a municipal advisor could be called into question. Adopting this interpretation would prevent municipal entities from effectively limiting the scope of the engagement and force municipal entities to bear the increased costs for services they have specifically decided they do not require.

Further, the MSRB should reconsider its position that, in the face of documentation limiting the scope of an engagement, a municipal advisor's "course of conduct" could "cause the municipal entity to expect that the advisor will be advising on appropriateness" and thereby re-impose the municipal advisor's duty to consider alternatives. This type of interpretation invites hindsight review of the course of conduct and will prevent municipal advisors from ever having certainty as to the extent of their duties. To protect themselves, municipal advisors will be forced to take on duties that their municipal entity clients have specifically declined, the cost of which will be borne by the municipal entities.

Indeed, the MSRB should adopt the position that if the engagement letter or other documentation between the parties expressly limits the scope of the engagement, then the scope of the engagement will be so limited, even if the municipal advisor's "course of conduct" could, notwithstanding the documentation, be viewed as broader than the scope of the engagement.

III. G-17 Proposal – Duties to Obligated Persons and Solicited Municipal Entities

Under Rule G-17, "[i]n the conduct of its . . . municipal advisory activities, each . . . municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." This duty of fair dealing extends to municipal advisory dealings with all persons, and the G-17 Proposal applies to (i) municipal advisors that advise obligated person clients and (ii) municipal advisors that solicit business from municipal entities on behalf of third parties.

A. Duty of Fair Dealing to Obligated Persons.

1. Absent a Fiduciary Duty, Municipal Advisors Should Not Owe a Duty of Care or Duty to Disclose Conflicts and Obtain Informed Consent.

The G-17 Proposal would interpret a municipal advisor's duty to "deal fairly" with obligated persons to include a duty of care, a duty to assess the appropriateness of a transaction and a duty to disclose material conflicts of interest and obtain informed consent. As proposed, the duties imposed on a municipal advisor engaged by an obligated person are barely distinguishable from the fiduciary duty owed to municipal entities under the G-36 Proposal. Because the duty of fair dealing, both by its nature and the words used in Rule G-17, is not the same as a fiduciary duty, the MSRB should impose significantly fewer obligations on a municipal advisor engaged by an obligated person under Rule G-17.

The G-17 Proposal is a novel and expansive interpretation of what constitutes "fair dealing." Rule G-17 is not a new rule, but was recently amended, only slightly, to simply add reference to municipal advisors.[24] This minor amendment made municipal advisors engaged in municipal advisory activities subject to the same standard of fair dealing that brokers, dealers and municipal

[24] *See* MSRB Fair Dealing Rule For Municipal Advisors Approved, MSRB Notice 2010-59 (Dec. 23, 2010).

securities dealers engaged in municipal securities activities were already subject to under the rule. However, the fiduciary concepts of a duty of care and a duty to disclose conflicts and obtain informed consent have never before been interpreted to be part of the duty to deal fairly that applied under Rule G-17. Additionally, such an interpretation is neither required nor proper under Section 975, which only deems a municipal advisor to have a fiduciary duty only when it is engaged by a municipal entity, not when it is engaged by an obligated person or engages in a solicitation of a municipal entity on behalf of a third party.[25]

SIFMA notes that the MSRB made no indication in its proposal to the SEC to amend Rule G-17 that it intended to take such an expansive interpretive view of how the existing Rule G-17 would apply to municipal advisors. To the contrary, the MSRB stated to the SEC that the purpose of the proposed rule change was merely "to apply the MSRB's core fair dealing rule to municipal advisors *in the same manner that it currently applies* to dealers."[26] In fact, the MSRB posited that the change to Rule G-17 would impose no burden on municipal advisors because "most municipal advisors already comport themselves in accordance with the standards of behavior required by Rule G-17 and no municipal advisor has a legitimate interest in engaging in behavior that is fraudulent or otherwise unfair."[27] However, the implied affirmative obligations that the G-17 Proposal would impose on municipal advisors clearly go far beyond simply refraining from engaging in fraudulent or unfair behavior, and is entirely foreign to the manner in which G-17 applies to other entities. As a result, SIFMA was unable to provide meaningful comments on the MSRB's amendment to Rule G-17 when it was published for comment by the SEC.

The MSRB should reconsider imposing a duty of care and duty to disclose conflicts and obtain informed consent as a part of Rule G-17's obligation of fair dealing. Such additional duties are not provided for by the language of MSRB Rule G-17 and should not be implied. Rather, the MSRB should state that a municipal advisor's duty of fair dealing requires it to fully and faithfully provide the services contracted by an obligated person and not engage in fraudulent or deceptive conduct. Further, by imposing its additional implied duties, the MSRB's interpretive notice and the obligations thereunder may be inconsistent with existing obligations of currently regulated persons, such as broker-dealers and investment advisers, as well as persons such as swap dealers that will be

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[25] *See* Exchange Act § 15B(c)(1).

[26] *See* Exchange Act Release No. 63309 (Nov. 12, 2010) (emphasis added).

[27] *Id.*

subject to similar duties in the near future. For example, a swap dealer, whose primary regulator is the CFTC, owes different duties depending on whether or not a counterparty that it is also advising is an obligated person. Because Section 975 imposes a fiduciary duty on a municipal advisor only with respect to its municipal entity clients, there does not appear, in the absence of a statutory mandate, to be any basis or justification for imposing a duty of care on a municipal advisor that advises an obligated person that is not otherwise a municipal entity.

2. Requested Clarifications Regarding the G-36 Fiduciary Duty Should Apply to Similar Obligations Under the Duty of Fair Dealing.

To the extent that the MSRB maintains its interpretation that Rule G-17 includes a duty of care and duty to disclose conflicts and obtain informed consent under, then it should clarify that any part of the application of Rule G-17 to municipal advisors that is similar to an obligation that would be incurred under Rule G-36 would be subject to the clarifications and contours (including with respect to the disclosure of fee arrangements) discussed above with respect to the G-36 Proposal.

3. The MSRB Should Not Create a New "Appropriateness" Standard.

The G-17 Proposal would require a municipal advisor that recommends a municipal securities transaction or municipal financial product to its obligated person client to have "concluded, in its professional judgment, that the transaction or product is appropriate for the client, given its financial circumstances, objectives and market conditions."

The MSRB should consider whether this "appropriateness" standard is effectively creating a new "suitability" standard, and if so, whether it is necessary to do so. Where possible, SIFMA believes the MSRB should avoid creating new, potentially conflicting, standards, the contours of which cannot be known in advance—especially when familiar and well recognized standards already exist. To the extent that the MSRB imposes such a new "appropriateness" duty, it should define this duty so that it is consistent with other suitability, fiduciary, fair practice or other already applicable obligations, as the case may be, to such persons as broker-dealers, municipal securities dealers and investment advisers.

In particular, the MSRB should reconsider imposing an "appropriateness" duty on a municipal advisor where the municipal advisor is already regulated and subject to a competing standard. For example, broker-dealers subject to the Financial Industry Regulatory Authority's ("**FINRA**") suitability standard and

investment advisers subject to a fiduciary duty should be deemed to have complied with the appropriateness standard when they comply with the standard that is otherwise applicable to them.

4. Duty to Inform of Material Risks of Transaction and Services.

In order to meet the "appropriateness" standard, the G-17 Proposal would require municipal advisors to advise their obligated person clients regarding the "material risks and characteristics" of any recommended transaction or product. Specifically, a municipal advisor that recommends to an obligated person that it enter into a municipal derivative contract is required to disclose the material risks (including market, credit, operational, and liquidity risks) and characteristics of the derivative.

In order to avoid duplicative and potentially conflicting regimes, the MSRB should clarify that a municipal advisor's duty to disclose material risks will be deemed satisfied where it complies with a similar requirement of another applicable regulatory regime. For example, in the case of a municipal advisor that recommends a swap or a security-based swap, the municipal advisor's disclosure obligation regarding material risks would be deemed satisfied if the municipal advisor satisfies applicable CFTC or SEC business conduct requirements.[28] In addition, this duty should be limited to specified types of transactions, and not extend to the full range of ordinary course transactions, such as bank deposits and the issuance of fixed or floating rate debt.

5. Municipal Advisors Should Not be Subject to Additional Implied Obligations When Reviewing Municipal Securities Transactions.

When a municipal advisor has been engaged by an obligated person to review a municipal securities transaction or municipal financial product recommended by another party (*e.g.*, an underwriter), the G-17 Proposal would imply an obligation of the municipal advisor to "evaluate and advise the client of the material risks and characteristics of the transaction or product and its appropriateness for the client, based on the client's financial circumstances, objectives, and market conditions."

[28] *See*, *e.g.*, CFTC Proposed Rule, Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 75 Fed. Reg. 80638 (Dec. 22, 2010).

The MSRB should reconsider imposing such an implied obligation on municipal advisors. Rather, the municipal advisor should only be obligated to do what the municipal entity has contracted for it to do in connection with reviewing the transaction. In this regard, the MSRB should clarify that a municipal advisor need not "expressly disclaim" the obligation to advise its client as to the appropriateness of the transaction or product, as, absent explicit agreement between the parties, the municipal advisor need not provide any services or undertake any analysis other than that for which the municipal advisor is hired by the obligated person.

Moreover, any duty to analyze the appropriateness of transactions should be limited to those facts that the municipal advisor is expressly required to obtain under MSRB rules or which municipal advisory personnel already have in their possession; no additional due diligence or fact gathering should be required.

6. Misrepresentation Requirements and Disclosures.

The G-17 Proposal would consider it a "misrepresentation" if, in a response to a request for proposals or qualifications, a municipal advisor failed to "fairly and accurately describe [its] capacity, resources and knowledge to perform the proposed municipal advisory engagement." The MSRB should reconsider this interpretation, as these requirements and their related prohibitions may be difficult for a municipal advisor to comply with when discussing a potential engagement with an obligated person.

To the extent that this interpretation is maintained, the MSRB should provide guidance as to how a municipal advisor may presently determine its capacity, resources and knowledge to perform the proposed municipal advisory engagement on a forward-looking basis. Further, the MSRB should confirm that municipal advisors may satisfy this disclosure obligations by providing generalized disclosures concerning their qualifications for an assignment in connection with the request for proposal or engagement process. In any case, the MSRB should clarify that a municipal advisor will not be deemed to have breached this duty if, it becomes apparent in hindsight that the municipal advisor was not properly qualified.

B. Duty of Fair Dealing When Soliciting on Behalf of Others.

1. Disclosures Regarding Solicitation and Offered Products and Services.

As part of a municipal advisor's duty of fair dealing when soliciting a municipal entity on behalf of a municipal advisor (in such capacity, a "**solicitor**"), the G-17 Proposal would require a solicitor to provide the municipal entity it solicits with various disclosures regarding the solicitation, the solicitor's client, the solicitor's compensation and the solicitor's relationships. Further, if the solicitor is soliciting with respect to a particular product or service, the proposal would require the solicitor to "disclose all material risks and characteristics of the product or service."

The MSRB should reconsider what disclosures a solicitor will be required to provide about the solicitation itself and the products or services being offered by its client to the municipal entity. In particular, disclosures of all relationships that the solicitor may have with influential employees, board members or affiliates of the municipal entity may be particularly extensive (and possibly unknowable) for large organizations—and of dubious value. Additionally, while a solicitor will typically familiarize itself with its municipal advisor client's products and services for purpose of making solicitations, it will not be in the best position to disclose all "material risks and characteristics" of the products or services being offered by its client and it should not have the obligation to do so. In any case, such disclosure is unnecessary and duplicative because a municipal advisor retained by the municipal entity will itself be required to provide this and various other disclosures in order to satisfy its own fiduciary duty to the municipal entity under Rule G-36.

2. Lavish Gifts and Gratuities.

The G-17 Proposal indicates that a solicitor would be considered to engage in deceptive, dishonest or unfair practices if the solicitor provides "lavish gifts and gratuities" to officials of a municipal entity or affiliated parties. A gift or gratuity will be considered "lavish" if it exceeds the limits imposed under Rule G-20 ($100 per year).

Gifts and gratuities is a complex topic that is not appropriately dealt with in the short-hand manner presented here. Notably, though Rule G-17, which also applies to brokers, dealers and municipal securities dealers, could be interpreted as implying a prohibition on lavish gifts and gratuities, nonetheless the MSRB dealt directly with this issue in Rule G-20. Rather that making a passing

reference to a prohibition on lavish gifts in the G-17 Proposal, if the MSRB believes solicitors should be subject to Rule G-20, it should include appropriate rules tailored to municipal advisors that solicit municipal entities on behalf of third parties in its proposal to amend Rule G-20.[29]

3. Duties Should Not Apply to Affiliated Solicitors.

As noted in Section II.F.4 above, Section 975 excludes from the definition of "municipal advisor" persons that solicit municipal entities on behalf of a persons under common control with the solicitor.[30] As such, even when a person is otherwise registered as a municipal advisor, such person should not be considered to be engaged in a municipal advisor activity when it solicits on behalf of its affiliate. The MSRB should therefore clarify that any requirements imposed by the G-17 Proposal would apply only to a solicitor that is unaffiliated with the entity on whose behalf it solicits, while a solicitor soliciting for an affiliate—even if otherwise registered as a municipal advisor—would not be subject to the obligations imposed by the G-17 Proposal while engaged in that solicitation. If the MSRB intended this provision to subject such persons to its pay-to-play rules, it should do so directly through its pay-to-play rulemaking, rather than indirectly through the G-17 Proposal.[31]

IV. Implementation Period.

Each of the Proposals would obligate municipal advisors to comply with detailed and specific requirements to which they are not currently subject. Many of these requirements, depending on whether they are adopted as proposed, will require significant lead time in order for municipal advisors to create systems to ensure compliance. Therefore, SIFMA requests that when a final Rule G-36 and related interpretive guidance and final interpretive guidance on Rule G-17 are adopted, the MSRB provides for a reasonable implementation period, which would certainly be no less than one year, before the Proposals become effective.

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[29] *See* Request for Comment on Gifts and Gratuities Rule for Municipal Advisors, MSRB Notice 2011-16 (Feb. 22, 2011).

[30] *See* Exchange Act § 15B(e)(9).

[31] *See supra* note 21 and accompanying text.

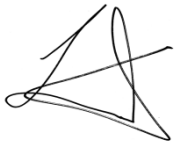
V. Conclusion

SIFMA supports the MSRB in its efforts to clarify the duties owed by municipal advisors to municipal entities and obligated persons. However, as discussed above, the MSRB Proposals are premature until the SEC has adopted final rules concerning what activities constitute acting as a "municipal advisor." In any case, the MSRB Proposals impose too many implied affirmative obligations that will prove unworkable and overly burdensome on municipal advisors, while expensive and unhelpful to municipal entities and obligated persons, these will ultimately lead to increased costs for municipal entities and obligated persons and decreased availability of beneficial products and services.

* * *

SIFMA appreciates this opportunity to comment upon the MSRB Draft Rule G-36 (on Fiduciary Duty Of Municipal Advisors) and related Draft Interpretive Notice and the MSRB Draft Interpretive Notice Concerning the Application of Rule G-17 to Municipal Advisors. Please do not hesitate to contact me with any questions at (212) 313-1130; or Robert L.D. Colby and Lanny A. Schwartz, of Davis Polk & Wardwell LLP, at (202) 962-7121 and (212) 450-4174, respectively.

Sincerely yours,



Leslie M. Norwood
Managing Director and
Associate General Counsel

cc: ***Securities and Exchange Commission***
The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Robert Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Martha Haines, Assistant Director and Chief, Office of Municipal Securities
Victoria Crane, Assistant Director, Office of Market Supervision

Municipal Securities Rulemaking Board
Lynnette Kelly Hotchkiss, Executive Director
Ernesto Lanza, Deputy Executive Director and General Counsel
Peg Henry, Deputy General Counsel
Karen Du Brul, Associate General Counsel

April 11, 2011

VIA EMAIL
Mr. Ronald W. Smith, Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke St.
Alexandria, VA 22314
CommentLetters@msrb.org

RE: MSRB Rule G-36 on Fiduciary Duty of Municipal Advisors and Draft Interpretive Notice

Dear Mr. Smith:

The Wisconsin Bankers Association (WBA) is the largest financial trade association in Wisconsin, representing approximately 300 state and nationally chartered banks, savings and loan associations, and savings banks located in communities throughout the state. WBA appreciates the opportunity to comment on the Municipal Securities Rulemaking Board's (MSRB's) Rule G-36 regarding the fiduciary duty of municipal advisors and draft interpretive notice (Rule).

WBA recognizes that the Rule is a direct result of a congressional mandate set forth in the Dodd-Frank Act (DFA), which amended Section 15(B) of the Securities Exchange Act of 1934 (Exchange Act) to provide that municipal advisors have a fiduciary duty to their municipal entity clients. WBA also recognizes that Section 15(B) of the Exchange Act directs MSRB to establish rules with respect to municipal advisors that "prescribe means reasonably designed to prevent acts, practices, and courses of business as are not consistent with the municipal advisor's fiduciary duty to its clients."

As these particular DFA revisions to Section 15(B) of the Exchange Act hinge on the definition of the term "municipal advisor;" WBA believes it premature for MSRB to propose its Rule until it is clear who is a municipal advisor, and what the standards for a fiduciary are, under the Securities Exchange Commission's (SEC's) pending rulemaking efforts. WBA believes that until SEC's rules regarding these matters are finalized, a full analysis of MSRB's Rule, to ensure that the Rule is not overly broad or unwarranted, is not possible.

We recognize the efforts MSRB has set forth in its review of amendments to Section 15(B) in this very challenging time of massive legislative and regulatory change; however, in its rulemaking, MSRB must be certain to avoid unnecessarily burdensome and duplicative regulation. WBA believes this difficult to ensure when such important components of the Rule's equation have yet to be clearly defined by the SEC.

To avoid inefficient, and repetitive review of MRSB's Rule, WBA recommends MSRB withdraw its premature Rule until SEC has finalized its definition of municipal advisor and the standards for a fiduciary. WBA believes this the most effective and efficient manner of review and implementation in these challenging times.

Once again, we appreciate the opportunity to comment on the Rule.

Sincerely,

Rose Oswald Poels
Interim CEO/President

4721 South Biltmore Lane
Madison, WI 53718

P. O. Box 8880
Madison, WI 53708-8880

608-441-1200
Fax 608-661-9381

www.wisbank.com