



## MSRB NOTICE 2010-27 (AUGUST 17, 2010)

### REQUEST FOR COMMENT ON RULE G-23 ON THE UNDERWRITING ACTIVITIES OF FINANCIAL ADVISORS

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The Municipal Securities Rulemaking Board ("MSRB") is requesting comments on draft amendments to Rule G-23, on activities of financial advisors, which would prohibit any broker, dealer or municipal securities dealer ("dealer") acting as financial advisor to an issuer in connection with its new issue of municipal securities from also serving as underwriter for such issue. The MSRB is considering these amendments in view of a request that it do so by the Securities and Exchange Commission ("SEC") and upcoming changes to the MSRB's enabling legislation relating to the regulation of municipal advisors (including but not limited to dealers acting as financial advisors to issuers) and the applicability of a federal fiduciary standard to their activities.[1]

#### **BACKGROUND**

Currently, Rule G-23 provides that a dealer acting as financial advisor with respect to a new issue of municipal securities may not acquire the issue as principal, either alone or in a syndicate, or act as agent for the issuer in the placement of such issue, unless certain requirements are met.[2] If a financial advisor for an issue wishes to be an underwriter for the issue to be sold on a negotiated basis, Rule G-23(d)(i) requires that: (i) the dealer terminate the financial advisory relationship with regard to the issue and at or after such termination the issuer expressly consent in writing to such acquisition or participation; (ii) at or before such termination, the dealer disclose in writing to the issuer that there may be a conflict of interest in changing from the capacity of financial advisor to that of purchaser of or placement agent for the securities and the issuer expressly acknowledge in writing to the dealer receipt of such disclosure; and (iii) the dealer disclose in writing to the issuer at or before such termination the source and anticipated amount of all remuneration to the dealer with respect to such issue and the issuer expressly acknowledge in writing to the dealer receipt of such disclosure. With respect to issues sold by competitive bids, Rule G-23(d)(ii) provides that a financial advisor must obtain the issuer's written consent prior to making a bid for the issue, but termination of the financial advisory relationship is not required.

In addition, current Rule G-23(e) provides that a dealer that has a financial advisory relationship with respect to a new issue may not act as agent for the issuer in remarketing such issue unless the dealer has disclosed in writing to the issuer: (i) that there may be a conflict of interest in acting as both financial advisor and remarketing agent for the securities; and (ii) the source and basis of the remuneration the dealer could earn as remarketing agent on such issue. The issuer must expressly acknowledge in writing to the dealer receipt of such disclosure and consent to the financial advisor acting in both capacities and to the source and basis of remuneration.

#### **DRAFT RULE CHANGE**

The draft rule change would amend Rule G-23 to prohibit a dealer that serves as financial advisor to an issuer for a particular issue sold on either a negotiated or competitive bid basis from switching roles and underwriting the same issue. Thus, the provisions of Rule G-23 regarding disclosures, terminations, and consents in connection with such change in roles are unnecessary and are eliminated.

The draft rule change provides a narrow exception for financings in which a dealer serving as financial advisor to an issuer places the entire issue with another governmental entity, as part of a plan of financing by such entity for or on behalf of the issuer (such as in the case of a state bond bank financing or other governmental

financing in which an issuer may issue a bond to such entity to evidence its indebtedness under a loan program), but only so long as the dealer does not receive compensation for such placement and is not compensated as an underwriter in connection with any related transaction undertaken by the governmental entity with which such issue is placed. For example, the exception would not apply with respect to a dealer financial advisor to a local government that places its new issue with a state bond bank if the dealer also serves as underwriter (or in some other similar role) to the bond bank in connection with a contemporaneous offering that funds the loan to the local government whose issue was placed with the bond bank. The draft rule change also preserves the existing ability of dealer financial advisors to purchase the new issue from the underwriters of the issue so long as this is not done to circumvent the prohibition on role switching.

In addition, the draft rule change would prohibit a dealer that serves as financial advisor to an issuer for a particular issue from serving as remarketing agent for such issue. However, the dealer would not be prohibited from later serving as successor remarketing agent for such issue if the financial advisory relationship with the issuer had been terminated for a period of at least one year.

Finally, the draft rule change eliminates certain additional disclosure requirements to issuers relating to activities of affiliates and to customers relating to a change in role from financial advisor to underwriter since the activities to be disclosed would no longer be permitted.

### **REQUEST FOR COMMENT**

The MSRB is requesting comments from the industry and other interested parties on the draft rule change and all relevant aspects of existing practices in the marketplace and the potential impact of adopting the draft rule change. In particular, the MSRB is seeking comments on the following specific topics:

1. Should a dealer be precluded for a specific timeframe from entering into a financial advisory relationship with an issuer after serving as an underwriter on one of the issuer's prior offerings of securities?
2. If the MSRB were to amend Rule G-23 to prohibit dealers from serving as underwriter on transactions for which they have served as financial advisor to the issuer, should there be an exception for competitively bid transactions? Would it matter if the notice of sale was made available 5-7 business days before a competitively bid transaction to allow additional time for other competing firms to conduct due diligence? Should a financial advisor be allowed to bid in a competitively bid transaction in which a failed bid had occurred? How would the situation be handled in which there is a failed bid and the financial advisor cannot step in to buy the bonds because of the prohibition? Is this a common occurrence?
3. Are there small and/or infrequent issuers that will be negatively affected by the proposed prohibition? What are the alternatives and costs for such issuers should the MSRB adopt the proposed draft rule amendment?
4. Is it appropriate for a dealer to serve as financial advisor to an issuer at the same time that it serves as underwriter on a separate issue for the same issuer?
5. As it relates to current practices, are there instances in competitively bid transactions in which a financial advisor should resign in order to "officially" bid on a competitive new issue transaction as an underwriter? Is there ever a time when the financial advisor does not conduct the bid process for the issuer, such as the use of electronic bidding platforms where the process of collecting bids is done by a third party on behalf of the issuer? Is it an uncommon practice for the bid process to be handled internally by the issuer?
6. In the context of a primary offering, should the exception found in Rule G-23(d)(iii) be limited to situations in which a financial advisor purchases bonds from underwriters who won a competitive bid for the bonds in which multiple bids were received?

7. In competitively bid transactions, are there situations where the issuer may hire a financial advisor to serve on a specific issue and then, at some point, hire a second financial advisor to oversee the competitive bid process in order to allow the original financial advisor to bid on the issue?

Comments should be submitted no later than September 30, 2010 and may be directed to Leslie Carey, Associate General Counsel, or Ronald W. Smith, Senior Legal Associate. Written comments will be available for public inspection on the MSRB's web site.[3]

August 17, 2010

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#### **TEXT OF DRAFT AMENDMENT TO RULE G-23[4]**

Rule G-23. Activities of Financial Advisors

(a) - (c) No change.

(d) Prohibition on Engaging in Underwriting Activities.

(i) Subject to provisions of subsections (d)(ii) and (iii), No broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to a new issue of municipal securities shall acquire as principal either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from the issuer all or any portion of such issue, or act as agent for the issuer in arranging the placement of such issue, unless

(i) if such issue is to be sold by the issuer on a negotiated basis,

(A) the financial advisory relationship with respect to such issue has been terminated in writing and at or after such termination the issuer has expressly consented in writing to such acquisition or participation, as principal or agent, in the purchase of the securities on a negotiated basis;

(B) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination that there may be a conflict of interest in changing from the capacity of financial advisor to purchaser of or placement agent for the securities with respect to which the financial advisory relationship exists and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; and

(C) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination the source and anticipated amount of all remuneration to the broker, dealer, or municipal securities dealer with respect to such issue in addition to the compensation referred to in section (c) of this rule, and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; or

(ii) if such issue is to be sold by the issuer at competitive bid, the issuer has expressly consented in writing prior to the bid to such acquisition or participation.

(ii) Notwithstanding subsection (d)(i), a broker, dealer or municipal securities dealer that has a financial advisory relationship with respect to a new issue of municipal securities shall not be prohibited from acting as agent for the issuer in arranging the placement of the entire issue with any state, local or federal governmental entity as part of a plan of financing by such entity for or on behalf of the issuer, but only if such broker, dealer or municipal securities dealer does not receive compensation from any person other than with respect to financial advisory services related to such placement and does not receive compensation from any person for underwriting any

contemporaneous financing transaction directly or indirectly related to such issue undertaken by the state, local or federal governmental entity with which such issue was placed.

(iii) The limitations and requirements set forth in this section (d) shall also apply to any broker, dealer, or municipal securities dealer controlling, controlled by, or under common control with the broker, dealer, or municipal securities dealer having a financial advisory relationship with respect to the new issue of municipal securities. The use of the term "indirectly" in this section (d) shall not preclude a broker, dealer, or municipal securities dealer who has a financial advisory relationship with respect to a new issue of municipal securities from purchasing such securities from an underwriter, either for its own trading account or for the account of customers, except to the extent that such purchase is made to contravene the purpose and intent of this rule.

(e) *Remarketing Activities*. No broker, dealer, or municipal securities dealer that has a financial advisory relationship with an issuer with respect to a new issue of municipal securities shall act as the remarketing agent for such issue; provided, however, that this section shall not prohibit such broker, dealer or municipal securities dealer from thereafter serving as successor remarketing agent for such issue if the financial advisory relationship in connection with such issue has been terminated for a period of at least one (1) year prior to such broker, dealer or municipal securities dealer being selected to serve as successor remarketing agent, unless the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer:

- (i) ~~that there may be a conflict of interest in acting as both financial advisor and remarketing agent for the securities with respect to which the financial advisory relationship exists; and~~
- (ii) ~~the source and basis of the remuneration the broker, dealer or municipal securities dealer could earn as remarketing agent on such issue.~~

~~This written disclosure to the issuer may be included either in a separate writing provided to the issuer prior to the execution of the remarketing agreement or in the remarketing agreement. The issuer must expressly acknowledge in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure and consent to the financial advisor acting in both capacities and to the source and basis of the remuneration.~~

~~(f) *Disclosure to Issuer of Corporate Affiliation*. If the financial advisor for the issue is not a broker, dealer or municipal securities dealer, and the broker, dealer or municipal securities dealer that acquires the issue or arranges for such acquisition pursuant to section (d) of this rule is controlling, controlled by, or under common control with such financial advisor, the broker, dealer or municipal securities dealer must disclose this affiliation in writing to the issuer prior to the acquisition and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure.~~

~~(g) Each broker, dealer, and municipal securities dealer subject to the provisions of sections (d), (e) or (f) of this rule shall maintain a copy of the written disclosures, acknowledgments and consents required by these sections in a separate file and in accordance with the provisions of rule G-9.~~

~~(h) *Disclosure to Customers*. If a broker, dealer, or municipal securities dealer acquires new issue municipal securities or participates in a syndicate or other account that acquires new issue municipal securities in accordance with section (d) of this rule, such broker, dealer, or municipal securities dealer shall disclose the existence of the financial advisory relationship in writing to each customer who purchases such securities from such broker, dealer, or municipal securities dealer, at or before the completion of the transaction with the customer.~~

~~(f) (i) *Applicability of State or Local Law*. Nothing contained in this rule shall be deemed to supersede any more restrictive provision of state or local law applicable to the activities of financial advisors.~~

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[1] See Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203. The provisions of Section 975 become effective on October 1, 2010.

[2] The original draft of Rule G-23, in 1977, would have prohibited a dealer from underwriting a negotiated sale of an issue on which it acted as a financial advisor, based on the view that a *prima facie* conflict existed between these two roles. Based in part on comments received at that time from issuer representatives, along with guidance from the SEC that such a prohibition did not exist in connection with corporate bond financings, the MSRB amended its original proposal to reflect the current requirements of Rule G-23, which allows for the change in role, subject to the specific requirements set forth in the rule. See MSRB Notice 2005-57 (November 18, 2005) for a discussion of the considerations undertaken in adopting Rule G-23.

[3] 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, commentators should submit only information that they wish to make publicly available.

[4] Underlining indicates additions; strikethrough indicates deletions.

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