National Association of Independent Public Finance Advisors
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September 14, 2011

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

Re: MSRB Notice No. 2011-42

Dear Mr. Smith:

Introduction

The National Association of Independent Public Finance Advisors ("NAIPFA"), founded 21 years ago, is an organization comprised of independent public finance advisory firms located across the nation. Our member firms solely and aggressively represent the interests of issuers of municipal securities.

NAIPFA appreciates this opportunity to comment on draft Rule G-46 ("Rule G-46"). NAIPFA believes that the MSRB's desires to eliminate the harmful effects that may result from unmanageable conflicts of interest. However, the MSRB's draft Rule falls short of this goal by recreating the unmanageable conflict of interest that had sought to be eliminated by another MSRB rule, Rule G-23. In addition, the draft Rule will confuse municipal issuers as to the role a broker-dealer is playing in a particular transaction and will likely create an anti-competitive business environment.

Therefore, NAIPFA respectfully requests that the MSRB amend Rule G-46 to make clear that:

(i) a broker-dealer who has any intention of potentially acting as underwriter, be prohibited from presenting Rule G-46 disclosures until the situation arises whereby the broker-dealer intends to be bound to the municipal issuer as its municipal advisor, or until the broker-dealer crosses the municipal advisory line by providing advice that would be considered municipal advisory in nature;

(ii) a broker-dealer who has any intention of potentially acting as a municipal advisor to a municipal issuer, be prohibited from presenting G-23 disclosures since under Rule G-23 an broker-dealer who has a financial

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advisory relationship is prohibited from underwriting securities with which they have served as municipal advisor; and

(iii) any broker-dealer who engaged in municipal advisory activities prior to presenting their Rule G-46 disclosures, assumes all liability as a fiduciary to the issuer for any and all of the municipal advisory services that they have rendered.

Unmanageable Conflict of Interest

On May 27, 2011, the Securities and Exchange Commission (the "SEC") approved amendments to Rule G-23. The stated purpose of these amendments was to eliminate the unmanageable conflict of interest known as "switching", the term used to describe the situation that occurs when a broker-dealer switches roles, typically occurring when the broker-dealer goes from being a financial advisor to an underwriter. Under amended Rule G-23 (herein simply referred to as "Rule G-23"), this conflict of interest was to be eliminated by limiting what broker-dealers could do. Principally, Rule G-23 attempted to limit a broker-dealer's ability to switch roles by denying the broker-dealer the ability to underwrite an issuance of securities when the broker-dealer has also served as the municipal entity's municipal advisor for that particular issuance.[1] However, Rule G-23 and draft Rule G-46, leave open a broker-dealer's ability to present multiple, inconsistent, disclosures that will confuse the issuer and will allow the broker-dealer to choose which role best serves their interests.

NAIPFA believes that the key question in determining whether a broker-dealer is restricted to the role of underwriter or municipal advisor depends on whether they have engaged in financial advisory services or have entered into an agreement to provide financial advisory services. Under G-23, a "financial advisory relationship shall be deemed to exist for purposes of Rule G-23 when a dealer renders or enters into an **agreement** to provide financial advisory services […] to or on behalf of an issuer [...] Rule G-23(b) also provides, however, that a financial advisory relationship shall **not** be deemed to exist when, in the course of acting as an underwriter and not as a financial advisor, a dealer provides advice to an issuer."[2] Thus, a broker-dealer will not be considered a municipal advisor unless they enter into an financial advisory contract or provide financial advisory services, which can occur even after a disclosure under G-23 has been made.[3]

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[1] Municipal Securities Rulemaking Board ("MSRB") Rule G-23(d)(i), MSRB Notice 2011-29 (May 31, 2011).
[2] MSRB Notice 2011-29, *Guidance on the Prohibition on Underwriting Issues of Municipal Securities for Which a Financial Advisory Relationship Exists Under Rule G-23*, May 31, 2011 (emphasis added).
[3] *See* MSRB Rule G-23(d) (allows a broker-dealer to engage in and receive a fee as a financial advisor in the event that they, intentionally or unintentionally, become a financial advisor after having presented their G-23 disclosure).

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Conversely, G-46 disclosures are only *required* where an individual has engaged in municipal advisory services or entered into an agreement to provide those services. Under G-46, a "municipal advisory relationship would be deemed to exist when a municipal advisor renders advice to a client or enters into an agreement with the client to render advice. The writing generally would be **required** to be created prior to, upon, or promptly after commencement of the municipal advisory relationship. The writing would **not** need to be a two-party **agreement**."[4] Thus, although disclosures required by G-46 ("G-46 Disclosures") are only *required* where financial advisory services have been provided or where a financial advisory agreement has been made, the Rule does not prohibit the voluntary dissemination of G-46 Disclosures. And, since G-46 Disclosures do not have to be in the form of an "agreement", the voluntary dissemination of G-46 Disclosures does not per se create a financial advisory relationship and thus does not limit a broker-dealers ability to also provide the disclosure outlined under Rule G-23 ("G-23 Disclosure"), at the same time, or the broker-dealer's ability to underwrite an issuance.

NAIPFA finds nothing in either the rules or interpretive guidance prohibiting a broker-dealer's from providing both G-46 and G-23 disclosures at the same time, since neither the writing contemplated by Rule G-23 nor Rule G-46 create an "agreement" to provide a particular kind of service. Instead, the writings are merely "disclosures". If either Rule G-23 or G-46 constituted an agreement to provide underwriting or financial advisory services, this would change NAIPFA's interpretation. However, MSRB Notice 2011-42 only reinforces NAIPFA's interpretation by stating that "the dealer could provide the *disclosures* required by Rule G-23 and draft Rule G-46 in the **same** writing".[5]

The foregoing leads NAIPFA to conclude that a broker-dealer who anticipates underwriting an issuance of securities but who also anticipates providing municipal advisory services could provide the issuer of municipal securities with both their G-23 Disclosure and their G-46 Disclosure. If NAIPFA is correct in its understanding, we fear that this will undermine the stated purpose of Rule G-23. Although this new form of role switching (herein referred to as "G-46 Switching" or a "G-46 Switch") differs from the switching sought to be eliminated by G-23, the reality is that Rule G-46 Switching will be no less harmful to municipalities.

Under a G-46 Switch, a broker-dealer will present both their G-23 Disclosure and their G-46 Disclosures. The broker-dealer will now be prepared to engage in a more in depth conversation with the issuer about the specifics of the transaction. For example, a

[4] MSRB Notice 2011-42, *Request for Comment on Draft Rule G-46 (On Activities of Municipal Advisors)*, August 10, 2011 ("Notice 2011-42") (emphasis added).
[5] *Id.* (emphasis added).

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broker-dealer could simply engage in a discussion with the issuer as to the overall makeup of the transaction such as asking, what are your plans for the project, how much do you anticipate needing in financing, or how long of a maturity schedule would you like to see; in this scenario the broker-dealer would not be giving advice and, under G-23, would not be a financial advisor. As a result of this conversation, the broker-dealer will be able to get a better picture of the size and scope of the project, which will allow the broker-dealer to decide whether their firm would prefer to underwrite the issuance, or whether their firm would rather they serve as a municipal advisor.[6] Thus, although G-23 eliminated a broker-dealer's ability to switch from financial advisor to underwriter, G-46 opens up a broker-dealer's ability to straddle the line between underwriter and municipal advisor until the broker-dealer decides which hat to wear.[7]

In this regard, the G-46 Switch, like its G-23 predecessor, creates an unmanageable conflict of interest whereby a broker-dealer is able to determine which role to play while disregarding the interests of the municipal issuer. This situation is made possible by the fact that individual is not bound by a fiduciary duty until the duty attaches, and so long as the broker-dealer does not provide advice that would be considered municipal advisory in nature, no duty will attach and the broker-dealer will be free to act as they choose. Therefore, without the amendments to Rule G-46 noted above, a broker-dealer will be free to choose a course of action that best suits its interests, not those of the municipal issuer, and because of the confusion that multiple disclosures will create, many unsophisticated municipal issuers will not be in a position to question the motives, justification or recommendation of a broker-dealer when the broker-dealer finally determines which role they want to play.

[6] MSRB Rule G-23(d)(ii) specifically grants broker-dealers the ability to engage in private placements of securities, even where the broker-dealer's original intention was to underwrite the bonds themselves but for their having crossed the line into becoming a municipal advisor. NAIPFA believes that there is a high degree of likelihood that a broker-dealer who accidently crosses into becoming a municipal advisor will prefer to place bonds with a firm with who they have a good working relationship, rather than a direct competitor. Therefore, NAIPFA asks for guidance regarding the fiduciary duty implications of a situation where a broker-dealer accidentally crosses the municipal advisory line and then privately places an issuance of securities with a firm with whom they have close times, rather than with an underwriting competitor, even though similarly situated individuals would come to the conclusion that a competitor's firm may be able to offer the municipal issuer more favorable financing terms.

[7] NAIPFA's believes that a broker-dealer would free to engage in this activity as long as the broker-dealer chose to do so, so long as the broker-dealer does not provide advice that would be considered municipal advisory in nature.

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Confusing to the Issuer

NAIPFA believes that draft Rule G-46's apparent allowance of multiple disclosures to be presented at the same time and as part of a single writing will only serve the purpose of confusing municipal issuers and ultimately will be harmful to their interests. This result will primarily stem from the differences in scope and nature of the disclosures that are required under rules G-23 and G-46.

Under Rule G-23, an underwriter is only required to:

> clearly identifies itself in writing as an underwriter and not as a financial advisor from the earliest stages of its relationship with the issuer with respect to that issue (e.g., in a response to a request for proposals or in promotional materials provided to an issuer) will be considered to be "acting as an underwriter" under Rule G-23(b) with respect to that issue. The writing must make clear that the primary role of an underwriter is to purchase, or arrange for the placement of, securities in an arm's-length commercial transaction between the issuer and the underwriter and that the underwriter has financial and other interests that differ from those of the issuer.

Notably, the G-23 Disclosure does not require the municipal issuer to acknowledge that it has received the disclosure; the underwriter is merely required to present its G-23 Disclosure to the issuer. Conversely, G-46 Disclosures require a bit more effort on the part of both the municipal advisor and the municipal issuer.

Under Rule G-46, a municipal advisor is required to obtain "written evidence of a municipal advisory relationship with a municipal entity."[8] The written documentation of the municipal advisory relationship must, among other things, include: (i) the basis of compensation, if any; (ii) the disclosures required by Rule G-17 and draft Rule G-36 (such as the amount of direct and indirect compensation, the scope of services and any conflicts of interest); and (iii) whether the municipal advisor is registered as a municipal advisor with the SEC and the MSRB. Additionally, unlike the G-23 Disclosure, the G-46 Disclosures do require the municipal issuer to acknowledge that they have received the disclosures and that they understand them.[9] Finally, although the Notice states that this

[8] Notice 2011-42.

[9] *See* draft MSRB Rule G-36, MSRB Notice 2011-48 (August 23, 2011); and draft MSRB Rule G-17, MSRB Notice 2011-49 (August 24, 2011).

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writing does "not need to be a two-party agreement," NAIPFA is concerned that the aggregate effect of both the items that must be included in the G-46 Disclosures and the requirement that the municipal issuer acknowledge receipt of the G-46 Disclosures, in writing, will be construed by a court to be a contract, binding upon the parties.

However, regardless of how a court may view such a writing, there is a high degree of certitude that a great many municipal issuers who, if presented with the Rule G-23 and Rule G-46 disclosures, could easily come to the same conclusion; that is, it is highly likely that a large number of municipal issuers will believe that they have hired a financial advisor, only later to find out that the broker-dealer's firm will now be underwriting the issuance. Notably, Rule G-23 may prevent the broker-dealer from underwriting in cases such as this. However, a concern NAIPFA and others have expressed in the past goes to the matter of enforcement, and who will be responsible for ensuring that a broker-dealer who serves as a municipal advisor will not subsequently underwrite the issuance. Further compounding NAIPFA's concern is the fact that Rule G-23 is premised on a broker-dealer being prevented from underwriting an issuance of municipal securities, while leaving unanswered the question of what happens if only after the fact the municipal issuer, the MSRB, or the SEC realize that an underwriter has crossed the municipal advisory line and should not have underwritten a particular issuance. Thus, who is to be responsible for ensuring that a broker-dealer municipal advisor does not underwrite an issuance, the broker-dealer, the municipal issuer, or some other third-party? This lack of clarity and the lack of practical preventative regulation to effectively eliminate the potential broker-dealer municipal advisory from switching roles and underwriting an issuance will only be exacerbated by draft Rule G-46's explicit allowance that both Rule G-23 and Rule G-46 disclosures can be made simultaneously, and in a contemporaneous writing.

Anti-Competitive

Under prior Rule G-23, broker-dealers were allowed to switch roles with relative ease. This allowed underwriters to, in some cases, shut-out their municipal advisor competitors by offering both services, sometimes doing so in a single writing. Similarly, under G-46, a broker-dealer will be able to determine which role they want to play by offering both underwriting and municipal advisory services in a single writing. Due to the confusing nature of presenting both the G-23 Disclosure and G-46 Disclosures, and similar to what occurred under prior Rule G-23, broker-dealers will be able to shut-out their municipal advisory competitors by appearing to be a one-stop-shop of services, even if this is not the case. Such a result will create an anti-competitive business environment, which will ultimately harm the interests of municipal issuers who otherwise would have sought out the services of a true municipal advisor.

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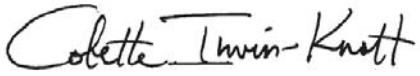
Conclusion

NAIPFA once again expresses its appreciation for the opportunity to submit its views on the MSRB's draft Rule G-46, and would like to reiterate its concerns regarding the conflict of interest created by draft Rule G-46's allowance of multiple, inconsistent, disclosures. To eliminate these concerns, NAIPFA respectfully requests that the MSRB prohibit broker-dealers from presenting multiple, inconsistent, disclosures to a single issuer. Please feel free to contact me if you have any questions or if further clarification of NAIPFA's comments are necessary.

Sincerely,



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

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Liban Jama, Counsel to Commissioner Aguilar
Lynnette Hotchkiss, Executive Director, Municipal Securities Rulemaking Board