



National Association of Independent Public Finance Advisors

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March 21, 2014

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

Re: MSRB Notice 2014-02

The National Association of Independent Public Finance Advisors (“NAIPFA”) appreciates this opportunity to provide comments in connection with Municipal Securities Rulemaking Board (“MSRB”) Notice 2014-02 –Request for Comment on Draft Best-Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals (the “Notice”).

Introduction

In general, NAIPFA not opposed to the imposition of a best execution standard; provided, however, that any such standard will not negatively impact issuers of municipal securities (each an “Issuer”), and their tax and rate payers. As such, these comments are designed to express our concerns and raise questions relating to proposed rule G-18 (the “Proposed Rule”) with respect to its potential impact on Issuers, and their rate and tax payers.

Comments

1. Use of the term “Customer” Should be Clarified

For purposes of the Proposed Rule, it is unclear who the MSRB is referring to when it uses the term “customer.” The term is not defined in the Proposed Rule nor in the MSRB Glossary. The closest definition to “customer” that appears in the MSRB Glossary is “customer trade,” which is defined broadly as essentially any trade in municipal securities involving a broker-dealer and a non-broker-dealer. Based on this definition, and because neither the Notice nor the Proposed Rule limit their use of the term “customer” solely to investors, an Issuer could arguably be considered a customer for purposes of the Proposed Rule. If this is the case, it is difficult to imagine how the Proposed Rule would be applied with respect to an underwriter’s purchase of securities from an Issuer. For example, would a broker-dealer have to utilize best execution procedures in connection with its purchase of securities from the Issuer in an initial public offering?

Despite the potentially broad nature of the term “customer,” there are indications within the Notice as well as MSRB Notice 2013-16, which suggest that the Proposed Rule is intended to be applicable only to investors. For instance, the Notice indicates that the “Stakeholders” include

“Investors,” but does not reference Issuers. Similarly, MSRB Notice 2013-16 makes several references to investors, stating in particular that the request for comment in connection therewith was “intended to elicit input from all interested parties . . . to more fully appreciate the benefits and impact of this requirement on investors and dealers.” In addition, no reference is made to Issuers in MSRB Notice 2013-16. Presumably, the MSRB would have noted Issuers in both notices if the Proposed Rule were intended to have a direct impact on them.

In light of the foregoing, NAIPFA is inclined to believe that the Proposed Rule is only intended to relate to the sale and purchase of municipal securities between a broker-dealer and an investor, and is not intended to establish rules relating to the purchase of securities from an Issuer. However, NAIPFA requests that the MSRB clarify his point, and to the extent that the Proposed Rule is intended to encompass an underwriter’s purchase of securities from an Issuer, NAIPFA requests that the Proposed Rule be re-proposed for comment prior to its submission to the SEC.

Notwithstanding this issue, we assume for the purposes of the comments below that the Notice and Proposed Rule’s use of the term “customer” is intended solely to refer to trades between investors and broker-dealers.

2. Fair Pricing Standard vs. Most Favorable Pricing Standard

NAIPFA disagrees with the Notice’s assessment of whether the Proposed Rule sets substantive pricing standards. Paragraph .01 of the Supplementary Materials of the Notice states:

The principal purpose of this rule is to promote, for customer transactions, dealers’ use of reasonable diligence in ascertaining the best market and obtaining the *most favorable price possible* under prevailing market conditions. A failure to have actually obtained the most favorable price will not necessarily mean that the dealer failed to use reasonable diligence.

Contrary to the Notice’s narrative portion, the above-referenced paragraph and the Proposed Rule create a substantive pricing standard. The first sentence obligates underwriters to undertake efforts to provide Issuers with the “most favorable price possible.” Whereas, the second sentence merely indicates that an underwriter’s failure to meet this substantive pricing standard will be a factor in determining whether the broker-dealer used reasonable due diligence. When viewed in conjunction with current Rules G-18 and G-30, these substantive pricing aspects become particularly evident.

In this regard, the Proposed Rule sets a substantive pricing expectation, that is, broker-dealers must strive to obtain the best price possible, whereas G-18 and G-30 establish substantive pricing floors, that is, prices given must be at least fair and reasonable. Thus, NAIPFA believes that the Proposed Rule, Paragraph .01, and current Rules G-18 and G-30 make clear that broker-dealers wishing to avoid MSRB rules violations must either (a) obtain the most favorable price, or (b) in the event that the most favorable price is not obtained, show that reasonable diligence was utilized in attempting to obtain the most favorable price and that the price ultimately obtained was nevertheless fair and reasonable.



However, regardless of whether the Proposed Rule establishes a substantive pricing standard, as discussed below, the Proposed Rule has implications with respect to the broker-dealer disclosures under MSRB Rule G-17 and may have significant negative impacts on the interests of Issuers, neither of which are addressed by the Notice.

3. Conflict with G-17

NAIPFA notes that the Notice does not make a distinction between transactions that occur during a primary/new offering of securities and those occurring in the secondary market. If, in fact, a broker-dealer will be obligated to undertake efforts to provide its customers with the most favorable prices within the context of a primary/new offering of securities, this will create an inconsistency in terms of a broker-dealer's obligations to Issuers and investors under Rule G-17.

As part of Rule G-17's interpretive guidance adopted by the MSRB in 2012, the MSRB mandated that broker-dealers serving as underwriters provide disclosures to Issuers stating, among other things, that

the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to sell municipal securities to investors at prices that are fair and reasonable.

This will no longer be true if the Proposed Rule is enacted, since broker-dealers will be obligated to attempt to sell municipal securities to investors at prices that are the most favorable to such investors. As such, the above referenced G-17 disclosure must be amended, otherwise Issuers will be misled with regard to their understanding of a broker-dealer's competing interests and the obligations owed by the underwriter to the various parties to the transaction.

Therefore, we respectfully request that broker-dealers acting as underwriters be obligated under G-17 to provide a disclosure to Issuers that accurately reflects the obligations imposed under the Proposed Rule. In this regard, the G-17 interpretive guidance should be revised to state something similar to the following:

the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to utilize reasonable due diligence to sell municipal securities to investors at prices that are the most favorable to such investors.

Currently, broker-dealers have to balance the competing, although equal, interests of Issuers and investors. However, the Proposed Rule will force underwriters to shift their pricing in favor of the interests of investors in a manner that will be contrary to the interests of Issuers. In other words, because broker-dealers will now be obligated to take steps to ensure that investors receive the most favorable prices, broker-dealers will be forced to offer less favorable prices, although still fair and reasonable, to Issuers. Thus, the Proposed Rule will potentially have a significant negative impact on Issuers, and their tax and rate payers.



Therefore, NAIPFA recommends that the MSRB limit the Proposed Rule to secondary market transactions in order to avoid the negative effects that the Proposed Rule is likely to have on Issuers and their constituents.

In the alternative, the MSRB must ensure that current MSRB Rules G-17, G-18 and G-30 do not conflict with the Proposed Rule. Further, to the extent that the Proposed Rule does conflict with any such rule, either the Proposed Rule or the conflicting rule must be amended to remedy any such inconsistency. Of particular concern in this regard is the apparent conflict between the Proposed Rule and the G-17 disclosure discussed above. Therefore, NAIPFA suggests that the G-17 disclosure be revised and harmonized with the new obligations imposed by the Proposed Rule.

Conclusion

As noted above, NAIPFA is in general not opposed to a best execution rule. However, we request clarity as to the meaning of the term “customer” for purposes of the Proposed Rule. Further, we believe that the Proposed Rule does establish a substantive pricing standard, although failure to meet that standard will not in and of itself be determinative of whether a violation occurs. Notwithstanding this, the Proposed Rule should be limited solely to transactions between investors and broker-dealers occurring in the secondary market, since the application of the Proposed Rule to initial offerings of securities may have a significant negative impact upon municipal issuers.

Sincerely,



Jeanine Rodgers Caruso, CIPFA
President, National Association of Independent Public Finance Advisors

cc: The Honorable Mary Jo White, Chairman
The Honorable Kara Stein, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Michael Piwowar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
Lynnette Kelly, Executive Director, Municipal Securities Rulemaking Board

