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Testimony on The Impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act on Municipal Finance
House Subcommittee on Capital Markets and Government Sponsored Enterprises
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Good morning Chairman Garrett, Ranking Member Waters and members of the Subcommittee. I appreciate the invitation to testify today on behalf of the Municipal Securities Rulemaking Board (MSRB). My name is Alan Polsky and I am Chair of the MSRB. I am also senior vice president of Dougherty & Co., LLC, a Minneapolis, Minnesota-based investment banking firm.

The MSRB was created by Congress in 1975 as the principal regulator for the municipal securities market with the mandate to protect investors and the public interest. By adopting a principles-based approach to regulating municipal securities dealers, operating retail-oriented information disclosure systems and establishing professional standards for municipal securities professionals, the MSRB has effectively created protections for retail investors in the $3.7 trillion United States municipal securities market.

The MSRB also acts as an independent resource and expert on the municipal securities market for policymakers such as Congress and the U.S. Department of the Treasury as well as other federal and state regulators including the Board of Governors of the Federal Reserve and the Internal Revenue Service.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) included multiple provisions that affect the municipal market and the MSRB. The provisions relating to the MSRB's rulemaking and related activities became effective on October 1, 2010. Specifically, Section 975 broadened the mission of the MSRB to include the protection of state and local governments, as well as certain private sector obligated persons — such as universities and hospitals — that access the capital markets through the issuance of municipal bonds. The MSRB, of course, also continues to pursue its original mission of protecting investors and the public interest.

Section 975 of the statute expanded the MSRB's responsibilities to include the regulation of municipal advisors. Municipal advisors include businesses and individuals that advise municipal entities concerning municipal financial products and municipal securities, as well as businesses and individuals that solicit certain types of business from municipal entities on behalf of unrelated broker-dealers, municipal advisors or investment advisors. Municipal securities dealers performing municipal advisory services were previously subject to MSRB regulation because of their municipal securities dealer activities. Under the new law, however, other municipal advisors are subject to MSRB regulation for the first time.

The MSRB's Board of Directors was reorganized under our amended authorizing statute to be made up for the first time of a majority of public, independent members and to include municipal advisor representatives. Previously, the Exchange Act required that the MSRB be governed by a board with a majority of industry members. Under the new structure, effective October 1, 2010, the MSRB is required by statute to maintain a balance of regulated and non-regulated Board members, with investors, municipal entities, securities dealers, bank dealers and municipal advisors each having representation on the MSRB Board of Directors.

Protection of State and Local Governments

Over the last two years under its majority public Board, the MSRB has acted to enhance disclosure and transparency measures to comply with the new law to protect a broader array of participants in the municipal market. The MSRB has undertaken its expanded mandate to strengthen protections for state and local governments — and the taxpayers who support municipal borrowing.

The role of the MSRB in protecting state and local governments is critical because these entities raise, through the issuance of bonds, notes and other debt obligations, an average of nearly $450 billion in the capital markets each year.[1] The municipal bond market has evolved from one in which states and municipalities offered traditional, general obligation fixed rate bonds to finance specific projects to one that involves the use of various security structures, complex derivative products and intricate investment strategies, and the presence of an ever-expanding group of service and product providers, advisors and sales teams.

Many of the bond transactions undertaken by state and local governments are complex transactions involving sometimes dozens of financial, legal and other players, each of whom represents his or her own interests and often has conflicts tied to an additional and often invisible set of market participants. Moreover, compensation of participants in a municipal finance transaction in almost all cases is contingent on the completion of the deal, creating incentives that put unknowing state and local governments at risk of inappropriate and unsuitable transactions and products — at the expense of taxpayers and ratepayers.

[1] Thomson Reuters SDC Platinum database on new municipal issuance from 2007-2011

In the vast majority of cases, state and local government officials are unfamiliar with the mechanics of a municipal finance transaction. At the local level, many are part-time staff. As public servants, these individuals are responsible for representing the interests of their communities, their taxpayers and their ratepayers, but in many cases, they lack the experience and/or expertise needed to assess the terms of the structures presented to them by financial professionals recommending structures and products. Transactions involving interest rate swaps and other complex structures further complicate the situation. In cases such as these, state and local governments can hire a municipal advisor or advisors but need to have the confidence that they represent their best interests.

As Committee Chairman Spencer T. Bachus wrote in 2009, "Although local governments frequently tap the municipal finance market to raise funds to pay for long-term projects, conflicts of interest and complexity in the municipal finance market can sometimes trap the unwary, particularly when local officials lack the expertise to independently assess the terms of the financing structures proffered by sophisticated underwriters."[2]

State and local governments are not the only ones who can lack expertise. Unqualified municipal advisors recommending ill-advised or unsuitable transactions to state and local governments can compound the challenges they face. Like underwriters of municipal securities, these advisors can have multiple undisclosed ties to other market participants that can threaten the integrity of the advice given to state and local governments. Until now, many market professionals acting as financial advisors to state and local governments have, by and large, been exempt from meeting any standards of quality, professionalism and expertise.

High profile examples like the Jefferson County, Alabama bankruptcy,[3] municipal bid-rigging convictions obtained by the U.S. Department of Justice,[4] unsuitable derivative transactions sold to local governments[5] and guarantees provided by localities for corporate projects that have

[2] Federal Policy Responses to the Predicament of Municipal Finance, Congressman Spencer T. Bachus, Cumberland Law Review, 2009.

[3] In re *Jefferson County, Alabama* Chapter 9 Case No. 11-05736-TBB-9, U.S. Bankruptcy Court for the Northern District of Alabama (November 9, 2011) ("Jefferson County Bankruptcy").

[4] *See, e.g.*, U.S. v. Carollo, 10-cr-00654, U.S. District Court, Southern District of New York (July 27, 2010); U.S. v. Rubin/Chambers, Dunhill Insurance Services Inc., 09-CR-01058, U.S. District Court, Southern District of New York (October 29, 2009). Allegations regarding bid rigging have been raised in other venues as well. *See also* SEC Complaint 1, SEC v. J.P. Morgan Securities LLP, Case No. 2:11-cv-03877 (D.N.J. July 7, 2011) (alleging fraudulent bidding practices by J.P. Morgan Securities in at least 93 municipal bond reinvestment transactions); SEC Litigation Release No. 21956, Securities and Exchange Commission v. UBS Financial Services Inc. (May 4, 2011) (alleging fraudulent bidding practices by UBS Financial Services in at least 100 municipal bond reinvestment transactions); In the Matter of Banc of America Securities LLP, Exchange Act Release No. 63451 (December 7, 2010) (alleging fraudulent bidding practices by Banc of America Securities in at least three municipal bond reinvestment transactions).

[5] Jefferson County Bankruptcy.

defaulted[6] illustrate the price of gaps in regulation of the municipal securities market. Local governments, rather than being able to turn to a trusted financial advisor to help defend against questionable advice, practices and complex products, in these cases instead received advice of questionable quality from unregulated financial advisors.

Many states, counties and communities across the country face this same alignment of professionals that, rather than serving the best interests of their state or local government clients, can serve to provide an avenue for taking advantage of financially less sophisticated public servants.

With a Congressionally mandated role to protect state and local governments, the MSRB has assessed and is amending its existing regulations for banks, broker-dealers and municipal securities dealers to explicitly protect state and local governments. These changes are intended to ensure that dealers follow rigorous fair-practice and other standards, and that state and local governments have the information they need to make appropriate decisions.

The MSRB has also developed the framework for a principles-based regulatory regime that would establish regulations for municipal advisors and protect state and local governments. These include draft rules on conflicts of interest, including pay-to-play.

I'd like to go in to some more detail about these draft rules so the Subcommittee has an understanding of the philosophy and consistency of the approach to municipal advisor regulation compared to that of dealers, and how the MSRB's draft rules would establish fair practice and other rules for the two groups of financial professionals with arguably the most extensive influence and contact with state and local governments.

Draft Municipal Advisor Rules

The MSRB is directed by statute to adopt rules for municipal advisors in a number of areas, including, among other things: (1) prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, enhance mechanisms of a free and open market, and protect investors, municipal entities, and obligated persons; (2) prescribe means reasonably designed to prevent acts, practices, and courses of business that are not consistent with a municipal advisor's fiduciary duty to its municipal entity clients; (3) prescribe professional standards; (4) provide continuing education requirements; and (5) provide for periodic compliance examinations. The MSRB is directed to not impose a regulatory burden on small municipal advisors that is neither necessary nor appropriate to the public interest and the protection of investors, municipal entities and obligated persons, provided that there is robust protection of investors against fraud.

Beginning in October 2010, the MSRB undertook an extensive outreach effort to solicit input

[6] *See, e.g.*, Report of the Missouri House Interim Committee on Government Oversight and Accountability Mamtek Report, (February 2012) and Yvette Shields, *Lombard Draws on Reserves*, The Bond Buyer (January 5, 2012).

from market participants and the public on the type and nature of regulations needed to protect state and local governments. At the same time, the MSRB conducted extensive analysis of its existing rules for municipal securities dealers and studied the nature of the professional services provided by municipal advisors.

Following this outreach and analysis, the MSRB began to lay the foundation for municipal advisor regulation under our expanded statutory mandate. As one of the MSRB's initial municipal advisor rules, the MSRB extended its fair dealing rule, MSRB Rule G-17, to cover the actions of municipal advisors. MSRB Rule G-17 provides that, in the conduct of its municipal securities and municipal advisory activities, each dealer and municipal advisor must deal fairly with all persons and may not engage in any deceptive, dishonest or unfair practice. This "fair dealing" rule is key to defining the relationships of dealers and municipal advisors with investors and issuers, serving as the core to the MSRB's principles-based approach to regulation and as the basis for numerous enforcement actions to address misbehavior in the marketplace.

Also, since October 1, 2010, Section 975 of the Dodd-Frank Act has imposed a federal fiduciary duty on municipal advisors to state and local governments when providing financial advice. Specifically, the MSRB proposed a new rule and an associated interpretation covering the details of an advisor's fiduciary duty. The proposed regulation would, consistent with the obligations of other types of fiduciaries under federal or state laws, require municipal advisors to act consistent with the basic duties of loyalty and care by, among other things, acting in the best interests of their state or local government clients and disclosing all material conflicts of interest. The proposed regulations would address these basic duties in the context of the relationships and activities between state and local governments and their municipal advisors. The proposed rule notes, for example, that municipal advisors must not undertake an engagement when an unmanageable conflict exists, must not charge excessive compensation, and must review reasonably feasible alternatives to proposed products and transactions when advising their state and local governments of a particular financing.

Prohibiting conflicts of interest on the part of financial professionals that can undermine the integrity of the municipal market is an important aspect of many MSRB regulations. One form of conflict of interest in the municipal market can arise if financial professionals seek to influence the award of business by state and local government officials by making political contributions to those officials or soliciting contributions on their behalf. This activity can have a negative impact on market fairness and public confidence in municipal capital markets. In 2011, the MSRB proposed a rule that would regulate so-called "pay to play" activities of municipal advisors, as well as firms and individuals that solicit certain business from municipal entities on behalf of others. Modeled after MSRB rules in place since 1994 for municipal securities dealers doing business with state and local governments, the proposed rule seeks to sever any connection between political contributions to municipal officials and the awarding of advisory service business to municipal advisors. Like municipal securities dealers, municipal advisors would be prohibited from engaging in business with municipal entities for two years if the firm or their municipal professionals make certain political contributions to state or local

government officials with authority to hire such municipal advisors. The proposed rule would also institute requirements designed to prevent circumvention through indirect activities and would require quarterly disclosures of certain information concerning municipal advisor political contributions to the MSRB, which would make the information available to the public through its website, at www.msrb.org.

The MSRB proposed several other rule changes designed to ensure that state and local governments are protected from potentially unfair conduct on the part of municipal advisors. These draft rules include: (1) restricting the use of gifts to curry favor with employees controlling the award of municipal business; (2) establishing basic standards of fairness and accuracy in advertising and other promotional materials; (3) providing guidance on fair practice duties toward obligated persons; and (4) establishing basic supervisory requirements for municipal advisors based in part on existing municipal securities dealer supervisory requirements but simplified and appropriately tailored in recognition that most municipal advisors are small firms with less complex structures.

Finalization of the MSRB's proposed municipal advisor rules have been put on hold pending completion by the Securities and Exchange Commission (the SEC) of its pending rule proposal to more clearly delineate the breadth of professionals covered under the new statutory definition of municipal advisors. The MSRB expects to complete its initial phase of municipal advisor rulemaking outlined above following resolution of the definition by the SEC.

Professional Qualifications of Municipal Advisors

In addition developing draft rules for municipal advisors to implement Section 975 of the Dodd-Frank Act, the MSRB began the process of establishing minimum professional qualifications for municipal advisors. This work started in October 2010 when the MSRB began conducting outreach events and focus groups to gather input from municipal advisors and others about the development of a professional qualification examination for assessing the competency of entry-level municipal advisors. The MSRB subsequently organized a municipal advisor examination working group to consider all comments received by the MSRB, assess commonalities in municipal advisory activities, provide additional input and assist in the drafting of a content outline for an examination.

Prior to finalizing the initial qualification exams after final SEC rulemaking on its definition of municipal advisor, the MSRB will survey registered municipal advisors about the proposed examination content to ensure it is properly tailored to their functions in the marketplace.

Expanded Obligations for Underwriters

As part of the MSRB's implementation of Section 975, the MSRB also reviewed the existing obligations of underwriters of municipal securities to state and local governments. As a result of this assessment, the MSRB determined that additional protections for state and local governments were necessary. These important new protections, in the form of a new

interpretive notice to MSRB Rule G-17 on fair dealing, take effect August 2, 2012.

The interpretive notice significantly clarifies the different roles, responsibilities and relationships of the financial professionals involved in municipal bond deals, and highlights for state and local governments the risks and characteristics involved in complex municipal financings.

Beginning August 2, 2012, an underwriter must disclose to its state or local government client that an underwriter's primary role is to purchase securities for distribution in an arm's-length commercial transaction and that it has financial and other interests that differ from those of its client. While the nature of this relationship may be clear to some, state and local governments that are not in the capital markets on a regular basis may not be aware that an underwriter and an issuer have an arms-length relationship. On the other hand, municipal advisors have a fiduciary duty to act in the best interests of their state and local government clients.

As part of the MSRB's effort to clarify the difference in these relationships to the issuer, the interpretive notice requires an underwriter to disclose that, unlike a municipal advisor, it does not have a fiduciary duty to its state or local government clients and, therefore, is not under a duty to subordinate its own financial or other interests to those of its clients. The underwriter must also disclose to the state and local government client any third-party relationships that may introduce conflicts of interest, including payments or profit-sharing arrangements with third parties, as well as the issuance or purchase of credit default swaps on the issuer's securities.

The new interpretive notice also requires underwriters to disclose the material financial characteristics and risks of complex municipal securities financings to help ensure that state and local governments understand the features, risks and characteristics of transactions recommended by an underwriter so they can make the best decision for their particular situation.

The MSRB continues to reevaluate other existing dealer regulations in light of the explicit mandate to protect state and local governments, and is considering changes where necessary. This effort includes addressing rules related to ensuring that underwriters honor the intention of state and local governments in selling certain portions of their bonds to retail investors and also to improving the availability of current information about initial offering prices or yields of new issues of municipal securities, among others.

Market Transparency, Education and Outreach

Part of the MSRB's effort to safeguard state and local governments over the last two years has been to make them aware of information that helps them make appropriate decisions. The MSRB's Electronic Municipal Market Access (EMMA) website, at http://emma.msrb.org, has dramatically improved the availability of information about the municipal market. This free, public website operated by the MSRB is the official source of municipal market documents and

data, helps state and local governments evaluate trading activity, and provides them with a free and centralized avenue for disseminating disclosure documents and related information on their municipal securities to their investors, taxpayers and other stakeholders. The EMMA website houses offering documents for almost every municipal security issued in the United States, secondary market disclosures that provide valuable information about the issuer of a bond throughout its life, real-time trade prices, interest rates and liquidity documents for variable rate securities, and other relevant information, including current credit ratings from rating agencies agreeing to make such information freely available to the public.

EMMA provides enormous benefits to investors, state and local governments, and other market participants because it ensures free, convenient and easy access to information that is essential for making investment and other decisions related to municipal securities. EMMA has been embraced by all categories of municipal market professionals, including regulated municipal securities dealers and municipal advisors, state and local governmental issuers, institutional and retail investors, other professionals that support issuers, and the general public. EMMA has been recognized broadly by the national financial press as a critical tool for retail investors who seek to be self-directed investors or who simply want more information about their investments or a way to check on the quality of service their brokers or investment advisors are providing.[7]

In 2011, the MSRB also began expanding its online tools for state and local governments, including videos and fact sheets about what to expect when working with municipal securities dealers and advisors, the continuing disclosure obligations of state and local governments, and using the EMMA website to communicate with investors.

The MSRB has also engaged in a proactive effort to communicate with state and local government issuers regarding the development of rules for municipal advisors and how the MSRB can effectively protect state and local governments through regulation and market transparency. This type of outreach by the MSRB has encouraged further discussion of the most efficient and effective means of ensuring the fairness and transparency of the municipal market for all participants.

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Response to H.R. 2827

The MSRB has been asked by this Subcommittee to provide its views with regard to Congressman Robert Dold's bill, H.R. 2827, that would amend Section 975 of the Dodd-Frank Act, and more generally on Titles VII and IX of the Dodd-Frank Act.

[7] *See, e.g., Forbes Magazine*, "Finally, An Easy Way To Get Timely Municipal Bond Data," July 9, 2012; *Smart Money*, "Muni Bonds Require More Attention Nowadays," July 10, 2012; *Wall Street Journal,* "A Site to Check Municipal Bond Ratings," November 19, 2011; *New York Times*, "In Uncertain Times, Municipal Bonds Call for Caution," October 18, 2011; *New York Times*, "Fresh Air in the Muni Market," August 20, 2009.

Congressman Robert Dold's bill to amend the Securities Exchange Act to clarify provisions relating to municipal advisors addresses the definition of municipal advisors and certain related definitions, and proposes to eliminate the federal fiduciary standard for municipal advisors. The MSRB would like to provide the Subcommittee with information useful in its consideration of the implications of the HR 2827's proposed expanded exclusions from the municipal advisor definition and removal of the federal fiduciary standard.

Section 975 of the statute currently provides a broad definition of municipal advisor. However, before the statute was established, many market professionals acting as financial advisors to state and local governments had, until 2010, been exempt from meeting any standards of quality, professionalism or professional conduct. This regulatory gap resulted in an array of firms and individuals that could simply declare themselves financial advisory professionals and begin advising state and local governments on capital market financings ranging from the tens of thousands of dollars to many billions of dollars. The skills, experience and professionalism of these financial advisors have ranged from the highest-minded expert professionals, on one end of the spectrum, to advisors that have no basis – professional or ethical – to be relied upon to provide qualified and un-conflicted advice to the public sector. It is important to ensure that the professionals on whom state and local governments rely for independent advice are properly qualified and regulated.

Putting aside, for the moment, the nuances of Section 975 in terms of the definition of municipal advisor, the MSRB is well positioned to assume the task of addressing the statutory requirement to ensure that state and local governments are adequately protected.

Definition of Municipal Advisor

In December 2010, the SEC issued a rule proposal to establish a permanent registration regime for municipal advisors (Proposed Exchange Act 15Ba1-1). The proposed rule was intended, in part, to provide greater clarity on the definition of municipal advisors. This proposal proved to be rather controversial, resulting in over 1,000 comment letters questioning many aspects of the definition.

Like Congressman Dold, the MSRB is concerned about the effects of an overly broad definition of municipal advisor. In February 2011, the MSRB submitted a comment letter to the SEC[8] that recommended several specific changes related to the efficiency of the proposed municipal advisor registration process and the scope of the definition of municipal advisor.[9] Consistent with the provisions of HR 2827, the MSRB also recommended excluding from the definition of municipal advisor not only municipal entities and employees of municipal entities,

[8] MSRB Comment Letter to the Securities and Exchange Commission on Proposed Rules on Registration of Municipal Advisors (File No. S7-45-10), February 22, 2011.

[9] For example, the MSRB recommended an approach to municipal advisor registration that parallels the current process undertaken by the SEC for registering municipal securities dealers, which would reduce considerably the burden on individuals associated with municipal advisors and streamline the process at the firm level.

but also any member of the governing body of a municipal entity regardless of how the membership is determined. This exclusion would apply when the employees or members were acting within the capacity of their jobs. The MSRB further recommended excluding similar employees, directors and officers of obligated persons from the definition of municipal advisor when they are acting on their own behalf and providing internal advice with respect to municipal financial products or the issuance of municipal securities.

More generally with regard to the definition of municipal advisor, the MSRB understands the need to avoid regulatory duplication – that is, requiring professionals to comply with two different rulebooks covering the same sets of activities. The MSRB offers two general observations we believe will help achieve the elimination of regulatory duplication without creating regulatory gaps. Such gaps should be avoided since they could result in regulatory arbitrage at the expense of the protection of state and local governments.

When creating exclusions for professionals already subject to another regulatory regime, it is important to consider whether these regulatory regimes specifically cover these professionals' municipal advisory work with state and local governments. A comprehensive "scope-based" approach that limits exclusions to activities otherwise subject to regulation could represent a solution to the challenge of regulatory gaps.

H.R. 2827 takes a scope-based approach for certain categories of exclusions but not for others. For example, its exclusion of SEC- or state-registered investment advisers is not scope-based, raising the likelihood that certain activities engaged in by investment advisers – such as, for example, advice to a state or local government on the structuring of a bond offering or of other plans, programs or investment pools – would be exempted from the coverage of the municipal advisor provisions. However these activities also would not be regulated under investment adviser regulations promulgated by the SEC and the various states since new issue or other program structuring advice to state and local governments would likely not be viewed as investment advice subject to the existing regulatory schemes of the SEC and the states.

The exclusion for financial institutions provided for in H.R. 2827 also creates the potential for regulatory gaps with respect to advice provided to state and local governments. Banking regulations are designed to address, first and foremost, the safety and soundness of the banking system, but are not designed to regulate the structuring of a bond offering or other non-banking activities and services that financial institutions may provide to state and local governments.

On the other hand, we believe H.R. 2827's approach to an exclusion from the definition of municipal advisor for those professionals involved with swaps or security-based swaps (collectively referred to as "swaps") is scope-based and therefore appropriately addresses the need to protect state and local governments. The exclusion for municipal advisors registered with the Commodity Futures Trading Commission (the CFTC) or the SEC would be limited in scope to their advice on, engagement in, or arrangement of a swap and is not likely to create a significant regulatory gap. This depends on the existence of SEC and CFTC rules applicable to these professionals covering the provision of advice to a state or local government (referred to

under Title VII of the Dodd-Frank Act as "special entities") with respect to swaps. This scope-based exclusion would appropriately continue to treat these professionals as municipal advisors if their advice to state or local governments relates to matters other than their swap activities.[10]

The MSRB therefore believes that the best approach with respect to exclusions to the definition of municipal advisor would be to make them all scope-based, so that these entities are excluded only when the activities they undertake are otherwise subject to regulation that provides for the protection of state and local governments.

The MSRB's second observation on regulatory duplication relates to H.R. 2827's exclusions from the definition of municipal advisor to associated persons of market participants. Because the term "associated person" under the federal securities laws can include any person within entities under common control of a corporate parent such as a bank or financial holding company, a blanket (that is, non-scope-based) exclusion for associated persons could result in their day-to-day municipal advisory activities having no regulation whatsoever — either as a municipal advisor, an investment adviser or a financial institution because the regulation of the parent company may not address the municipal advisory services to state and local governments. Such a scenario could reduce protection of state and local governments and again raise the possibility of certain professionals benefiting from regulatory arbitrage.

The Subcommittee should also consider that a wholly unintended and undesirable result of a blanket, non-scope-based exclusion for associated persons could be that only those municipal advisory firms that are fully unaffiliated with larger corporate parents — the vast majority of which are very small businesses — would be subject to regulation as municipal advisors while firms that are part of large financially-oriented corporate families would be left unregulated. This would be the antithesis of the Congressional determination that regulation of municipal advisors be designed not to impose a regulatory burden on small municipal advisors given that their larger competitors would be free of all regulation.

Federal Fiduciary Duty

I would now like to address the issue of a federal fiduciary duty for municipal advisors and H.R. 2827's elimination of this duty. The MSRB is concerned, above all, in protecting state and local governments in the context of their municipal finance transactions. We recognize that it is up to the Subcommittee and Congress to determine whether a federal fiduciary duty for advisors is appropriate and think that we can offer helpful considerations in that determination.

In a relationship of trust between a state or local government and a municipal advisor, a fiduciary duty applies by virtue of common law.[11] The existing fiduciary duty may not be a

[10] To further reduce the potential for regulatory duplication and regulatory gaps, the MSRB recommends that the SEC and CFTC, which are directed under Title VII of the Dodd-Frank Act to coordinate their regulatory activities with one another with respect to swaps, should be further directed to coordinate their regulatory activities with the MSRB with respect to swap activities involving special entities, where expertise on the specific needs of state and local governments resides within the federal securities regulatory expertise of the MSRB.

federal one, but it exists nonetheless, whether labeled formally as a fiduciary duty, a duty of trust, a duty arising from an agent-principal relationship, or any other such other label.

If the federal fiduciary standard were to be eliminated, there would still be applicable fiduciary duty standards in each of the fifty states. Each state could fashion appropriate laws taking into account the unique needs of the localities within its jurisdiction. Municipal advisors would continue to be required to comply with the separate state laws in each of the jurisdictions in which they practice. Eliminating a federal fiduciary duty would reinforce state fiduciary duty laws and perhaps encourage more vigorous state-level enforcement in effectively preventing scandals in the municipal market. However, eliminating the federal fiduciary duty would require municipal advisors to understand the varying standards from state-to-state. Uneven enforcement of such standards that depend on the degree of vigor in pursuing enforcement from state-to-state also would continue.

Retaining a federal fiduciary standard for municipal advisors would provide the national municipal marketplace with a single, consistent set of rules for municipal advisors who operate locally, regionally and nationally. A clear and uniform understanding of their legal duties will give rise to the level of consistency needed to maintain a fair and efficient national market in municipal securities. A federal fiduciary duty would also provide state and local governments with a clear understanding and expectation of the obligations of their municipal advisors. MSRB rules would articulate clearly what is meant by this duty of loyalty.

As I mentioned earlier, once the SEC moves forward with a definitional rule for municipal advisors, the MSRB will re-release draft rule proposals relating to how such federal fiduciary rule would be applied. Rulemaking on the federal fiduciary standard and on other key municipal advisor rule proposals was suspended precisely to provide municipal advisors — once they know who they are — with the opportunity to study the proposals and to provide meaningful comments to the MSRB prior to the rules being filed with the SEC to complete the rulemaking process.

Retaining a federal fiduciary duty will enable municipal advisors and other market participants to provide their analysis and suggestions for better refining these regulatory proposals — particularly with regard to questions of balancing the benefits of a rigorous set of regulatory standards with the relative burden of compliance with such new standards, as well as potential consideration of alternative approaches to achieving the same objectives. The ability of the marketplace to engage in a conversation with the MSRB regarding the appropriate construction and application of a federal fiduciary duty is far greater than the ability of market participants to influence any necessary evolution of common law fiduciary standards upheld by state courts

[11] Although in the past these duties arising out of the relationship of trust have not always been well understood, the fact that such relationship exists and gives rise to specific duties has become increasingly clear in recent years, whether through enforcement actions, the enactment of the federal fiduciary duty itself or the extensive discussions regarding fiduciary standards since enactment of the statute. Elimination of the federal fiduciary standard in the statute would not ultimately be successful at reducing the expectation of adherence by municipal advisors to state-based fiduciary obligations owed to state and local governments.

in the context of specific legal proceedings.

Elimination of a federal fiduciary duty for municipal advisors would not change the MSRB's mandate to protect state and local governments. It will continue to fulfill its mission to include the adoption of rules on the advisory activities of municipal advisors for the purpose of, among other things, protecting state and local governments. This mission includes rulemaking authority with respect to standards of fair dealing, conflicts of interest (including pay-to-play activities), professional qualifications, continuing education, supervision, recordkeeping and a range of other areas. The MSRB will, as mandated by Congress, adopt a rigorous, well-balanced set of municipal advisor rules designed to provide the full range of protections that state and local governments, obligated persons, investors and the general public deserve and are entitled to under the Exchange Act. As the Subcommittee wrestles with the issue of how to best fulfill this mission, please carefully consider the vital need for municipal advisors to have the obligation to act in the best interest of their state and local government clients.

I hope that I have provided the Subcommittee with helpful information with respect to your consideration of a federal fiduciary duty for municipal advisors, the merits of scope-based exclusions to the definition of municipal advisor, our overall views on their regulation and the importance of moving forward with implementation of Section 975 of the statute.