MSRB Municipal Securities Rulemaking Board

MSRB Notice

2019-13

Publication Date
May 20, 2019

Retrospective Rule Review

Stakeholders
Municipal Securities Dealers, Municipal Advisors, Issuers

Notice Type
Request for Comment

Comment Deadline
August 19, 2019

Category
Fair Practice

Affected Rules
Rule G-23

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Request for Comment on MSRB Rule G-23 on Activities of Dealers Acting as Financial Advisors

Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on MSRB Rule G-23, on activities of financial advisors, in connection with its ongoing retrospective review of MSRB rules and guidance.[1] This request for comment is intended to elicit input on whether Rule G-23's requirements on brokers, dealers and municipal securities dealers (together, "dealers") acting in a financial advisor capacity to issuers with respect to the issuance of municipal securities, and related MSRB interpretive guidance, continue to achieve the rule's intended purpose and reflect current practices in the municipal securities market. The MSRB invites all interested parties to submit comments in response to this request, along with any other information they believe would be useful.

Comments should be submitted no later than August 19, 2019 and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking here. Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1300 I Street NW, Washington, DC 20005. All comments will be available for public inspection on the MSRB's website.[2]

[1] *See* MSRB Notice 2019-04 (Feb. 5, 2019). The goal of the retrospective rule review is to help ensure MSRB rules and interpretive guidance are effective in their principal goal of protecting investors, issuers and the public interest; not overly burdensome; clear; harmonized with the rules of other regulators, as appropriate; and reflective of current market practices.

[2] Comments generally are posted on the MSRB's website without change. For example, personal identifying information such as name, address, telephone number or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.

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Questions about this notice should be directed to Lanny A. Schwartz, Chief Regulatory Officer, or Stephen Vogt, Assistant General Counsel, at 202-838-1500.

Regulatory History

Rule G-23 was initially adopted by the MSRB in 1980 to establish ethical standards and disclosure requirements for dealers who act as financial advisors to issuers with respect to the issuance of municipal securities ("dealer financial advisors").[3] The rule is designed principally to minimize the *prima facie* conflict of interest that exists when a dealer acts as both a financial advisor and an underwriter with respect to the same issue (*i.e.*, "role switching").[4]

Historically Rule G-23 addressed conflicts of interest related to role switching by imposing obligations on dealer financial advisors that included making certain disclosures, obtaining issuer consent and other requirements. The MSRB revisited Rule G-23's requirements on several occasions leading up to its most recent amendment in 2011.[5] The MSRB also adopted interpretive guidance over the course of the rule's history covering such topics as financial advisory services to corporate obligors

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[3] *See* Securities Exchange Act (Exchange Act) Release No. 16630 (Mar. 6, 1980), 45 FR 16065 (Mar. 12, 1980) (File No. SR-MSRB-77-12).

[4] *See, e.g.*, Exchange Act Release No. 41217 (Mar. 26, 1999), 64 FR 15855 (Apr. 1, 1999) (File No. SR-MSRB-97-16). The MSRB has explained:

> The role and interests of the dealer financial advisor are significantly different from the role and interests of a dealer acting as an underwriter for the same governmental unit. Often, when a dealer financial advisor switches roles to underwrite a transaction, 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 financial advisor's becoming the underwriter on the transaction.

Exchange Act Release No. 63946 (Feb. 22, 2011), 76 FR 10926, at 10935 (Feb. 28, 2011) (File No. SR-MSRB-2011-03) (internal quotation omitted).

[5] *See, e.g.*, Exchange Act Release No. 29290 (June 11, 1991), 56 FR 28206 (June 19, 1991) (File No. SR-MSRB-91-02); Exchange Act Release No. 30258 (Jan. 16, 1992), 57 FR 2939 (Jan. 24, 1992) (File No. SR-MSRB-91-6); and Exchange Act Release No. 41217 (Mar. 26, 1999), 64 FR 15855 (Apr. 1, 1999) (File No. SR-MSRB-97-16).

with respect to industrial development bonds, fairness opinions and blanket financial advisory agreements.[6]

The MSRB most recently amended Rule G-23 in 2011, at which time the rule's prohibition on role switching was expanded.[7] The MSRB stated in the proposing release that the 2011 amendments:

> [R]esulted from a concern that a dealer financial advisor's ability to underwrite the same issue of municipal securities, on which it acted as financial advisor, presented a conflict that is too significant for the existing disclosure and consent provisions of Rule G-23 to cure. Even in the case of a competitive underwriting, the perception on the part of issuers and investors that such a conflict might exist was sufficient to cause concern that permitting such role switching was not consistent with "a free and open market in municipal securities," which the Board is mandated to perfect.
>
> The imposition by [the Dodd-Frank Wall Street Reform and Consumer Protection Act] of a fiduciary duty upon municipal advisors, which includes financial advisors, made the existence of such a conflict a greater concern.[8]

As amended in 2011, Rule G-23 states that the purpose of the rule is to establish ethical standards and disclosure requirements for dealer financial advisors.[9] Rule G-23 provides that for purposes of the rule, a financial advisory relationship shall be deemed to exist when a dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to the issuance of municipal

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[6] *See generally*, Rule G-23 Interpretive Guidance. Among the most significant of these is the Notice on Application of Board Rules to Financial Advisory Services Rendered to Corporate Obligors on Industrial Development Bonds (May 23, 1983), which states that Rule G-23 does not apply to dealers providing financial advisory services to conduit borrowers.

[7] *See* MSRB Notice 2011-29 (May 31, 2011); *see also* Exchange Act Release No. 64564 (May 27, 2011), 76 FR 32248 (June 3, 2011) (File No. SR-MSRB-2011-03).

[8] Exchange Act Release No. 63946 (Feb. 22, 2011), 76 FR 10926, at 10927 (Feb. 28, 2011) (File No. SR-MSRB-2011-03).

[9] Rule G-23(a). Rule G-23(f) provides that the rule shall not be deemed to supersede any more restrictive provision of state or local law applicable to the activities of financial advisors.

securities.[10] The rule requires each financial advisory relationship to be evidenced by a writing that meets certain minimum requirements specified in the rule.[11] Notwithstanding this requirement, a financial advisory relationship will be deemed to exist whenever a dealer renders the types of advice provided for in Rule G-23(b), regardless of the existence of a written agreement.[12]

Further, Rule G-23: (i) prohibits a dealer financial advisor with respect to the issuance of municipal securities from acquiring all or any portion of such issue directly or indirectly, from the issuer as principal, or acting as agent for the issuer in arranging the placement of such issue, either alone or as a participant, in a syndicate or other similar account formed for that purpose;[13] (ii) applies the same prohibition to any dealer controlling, controlled by, or under common control with the dealer financial advisor;[14] and (iii) prohibits a dealer financial advisor from acting as the remarketing agent for such issue.[15]

Rule G-23 provides several exceptions to the prohibition on role switching (the "Role Switching Exceptions"). Specifically, a dealer financial advisor is not prohibited from:

- Placing an issuer's entire issue with another governmental entity, such as a bond bank, as part of a plan of financing by such entity for or on behalf of the dealer financial advisor's issuer client, under certain conditions (the "Bond Bank Exception");[16]

- Serving as a successor remarketing agent to an issuer for the same issue with respect to which it provided financial advisory services if

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[10] Rule G-23(b).

[11] Rule G-23(c).

[12] *See* Guidance on the Prohibition on Underwriting Issues of Municipal Securities for Which a Financial Advisory Relationship Exists under Rule G-23 (Nov. 27, 2011).

[13] Rule G-23(d)(i).

[14] Rule G-23(d)(iii).

[15] Rule G-23(e).

[16] Rule G-23(d)(ii).

the financial advisory relationship with the issuer has been terminated for at least one (1) year;[17] or

- Purchasing securities from an underwriter, either for its own trading account or for the account of its customers, except to the extent that such purchase is made to contravene the purpose and intent of the rule.[18]

As part of the 2011 amendment to Rule G-23, the MSRB also adopted interpretive guidance applicable to dealer financial advisors.[19] The interpretive guidance provides that an underwriter may, without being subject to the rule's prohibition on role switching, provide advice concerning the structure, timing, terms, and other similar matters concerning an issue of municipal securities that it is underwriting if:

- It 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);

- The writing makes clear that the primary role of an underwriter is to purchase 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; and

- The dealer does not engage in a course of conduct that is inconsistent with an arm's length relationship with the issuer in connection with such issue of municipal securities.

Finally, this same interpretive guidance provides that, in addition to engaging in underwriting activities, a dealer that states that it is acting as an underwriter with respect to the issuance of municipal securities may also provide advice on the investment of the proceeds of the issue, municipal derivatives integrally related to the issue, and other similar matters concerning the issue without being subject to Rule G-23's prohibition on role switching.

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[17] Rule G-23(e).

[18] Rule G-23(d)(iii).

[19] *See supra* note 12.

Federal Municipal Advisor Regulation

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), enacted in 2010, amended the Exchange Act by, among other things, requiring municipal advisors to register with the Securities and Exchange Commission (SEC), prescribing a fiduciary duty for municipal advisors providing certain kinds of advice to municipal entities, and directing the MSRB to make rules with respect to municipal advisors and their activities.[20] As amended, the Exchange Act defines "municipal advisor" as any person (other than a municipal entity or an employee of a municipal entity) that (i) provides advice to or on behalf of a municipal entity[21] or obligated person[22] 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.[23]

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[20] *See* Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010), codified as various provisions of Section 15B of the Exchange Act.

[21] Section 15B(e)(8) of the Exchange Act defines "municipal entity" to mean "any State, political subdivision of a State, or municipal corporate instrumentality of a State or of a political subdivision of a State, including: (1) [a]ny agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (2) [a]ny 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 (3) [a]ny other issuer of municipal securities." 15 U.S.C. 78o-4(e)(8). *See also* 17 C.F.R. § 240.15Ba1-1(g).

[22] Section 15B(e)(10) of the Exchange Act defines "obligated person" to mean ''any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in an offering of municipal securities.'' 15 U.S.C. 78o-4(e)(10). *See also* 17 C.F.R. § 240.15Ba1-1(k).

[23] 15 U.S.C. 78o-4(e)(4)(A). *See also* 17 C.F.R. § 240.15Ba1-1(d). Section 15B(e)(9) of the Exchange Act defines "solicitation of a municipal entity or obligated person" to mean "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser (as defined in section 202 of the Investment Advisers Act of 1940 [15 U.S.C. 80b–2]) that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity." 15 U.S.C. 78o-4(e)(9). *See also* 17 C.F.R. § 240.15Ba1-1(n).

In 2013, the SEC adopted its final rule governing the registration of municipal advisors.[24] The final rule provides several exclusions and exemptions from the definition of municipal advisor, including but not limited to the following:

- Underwriter exclusion: SEC Rule 15Ba1-1(d)(2)(i) excludes from the municipal advisor definition a broker, dealer, or municipal securities dealer serving as an underwriter of a particular issuance of municipal securities to the extent that the broker, dealer, or municipal securities dealer engages in activities that are within the scope of an underwriting of such issuance of municipal securities, provided certain requirements are met.[25]

- Independent registered municipal advisor (IRMA) exemption: SEC Rule 15Ba1-1(d)(3)(vi) excludes from the municipal advisor definition any person engaging in municipal advisory activities in a circumstance in which a municipal entity or obligated person is otherwise represented by an independent registered municipal advisor, provided certain requirements are met.[26]

- Bank exemption: SEC Rule 15Ba1-1(d)(3)(iii) excludes from the municipal advisor definition any bank, as defined in section 3(a)(6) of the Exchange Act (15 U.S.C. 78c(a)(6)), to the extent the bank provides advice with respect to certain traditional banking products and services, as enumerated in the rule.[27]

Following the implementation of the federal regulatory framework for municipal advisors, many dealers registered as municipal advisors in order to engage in non-exempt municipal advisory activities. In addition, certain municipal advisors have since registered as dealers. As a result, there are many entities dually registered as a dealer and a municipal advisor.

[24] *See* Registration of Municipal Advisors, Exchange Act Release No. 70462 (Sept. 20, 2013), 78 FR 67468 (Nov. 12, 2013). *See also supra* note 23 and accompanying text.

[25] 17 C.F.R. § 240.15Ba1-1(d)(2)(i).

[26] 17 C.F.R. § 240.15Ba1-1(d)(3)(vi).

[27] 17 C.F.R. § 240.15Ba1-1(d)(3)(iii).

MSRB Regulation of Municipal Advisors

In 2015 the MSRB adopted new Rule G-42, on duties of non-solicitor municipal advisors, which became effective on June 23, 2016.[28] Rule G-42 establishes standards of conduct for municipal advisors, which includes a duty of loyalty and a duty of care, for municipal advisors in the conduct of municipal advisory activities for municipal entity clients.[29] The rule requires municipal advisors to provide clients with written disclosures related to material conflicts of interest and certain other information.[30] The rule also requires that municipal advisors evidence each municipal advisory relationship by a writing or writings created and delivered to the municipal entity or obligated person client prior to, upon or promptly after the establishment of the municipal advisory relationship.[31] In addition, the rule prohibits municipal advisors from, among other things, engaging with a municipal entity client in a principal transaction that is the same, or directly related to the, issue of municipal securities or municipal financial product as to which the municipal advisor is providing or has provided advice to the municipal entity client.[32]

The MSRB understands that the municipal securities market has seen significant changes in the regulatory landscape over the last few years. The MSRB has received feedback from industry participants that Rule G-23 should be reconsidered in light of the implementation of the municipal advisor regulatory framework. One of the principal goals of the MSRB's

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[28] *See* MSRB Regulatory Notice 2016-03 (Jan. 13, 2016); *see also* Exchange Act Release No. 76753 (Dec. 23, 2015), 80 FR 81614 (Dec. 30, 2015) (File No. SR-MSRB-2015-03). The MSRB also adopted related amendments to MSRB Rule G-8, on books and records to be made by brokers, dealers, municipal securities dealers, and municipal advisors. *See id*. Additionally, since the enactment of Dodd-Frank, the MSRB has adopted numerous other rules and rule amendments related to municipal advisors, including: Rule A-12, requiring registration with the MSRB; Rule G-2, on standards of professional qualification; Rule G-3, on professional qualification requirements; Rule G-17, on conduct of municipal securities and municipal advisory activities; Rule G-20, on gifts, gratuities and non-cash compensation; Rule G-37, on political contributions and prohibitions on municipal securities business and municipal advisory business; and Rule G-44, on supervisory and compliance obligations of municipal advisors.

[29] Rule G-42(a)(ii). Under Rule G-42(a)(i), the standard of care for a municipal advisor providing municipal advisory services to an obligated person client includes a duty of care.

[30] Rule G-42(b).

[31] Rule G-42(c).

[32] Rule G-42(e)(ii).

retrospective review of Rule G-23 is to seek input on whether the rule is appropriately aligned with that framework.

Interaction between Rule G-23 and Rule G-17

Although many dealers (or their affiliates) who act in a financial advisory capacity to municipal issuers have registered as municipal advisors, some dealers have chosen to limit their activities to those which are permitted without registration, such as acting as underwriters (subject to conditions). Since the enactment of Dodd-Frank, the MSRB issued an interpretive notice concerning the application of MSRB Rule G-17 to underwriters of municipal securities (the "Rule G-17 Interpretive Notice").[33] Specifically, the Rule G-17 Interpretive Notice requires dealers to deal fairly with issuers in connection with the underwriting of their municipal securities and to make disclosures regarding the role of the underwriter, conflicts of interest and certain other information related to the underwriting. For example, disclosure concerning the arm's-length nature of the relationship between the issuer and underwriter must be made in the earliest stages of the relationship with respect to the issue (*e.g.*, in a response to a request for proposals or in promotional materials provided to an issuer).

Because both Rule G-23 and the Rule G-17 Interpretive Notice provide disclosure, documentation and other requirements concerning the activities of dealers, as part of its retrospective review of Rule G-23, the MSRB is interested in ensuring that there are no inconsistencies or unwarranted burdens associated with the operation of those requirements.

Request for Comments

The MSRB seeks comments in response to the following questions, as well as on any other relevant topic. The MSRB particularly welcomes statistical, empirical and other data from commenters that may support their views and/or relate to the topics, statements or questions raised in this request for comment.

1. What has been the experience of issuers, dealers, municipal advisors, and other market participants with respect to Rule G-23's prohibition on role switching since the 2011 amendment? Has the rule been effective in achieving its primary purpose of addressing the conflict of

[33] *See* Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities (Aug. 2, 2012). The Rule G-17 Interpretive Notice is the subject of the MSRB's ongoing retrospective review of its rules and guidance. *See* MSRB Notice 2018-10 (June 5, 2018) and MSRB Notice 2018-29 (Nov. 16, 2018).

interest that exists when a dealer acts as both a financial advisor and an underwriter with respect to the same issue?

2. Have small and/or infrequent issuers experienced any particularized benefits or costs, such as limited choices among financial advisors or underwriters or placement agents serving their market, due to Rule G-23's prohibition on role switching? Does Rule G-23 strike the right balance between issuer protection and issuer choice?

3. Considering the implementation of the MSRB's and SEC's municipal advisor rules, are there ways the MSRB could achieve Rule G-23's purpose without retaining it as a standalone rule? For example, should the MSRB eliminate Rule G-23 and address any need for regulatory requirements and exceptions through enhancements to other MSRB rules, such as Rule G-42?

4. If Rule G-23 continues as a standalone rule, what are the ways in which Rule G-23 should be better aligned to the municipal advisor rules? Should Rule G-23 incorporate the defined terms and key terms of art of the MSRB's and SEC's municipal advisor rules? Are there terms in the MSRB's and SEC's municipal advisor rules that should not be incorporated in Rule G-23?

5. Does Rule G-23 prohibit any activities that would be permitted under the SEC's municipal advisor rules in ways that are contrary to the regulatory purpose underlying the rules? For example, does Rule G-23 unduly impede the activities of dealers operating under an exclusion or exemption from registration under the SEC's municipal advisor rules?

6. Should the MSRB make any amendments to the Role Switching Exceptions? For example –

    a. Does the Bond Bank Exception remain appropriate? Should this exception be broader or narrower?

    b. Should Rule G-23 provide an exception to a dealer that avails itself of any of the exclusions or exemptions under the SEC's municipal advisor rules, such as the IRMA exemption?

    c. Should Rule G-23 provide an exception for competitive bid underwritings? If so, should such an exception be limited to small issuances (*e.g.*, $15 million or less in aggregate principal amount)?

   d. Should Rule G-23 provide an exception for a dealer financial advisor if it disengages as financial advisor and a successor financial advisor is engaged by the issuer? If so, should the rule impose a cooling off period?

7. Rule G-23's prohibition on role switching currently extends to dealer financial advisors acting as a placement agent for the issuance of municipal securities.

   a. As it pertains to placement agent activities, is the prohibition sufficiently clear as to what activities are, or are not, permissible for dealer financial advisors? Should the MSRB provide interpretive guidance regarding the scope of activities that a dealer financial advisor may perform under Rule G-23 without being regarded as a placement agent for purposes of the rule's prohibition on role switching?

   b. If Rule G-23 were eliminated as a standalone rule, with any substantive requirements being moved to Rule G-42 or another MSRB rule, should the MSRB modify Rule G-42 or such other rule to address any permitted or prohibited placement agent activities by a municipal advisor insofar as MSRB rules are concerned?

8. In the context of a dealer acting as a financial advisor, are there ways the MSRB could improve the efficiency and effectiveness of disclosures and related documentation requirements under Rules G-23 and G-42 and the Rule G-17 Interpretive Notice while preserving issuer protection?

9. Rule G-23's prohibition on role switching applies on an issue-by-issue basis.[34] Does this standard continue to be appropriate? Should the prohibition be broader or narrower? Should the MSRB provide interpretive guidance regarding what constitutes an "issuance" for this purpose, and if so, how should it be defined?

10. Should the MSRB retire any interpretive guidance related to Rule G-23? What aspects of Rule G-23's interpretive guidance should be updated and/or retained? For any interpretive guidance that is not retired, should the MSRB recast the interpretive guidance as a single

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[34] *See* Exchange Act Release No. 64564, *supra* note 7, 76 FR at 32254.

publication? Are there topics related to Rule G-23 about which the MSRB should provide new or additional interpretive guidance?

May 20, 2019

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