



September 17, 2012

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

**Re: MSRB Notice 2012-43 (Aug. 15, 2012), Request for Comment: Rule G-37 on
Political Contributions and Prohibitions on Municipal Securities Business—Bond
Ballot Campaign Committee Contributions**

Ladies and Gentlemen:

Thank you for this opportunity to comment on MSRB Notice 2012-43 (Aug. 15, 2012), Request for Comment: Rule G-37 on Political Contributions and Prohibitions on Municipal Securities Business—Bond Ballot Campaign Committee Contributions (“Notice 2012-43”).

By requesting comment on disclosures contemplated in Notice 2012-43, the Board is taking another important step in the right direction with reference to bond election contributions by dealers serving in underwriting capacities. We believe that further action will be warranted as the Board continues to examine this area, but the disclosures contemplated in Notice 2012-43 would be an important step nonetheless. Among other things, once the definition of the “municipal advisor” concept is finalized by the Securities and Exchange Commission, financial advisors and other municipal advisors can be brought within the scope of the regulation.

In California, where school bond elections have required only a 55% voter approval since 2000, there has been a large increase in the number of bond measures submitted to voters. Government Financial Strategies is concerned about the lack of transparency in how school bond campaigns are funded, frequently by interested parties and in significant amounts, and how this leads to corruption.

Our President, Lori Raineri, has testified on the subject before the California Legislature. In doing so, Ms. Raineri made the following points—

- This common practice is an illegal use of public funds for campaigning

In Opinions No. 7861 dated March 21, 2003, and No. 1008348 dated June 28, 2010, the California Legislative Counsel concluded that “it is our opinion that a school district or other local agency may not condition the award of an agreement to provide bond underwriting services on the underwriter also providing campaign services in support of that bond measure or another bond measure proposed by the school district or other local agency.”

- It is important to prevent the corruption of a negotiation in which great sums of public funds are at stake

The public official’s ability to negotiate fees and costs is compromised because the party on the opposite side at the time of the negotiation was formerly the issuer’s uncompensated, and often secret, advocate. There is a lingering obligation to reimburse the opposing party for this advocacy. When the negotiation is about bond pricing, a seemingly small differential (at the magnitude of basis points) can mean millions of dollars. Because public officials are very focused on the core mission of the public agency, they often perform little or no due diligence on bond costs, have little or no information about market pricing other than what the party with whom they are negotiating provides, and are motivated by the history of support for the campaign.

- It is important to eliminate an unfair and improper public purchasing practice of professional services

Hiring of financial professionals is exempted from customary public bidding requirements, and public agencies may select professional service firms on the basis of qualifications. However, the selection often seems to utilize an unfair and improper purchasing criterion, namely the provision of campaign contributions and/or services. The opportunity to provide these services is not advertised or requested of all potential responders, because to do so brings us right back to the first and over-riding problem, the illegal use of public funds for campaign activities.

- It is important to reduce the conflict of interest on the part of professionals in the provision of advice

Financial professionals who provide uncompensated bond campaign services have made a substantial investment, and have substantial interest in its passage but also in the issuance of bonds so they can be paid. These same financial professionals are typically also advising on the financing plans, including important assumptions regarding tax base growth and term of

bonds, and providing statutorily required conclusions such as projected tax rates. This particular problem was illuminated with the cash out general obligation bond refundings, which the Attorney General concluded were in violation of the California Constitution.

These practices also are contrary to the Best Practice recommendation of the Government Finance Officers Association (“Selecting and Managing the Method of Sale of State and Local Government Bonds”) that general obligation bonds in the “A” rated categories or higher (which are the vast majority of general obligations bonds) should be sold through competitive bids. One inefficient result of bond election contribution practices is that underwriters are selected by means of negotiated sales, and that higher interest rates than are necessary are negotiated with issuers and imposed upon taxpayers in order to sell the bonds.

Further, we are aware of situations in which financial advisors manage bond elections, and both recommend the engagement of other professionals such as bond counsel and underwriters and solicit campaign contributions from these professionals. The advisors then are paid for the management of the campaign from these contributions. Often, these contributions are substantial, in amounts that may range from \$5,000 to \$25,000 or \$35,000 or more. The contributions may flow through election campaigns directly to the advisors on a noncontingent basis. Election campaigns in California are separate from the bond issuers (frequently school districts, but also cities and other local governments), but naturally have a high correlation with the bond issuers’ leadership.

Government Financial Strategies has a policy of donating \$500 to every tax and bond campaign of our client agencies, without regard to whether the firm has any related work. We don’t object to vendors of public agencies providing donations for charitable or political efforts of the agencies, and certainly if this were prohibited by State or Federal law, we would cease immediately. Our concern is that, in the absence of holding financial advisors and bond underwriters to performance standards related to the appropriateness and efficiency of financing relative to taxpayer goals, the principal standard of performance often becomes the size of the campaign contributions. Further, if a financial advisor or underwriter is also serving as an election consultant/campaign manager, the financial advisor or underwriter may receive compensation through the campaign, the funding for which comes from other professionals recommended by the financial advisor or underwriter. That creates a conflict of interest for both the financial advisor with a duty to the bond issuer and for the underwriter with a duty to investors.

Financial advisors and other municipal advisors already are subject to the statutory fiduciary duty imposed in the Dodd-Frank Wall Street Reform and Consumer Protection Act (and commonly under state law). The advisors already are subject to the fair dealing requirements and antifraud prohibitions of the MSRB’s Rule G-17. The municipal advisors’ fiduciary duty requires that the advisors provide

advice to issuer decision-makers in the issuers' best interests. Practices that clearly corrupt the municipal advisor from its duty should not be allowed.

Surely, these practices present significant issues under both the financial advisors' statutory fiduciary duty and, for both underwriters making payments and advisors receiving them, Rule G-17. While the definition of "municipal advisor" may be uncertain at the margins as the market awaits final SEC action on the definition, there is little doubt that financial advisors advising issuers regarding the issuance of municipal bonds are, in fact, well within the definition and are subject to the fiduciary duty and Rule G-17.

There are variations in bond election contribution patterns. Other underwriters simply administer bond election campaigns themselves. In doing so, those firms provide both monetary and in-kind value. Those underwriters may advertise this function as a "service" provided to issuers. Yet, in California and other states the issuers cannot administer bond election campaign themselves. Still, in those facts and circumstances, the issuers invariably employ those underwriters to underwrite the bonds the voters approve. The practice has the appearance of those issuers doing indirectly through municipal finance professionals what the issuers cannot do directly.

For example, some underwriters charge, as underwriter compensation for selling general obligation bonds, compensation of 1.00%, 1.25% or even 1.50% of the bond sale proceeds received by the issuers. Meanwhile, Bond Buyer surveys have demonstrated repeatedly for many years that typical underwriter compensation in the municipal securities market is approximately only 0.60% or less for underwriting general obligation bonds. General obligation bonds sold at competitive bids would never entail such excessive underwriter compensation.

Given the foregoing considerations, we do not believe the disclosure requirements that are contemplated in Notice 2012-43 would impose undue burdens upon underwriters, nor do we believe that a future extension of those disclosure requirements to municipal advisors would do so. It would be quite helpful to place on the public record information regarding the specific issuers and bond issues implicated through the actions of municipal finance professionals. It also would be helpful to include reporting of in-kind contributions and the value of in-kind contributions, which are excluded from current reporting requirements. Certainly, Government Financial Strategies would not regard it to be onerous to report our contributions.

Unfortunately, reports on EMMA regarding underwriter contributions consist of quarterly reports. Quarterly reports are not necessarily provided in a timely manner for the benefit of the electorate. For example, contributions in October for elections in November will not be reported until after December. Moreover, EMMA's online campaign contribution report records are difficult to search in a systematic manner.

For example, EMMA's records cannot be searched at present by issuer names or titles of bond issues, which voters may wish to do.

Making matters even more difficult for voters, in California where these practices are prevalent, county election expenditure reports showing payments of contributed funds to advisors may not be released in some counties until after the elections. Counties also may make the reports available in different ways. It is virtually impossible to match election campaign expenditure reports by counties with campaign contribution reports to the Board. It is quite difficult to determine which municipal securities professional firms are making payments that flow through campaigns to which financial advisors or election advisors. For the average voter, who already has voted, such matching is far beyond reasonable capabilities.

So, a key missing ingredient in Notice 2012-43 is that the voters—the decision makers—are not given key information they need in order to make informed decisions. They make their authorizing decisions while entirely ignorant of who is paying for the election campaigns, how much those parties are contributing, how much those parties anticipate receiving in compensation when the bonds are issued, the contingent fee structures pursuant to which the professionals are to be paid, and the roles of those parties in preparation of tax rate statements and other information published by issuers in connection with the ballot measures.

When elections are held, the voters are the decision-makers at a policy level for the issuers. In a very real sense, at election time, the voters are the governing bodies of the issuers for the purpose of making decisions whether bonds and taxes should be approved and whether the issuers should be able to enter into contracts constituting and associated with the bond issues. Not even issuer boards of directors are able to alter the voters' decisions. Fairness under Rule G-17 demands that these key decision-makers—the voters—be fully informed of the identities and significant financial interests of municipal finance firms contributing in support of the ballot measures. After all, Rule G-17 demands that municipal finance professionals "shall deal fairly with all persons," and the voters are "persons."

Given the foregoing considerations, and without detracting from our support for the important step the Board is contemplating in Notice 2012-43, we believe, and suggest respectfully, that there are a number of appropriate subjects for further consideration by the Board in the future, as follows—

1. Require reporting promptly after contributions are made, and in any event, prior to elections and in time to inform the electorate.
2. Require reporting of payments *made by* underwriters *to* (not only of payments *received from*) other municipal finance professionals, such as financial advisors and election advisors, channeled through bond election campaigns.

3. Make the campaign contribution reports more easily searchable on EMMA by issuer name and by titles of bond issues.
4. Require timely disclosure to the voters of the identities of financial firms paying for the election materials, advertising and staff in support of bond measures; how much those firms are contributing; how much compensation those firms expect to receive from bond issues the voters approve; whether the compensation is contingent and, if so, that the contingent compensation constitutes a conflict of interest; the roles of those parties in preparation of tax rate statements and other information published by issuers in connection with the ballot measures; and the identities of financial advisors and election advisors receiving payments through the structure of bond election campaigns and how much those advisors receive through campaign administration.
5. Do not limit disclosure merely to compensation received by firms in connection with the issuance of bonds when that compensation is in excess of compensation the firms receive in other municipal securities transactions. Rather, the disclosure should be made of compensation in excess of general industry compensation practices for the types of very secure voted general obligation bonds that are involved.
6. Require disclosure of relevant information to investors when firms participating in the bond issues have contributed to election campaigns, and require disclosure of relevant information to investors when the election campaigns to which the underwriters have contributed are administered by municipal advisors. As the Securities and Exchange Commission stated, "such information could indicate the existence of actual or potential conflicts of interest, breaches of duty, or less than arms' length transactions. Similarly, these matters may reflect upon the qualifications, level of diligence, and disinterestedness of financial advisers, underwriters, experts and other participants in an offering. Failure to disclose material information concerning such relationships, arrangements or practices may render misleading statements made in connection with the process" SEC Rel. No. 33-7049, 34-33741, 59 F.R. 12748, 1251 (March 9, 1994).

Once again, Government Financial Strategies strongly supports the direction in which the Board is moving to improve the functioning, efficiency and integrity of the municipal securities market and to protect both investors and issuers.

Thank you again for this opportunity to respond to the Board's important and very positive request for comment. We support the Board's efforts as expressed in Notice 2012-43, and look forward to future developments in this important area.

Yours truly,
**GOVERNMENT FINANCIAL
STRATEGIES**

A handwritten signature in black ink, appearing to read "Robert W. Doty", written over the company name.

Robert W. Doty
General Counsel