MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com

6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

April 11, 2011

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

Sent via email to CommentLetters@msrb.org

Re: MSRB Notice No. 2011-12: 2011-13; 2011-14

Dear Mr. Smith:

Thank you for the opportunity to comment on the various matters included within the Requests for Comment on MSRB's Rules G-36 and G-17. Municipal Regulatory Consulting LLC is a professional consulting firm serving the municipal securities industry. In providing regulatory advice to municipal advisors and broker-dealers, I am sometimes called upon to interpret rules of the MSRB and other agencies or SROs. More to the point, my clients often seek advice how to apply those rules in the context of their business.

If anything is clear at this point in the rulemaking process spurred by the Dodd-Frank Act, it is that nothing is clear. Virtually all the rules and guidance proposed by the MSRB in 2011 come with the following explicit or implicit caveat: "Until the SEC settles on a definition that everyone can understand, even we (the MSRB) aren't certain what specific activities qualify as municipal advisory activities, nor do we know for certain when they begin. If we don't know which activities are advisory, we also don't know exactly who the advisors are. But we've been told we have to propose rules, so here they are." Market participants may have sympathy for the position in which the MSRB finds itself, but they have to react to what has been proposed, and many wonder given the circumstances why the MSRB has not chosen to be more circumspect.

I believe the proposals as written do not resolve but exacerbate confusion among market participants, including issuers, and create potential compliance nightmares. The MSRB would do the municipal securities community – including the issuers it is now mandated to protect – a great service if it scales back its proposals, moderates some of its positions and clarifies others.

1. The MSRB Should Do No More than Establish Guiding Principles

The MSRB does well by taking a minimalist approach to Rule G-36. "In the conduct of its municipal advisory activities on behalf of municipal entities, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and a duty of care." It is obviously modeled after Rule G-17, which reads, "In the conduct of its municipal securities or municipal

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com
6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

Unfortunately, the MSRB goes too far and too deep in its efforts to address as many different aspects of the duties of loyalty, care and fair dealing as it can. The goal at this stage in the regulatory cycle, with certain market participants subject to rules and regulations for the first time, should be to promulgate rules everyone can understand and with which they can readily comply. Now is a time for establishing guiding principles. There will be plenty of time later for crawling in the weeds.

For example, the MSRB appropriately addresses the duty of loyalties and care by stating its view of the general principles underlying each. The duty of loyalty "requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor." The duty of care requires a municipal advisor to "exercise due care in performing its responsibilities."

The MSRB also does the regulated community a service by aggregating in a series of footnotes a variety of cases in which individuals or firms were found to have violated their fiduciary duty or fair dealing obligations under federal and state law and/or securities regulation. It would be reasonable for the MSRB to state that the activities with which the defendants in those cases were charged would violate Rule G-36 and/or Rule G-17. At least for now, however, the MSRB should stop there.[1]

2. If the MSRB Wishes to Regulate Specific Market Activities, It Should Do So In Rules Designed Specifically to Address that Activity

a. Issues Relating to Advisory Contracts Should Be Addressed in Rule G-23

In my view, the MSRB unreasonably intrudes on the commercial relationship between issuers and advisors when it specifies exactly who needs to say what to whom and when. The error is compounded because the MSRB fails to allow for variance when the facts and circumstances suggest that another approach would better accomplish the stated goals. Indeed, the MSRB's rigid requirements might even have the (presumably) unintended consequences of confusing issuers and creating an unlevel playing field between advisors and underwriters.

[1] An argument can be made that going one step further, *i.e.,* stating as a general proposition that material conflicts of interest should be disclosed, would not be one step too far, but stepping on that slippery slope led to the MSRB sliding all the way down the hill. Micromanaging the disclosure requirements – especially the ones relating to compensation - as the MSRB does would be difficult to justify even after time has passed; at this stage of the process, it makes no sense at all.

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com

6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

For many years, the MSRB had a straightforward approach to when and under what circumstances a financial advisory relationship existed between an issuer and a dealer firm. In Rule G-23, it said

> (b) *Financial Advisory Relationship.* For purposes of this rule, a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services. Notwithstanding the foregoing, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker, dealer or municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities.
> (c) *Basis of Compensation*. Each financial advisory relationship shall be evidenced by a writing entered into prior to, upon or promptly after the inception of the financial advisory relationship (or promptly after the creation or selection of the issuer if the issuer does not exist or has not been determined at the time the relationship commences). Such writing shall set forth the basis of compensation for the financial advisory services to be rendered, including provisions relating to the deposit of funds with or the utilization of fiduciary or agency services offered by such broker, dealer, or municipal securities dealer or by a person controlling, controlled by, or under common control with such broker, dealer, or municipal securities dealer in connection with the rendering of such financial advisory services.

For some reason, the MSRB did not extend Rule G-23 to non-dealer municipal advisors and/or modify Rule G-23 to address what it views as shortcomings in the contents of advisory contracts. Instead, the MSRB chose to make the content and context of written disclosures a subject of interpretive guidance under the rubric of fiduciary duty and fair dealing. If the MSRB feels so strongly that it needs to specify what goes in contracts, I submit that it should do so by rule and not by interpretation, and subject that proposal to the usual scrutiny and process that apply to rule changes.

b. Issues Relating to Appropriateness or Suitability Should Be Addressed in Rule G-19

The MSRB also has a rule that relates to the obligations of dealers when they recommend transactions to customers. The rule even distinguishes among (i) institutional accounts and non-institutional accounts and (ii) discretionary accounts[2] and non-discretionary accounts. Rule

[2] It is generally accepted that firms have a fiduciary duty with respect to discretionary accounts, though the term fiduciary does not appear anywhere in Rule G-19.

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com

6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

G-19 imposes obligations on dealers to obtain certain information about its customers and about the products it offers before making any recommendations to customers.

As was the case with contracts, for some reason the MSRB chose not to address recommendations to municipal entity or obligated person clients by amending Rule G-19. Instead, the MSRB proposes to address these issues by issuing interpretive guidance under Rules G-36 and G-17. What is worse, it uses language utterly foreign to municipal regulation. Thus, depending on the circumstances and whether the client is a municipal entity or an obligated person, an advisor might have one or more of the following duties:

- To investigate and advise the municipal entity of alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity.
- To make a reasonable inquiry as to the facts that are relevant to a municipal entity's determination of whether to proceed with a course of action.
- To act competently and provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to the financings or products proposed that might better serve the interests of its municipal entity client.
- To recommend a transaction or product only if it has concluded, in its professional judgment, that the transaction or product is appropriate for the client, given its financial circumstances, objectives, and market conditions, and advise the client of material risks and characteristics of the structure or product.

If the MSRB believes that municipal advisors have an obligation to municipal entity and obligated person clients to "know their customer," and to have a "reasonable basis" for recommending transactions, products or courses of action, the MSRB should abandon the multiple and confusing formulations quoted above.[3] The MSRB should simply say what it means in Rule G-19 and it should use terminology the industry already understands.[4]

3. The MSRB Should Abandon Appendix A Altogether

Even if the MSRB accepts my suggestion and chooses to address advisor compensation directly in Rule G-23 instead of in interpretive guidance under fiduciary duty or fair dealing, it should get rid of its inappropriate and ill-conceived attempt to demonstrate that all compensation

[3] The same principle applies to the MSRB's disclosure requirements in the context of "complex municipal securities financings," although it does not appear that the MSRB has imposed upon underwriters any suitability or appropriateness obligations when recommending any financing, complex or otherwise. Whatever the requirements, they should be set forth in Rule G-19.

[4] Among the advantages of using Rule G-19 is that there is a wealth of existing interpretive guidance relating to the concept of suitability and what is required to have a reasonable basis for making a recommendation.

MUNICIPAL REGULATORY CONSULTING

telephone | 609.903.1110 fax | 609.936.0068
email | david@muniregconsulting.com
6 Almond Court, West Windsor, New Jersey 08550
www.muniregconsulting.com

creates conflicts between advisors and issuers. The MSRB does indeed have a mandate to protect issuers, but it seems to me that there are many more important things to worry about than whether an advisor being paid by the hour is padding her bill. And there are better ways to do it than requiring a senior issuer official to attest in writing that he understands this "conflict" and is OK with going ahead anyway.

Conclusion

Writing guidance to establish the parameters of fiduciary duty and fair dealing is not easy. The MSRB should not make the task more difficult than it is by trying to fit so many things into boxes not designed to hold them. Instead, it should concentrate on establishing guiding principles and use the existing regulatory structure where possible to address specific concerns.

Very truly yours,

David Levy, Principal

cc: Martha Haines, SEC