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Invested in America

March 10, 2014

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

Re: Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors; MSRB Regulatory Notice 2014-01

Dear Mr. Smith:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to provide comments on the Municipal Securities Rulemaking Board ("**MSRB**") Regulatory Notice 2014-01 (the "**Regulatory Notice**") containing a draft proposal for MSRB Rule G-42 ("**Proposed Rule G-42**") on the standards of conduct and duties of municipal advisors when engaging in municipal advisory activities other than the undertaking of solicitations.

I. Executive Summary

SIFMA supports the MSRB's efforts to develop a framework for the regulation of municipal advisors, including the establishment of standards of conduct and duties of municipal advisors. However, SIFMA has significant concerns regarding Proposed Rule G-42. In particular:

- Proposed Rule G-42 would improperly impose, in effect if not in name, a fiduciary duty on municipal advisors providing advice to obligated persons. SIFMA opposes the imposition of a fiduciary duty on this relationship between private parties. Such a duty would be contrary to Congressional intent, unnecessary for the protection of obligated persons and extremely burdensome.

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

- SIFMA also opposes the proposed blanket prohibition on principal transactions between a municipal advisor with either municipal entity or obligated person clients. The proposed prohibition, as drafted, is unworkable, unnecessarily broad and does not balance the interests of municipal entities. A fiduciary duty—which only applies in connection with advising municipal entity clients—does not necessitate a complete prohibition on transacting as principal, and such a prohibition clearly has no application to non-fiduciary advice provided to obligated persons.

- The fiduciary duty should be limited to the specific transaction or matter as to which a municipal advisor gives advice and not broadly extended to all potential dealings between the parties.

- Extending the fiduciary duty to affiliates is not necessary and is highly burdensome where affiliates engage in unrelated transactions. Many large financial institutions have investment affiliates that are completely separate from their municipal advisor, and their activities should be treated as being separate.

- The documentation and disclosure requirements under Proposed Rule G-42, in several instances, are inappropriate outside of the context of a municipal advisory relationship relating to an offering of municipal securities. However, as proposed, these obligations would apply, inappropriately, to all municipal advisory relationships, which could include, for example, incidental advice in connection with brokerage or other investment activities.

- In many cases, Proposed Rule G-42 is unnecessarily prescriptive—forcing municipal advisors to provide, and their clients to bear the cost of, services that the client may not have an interest in receiving. Rather, the MSRB should make clear that municipal advisors and their clients are free to agree to limit the services provided and duties undertaken.

- As discussed in Section II below, SIFMA believes that it would avoid confusion and promote compliance if the MSRB were to propose several separate and distinct rules that establish the duties of a municipal advisor depending upon whether the client is advising a municipal entity or an obligated person, and whether the advice is in connection with an offering of municipal securities or relates to investments (such as advice incidental to brokerage or banking services pertaining to the proceeds of a municipal securities offering).

Finally, while SIFMA applauds the MSRB's new policy on the use of economic analysis in its rulemaking, and its request for comment on its economic analysis on Proposed Rule G-42, SIFMA believes that the MSRB's draft economic analysis fails to meet the MSRB's statutory mandate and its own stated policy. Moreover, to be effective

in the specific case of Proposed Rule G-42, the MSRB's economic analysis should focus at a much more granular level on the benefits and burdens of each specific proposed requirement, as applied to the full range of covered activities and market participants. A further discussion of SIFMA's views regarding the MSRB's draft economic analysis contained in the Regulatory Notice is contained in Annex A to this letter.

II. Scope and Structure of Proposed Rule G-42

As a general matter, SIFMA has concerns regarding the manner in which, with narrow exception, Proposed Rule G-42 would create a "one-size fits all" set of duties and obligations for municipal advisors that may not (i) align with the actual legal duties that apply or (ii) be appropriately tailored to the type of advisory activity involved. As the Securities and Exchange Commission ("**SEC**") made clear in the release accompanying its adoption of final municipal advisor registration rules (the "**Final MA Rules**"),[2] a wide range of activities could potentially trigger municipal advisor status. Structuring a single rule that addresses the different duties in each different relationship and advisory assignment will ultimately be both over- and under-inclusive and not well-tailored to the activity being regulated.

Instead, SIFMA believes that the MSRB should adopt separate rules that appropriately set out the particular duties and obligations of a municipal advisor that apply in each context. As a starting point, different duties and obligations should be established depending on whether the municipal advisor is providing advice: (i) to a municipal entity in connection with a municipal securities offering; (ii) to an obligated person in connection with a municipal securities offering; (iii) to a municipal entity in connection with other activities, such as giving advice in connection with brokerage or banking services relating to the investment of the proceeds of an offering; or (iv) to an obligated person in connection with other activities, such as giving advice in connection with brokerage or banking services related to the investment of the proceeds of an offering.

In addition, the MSRB should consider applying certain of its rules somewhat differently depending on the level of sophistication of each client, including the size and complexity of the municipal entity or obligated person (*e.g.*, whether they are applied to advice given to large issuers with experienced staffs or advice given to small issuers with volunteer boards and officials). For example, an obligated person that is a sophisticated public company (*e.g.*, a publicly-traded airlines operator) should be distinguished from a significantly smaller type of obligated person (*e.g.*, an operator of a single private nursing home). We observe below several places where the MSRB might consider this approach.

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[2] *See* Registration of Municipal Advisors, Exchange Act Release No. 34-70462, *available at* https://www.sec.gov/rules/final/2013/34-70462.pdf (the "**Adopting Release**").

Many of SIFMA's concerns discussed in this letter could be addressed through a more precise rule framework that better matches the duties and obligations to the type of municipal advisory relationship to which it applies.

III. Comments on Content of Proposed Rule G-42

A. Principal Transactions

Proposed Rule G-42(f) would impose an absolute[3] prohibition on a municipal advisor or any of its affiliates engaging in any transaction in a principal capacity with a municipal entity or obligated person client whether or not the principal transactions relate to the municipal advisor relationship.

1. The Proposed Principal Transaction Prohibition Should be Clarified and Narrowed

If the MSRB determines to retain the outright prohibition on principal transactions, it should clarify and narrow its scope, including by defining when a person's involvement in a transaction is in a "principal capacity."

(a) Application to Matters Unrelated to the Municipal Advisory Engagement

Any restriction on engaging in principal transactions should be limited to the specific transaction or matter as to which the municipal advisor is providing advice, rather than applying broadly across any and all unrelated activities of the municipal entity or its affiliates. The MSRB accepted this premise in connection with its earlier proposed interpretation of a municipal advisor's fiduciary duty to municipal entity clients, where it more appropriately proposed to prohibit acting as principal *only* "in matters concerning the municipal advisory engagement."[4] Similarly, the SEC staff, in providing guidance in the form of responses to Frequently Asked Questions, indicated its expectation that any fiduciary duty (and resulting restrictions on principal transactions) would apply only "with respect to that issue" on which the municipal advisor is engaged to provide advice, not unrelated matters.[5]

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[3] While SIFMA refers to the proposed prohibition on principal transactions as "absolute," we acknowledge that Proposed Rule G-42 includes an exception for activity "expressly permitted under Rule G-23." As discussed in Section III.A.1(c) below, SIFMA requests guidance regarding what would be permissible under this exception.

[4] MSRB Notice 2011-48 (Aug. 23, 2011).

[5] *See* Final MA Rule FAQs at Question 5.2.

As drafted, the proposed prohibition is unbounded; unrelated businesses and affiliates of a financial institution would be swept into the principal transaction prohibition for unrelated transactions. Such a universal prohibition divorced from the context of the advisory relationship would not serve any useful policy objective and would deny a range of services to clients and would be unworkable in practice. If a municipal advisor and all of its affiliates were prohibited from engaging in any principal transaction with the municipal advisor's client, regardless of the nature of the transaction and connection to the advisory engagement, many multi-service financial institutions might determine that the business that must be given up in order to act as a municipal advisor could not economically justify acting as a municipal advisor. As a result, fewer firms would be willing to act as municipal advisors, reducing clients' choices and competition, particularly in markets where the availability of highly qualified municipal advisors is more limited or non-existent.

Finally, while SIFMA believes, as discussed below in Section III.A.2, that any restriction on principal transactions should not apply in the context of obligated person clients, it is worth noting the extraordinary effect not limiting the proposed restriction to matters relating to the municipal advisory engagement would have in the context of obligated persons. Private businesses, whether or not for profit, may obtain financing through conduit bonds and become obligated persons on those municipal securities. As drafted, Proposed Rule G-42 would prohibit any affiliate of the municipal advisor from engaging in any business activity, as principal, with that private enterprise.

(b) Application to Common Principal Activities

Any restriction should not apply to certain common principal activities of persons that are also municipal advisors or affiliated with municipal advisors, such as taking deposits, entering into swaps or security-based swaps that comply with applicable CFTC or SEC business conduct rules,[6] selling securities or foreign exchange products. In particular, if deposit-taking and other traditional banking services are not excluded from the prohibition, a bank should not be prohibited from acting as principal and performing these principal activities where it is the bank's separately identifiable department or division, and not the bank itself, that is the municipal advisor.

(c) Extent of G-23 Exception

Proposed Rule G-42(f) provides that the prohibition on principal transactions would not apply to "an activity that is expressly permitted under Rule G-23." The Regulatory Notice explains that in order to "avoid conflict" with another MSRB rule, the proposed rule would allow activity "expressly permitted by underwriters under Rule G-23." The extent of this exception is not entirely clear. SIFMA requests that the MSRB

[6] As noted above in Section III.A, Congress specifically considered and permitted swap dealers to provide advice to special entities and engage in those principal transactions.

confirm that this exception is intended to refer to and apply the two interpretive materials regarding Rule G-23, discussed below, rather than Rule G-23 itself.

First, under an MSRB Interpretive Notice, dated November 21, 2011,[7] the MSRB indicated that when a dealer "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 [an] issue," then the dealer would not be prohibited from acting as an underwriter with respect to that issue. As a result, if a firm that is both a municipal securities dealer and a municipal advisor were to clearly identify itself in writing as an underwriter from the earliest stages, in accordance with Rule G-23, then even if the firm provides advice that would otherwise trigger municipal advisor status (outside of the underwriter exclusion under the Final MA Rules), then the resulting municipal advisory relationship, as a result of the exception contained in Rule G-42(f), would not be subject to a prohibition on transacting as principal.

Second, under a separate MSRB Interpretive Notice, dated May 23, 1983,[8] the MSRB clarified that Rule G-23 applies to "financial advisory services rendered to state or local governments and their agencies, as well as to municipal corporations," but not to corporate obligors.[9] As a result, a financial advisor to an obligated person is expressly permitted under interpretations of Rule G-23 to act as an underwriter with respect to the transaction. The exception from the proposed prohibition on principal transactions for activities permitted by Rule G-23 should be revised to clarify that a municipal advisor to an obligated person is not restricted from also acting as an underwriter with respect to the transactions being advised on.

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[7] *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), *available at* http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-23.aspx?tab=2#_B79A2C2C-796A-4152-BEEB-93E0C5944753.

[8] *See* Notice on Application of Board Rules to Financial Advisory Services Rendered to Corporate Obligors on Industrial Development Bonds (May 23, 1983), *available at* http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-23.aspx?tab=2#_42E084C9-F9D3-4CBA-97C2-2944B9A48596.

[9] *See also* Notice of Filing of Amendments to Rule G-23, on Activities of Financial Advisors, SR-MSRB-2011-03, Exchange Act Release No. 63946 (Feb. 22, 2011) (MSRB stating that "Rule G-23 does not preclude a dealer from serving as financial advisor to a conduit [private] borrower on an issuance of municipal securities and the proposed amendments [to Rule G-23] would not prohibit the dealer from providing underwriting services for such issue of the conduit issuer so long as it has not also become the financial advisor to the conduit [municipal] issuer.").

2. The Proposed Prohibition on Principal Transactions Should Not Extend To Obligated Person Clients

As discussed throughout this letter, Proposed Rule G-42 does not appropriately distinguish between the fiduciary duty owed by a municipal advisor to its municipal entity client, and its duties of care and fair dealing owed to an obligated person client. While, as discussed above, SIFMA does not believe a complete prohibition on engaging in principal transactions is appropriate in general, such a rule would be entirely misplaced as applied to obligated persons where no duty of loyalty exists.[10]

3. Application to Affiliates is Impractical

The proposed prohibition on principal transactions would purport to extend to any activities of a municipal advisor's affiliates.

To the extent that the restrictions on principal transactions are retained, the MSRB should reconsider the extent of their application to affiliates of the municipal advisor where the affiliate is not directly involved in the same municipal securities offering as the affiliated municipal advisor. Such restrictions would likely prove unworkable—particularly for large financial institutions engaged in the provision of multiple services to clients.

Large financial institutions, which may have a municipal advisor affiliate, often have thousands of other affiliates throughout the world engaged in other separately managed business activities. In order to ensure compliance with Proposed Rule G-42, a municipal advisor would first need to identify all of its affiliates, then determine whether any of its affiliates have any business relationship with the client, as well as whether there is any principal aspect to these relationships. Conducting this analysis across thousands of affiliates would be overly burdensome and would require major compliance and operational resources for such municipal advisors and their affiliates. For example, these financial institutions would need to develop systems and databases that keep track of the activities of all of their affiliates, which, as described below in the Appendix, would require costly projects to build such significant infrastructure.

Rather, any restrictions on principal transactions should apply only to the activities of the municipal advisor and affiliates directly involved in the municipal securities offering on which it advises, rather than all of its affiliates.

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[10] SIFMA notes that in this regard Proposed Rule G-42 is inconsistent with the MSRB's initial 2011 proposal interpreting the duty of care owed by a municipal entity to an obligated person under Rule G-17. Rather than restricting principal transactions in any manner, at that time the MSRB more appropriately proposed to require that a municipal advisor disclose to its obligated person client "whether the municipal advisor or an affiliate of the municipal advisor is acting as a principal in matters concerning the municipal advisory engagement." *See* MSRB Notice 2011-49.

4. The Proposed Complete Prohibition on Principal Transactions, Notwithstanding Disclosure and Consent, is Overbroad, Unprecedented, and Harmful to Clients

The proposed complete prohibition on municipal advisors transacting as principal with their clients is unprecedented and of startling breadth. While certain principal transactions may raise conflicts of interest, not all such conflicts are irreconcilable and many such conflicts can be disclosed and, at the option of the client, waived. Specifically, while SIFMA understands why the MSRB might wish to prohibit a municipal advisor advising a municipal entity on a municipal securities offering and then acting as principal in connection with the investment of the proceeds, the same conflict of interest does not arise in other forms of municipal advisory engagements.

Where a municipal advisor is engaged specifically to advise on the investment of bond proceeds or municipal escrow investments, or derivatives, rather than on a municipal securities offering, principal transactions should be permissible, so long as a municipal advisor has provided reasonable disclosure of, and obtained informed consent to, the potential conflicts associated with the principal activities. Such disclosure and informed consent should be required only when a municipal advisory relationship is established or when an account is opened between a municipal advisor and a municipal entity or obligated person and not on a transaction by transaction basis.

Even investment advisers, which have long been recognized as owing a fiduciary duty and the utmost good faith in dealings with their clients,[11] are not subject to an immutable prohibition on transacting with a client as principal. Rather, consistent with its fiduciary duty, an investment adviser and its affiliates may engage in a principal transaction with a client so long as the adviser obtains the client's consent after disclosing the capacity in which the adviser will act, any compensation the adviser will receive and any other relevant facts.[12]

In fact, throughout the Dodd-Frank Act, where Congress considered advisory relationships and the potential for principal activity, it made clear that the two were compatible with appropriate safeguards. The MSRB should interpret the duties of municipal advisors, created under the same act of Congress, consistent with how Congress viewed them. For example, the Dodd-Frank Act subjects a swap dealer and security-based swap dealer, when acting as an advisor to a "Special Entity" (which generally includes municipal entities), to a duty to act in the best interests of the Special

[11] *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

[12] *See* Investment Advisers Act of 1940 § 206(3). *See also* SEC Staff Study on Investment Advisers and Broker-Dealers (Jan. 2011) at 24–26.

Entity.[13] But swap dealers and security-based swaps dealers, by their nature, transact as principal. Permitting these dealers to act as both principals and advisors, subject to the best interest standard, reflects a Congressional determination, contrary to the MSRB's proposal, that acting as both an advisor and a principal on the same transaction does not always raise such a "high potential for self-dealing"[14] that disclosure and client consent could not cure.

Similarly, Section 913 of the Dodd-Frank Act, codified at the second Section 15(k) of the Exchange Act, permits the SEC to promulgate rules subjecting broker-dealers to a fiduciary duty when providing personalized investment advice about securities to retail customers. However, Congress instructed the SEC that notwithstanding any fiduciary duty rule the SEC adopts, a broker-dealer would not be in violation of such a fiduciary duty by selling only proprietary products, although the SEC could require that the broker-dealer provides its customer with notice and obtains consent or acknowledgement.[15] So too, when a municipal advisor is providing advice on investments incidental to its brokerage activities rather than advising on a municipal securities offering, the municipal advisor and its affiliates should not be prohibited from transacting as principal, so long as the client has received full and fair disclosure and consent to the principal transaction.

Notably, a registered investment adviser is generally exempt from registration as a municipal advisor to the extent that it is providing investment advice.[16] Congress adopted this exclusion because it believed clients of registered investment advisers were adequately protected by the fiduciary duty inherent in that regulatory scheme—including the requirement that investment advisers disclose and obtain consent prior to engaging in principal transactions. It would be an anomalous result (and contrary to Congressional intent) if the MSRB were to adopt a rule that prohibited a municipal advisor from engaging in principal transactions—while the exact same transaction would be permissible for a registered investment adviser engaging in the exact same advisory activity—solely because the investment adviser may operate under an exemption from municipal advisor registration.

In addition to being unprecedented and beyond Congressional intent, the proposed absolute prohibition on principal transactions is bad policy. A prohibition that could not be cured through disclosure and consent would deprive clients of access to certain financial products, such as debt securities the municipal advisor sells in its capacity as a dealer in securities, or swaps the municipal advisor enters into in its swap dealer capacity. Moreover, restricting the municipal entity client's options could compromise the client's

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[13] *See* Commodity Exchange Act § 4s(h)(4)(B) (added by Section 731 of the Dodd-Frank Act).

[14] *See* Regulatory Notice at 13.

[15] *See* Exchange Act § 15(k)(2).

[16] *See* Exchange Act § 15B(e)(4)(C); *see also* Exchange Act Rule 15Ba1-1(d)(2)(ii).

ability to receive better pricing given that large market makers may not be able to provide certain pricing if they are not able to compete.

5. The Proposed Prohibition Would Require Large Financial Institutions to Share Confidential or Material Nonpublic Client Data Among Their Affiliated Legal Entities

In order to comply with the proposed prohibition on principal transactions, large financial institutions will be required to know whether any of its affiliated legal entities are acting as either a principal or advisor on a specific transaction with a municipal entity or obligated person. This, in turn, will require such large financial institutions to develop new, or enhance already existing, systems that would force these institutions to share confidential or material nonpublic information involving municipal entities or obligated persons across their many lines of business. However, client privacy requirements and standard business practice may prohibit or limit the ability of large financial organizations to share client data among affiliated, but separate, legal entities. This may create a situation in which it would be impossible to identify where affiliates act as principals with municipal entities or obligated persons. Moreover, these large financial organizations will necessarily need to violate their own information barrier policies and procedures, established pursuant to regulatory requirements under the Exchange Act, in order to protect against the misuse of material nonpublic information and to protect their clients' privacy.[17]

B. Municipal Advisor Standards of Conduct Generally

1. Municipal Advisors Should Not Be Subject to an Explicit or Implicit Fiduciary Duty When Advising Obligated Persons

Proposed Rule G-42(a) correctly notes that a municipal advisor is subject to different legal duties when it advises an obligated person than when it advises a municipal entity, since in the latter case, the municipal advisor is subject to a fiduciary duty. However, the distinction becomes illusory in light of the manner in which Proposed Rule G-42 would impose uniform obligations and restrictions on both relationships—effectively imposing a fiduciary duty on municipal advisors dealing with obligated persons. Many of the obligations under Proposed Rule G-42 presuppose the existence of a fiduciary duty and would be wholly inappropriate to more arms-length relationships only involving a duty of fair dealing. For example, the need to avoid or

[17] *See e.g.*, Exchange Act Section 15(g) (requiring registered broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business, to prevent the misuse of material nonpublic information by the firm or its associated persons in violation of the Exchange Act).

disclose extensive information regarding conflicts of interest, and the proposed prohibition on transacting as principal, appear to be expounding upon a duty of loyalty.[18] And, as discussed more fully in Section III.A.2 below, the imposition of a principal transaction ban on relationships with obligated persons is also an inappropriate extension of fiduciary standards to the obligated person client. By applying these requirements equally to both relationships, the MSRB would, in effect, inappropriately extend a fiduciary duty to advisory activities with obligated persons.[19]

Applying a fiduciary duty to a municipal advisor's relationship with an obligated person would be inconsistent with Congress's statutory directive to the MSRB under Section 15B of the Securities Exchange Act of 1943 (the "**Exchange Act**") (as amended by the Dodd-Frank Act) and would arguably exceed the MSRB's authority. If Congress intended for a uniform standard to apply when advising obligated persons and municipal entities, it would have assigned a statutory fiduciary duty to both relationships. Rather, as the MSRB has noted, Congress only directed that a municipal advisor have a fiduciary duty when it acts as an advisor "to [a] municipal entity,"[20] and that the MSRB adopt rules relating to this fiduciary relationship. Congress clearly had the opportunity to consider requiring municipal advisors to observe a uniform standard or duty, and specifically declined to do so. In adopting the Final MA Rules, the SEC similarly indicated its belief that separate duties would apply, with municipal advisors to obligated persons being subject to a duty of fair dealing under Rule G-17, rather than a fiduciary duty.[21]

The distinction mandated by Congress and referenced by the SEC, in fact, makes sense and should be respected and maintained by the MSRB. In adopting the provisions of the Dodd-Frank Act establishing the municipal advisor regulatory scheme, Congress was concerned regarding losses suffered by *municipal entities* who may have over-relied on the advice of unregulated municipal advisors that put their own interests ahead of their clients'.[22] In contrast, obligated persons are *private* sector entities (whether or not for-profit) with the wherewithal to evaluate any advice received; most have access to financial markets using their own credit, much like other private issuers whose interface

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[18] *See infra* Sections III.C.2 (noting that requiring non-individualized disclosures is inappropriate in a non-fiduciary context); III.C.3 (noting that the disclosure requirements appear to presuppose a duty of loyalty); III.A (noting that municipal advisors should be permitted to reasonably disclose, and obtain informed consent, of potential conflicts associated with principal activities); III.A.2 (noting that the proposed prohibition on principal transactions is inappropriate when the client is an obligated person).

[19] SIFMA notes that the MSRB specifically requested comment on whether it should, in fact, explicitly adopt a uniform fiduciary duty for municipal advisors dealing with obligated persons. As noted above, SIFMA opposes such an expansion, whether explicit or implicit.

[20] Exchange Act § 15B(c)(1).

[21] *See* Adopting Release at 156.

[22] *See* Regulatory Notice at 4.

with financial services providers is not specially protected by a fiduciary standard, but more arms-length duties of due care and fair dealing. Moreover, obligated persons generally engage in many types of activities that are wholly unrelated to the issuance of municipal securities. For example, the fact that an airline raised capital through a conduit offering to build an airport terminal should not mean that all of the transactions between the airline and an advisor on that offering should be subject to Rule G-42.

SIFMA therefore believes that, as discussed above, the MSRB should adopt separate rules with respect to the obligations of municipal advisors when advising municipal entities, on the one hand, and when advising obligated persons, on the other—as the MSRB proposed to do when it initially proposed rules relating to the duties of municipal advisors in 2011.[23] These separate rules should clearly reflect a fiduciary duty (*i.e.*, duty of care and duty of loyalty), in the case of advising municipal entities, and a duty of fair dealing, in the case of advising obligated persons. Further, any special affirmative duties that are owed to obligated persons under the duty of fair dealing should reflect the specific characteristics of the municipal securities market and the obligated person's activities in it, rather than to any special needs of the obligated person for special protective conduct standards.

2. Rule G-42 Should Not Apply to Any Transaction or Activity That Would Not Trigger Municipal Advisor Status

Where an entity is engaging in conduct that would not trigger municipal advisor registration under the Exchange Act or the Final MA Rules, the MSRB should exclude such entity or activity from Rule G-42. For example, Proposed Rule G-42 defines "municipal advisory activities" as those activities described in Section 15B(e)(4)(A) of the Exchange Act (with the exception of Section 15B(e)(4)(A)(ii)). However, the definition does not exclude the statutory exclusions from being considered a municipal advisor under Section 15B(e)(4)(c) of the Exchange Act (*e.g.*, underwriters or registered investment advisers) or the exemptions set forth in the SEC's Final MA Rules (*e.g.*, certain bank activities, certain swap dealer activities, situations where an independent registered municipal advisor is involved, responding to RFPs/RFQs). As a result, Proposed Rule G-42 could be read to apply, for example, to an underwriter whenever the underwriter provides advice regarding structuring a municipal securities transaction, even though such activity would not trigger municipal advisor status.

By excluding and exempting certain activities from municipal advisor registration, Congress and the SEC, of course, also intended the persons engaging in those activities to not be subject to the duties attendant to municipal advisor status. While expanding the application of Rule G-42 to apply to persons excluded or exempted from municipal

[23] *See* MSRB Notice 2011-48; MSRB Notice 2011-49.

advisor status might not have been the MSRB's intent, the MSRB should explicitly clarify the language of the rule to properly reflect its scope.

3. Proposed Rule G-42 Duty of Care Must be Appropriate for All Municipal Advisory Activities

If, contrary to SIFMA's proposal above,[24] the MSRB proposes to adopt a single rule applicable to all municipal advisory activities (other than solicitation activities), it must be sure that the obligations imposed under the rule are appropriate for all municipal advisory activities to which they would apply. This would include, for example, a registered municipal advisor that is a broker-dealer not involved in a municipal securities offering that provides advice in connection with a brokerage account that contains the proceeds of the offering.

It is not clear whether the application of Proposed Rule G-42 outside of the municipal securities offering context was adequately considered or appropriately limited. For example, proposed Supplementary Material .01 would require that a municipal advisor make a reasonable inquiry regarding the facts that are relevant to a client's determination to pursue a particular course of action. While this requirement may be appropriate in the context of arranging a municipal securities issuance, it could be prohibitive in the case of ordinary brokerage and related advice, given the number of trades involved, timing considerations and the general context of broker-related advice.[25]

Similarly, the obligation under Supplementary Material .02 for municipal advisors to investigate or consider reasonably feasible alternatives appears overly broad outside the context of municipal securities issuances. For example, consider a situation where a municipal entity has determined to invest the proceeds of a municipal securities offering in a particular asset class and whether or not they hired a municipal advisor to assist with selecting the investment within that class. That municipal advisor should not be obligated to consider whether an investment in another asset class would be a reasonably feasible alternative, unless actually engaged to do so.

C. Disclosure of Conflicts of Interest and Other Information

1. The MSRB Should Clarify When the Inception of a Municipal Advisory Relationship Occurs

Proposed Rule G-42(b) would require that certain disclosures are provided by a municipal advisor to its client "at or prior to the inception of a municipal advisory

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[24] *See supra* Section III.B.1.

[25] We also observe that the proceeds of municipal securities issuances are generally required to be invested in limited types of assets with limited duration and of high quality, reducing the risks raised by this type of advisory relationship.

relationship." The MSRB should clarify when the "inception" of such a relationship will be deemed to occur for purposes of the rule, in particular, outside of the municipal securities issuance context. Such a clarification should encompass the varied types of relationships that could trigger municipal advisor status, including when the disclosures must be sent when advising on an offering and when the disclosures must be sent when opening a brokerage account. In particular, when a municipal advisor gives advice in connection with brokerage or banking services relating to the investment of the proceeds of an offering, the disclosures should be limited to when an account is opened (*i.e.*, when a relationship is established) and should not be required on a trade-by trade-basis.

As discussed below,[26] a municipal advisor may have pre-engagement or other communications with a client that include informal advice, triggering municipal advisor status under the Final MA Rules. For example, a broker-dealer may provide incidental advice regarding the investment of funds in an account, only to learn that the account includes the proceeds of a municipal securities offering—triggering municipal advisor status. The parties would not have anticipated, in advance, entering into a municipal advisory relationship. As such, it would not have been possible for the broker-dealer/municipal advisor to have prepared the required disclosures. To address this, the MSRB should clarify when the "inception" of the relationship is deemed to have occurred for purposes of the disclosure requirements under Proposed Rule G-42(b), taking into account the need for a reasonable period within which to make these disclosures once the parties realize that a municipal advisory relationship has been formed.

2. Non- Individualized Disclosure Should be Permitted for Non-Fiduciary Relationships

Proposed Rule G-42(b) would require municipal advisors to provide extensive, and potentially burdensome, disclosures to clients, including disclosures regarding certain conflicts of interest. Supplementary Material .05 would further require that these disclosures include "an explanation of how the [municipal] advisor addresses or intends to manage or mitigate each conflict."

While SIFMA believes that such extensive and individualized conflicts disclosure may be appropriate in the context of fiduciary relationships, *i.e.*, where a municipal advisor is advising a municipal entity, they are unnecessarily burdensome and inappropriate in other relationships. As noted above, SIFMA believes that the MSRB should adopt separate rules relating to the duties of municipal advisors to obligated persons. In doing so, or to the extent that the MSRB determines to maintain a single rule, it should revise the proposed disclosure requirements for municipal advisors to obligated persons to a level more appropriate to satisfy a duty of care and duty of fair dealing. In

[26] *See infra* Section III.D.1 (noting that it is not practical to require municipal advisors to have a formal written engagement when providing informal advice).

particular, the MSRB should permit any conflicts disclosure to be satisfied through disclosures that are not individualized to the obligated person client. Where, in a particular circumstance, the municipal advisor determines that general disclosures would not be sufficient because there exists a conflict of interest specific to the obligated person client, the municipal advisor only then would be required to provide individually tailored disclosures.

Similarly, the proposed obligation under Supplementary Material .05, requiring individualized disclosure of how a conflict will be managed, is inappropriate in a non-fiduciary relationship where no duty of loyalty exists. Of course, once the conflict is disclosed, then, if the obligated person has concerns regarding how the municipal advisor plans to manage or mitigate a conflict, the obligated person can ask the municipal advisor directly.

3. Proposed Required Disclosure of Affiliate Products and Services is Vague and Overbroad

Proposed Rule G-42(b)(ii) would require municipal advisors to disclose (i) "any affiliate . . . that provides any advice, service, or product to or on behalf of the client that is directly or indirectly related" to the services to be provided and (ii) any other relationships of the municipal advisor or its affiliates "that might impair the [municipal] advisor's ability to render unbiased and competent advice."

The MSRB should clarify the circumstances under which an affiliate of a municipal advisor would be providing advice or other services that are "indirectly related" to the municipal advisor's activities for purposes of Proposed Rule G-42(b)(ii). The concept of "indirectly related" advice, services or products in this context is open-ended and will be difficult or impossible to apply in practice. For example, as drafted, advice provided by an affiliate related to a deposit bank or a credit relationship with some relationship to the municipal advisory services to be performed could appear to be captured, but such ordinary course relationships should be beyond the scope of the disclosure requirements.

In addition, the broad language of the Proposed Rule G-42(b)(ii) and (vii) should be limited by materiality and knowledge standards, such that a municipal advisor is only required to disclose (i) for purposes of Proposed Rule G-42(b)(ii), advice, services, or products provided by an affiliate that are *material* in the context of the municipal advisory relationship that the municipal advisor has actual knowledge of, and (ii) for purposes of Proposed Rule G-42(b)(vii), other engagements or relationships that might *materially* impair the municipal advisor's ability to render unbiased and competent advice, and in the case of the municipal advisor's affiliates' relationships or engagements, where the municipal advisor has knowledge of such relationships or engagements. The MSRB should also clarify how a municipal advisor may comply with the proposed requirement to disclose the existence of another engagement in situations where it, or its

affiliate (as applicable), is subject to a confidentiality arrangement prohibiting such disclosure.

Further, as noted above with regard to similar proposed requirements, these disclosure requirements appear to presuppose a duty of loyalty, not mere duties of care and fair dealing. As such, they should only apply to the fiduciary relationships between a municipal advisor and a municipal entity client, rather than the duties of care and fair dealing between a municipal advisor and a private obligated person client.

4. Disclosure of Legal and Disciplinary History is Unnecessary and Burdensome

Proposed Rule G-42(b)(ix) would require a municipal advisor to disclose to clients legal or disciplinary events "material to the client's evaluation" of the municipal advisor or its integrity or otherwise disclosed on Forms MA or MA-I.

Municipal advisors should not be required to specially disclose any legal or disciplinary event that is already disclosed in the most recent Forms MA, MA-I, BD, ADV or other publicly available disclosures. Requiring such duplicate disclosure provides little, if any, benefit to municipal entities or obligated persons, while it imposes unnecessary additional burdens on municipal advisors.[27]

Further, to the extent that the MSRB retains Proposed Rule G-42(b)(ix), it should limit any disclosure to the information contained in Forms MA and applicable MA-Is, rather than further requiring disclosure of legal and disciplinary events "material" to the client's evaluation. A municipal advisor is not in the position to determine the manner in which a client evaluates potential municipal advisors or how a client may view the integrity of the advisor's personnel.

In addition, the SEC, in adopting Forms MA and MA-I, has already determined what legal and disciplinary events it believes would be material to disclose in the context of municipal advisory engagements. Requiring municipal advisors to consider whether there are other events, not disclosed on Forms MA or MA-I, that a particular client might find to be material would generally produce a null set, but still impose substantial costs and burdens on municipal advisors to investigate and make that determination.

5. Affirmative Disclosure of Lack of Conflicts is Unprecedented

Fiduciaries are generally required to disclose the extent to which they have any conflicts of interest with their client. However, the requirement under Proposed Rule G-

[27] Municipal entities and obligated persons are, of course, free to request such information specifically in RFPs or otherwise if they find it useful.

42(b) that a municipal advisor affirmatively disclose if it has concluded that it has no material conflicts of interest is rightfully unprecedented. No other SEC, FINRA or MSRB rule includes a similar requirement that forces a financial service provider, including fiduciary advisors, to affirmatively disclose that it believes no material conflicts of interest exist.

A requirement to affirmatively disclose a lack of conflicts may subject municipal advisors to increased liability, litigation, and enforcement actions. A municipal advisor that discloses its good faith determination that no material conflicts of interest exist may later be forced to explain in a subsequent litigation or enforcement action, subject to hindsight bias, why a conflict that later became a concern was viewed as immaterial in advance.

6. Municipal Advisors Should Not Have Disclosure Obligations to Investors

Supplementary Material .07 to Proposed Rule G-42 would require that, where a municipal advisor or its affiliate prepared any material that is included, in whole or part, in an official statement, the municipal advisor must provide investors with the same conflict disclosure the municipal advisor must provide its municipal entity or obligated person client under Proposed Rule G-42(b)(ii). Direct disclosure to investors would be improper for a municipal advisor, and the MSRB should eliminate this proposed requirement.

Municipal advisors have no contractual or other relationship with investors. Rather, it is the obligation of the issuer to make sure that its disclosure is materially accurate and complete. A municipal advisor may be engaged to advise and assist an issuer in connection with the preparation of the issuer's disclosure—but it remains the issuer's disclosure, not the municipal advisor's. Indeed, Proposed Rule G-42(b)(ii) would already otherwise require that municipal advisors provide this same conflict information to the issuer; with the information in the issuer's possession, the MSRB should leave it to the issuer to determine whether or not such information is material to investors and warrant disclosure.

7. Disclosure Rules, if Retained, Should be Clarified

Proposed Rule G-42(b)(i) would require disclosure of "any . . . potential conflicts of interest . . . that *might* impair" a municipal advisor's advice or its ability to act as a fiduciary. If this requirement is retained, it should be limited to conflicts "that could reasonably be anticipated to impair" such matters.

Proposed Rule G-42(b)(viii) would also require disclosure of "the amount and scope of coverage of professional liability insurance that the municipal advisor carries." The presence, absence or level of professional liability insurance is not particularly relevant and should not affect the quality of an advisor's advice. Many large firms may

self-insure due to financial considerations, not because of the level of service they provide. Those professional firms that do obtain liability coverage do so for their own benefit, not to benefit clients. Therefore, disclosure of professional liability insurance should not be required unless specifically requested by a municipal entity or obligated person.

D. Documentation of Municipal Advisory Relationship

1. Documentation Should Only Be Required in Connection with Formal Mandates

Under Proposed Rule G-42(c), municipal advisors would be required to document each municipal advisory relationship in writing prior to, or promptly after the inception of, the municipal advisory relationship. Requiring detailed documentation may be sensible in the context of formal mandates to provide advice in connection with a significant municipal securities offering, financing plans or investment plan. However, as interpreted by the SEC and its staff,[28] more informal advice—even uncompensated advice—may also trigger municipal advisor status. It is not practical to require a municipal advisor to evidence these forms of informal advice in a formal written document containing all the elements the MSRB has proposed to require.

For example, a business pitch that does not fit within the SEC's guidance for communications that are deemed not to constitute advice, providing incidental or post-issuance advice or investment advice in connection with a brokerage account containing the proceeds of a municipal securities offering, may trigger municipal advisor status. In such a context, neither party would expect there to be a formal advisory engagement in place. Requiring a formal written engagement in such circumstances would greatly impede the flow of timely communications which could be exigent in light of market conditions. Further, in the case of intermittent investment advice regarding a brokerage account, the amount of each investment in question or the frequency of the advice would typically make it impractical to enter into a formal agreement each time advice is given.[29]

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[28] *See* Adopting Release at 39-47 (defining the advice standard in general); *see also* Registration of Municipal Advisors, Frequently Asked Questions, *available at* http://www.sec.gov/info/municipal/mun-advisors-faqs.pdf ("**Final MA Rule FAQs**") at Question 1.1.

[29] Even if a written agreement were to be required in these cases, the MSRB would need to reconsider the required content. For example, it is unclear how one could satisfy the requirements concerning specifying termination triggers and material amendments outside the context of a formal advisory mandate.

2. Proposed Duties in Connection with the Official Statement are Contradictory and Confusing

Proposed Rule G-42(c)(iv) reasonably allows a municipal entity and its client to generally specify in the relationship documentation the scope of municipal advisory engagement and any limitations on that scope that the parties agree on. However, in connection with municipal advisory activities relating to a new issue or reoffering of municipal securities, Proposed Rule G-42(c)(v) requires that the engagement include that the municipal advisor will perform "the specific undertakings, if any, requested by the client" relating to the official statement—apparently limiting a municipal advisor's ability to choose to limit the scope of its engagement in this context. Similarly, Supplementary Material .01 to Proposed Rule G-42 provides a default requirement that a municipal advisor "must . . . undertake a thorough review of the official statement . . . unless otherwise directed by the client."

Instead, the MSRB should adopt a broadly applicable standard that a municipal advisor is only required to perform (and the client is only required to pay for) the services that the municipal advisor and its client mutually agree to as the scope of the engagement. This mutual agreement standard should apply to all aspects of the engagement, including review of official statements, so as to allow the municipal advisor and client, at the outset of the transaction, to exclude from the scope of the municipal advisory relationship any services the parties do not mutually wish to include within the scope of their engagement.

3. Additional Clarity is Needed on Certain Documentation Requirements

Proposed Rule G-42(c)(i) would require municipal advisors to include in their relationship documentation "the form and basis of direct and indirect compensation" for the services. SIFMA requests that the MSRB clarify what it believes would need to be included within the form and basis of "indirect" compensation. While it is customary to set out the form and basis of direct compensation in engagement documentation, it is not clear what indirect compensation would be appropriate to include. To the extent that a municipal advisor is to receive compensation from a third party in connection with the engagement, that fact would more appropriately be considered a potential conflict of interest subject to disclosure under Proposed Rule G-42(b), rather than a matter to be evidenced in engagement documentation.

Proposed Rule G-42(c)(ii) would require municipal advisors to include in their relationship documentation the reasonably expected amount of compensation in dollars (to the extent quantifiable), and to modify their relationship documents at the time of each material adjustment to their expectation. To the extent permitted, if the basis of compensation is a percentage or other mathematical function of the principal amount of an issue of bonds, there should be no need to update the math, even if the amount of the issue changes materially.

Proposed Rule G-42(c) would require that "during the term of the municipal advisory relationship" the disclosure information under paragraph (b) and the engagement documentation under paragraph (c) be promptly amended or supplemented to reflect certain changes or additions. The MSRB should confirm that, for purposes of this requirement, the term of the municipal advisory relationship is determined in the manner in which the termination has been described for purposes of the engagement documentation (as required by Proposed Rule G-42(c)(vi)).

E. Recommendations

1. The MSRB Should Not Mandate Specific Discussions

Proposed Rule G-42(d)(i) through (iii) would specifically mandate that a municipal advisor discuss with its client the municipal advisor's evaluation of material risks and benefits of a recommended transaction or product, the basis on which the municipal advisor believes the transaction is suitable and whether the municipal advisor investigated alternatives. Unless the client explicitly requests this information, these affirmative mandates go beyond what is required of fiduciaries generally and may be unworkable for municipal advisors and burdensome to clients.

In addition, if the MSRB retains this proposed requirement, it should clarify what type of documentation municipal advisors would be expected to maintain as evidence that the enumerated topics were discussed.

2. The MSRB Should Clarify the Proposed Requirement that a Municipal Advisor Only Recommend Transactions that are in the Client's Best Interest

While SIFMA supports the requirement in Proposed Rule G-42(d) that a municipal advisor only recommend municipal securities transactions or municipal financial products that are in the client's best interest, this provision is drafted in an overbroad manner. A client will often ask for a municipal advisor's recommendation regarding how to best meet a stated objective, which the municipal advisor may or may not have determined to be in the client's best interest. The MSRB should clarify that if a client has stated its objectives, the requirement to make only recommendations that are in the client's best interest does not imply that the municipal advisor must go behind the client's stated objectives, since such an inquiry may not be consistent with, or within the scope of, the engagement. The MSRB should also clarify that the obligation to make recommendations in the client's best interest does not imply that a recommended course of action must clearly be superior to other alternatives, in situations where there may be multiple alternatives, each of which has its own risks and costs, none of which may be objectively superior.

A further concern is that Proposed Rule G-42 may be read to suggest that a municipal advisor's compliance will be judged by whether a recommended transaction

actually is (or turns out to be) in the client's best interest, rather than by whether the advisor actually and reasonably believes that to be the case. Municipal advisors are not guarantors of what is in the best interest of their clients, and thus the MSRB should revise Proposed Rule G-42, or add Supplementary Material, confirming that the "best interest" standard is based upon a municipal advisor's reasonable belief, rather than an absolute standard. A reasonable belief standard of what is in the client's best interest should thus be satisfied by permitting an advisor to recommend (i) a range of possible action; (ii) multiple reasonably foreseeable alternatives; and (iii) any transaction that it reasonably believes to be in the client's best interest.

Finally, to the extent that this is retained, the requirement should only apply to engagements where a fiduciary duty applies.

3. The MSRB Should Not Mandate the Scope of Review of Third Party Recommendations

Proposed Rule G-42(e) would require that, when requested to do so by its client "and within the scope of its engagement," a municipal advisor must review recommendations by third parties and discuss specific aspects of its review and views with the client. It is unclear why such a requirement would be necessary or beneficial.

As proposed, a municipal advisor would only be required to undertake such a review to the extent that such reviews are "within the scope of its engagement" already otherwise agreed to with the client. A municipal advisor is, of course, required to perform the services that are within the scope of its engagement, whether or not specifically required by Proposed Rule G-42. Further, just as the parties were able to decide to include such a service within the engagement, they should be free to determine what the scope of such a review should be and what they deem appropriate to discuss.

F. Specified Prohibitions

1. Excessive Compensation

Proposed Rule G-42(g)(i) would prohibit a municipal advisor from receiving compensation that "is excessive in relation to the municipal advisory services actually performed." However, Proposed Rule G-42 and the Regulatory Notice provide no guidance as to where the line between reasonable and excessive lies, leaving municipal advisors at risk of this standard being set only in hindsight. Clients should be considered capable of evaluating and negotiating how much to pay for services and to go seek bids from others.

In its 2011 proposals relating to the duties of municipal advisors, the MSRB proposed to interpret a similar prohibition on excessive compensation as follows:

> The MSRB recognizes that what is considered reasonable compensation for a municipal advisor will vary according to the municipal advisor's expertise, the

> complexity of the financing, whether the fee is contingent upon the closing of the transaction, and the length of time spent on the engagement, among other factors. However, in certain cases and depending upon the specific facts and circumstances of the engagement, a municipal advisor's compensation may be so disproportionate to the nature of the municipal advisory services performed as to indicate that the municipal advisor is violating its duties to the client.[30]

The MSRB should confirm whether this proposed interpretation would apply to the similar prohibition under Proposed Rule G-42.

2. Accuracy of Invoices

Proposed Rule G-42(G)(ii) would prohibit a municipal advisor from delivering an invoice for fees or expenses that does not accurately reflect the activities actually performed or the personnel that actually performed the services. SIFMA agrees that such practices should be prohibited, however, we suggest adding materiality and knowledge qualifiers (*i.e.*, a municipal advisor may not *intentionally* deliver a *materially* inaccurate invoice), so as to avoid prohibiting immaterial or unintentional errors.

3. Payments to Obtain Business

Proposed Rule G-42(g)(v) would prohibit "payments made for the purpose of obtaining or retaining municipal advisory business" except for reasonable fees paid to another registered municipal advisor. If retained, the rule should be clarified to permit payments to affiliates or natural associated persons (who are not themselves required to register as a municipal advisor) in preparing responses to RFPs or RFQs, normal business entertainment expenses, and other unobjectionable expenditures made in the ordinary course of marketing and sales activities.

IV. General Requests for Comment

In response to certain of the MSRB's additional specific questions, below are SIFMA's views regarding certain of the MSRB's questions not otherwise addressed above. For ease of reference, each question is repeated in italics below, followed by SIFMA's comment.

Question 5:

> *Draft Rule G-42 allows fee-splitting arrangements with providers of investments or services to a municipal entity or obligated person client, but requires written full and fair disclosure of the arrangement. Should such fee-splitting*

[30] MSRB Notice 2011-48; MSRB Notice 2011-49.

arrangements be prohibited, regardless of whether they are fully and fairly disclosed?

If properly disclosed, fee-splitting arrangements should not be prohibited. There may be legitimate reasons for fee-splitting arrangements, including fee structures requested by clients. If a client receives full and fair disclosure regarding the arrangements and any conflicts of interest it may entail, the parties should be free to agree to the fee arrangement that it believes is most economical and efficient under the circumstances.

Question 7

Should a municipal advisor be required to obtain a written acknowledgment from the client of receipt of the conflicts disclosure and consent to any conflicts disclosed before proceeding with a municipal advisory engagement?

Municipal advisors should not be required to obtain a written acknowledgment of disclosures before proceeding with an engagement, so long as the disclosures are provided and not objected to. Requiring municipal advisors to obtain acknowledgement would effectively impose an obligation *on the client*, which could significantly delay the provision of services while clients determine what might be necessary to provide formal acknowledgment. In SIFMA members' experience in connection with disclosures provided under MSRB Rule G-17, issuers are often reluctant to formally acknowledge disclosures, even though they have received them and may request additional information.

Question 8

Should a municipal advisor be required to disclose legal and disciplinary events that relate to an individual that is employed by the municipal advisor even if the individual is not a part of (or reasonably expected to be part of) the advisor's team working for the client?

No. If the individual is not involved in providing services to the client, the disclosure would be unnecessary and potentially confusing. Moreover, if the municipal entity or obligated person wants such information, they can independently obtain such information on the Form MA-I for the municipal advisor.

Question 11

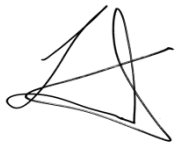
Should an advisor be required to review any feasibility study as a part of the information considered in its evaluation of whether a transaction it recommends is suitable for the client?

A municipal advisor should only be required to review a feasibility study if it is specifically engaged and agrees to do so as part of its engagement.

* * *

Please do not hesitate to contact me with any questions at (212) 313-1130, or our counsel, Lanny A. Schwartz of Davis Polk & Wardwell LLP, at (212) 450-4174.

Sincerely yours,



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Appendix: Comments on Proposed Economic Analysis

I. MSRB's Statutory Mandate

SIFMA supports the MSRB's inclusion of economic analysis in requests for comment in general, and particularly in the case of Proposed Rule G-42. Not only is an economic analysis ultimately necessary in order to meet statutory standards applicable to the approval of a self-regulatory organization's rulemaking[1] and to the MSRB's own rules,[2] but a reasoned economic analysis will inform good policy, including protection of investors, municipal entities and obligated persons, and promote a fair and robust market for the provision of financial services and prevent undue burdens on competition.

In proposing Rule G-42, the MSRB is responding to a specific statutory mandate to prescribe standards for the conduct of municipal advisors in general[3] and also to define the nature of a municipal advisor's fiduciary duty when furnishing advice to municipal entities.[4] In this context, SIFMA believes that the MSRB's economic analysis must consider the costs and benefits of Proposed Rule G-42 in light of this specific statutory directive. However, the MSRB must still evaluate the costs and benefits with respect to *each provision* of Proposed Rule G-42 in view of the differing statutory requirements applicable to municipal advisors when providing advice to municipal entities and those providing advice to obligated persons.

In light of the fact that municipal advisors are not similarly situated – particularly in regard to the range of services they and their affiliates offer – and the complexity of the corporate organizations in which they function, the MSRB should consider the costs and benefits of each proposed requirement of the proposal on each different type of municipal advisor. For example, some municipal advisors' activities (and those of their affiliates, if any, and associated persons) are limited to providing advice with respect to the issuance of municipal securities, whereas others offer underwriting, brokerage, market making, investment management and other investment services, swaps, traditional

[1] *See* Exchange Act §§ 3(f); 15B(b)(2).

[2] *See* Exchange Act § 15B(b)(2).

[3] *See* Exchange Act § 15B(b)(2)(L) (requiring the MSRB, with respect to municipal advisors, to (i) prescribe means reasonably designed to prevent acts, practices, and courses of business as are not consistent with a municipal advisor's fiduciary duty to its clients; (ii) provide continuing education requirements for municipal advisors; (iii) provide professional standards; and (iv) not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, municipal entities, and obligated persons, provided that there is robust protection of investors against fraud).

[4] *See* Exchange Act § 15B(c).

banking services, among others. The costs and benefits of Proposed Rule G-42 will differ across the different business models and must be considered.[5]

II. Assessing Costs and Benefits

With this framework in mind, SIFMA believes that what would be most appropriate, and most constructive, is for the MSRB to consider the benefits in terms of the protection of municipal entities, obligated persons and investors, in light of the relevant statutory standards, and the costs and competitive burdens, with respect to each proposed requirement, and as applied to the various types of municipal advisors and the variety of services offered by them.

SIFMA believes that this approach to analysis will likely facilitate more objective quantification, in particular of costs and burdens of each provision, and would help clarify for the MSRB, the SEC and market participants, the appropriateness of each provision as applied to the full range of municipal advisors and their related activities. It would also facilitate the MSRB and the SEC's evaluation of whether particular requirements are necessary or appropriate and would promote efficiency, competition, and capital formation, when applied to particular municipal advisory activities.

Concerning quantifying costs and burdens, SIFMA is concerned that the MSRB has, in direct conflict with its own policy, neglected to even attempt to do so,[6] instead asserting that cost quantification is not possible, or assuming that burdens would be minimal.[7] Moreover, there is no attempt to quantify the costs of defining the universe of relevant clients, the costs to entities in dealing with the principal transaction prohibition (including dealing with informational barriers and preventing leakage of material non-public information or the costs associated with preventing becoming a municipal advisor inadvertently). SIFMA believes that the MSRB could reasonably solicit from municipal advisors having differing profiles the expected costs of performing specified functions (*e.g.*, drafting and negotiating written agreements—which requires expenditures of time and money both for municipal advisors and their clients—preparing and providing disclosures, evaluating clients' objectives, limiting principal dealings) as well as evaluating burdens and competitive issues if the MSRB uses this analytical approach.

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[5] SIFMA notes that the MSRB has statutory authority to apply different rules to different classes of municipal advisors. *See* Exchange Act § 15B(b)(2)(A)(i) (stating that that "in connection with the definition and application of such ***standards*** the Board may appropriately classify municipal securities brokers, municipal securities dealers, and municipal advisors (taking into account relevant matters, including types of business done, nature of securities other than municipal securities sold, and character of business organization), and persons associated with municipal securities brokers, municipal securities dealers, and municipal advisors).

[6] *See* MSRB, Policy on the Use of Economic Analysis in MSRB Rulemaking, *available at* http://msrb.org/About-MSRB/Financial-and-Other-Information/Financial-Policies/Economic-Analysis-Policy.aspx (incorporating the SEC's policy that "stresses the need to attempt to quantify anticipated costs and benefits even where the available data is imperfect.").

[7] *See* Regulatory Notice at 21-24.

The MSRB's proposed economic analysis does not take into consideration the significant costs that large firms will need to bear in order to amend and/or develop their systems to comply with Proposed Rule G-42. Specifically, large firms need to consider the cost of creating information gathering that is necessary to support compliance under Proposed Rule G-42. Such large firms will also need to modify or resolve conflicts with existing information barriers that do not breach limitations of the sharing of material nonpublic information or other privacy concerns. Moreover, it is often the case that large firms have global operations, in which such firms' systems would need to be updated and/or developed on an international scale. The MSRB must therefore factor in the costs and burdens of developing such systems in relation to the size and complexity of each firm.

The MSRB must also consider the cost of certain *implied* requirements that firms necessarily will need to comply with as an incidental result of the requirements under Proposed Rule G-42. For example, municipal advisors may not be required under Proposed Rule G-42 or the proposed amendments to Rules G-8 and G-9 to keep records of all conversations relating to the relationship between a municipal advisor and its municipal entity or obligated person client. However, because Proposed Rule G-42 would require municipal advisors to undertake specific discussions, municipal advisors will, in effect, be required to maintain records that those discussions occurred in order to prove compliance with Proposed Rule G-42 during a regulatory examination.

SIFMA strongly disagrees with the MSRB's unsupported assertion that any increase in municipal advisory fees as a result of Proposed Rule G-42 "will be, in the aggregate, minimal" or that they can "be spread across the number of advisory engagements for each firm."[8] To the contrary, many of the incremental costs under Proposed Rule G-42 are not fixed overhead costs that can be spread out across all engagements. Rather, Proposed Rule G-42 would create additional costs on every single engagement, such as potentially bespoke disclosure requirements. These additional costs will need to be passed through in full, raising client's costs.

The MSRB's proposed economic analysis also fails to consider opportunity costs, which will differ depending on each and every engagement. Because of the proposed prohibition on principal transactions with clients, choosing to be engaged as a municipal advisor will mean foregoing the potential business of transacting as principal with the client. This opportunity cost will differ depending on the municipal advisor and client involved, and in some cases, need to be passed through to the client through higher advisory fees in order to justify accepting the municipal advisory engagement rather than the principal business relationship.

III. Baselines

Regarding "baselines," as suggested in the body of SIFMA's letter regarding Proposed Rule G-42, we believe that Proposed Rule G-42 as a whole should distinguish

[8] *See* Regulatory Notice at 23.

conduct standards where the municipal advisor is advising a municipal entity with respect to the issuance of municipal securities, swaps, and brokerage and dealing activities and when it is advising an obligated person (or, preferably, codify these two cases in separate rules). In the case of advising municipal entities, each requirement in the rule should be analyzed as applied to specific activities (advising with respect to the issuance of municipal securities, swaps, brokerage and dealing activities) in light of commonly understood standards of fiduciary duty in the financial services business and the specific circumstances of the municipal securities market. In the case of advising obligated persons, the baseline standard of analysis should be the fair dealing standard under MSRB Rule G-17.

IV. Consideration of Alternatives

SIFMA believes that the more granular analysis advocated above would lend itself to consideration of alternative regulatory approaches, as applied to particular requirements for particular activities—when a fiduciary standard applies and when it does not. The MSRB's proposed economic analysis does not consider alternatives at this level but instead merely considers the alternatives of (i) not adopting rules at all or (ii) adopting principles-based rules.[9] SIFMA believes that this approach is too general to be meaningful. It may be (and likely is the case) that certain *individual* requirements of Proposed Rule G-42 would, for example, be more appropriate as principles-based requirements as applied to particular activities, but others would benefit from a more prescriptive approach. The MSRB should consider these alternatives on a requirement-by-requirement basis to more meaningfully consider alternatives, rather than generalizing.

A more granular approach to evaluating costs and benefits would be particularly appropriate when considering the proposed prohibition on principal transactions, which, as noted in the body of SIFMA's comments, is overbroad. The costs and benefits of such a prohibition—and alternative approaches—should be analyzed, taking into account whether the client is a municipal entity or an obligated person, whether the transaction is one on which the municipal advisor or its affiliates are advising as a municipal advisor, the different activities (*e.g.*, investment services, swaps) that may be offered by the municipal advisor, and the practicality for compliance by a complex organization, given the impracticability of one affiliate even knowing whether another affiliate is acting as a municipal advisor on a given transaction or whether an affiliated entity or a distant trading desk may be trading as principal. Here, as elsewhere in Proposed Rule G-42, the question is not whether to have any rules at all, but how to craft the requirement so that benefits to municipal entities and obligated persons are maximized and burdens are minimized in particular contexts.

[9] In its consideration of the alternative principles-based approach, the MSRB should also discuss why a principles-based regime would be inferior to a rules-based structure, particularly given that Congress and the SEC have found a principles-based regime to be the most appropriate in the context of investment advisers—another financial advisory relationship with a statutory fiduciary duty.

V. Effect on Competition

The MSRB should expand its analysis of the effects on competition—and potential exits from the business—if MSRB rules will be applied in particular ways to particular persons, as described above. After acknowledging that the costs of Proposed Rule G-42 may lead some municipal advisors to leave the market, or others to consolidate for economies of scale, the MSRB asserts the conclusion that, nonetheless, the "market for municipal advisory services is likely to remain competitive."[10] The MSRB provides no arguments that support this conclusion, but rather cites potential offsetting benefits of Proposed Rule G-42 (*e.g.*, that clients will benefit from greater disclosure).

In fact, Proposed Rule G-42 will significantly harm competition, as many firms decide that providing municipal advisory services is not economical. For example, if, as proposed, neither a municipal advisor nor any of its affiliates is permitted to enter into any principal relationship with a client, many multiservice firms, such as firms affiliated with broker-dealers, will determine that the inability to enter into other business with the client makes the cost of providing municipal advisory services too high. As a result, the pool of firms willing to act as municipal advisors may be limited to only a smaller universe of stand-alone monoline firms. Lacking in competition, these remaining municipal advisors will increase their fees, and the quality of their service may decline, harming clients much more than they benefit from increased disclosures.

[10] *See* Regulatory Notice at 24.