gkb George K. Baum & Company
INVESTMENT BANKERS SINCE 1928

March 10, 2014

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

RE: MSRB Notice 2014-01 (January 9, 2014): Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors

Dear Mr. Smith:

On behalf of George K. Baum & Company ("GKB" or the "Firm"), we are pleased to provide our response to Municipal Securities Rulemaking Board ("MSRB") Notice 2014-01 (the "Request for Comment"). To help put our response in context; GKB is a small broker dealer whose principal business is municipal finance. Our firm provides a multitude of services to our clients, both municipal entities and obligated persons, including underwriting services and financial advisory services. When serving in an underwriting capacity, our principal bond distribution network is to institutional investors. We also have a relatively small retail distribution capacity. Accordingly, our comments are restricted only to our areas of expertise and therefore are not intended to be comprehensive of all of the provisions of Proposed Rule G-42.

Please also note that our firm is a member of both the Bond Dealers of America ("BDA") and the Securities Industry and Financial Markets Association ("SIFMA"). The BDA and SIFMA are submitting separate comment letters in response to the Request for Comment. GKB approves, endorses and supports all of the comments and suggestions being provided by the BDA and by SIFMA.

Comprehensive Rules Pertaining to Municipal Advisors

The MSRB previously has stated that it will be issuing various proposed regulations pertaining to Municipal Advisors, in addition to Proposed Rule G-42. The MSRB has announced its intention to issue such proposed regulations in phases, beginning first with Proposed Rule G-42 (and related proposed revisions to Rules G-8 and G-9). While we acknowledge that forthcoming additional regulations beyond Proposed Rule G-42 would be prudent and appropriate, we are concerned that this phased approach to issuing proposed regulations may lead to unintended inconsistencies and related undue burdens. Because we cannot know or predict with certainty where the purview of each such future additional proposed rule will begin or end, or how each might impact or correlate to Proposed Rule G-42, in our opinion it is likely that such future proposed rules might necessitate or warrant additional comments regarding the scope, purview or application of Proposed Rule G-42. Therefore, we urge the MSRB to not

finalize any of the rules governing the behavior of municipal advisors, including but not limited to Proposed Rule G-42, until all of those rules which the MSRB intends to propose at least have been published for comment. Doing so, in our opinion, will help mitigate any unintended inconsistencies in drafting, interpretation and application of comprehensive rules for municipal advisory activities.

Whether Proposed Rule G-42 Should Require a Duty of Care to an Obligated Person

The Request for Comment on Proposed Rule G-42 properly notes (on page 3) that, "the Dodd-Frank Act itself specifically establishes that a fiduciary duty is owed by a municipal advisor to its municipal entity clients. By contrast, the Dodd-Frank Act does not impose a fiduciary duty with respect to a municipal advisor's obligated person clients." (footnote citations omitted) As so acknowledged by the MSRB, federal securities law dictates that a Municipal Advisor owes a fiduciary duty when it acts as an advisor "to [a] municipal entity." (See Securities Exchange Act of 1043, as amended (the "Exchange Act"), § 15B(c)(1).) Congress did not authorize or impose a fiduciary duty on Municipal Advisors when acting as an advisor to obligated persons. The Securities and Exchange Commission ("SEC"), in promulgating its final municipal advisor registration rules (the "SEC MA Rules"), clearly recognized these distinctions and expressed its opinion that Municipal Advisors owe a duty of fair dealing to obligated person clients under MSRB Rule G-17, and not a fiduciary duty. (See SEC Adopting Release, No. 34-70462, at page 156.)

Proposed Rule G-42, however, does not adopt this same approach, instead proposing to impose a duty of care on a Municipal Advisor when acting as an advisor to an obligated person client. Because neither Congress nor the SEC requires or imposes such an obligation, we believe that if the MSRB wishes to impose a duty of care on a Municipal Advisor when acting as an advisor to an obligated person client, the MSRB should clearly state the legal authority for that requirement, and the justification for taking this additional step, including providing evidence of abuses which demonstrate the need for a more robust regulatory framework than that adopted by Congress and the SEC. We recommend instead that the MSRB revise Proposed Rule G-42 to remove any imposition of a duty of care on a Municipal Advisor when acting as an advisor to obligated persons, and instead rely upon the existing provisions of Rule G-17 that impose a duty of fair dealing on all Municipal Advisors. In our opinion, that approach will enhance simplicity and consistency between the requirements, interpretation and application of federal securities laws, the SEC MA Rules and applicable MSRB Rules pertaining to duties owed by Municipal Advisors to obligated person clients. In our opinion, non- municipal entity obligated persons have different characteristics than municipal entities. Non-municipal entity obligated persons are not associated with the handling of public funds. Non-municipal entity obligated persons are private business, either for-profit or not-for-profit, and therefore operate with a different level of public accountability. Since the MSRB requires only that a duty of fairness apply when brokers, dealers, or municipal securities dealers deal with other types of private business (such as other broker dealers), we believe this same duty should be applied when Municipal Advisors deal with the type of private business class defined as obligated persons.

Municipal Advisors Acting as a Principal

Proposed Rule G-42(f) is summarized in the Request for Comment (page 6), as follows: "Draft Rule G-42 prohibits a municipal advisor (and any affiliate) from engaging in any transaction in a principal capacity to which the municipal entity or obligated person client of the municipal advisor is a counterparty, except for activity that is expressly permitted by underwriters under Rule G-23." The Request for Comment and Proposed Rule G-42(f), however, do not specifically identify which provisions of Rule G-23 were intended to be included within this exception. Accordingly, Proposed Rule G-42(f) is too ambiguous and overly broad. If the MSRB intended the exception to incorporate the provisions of Rule 23 (d) (ii) and (iii), we believe that affirmatively stating similar exceptions, revised to apply to Municipal Advisors to municipal entity clients and limited to specific transactions, would be much more direct and clear. Accordingly, for the reasons set forth below, we recommend that Proposed Rule G-42(f) should be revised to state as follows:

> "A municipal advisor for a municipal entity on a transaction is prohibited from engaging in any principal capacity on that transaction, except as stated below:
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> A municipal advisor for a municipal entity shall not be prohibited from acting as agent for the municipal entity in arranging the placement of the entire issue with any state, local or federal governmental entity as part of a plan of financing by such entity for or on behalf of the municipal entity, but only if such municipal advisor does not receive compensation from any person other than with respect to municipal advisory services related to such placement and does not receive compensation from any person for underwriting any contemporaneous financing transaction directly or indirectly related to such issue undertaken by the state, local or federal governmental entity with which such issue was placed.
>
> The limitations set forth above shall also apply to any broker, dealer, or municipal securities dealer controlling, controlled by, or under common control with the broker, dealer, or municipal securities dealer having a municipal advisory relationship with a municipal entity client with respect to the issuance of municipal securities. The use of the term "indirectly" shall not preclude a broker, dealer or municipal securities dealer that has a municipal advisory relationship with a municipal entity client with respect to the issuance of municipal securities from purchasing such securities from an underwriter, either for its own trading account of for the account of customers, except to the extent that such purchase is made to contravene the purpose and intent of this rule."

In our opinion, Rule G-42(f) should be revised as suggested above for two reasons. First, as currently proposed by the MSRB, Proposed Rule G-42(f) would overstep the guidance in other existing regulations (such as Rule G-23 and the SEC MA Rules) which clearly recognize that a municipal advisory relationship related to the issuance of municipal securities is a transaction-by-transaction decision between a service provider and a municipal entity. Under the current version of Proposed Rule G-42(f), however, a

municipal advisory relationship instead would become a client based relationship which seemingly would continue forever in time. Given the nature of the municipal securities business, it will be almost impossible for a broker dealer to never act as a Municipal Advisor for a client. Under Proposed Rule G-42(f), as currently written, if a broker dealer ever worked as a Municipal Advisor for a client, that broker dealer would be prohibited from acting as a principal on any of the client's transactions forever. If Proposed Rule G-42(f) becomes effective as currently proposed by the MSRB, ultimately no broker dealer will be available to act as an underwriter for any client.

Second, as noted above, Proposed Rule G-42(f) would overstep the guidance in other existing regulations (such as Rule G-23 and the SEC MA Rules) which currently recognize the difference between a financial advisory or municipal advisory relationship with a municipal entity or an obligated person. In the MSRB's Notice On Application Of Board Rules To Financial Advisory Services Rendered To Corporate Obligors On Industrial Development Bonds (May 23, 1983), the MSRB states:

> "Board rules G-1 and G-3 provide that rendering "financial advisory or consulting services for *issuers*" is an activity to which those rules are applicable (emphasis added). Similarly, Board rule G-23, on the activities of financial advisors, applies to brokers, dealers, and municipal securities dealers who agree to render "financial advisory or consultant services to or on behalf of an *issuer*" (emphasis added). Clearly these rules are applicable to financial advisory services rendered to state or local governments and their agencies, as well as to municipal corporations. In the Board's view, however, rules G-1, G-3, and G-23 do not apply to financial advisory services which are provided to corporate obligors [obligated persons] in connection with proposed IDB financings."

Moreover, the SEC states in its Registration of Municipal Advisors, Frequently Asked Questions, issued on January 10, 2014 (last updated on January 16, 2014) (the "FAQs"), in the section titled "Question 5.2: Switching Roles From Municipal Advisor to Underwriter":

> "If a broker-dealer acts as a municipal advisor to a municipal entity with respect to an issuance of municipal securities, it owes a fiduciary duty to the municipal entity with respect to that issue and must not take any action inconsistent with its fiduciary duty to the municipal entity. Additionally, the broker-dealer must comply with MSRB Rule G-23, which prohibits persons from switching from the role of financial advisor to the role of underwriter with respect to the same issuance of municipal securities."

Only here, in all of the SEC's FAQs and answers, does it omit any mention of obligated persons. The SEC expressly mentions obligated persons in many other places in its FAQs and the SEC MA Rules. The SEC could have included obligated persons in its discussion of restrictions imposed by MSRB Rule G-23 on role switching, but did not do so. Clearly the SEC intended that a person can be a Municipal Advisor for an obligated person and still be an underwriter on the municipal securities issued by the municipal entity.

Evidencing a Municipal Advisory Relationship in Writing

In describing Proposed Rule G-42(c), the Request for Comment (page 9) states, "Under draft rule G-42(c), municipal advisors must evidence each of their municipal advisory relationships by a writing entered into prior to, upon or promptly after the inception of the municipal advisory relationship."

Section 15B(e)(4)(A) of the Exchange Act (as amended by the Dodd-Frank Act) and the SEC MA Rules define a Municipal Advisor to mean a person (who is not a municipal entity or an employee or a municipal entity) that: 1) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such financial products or issues; or 2) undertakes a solicitation of a municipal entity.

In summary, there are three activities which can make someone a Municipal Advisor:

- Providing advice with respect to the issuance of municipal securities;
- Providing advice with respect to municipal financial products; or
- Undertaking a solicitation of a municipal entity.

In our opinion, each of these circumstances should be dealt with and addressed separately in determining when and how a Municipal Advisor must evidence its relationship with its clients.

<u>Providing advice with respect to the issuance of municipal securities</u>

Rule G-23(b) states, "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 the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue." Clearly for a broker, dealer, or municipal securities dealer, when providing advice to or on behalf of an issuer with respect to the issuance of municipal securities to an issuer, acting as a Financial Advisor or as a Municipal Advisor are functionally the same.

Rule G-23(c) states, "Each financial advisory relationship shall be evidenced by a writing entered into prior to, upon or promptly after the inception of the financial advisor relationship". The MSRB's Guidance on the Prohibition on Underwriting Issues of Municipal Securities for Which a Financial Advisor Relationship Exists Under Rule G-23 states, "Although Rule G-23(c) requires a financial advisory relationship to be evidenced in writing, a financial advisory relationship will be deemed to exist whenever a dealer renders the types of advice provided for in Rule G-23(b), regardless of the existence of a written agreement."

Therefore, according to Rule G-23, in order to establish a financial advisory relationship two conditions must be present. The first is that there must be an agreement between the broker, dealer, or municipal securities dealer and an issuer that there is mutual desire to enter into a financial advisory relationship

(even if such agreement is not in writing) and second, that the financial advisor has to provide advice. The fact that these two requirements exist in combination is very important because it means that a broker, dealer, or municipal securities dealer doesn't inadvertently become a financial advisor without the participation by the issuer. This extremely important concept is also present in the SEC MA Rules where an underwriter cannot take advantage of the underwriter exemption without the participation of the issuer, because the issuer has to grant the exemption to the underwriter.

For the purposes of Proposed Rule G-42, we believe that the regulatory requirement for becoming a municipal advisor when providing advice with respect to the issuance of municipal securities should require: (1) that the municipal advisor must provide advice, and (2) that the municipal entity or obligated person must have recognized that it is advice and have the expectation and desire that it carried a fiduciary duty or a duty of fairness, respectively. Without this second prong, unintended problems or complications are likely to arise. An example of when this would be a problem would involve an employee of a broker dealer whose firm has invented a new type of financing mechanism. If the sponsors of a municipal entity conference invite the employee to make a presentation at the conference about the new financing mechanism, then the employee presenting that information could be viewed as giving "advice" to every municipal entity in attendance. We believe, however, that none of the municipal entities in attendance would be hearing the information with any expectation or desire that the presenter had a fiduciary responsibility to the municipal entity. As a result, we believe that only when information is conveyed or given in a forum or manner where a municipal entity has an expectation and a clearly stated desire that the presenter owes it a fiduciary responsibility, does the employee/presenter or his or her firm become a municipal advisor and trigger the requirement to evidence the relationship in writing, whether or not the municipal advisor will be paid for the advice.

<u>Providing advice with respect to municipal financial products</u>

When a person or entity becomes a municipal advisor by providing advice with respect to municipal financial products, we believe that all of the requirements for being deemed a municipal advisor with respect to the issuance of municipal securities should apply, with the exception that the municipal advisor should only have to evidence the relationship if they are to be paid for the advice. Unlike the situation where a person becomes a municipal advisor by providing advice with respect to the issuance of municipal securities, when providing advice with respect to municipal financial products, there is only one possible roll - municipal advisor. No other role which might provide a conflict with the municipal entity or obligated person is possible. As a result, when a person becomes a municipal advisor with respect to municipal financial products, the only need for a written agreement is to clearly describe the consideration to be exchanged between the parties for those services - the payment to be made to the municipal advisor. We believe that this is the only instance where a written agreement should be required when rendering advice with respect to municipal financial products.

Undertaking a solicitation of a municipal entity

Even though Proposed Rule G-42 does not address the duties of a Municipal Advisor when undertaking the solicitation of a municipal entity, the rule as currently proposed would require a written agreement for any municipal advisory relationship, even one obtained through a solicitation. We recommend the language in Proposed Rule G-42 be changed so that it is clear that Proposed Rule G-42 covers only those instances where an entity becomes a municipal advisor by providing advice on the issuer of municipal securities or municipal finance products.

In the Request for Comment, the MSRB states that it intends to issue, at a later date, additional proposed rules with regard to solicitation activities. When the MSRB is drafting any such future proposed rules, we urge the MSRB to separately address and treat differently a solicitation of municipal entity with respect to the issuance of municipal securities, and a solicitation with respect to municipal financial products. In our opinion, a person who becomes a municipal advisor because they undertake a solicitation of a municipal entity with respect to the issuance of municipal securities should have to evidence the relationship in writing as illustrated above. We also believe that a person who becomes a municipal advisor because they undertake a solicitation with respect to municipal financial products should only have to evidence their relationship in writing if they are successful in the solicitation, and as described above, if the resulting engagement will result in the municipal advisor being paid a fee for their advice.

Thank you in advance for your attention to our concerns and suggestions.

Sincerely,

Guy E. Yandel
EVP & Head of Public Finance

Dana L. Bjornson
EVP, CFO & Chief Compliance Officer

Andrew F. Sears
SVP & General Counsel