**New York State Bar Association**
One Elk Street
Albany, NY 12207
518-463-3200

**Business Law Section**
**Securities Regulation Committee**

August 27, 2014

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

Re : Regulatory Notice 2014-12
Request for Comment on Revised Draft MSRB Rule G-42,
on Duties of Non-Solicitor Municipal Advisors

The Securities Regulation Committee of the Business Law Section of the New York State Bar Association appreciates the invitation from the Municipal Securities Rulemaking Board ("MSRB" or "Board") in Regulatory Notice 2014-12 to comment on the MSRB's revised draft Rule G-42 (Duties of Non-Solicitor Municipal Advisors).

The Committee is composed of members of the New York State Bar Association, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and corporation law departments. A draft of this letter was reviewed by certain members of the Committee. The views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association or its Business Law Section.

## Introduction

As the Securities and Exchange Commission ("SEC") noted in the release adopting final rules for municipal advisors (SEC Release No. 34-70462[1])("Adopting Release"), citing the Senate report related to the Dodd-Frank Act, the municipal securities market has been

[1] www.sec.gov/rules/final/2013/34-70462.pdf.

significantly less regulated than the corporate securities market, and during the financial crisis a number of municipalities suffered losses from complex derivatives products marketed by unregulated financial intermediaries.[2] We support the efforts of Congress and the SEC to regulate those financial intermediaries as municipal advisors, and we generally support the Board's effort to impose standards of conduct on municipal advisors. We also support many of the changes the Board has made in response to comments on the original proposal in Regulatory Notice 2014-01. However, we would like to take this opportunity to comment specifically on the amended prohibition on principal transactions, which we believe still does not provide adequate flexibility to accommodate special circumstances.

As we noted in our comment latter, dated March 12, 2014, on Regulatory Notice 2014-01, the definition of "municipal advisor" in Section 15B(e) of the Securities Exchange Act of 1934 ("Exchange Act"), as interpreted by the SEC, encompasses a wide variety of persons and activities, including persons that advise municipal entities on the issuance of municipal securities or act as intermediaries or finders between municipal entities and municipal underwriters, and also persons that advise municipal entities and obligated persons with respect to municipal financial products – municipal derivatives, guaranteed investment contracts and investment strategies, including plans or programs for the investment of the proceeds of municipal securities.

The definition of municipal advisor as interpreted by the SEC may include other categories of persons who may not consider themselves to be in the business of acting as municipal advisors, including providers of guaranteed investment contracts and counterparties in municipal derivatives. If those persons provide advice about their products, in addition to selling them, they may be considered municipal advisors.

**Comments on Prohibition on Principal Transactions**

Permitting Exceptions in Appropriate Circumstances. Section (e)(ii) of proposed MSRB Rule G-42, as revised, would provide as follows:

> A municipal advisor to a municipal entity client, and any affiliate of such municipal advisor, is prohibited from engaging in a principal transaction directly related to the same municipal securities transaction or municipal financial product as to which the municipal advisor is providing advice.

For the reasons stated below, we believe Paragraph (e)(ii) of proposed Rule G-42 should be revised to permit principal transactions where (1) the municipal advisor does not make a recommendation to the municipal advisory client to enter into a transaction with the municipal advisor or its affiliate, (2) the municipal advisor discloses the potential conflict of interest and (3) the municipal advisor receives written acknowledgement from te municipal entity client of the conflict prior to the transaction.

[2] Adopting Release text at n. 3.

We continue to believe that there are circumstances in which a municipal advisor or its affiliate should not be barred from engaging in a principal transaction with the municipal entity client, notwithstanding the fact that the transaction is directly related to the municipal securities transaction or municipal financial product as to which the municipal advisor is providing advice, if there is adequate disclosure of the potential conflict of interest and written consent and acknowledgment by the municipal entity client. Those circumstances may arise in the following situations, among others:

- The municipal entity client comes to the municipal advisor and, if applicable, its affiliate, specifically to purchase a municipal financial product and to obtain advice about the use of that product.
- The municipal advisor provides advice about a municipal securities transaction or municipal financial product and the decision to enter into a principal transaction with the municipal advisor or its affiliate is made by the municipal entity client on the basis of advice by an independent advisor, such as another municipal advisor, an investment adviser or a broker-dealer.
- The municipal advisor provides advice about a municipal securities transaction or municipal financial product, but not including a recommendation to use the advisor or its affiliate as a counterparty, and the client makes an independent determination to use the advisor or its affiliate.

In those and other situations in which the municipal advisor is providing advice about the municipal securities transaction or municipal financial product but not making a recommendation that it or its affiliate should be the counterparty, the transaction should not be prohibited so long as the municipal advisor provides disclosure concerning the potential conflict of interest and obtains prior written acknowledgment from the municipal entity client of the conflict and of the fact that the advisor has not made a recommendation that it or its affiliate act as principal in the transaction.

Section 206(3) of the Investment Advisers Act of 1940 does not contain a blanket prohibition on principal transactions but instead prohibits investment advisers from engaging in principal transactions "without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction." The SEC has provided further guidance concerning the nature of the disclosure and client consent in temporary rule 206(3)-3T. Similarly, Congress, in the Dodd-Frank Act, recognized that there may be circumstances where principal transactions by a fiduciary should be permissible with adequate disclosure. Section 913(g) of the Dodd-Frank Act added Section 15(k) of the Exchange Act, authorizing the SEC to establish a standard of fiduciary duty for brokers and dealers. Section 15(k)(2) of the Exchange Act authorizes the SEC to adopt standards of conduct for brokers and dealers that permit brokers or dealers that sell only proprietary or other limited range of products to sell those products without violation of the standards, on the condition that the broker or dealer provides notice to each retail customer and obtains the consent or acknowledgment of the customer.

Paragraph (e)(ii) of proposed Rule G-42 should be revised to permit principal transactions where (1) the municipal advisor does not make a recommendation to the municipal

entity client to enter into a transaction with the municipal advisor or its affiliate, (2) the municipal advisor discloses the potential conflict of interest and (3) the municipal advisor receives written acknowledgement of the conflict prior to the transaction. We believe that this will give municipal entities the freedom to choose the parties with whom they wish to enter into transactions while providing adequate protection against self-dealing by municipal advisors.

Clarification of Definition of "Engaging in a Principal Transaction". Proposed Rule G-42(f)(i) would define "engaging in a principal transaction" to include, when acting for one's own account, "entering into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client." The phrase "other similar financial product" is somewhat open-ended and capable of varying interpretations. We suggest that the phrase be changed to: "or other municipal financial product," since that term is defined in the statute. Alternatively, because derivatives and guaranteed investment contracts are included within the definition of municipal financial product, the quoted portion of the proposed definition could be revised and shortened to say: "entering into any municipal financial product with the municipal entity client.

The definition, or the supplementary material, should further clarify that the definition of "engaging in a principal transaction" does not include any of the banking activities about which a bank may provide advice without being registered as a municipal advisor, pursuant to the exemption in SEC Rule 15Ba1-1(d)(3)(iii). Those activities include:

- Holding investments in a deposit account, savings account, certificate of deposit or other deposit instrument issued by a bank;
- Extensions of credit by a bank to a municipal entity or obligated person, including the issuance of a letter of credit, the making of a direct loan, or the purchase of a municipal security by the bank for its own account;
- Holding funds in a sweep account; or
- Investments made by a bank acting in the capacity of an indenture trustee or similar capacity.

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We are grateful for the opportunity to provide these comments on the revised draft Rule and for the Board's attention and consideration. We hope that our comments, observations, and recommendations contribute to the important work of the Board in carrying out the regulatory initiatives under the Dodd-Frank. We would be happy to discuss these comments further with the Board and its staff.

Respectfully submitted,

SECURITIES REGULATION COMMITTEE

By: /s/
Peter W. LaVigne
Chair of the Committee