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Municipal Advisors Seek Changes, Clarifications on MSRB's MA Rule.

WASHINGTON — The Municipal Securities Rulemaking Board's proposed standards of conduct for municipal advisors would unnecessarily prevent banks from providing normal banking services as well as muni advice, the American Bankers Association is warning.

The ABA raised the concerns in one of more than 12 comment letters filed prior to Monday's deadline to provide input on the MSRB's proposed Rule G-42, called "Duties of Non-Solicitor Municipal Advisors."

The proposed rule codifies the language of the Dodd-Frank Act and the Securities and Exchange Commission's registration rule for MAs, which impose a fiduciary duty on them to put their client's interest first before their own. The draft rule says MAs owe both a duty of loyalty and a duty of care to their municipal entity clients. It would prohibit MAs and their affiliates from engaging in any other transaction in a principal capacity with a client, which some market participants read as barring MAs from engaging in any non-fiduciary business relationship running concurrent to the municipal advisory agreement.

"Draft Rule G-42 would prohibit a municipal advisor and any of its affiliates from acting as principal in any transaction with entities or obligated persons," wrote ABA vice president and senior counsel Cristeena Naser. "We believe that the proposed complete prohibition is far too blunt an instrument to address any concerns the MSRB may have regarding principal transactions."

"Such a ban would also force banking organizations' municipal entity customers and obligated persons to decide to choose between receiving covered municipal advice or banking products and services from their banks, because banks would not be permitted to provide both," her letter adds.

The ABA letter points out that other regulatory regimes imposing a fiduciary standard do not have similar requirements. Naser conceded that a ban on principal transactions might work in the case of firms that provide only MA services, but would be very disruptive to advisors with banking affiliates.

"Although a complete ban on principal transactions by affiliates might be feasible in the case of stand-alone advisors, it is entirely unreasonable and impractical in the context of the structure of the banking industry. Such a prohibition would necessarily force a banking organization to assess the value of providing advisory services to municipal entities and obligated persons as compared to the value of providing all other products and services to municipal entities and obligated persons."

Leslie Norwood, associate general counsel and co-head of the municipal securities group at the Securities Industry and Financial Markets Association, called the prohibition on acting as a principal in other transactions "unworkable."

"We support the MSRB's effort," Norwood said. "We oppose the blanket prohibition on principal transactions.

Susan Collet, senior vice president of government relations at the Bond Dealers of America, said the MSRB proposal and its ban on principal transactions is confusing in light of recent SEC guidance, which stated that an underwriting firm acting as an MA can not switch roles to underwrite bonds on the same transaction.

“The MSRB has an important opportunity with G-42 to add clarity to the framework created under the SEC municipal advisor rule,” Collet said. “The two rules need to work together, yet the proposed G-42 language on principal transactions makes very confusing something that the SEC rule made clear: the scope of a prohibition on ‘role switching’ is limited to the specific issuance or transaction for which a municipal advisor is engaged.”

The National Association of Independent Finance Advisors expressed support for the rule and its letter, signed by NAIPFA president Jeanine Rodgers Caruso, said the ban on principal transactions is appropriate but should be further clarified in any final rule. However, rule goes too far in some areas, such as the proposal to require MAs to disclose the scope and size of any professional liability insurance they carry, NAIPFA said. That proposal would put smaller firms at a competitive disadvantage since larger firms and those affiliated with broker-dealers would certainly carry larger and more expensive policies, she said.

“NAIPFA would welcome a revised provision that states in effect that municipal advisors must truthfully disclose, upon request, information related to any professional liability insurance maintained,” Rodgers Caruso wrote.

Another point of contention for commenters was the MSRB’s request for comment on whether the rule should impose a fiduciary duty on “obligated persons” such as conduit borrowers. The law explicitly places the fiduciary duty on MAs only with respect to municipal entities, which are issuers but not conduit borrowers. The draft of G-42 proposes a lesser duty of care for clients that are not municipal entities. NAIPFA said it would be supportive of such a measure, but the ABA and SIFMA both said that the MSRB should not impose a fiduciary standard on MAs providing advice to any client other than a municipal entity.

Illinois Finance Authority vice president and president of the National Association of Health and Educational Facilities Finance Authorities Pamela Lenane said many conduit issuers retain advisors who may also provide advice to municipal entities, and that the current system is efficient and should not be interfered with by the new rule.

“The association respectfully submits that imposing a fiduciary duty (whether implicitly or explicitly) on a municipal advisor that provides advice to an obligated person is contrary to the specific legislative intent expressed in the Dodd-Frank Act and unnecessarily complicates a municipal advisor’s role in conduit financings,” NAHEFFA said in its letter. The group, which represents certain conduit issuers, said the MSRB should clarify the differences between the duty of loyalty owed to municipal entities and the duty of care owed to other clients and perhaps create a separate rule governing the conduct of MAs with “obligated persons,” meaning conduit borrowers. The MSRB could also clarify how the duties of MAs would apply to a conduit borrower in cases where the borrower retains its own MA in addition to the MA retained by the municipal entity issuing the bonds.

The American Council of Engineering Companies is also seeking clarification from the MSRB for any engineers who might find themselves ensnared by the regime. The SEC rule sought to provide an exemption for engineers providing normal engineering advice to municipalities, but some firms remain concerned that services such as feasibility studies evaluating the financial potential of a toll road or other revenue-producing asset could have to register as an MA. The group pointed out that

engineers are already heavily regulated at the state level owe a high ethical duty to the public.

The MSRB must seek final approval from the SEC before any rule could take effect.

BY KYLE GLAZIER
MAR 10, 2014 4:36pm ET