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Conduct Rule 'Unclear' on Underwriters Giving Advisory Services.

WASHINGTON — Market participants said they are concerned and confused about an aspect of the Municipal Securities Rulemaking Board's proposed municipal advisor core conduct rule that some observers are reading as allowing investment banks to provide certain advisory services on deals they underwrite.

Groups representing both dealer and non-dealer MAs said Thursday that they are particularly interested in proposed Rule G-42's provision that would prohibit MAs from acting as a principal in most financial transactions related to their advice to state and local government clients, except certain transactions addressed in the board's Rule G-23 on the activities of financial advisors. That rule prevents dealers from "role switching" and acting as a financial advisor and underwriter on the same deal, and the SEC staff has said that an underwriter relationship is not consistent with a fiduciary relationship.

November 2011 guidance from the MSRB on G-23 states that "it shall not be a violation of Rule G-23(d) for a dealer that states that it is acting as an underwriter with respect to the issuance of municipal securities to provide advice with respect to the investment of the proceeds of the issue, municipal derivatives integrally related to the issue, or other similar matters concerning the issue."

Some market participants said that proposed Rule G-42 and Rule G-23 can coexist as written because G-23 applies to financial advisors and G-42 would apply to municipal advisors — roles that can overlap but which are not necessarily the same thing. G-23 prevents financial advisors from underwriting, while allowing underwriters to provide advice on proceeds and derivatives. Some groups affected by the rule argue the issue is confusing and warrants clarification.

"NAMA is concerned the provisions of Revised Rule G-42, specifically related to principal transactions, may serve to increase marketplace confusion and decrease clarity," said National Association of Municipal Advisors president Terri Heaton. "There is concern that the Revised Rule G-42 conflicts with MSRB Rule G-23 and provides basis for investment banks to provide advice and underwrite same transactions in connection with derivative products and investment of bond proceeds transactions. NAMA supports rulemaking and regulation which serves to eliminate the practice of market participants to serve in dual roles, or to switch roles, in municipal transactions."

Heaton said NAMA is highly supportive of the MSRB's efforts to expedite MA rulemaking, but stressed that the rules should strengthen the market and protect issuers, investors, and the public trust while cutting down on confusion and eliminating inconsistencies in the marketplace.

Jessica Giroux, general counsel and managing director at the Bond Dealers of America, said her group could benefit from some clarification.

"We believe that the revisions to MSRB proposed Rule G-42 will go a long way toward regulating a previously unregulated component of the industry, but the BDA still has some questions as it relates to certain elements in the proposed rule," she said. "In particular, we would like to see more clarity

around what it means for a transaction to be considered 'directly related' to another transaction and how Rule G-42 meshes with Rule G-23. While we still have some analysis to do, we hope to be able to work with the MSRB on some interpretive guidance which might alleviate any outstanding concerns."

Leslie Norwood, managing director, associate general counsel, and co-head of the Securities Industry and Financial Markets Association's municipal group also applauded the MSRB's efforts and said SIFMA is pleased with changes from previous drafts that removed a requirement that MAs disclose potential conflicts of interest to investors and other clarifications it made about conflict disclosure.

"We have concerns, however, including our disappointment that the MSRB didn't take our suggestions regarding narrowing the principal transactions ban even further, and suitability for brokerage transactions," she said.

All three groups said they plan to comment to the SEC, which general solicits a fresh round of comments before approving significant rule changes.

THE BOND BUYER

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