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MSRB Changes MA Conduct Proposal, But Not Principal Transaction Bar.

WASHINGTON – The Municipal Securities Rulemaking Board proposed several changes to clarify its proposed Rule G-42 on core duties of municipal advisors, but declined to ease a controversial provision that would bar an MA giving advice from acting as a principal in the same transaction.

The amendments, filed with the Securities and Exchange Commission on Thursday, were a response to criticisms and other comments the SEC received on the proposed modified rule filed by the MSRB on April 24.

The SEC published the proposal for comments on May 8, but recently asked for a second extension – up to 90 days from Aug. 6 – to consider whether to approve it.

The MSRB's proposal states that MAs owe a fiduciary "duty of loyalty" to their municipal issuer clients, requiring "without limitation … to deal honestly and with the upmost good faith with a municipal entity and act in the client's best interests without regard to the financial or other interests of the municipal advisor." The fiduciary duty was imposed on MAs by the Dodd-Frank Act.

The proposal also mandates a less stringent "duty of care" for all clients. The duty of care provision requires MAs to: exercise due care in their work; be qualified to provide advisor services; make a "reasonable inquiry" into the facts relevant to client's request before deciding whether to proceed; and undertake a "reasonable investigation" to determine their advice is not based on bad information.

The MSRB told the SEC that it had considered a number of comments on the proposed prohibition against an MA acting as a principal in a transaction with a muni issuer client that is directly related to a transaction on which the MA is providing advice.

Several groups complained the prohibition is unreasonable and overly burdensome. The groups pushed for exceptions to the ban such as allowing the relationship: if the MA has client consent; if the advice is provided incidentally or is necessary for a broker-dealer to complete a transaction; or if the dealer is an affiliate of a larger business also advising an issuer.

But the MSRB did not agree with the complaints, saying the ban as proposed is sufficient and will protect issuers from conflicts of interest that could arise from an MA acting as principal.

In one change to the proposal, the MSRB removed the words "without limitation" from the rule's standards of conduct section. The rule had read: "A municipal advisor to a municipal entity client shall, in the conduct of all municipal advisory activities for that client, be subject to a fiduciary duty that includes, without limitation, a duty of loyalty and a duty of care." The MSRB said eliminating "without limitation" will address concerns about "ambiguity regarding the relationship between additional fiduciary duties and the specified duties of care and loyalty." The board stressed, however, that this change does not narrow or modify the scope of fiduciary duty under the rule.

Another change was made to prevent duplicative disclosures of conflicts of interest in municipal advisor relationships. The rule had required disclosure of any conflicts of interest prior to, or upon, engaging in municipal advisory activities and then also required a similar disclosure be made when the advisory relationship would later be documented. Instead, the MSRB said it will not require an MA to disclose conflicts of interest in the documentation of the relationship if it has already been disclosed prior to the MA's activities and has not changed.

The MSRB also expanded the portion of the rule that requires MAs to disclose the last material change or addition to legal or disciplinary event disclosures on any Form MA or MA-I. The board said the MA should also provide a brief explanation for why the change or addition to the form was material.

The board clarified a section of the proposed rule that required MAs to alert clients if an advisory recommendation is unsuitable. Commenters had said the requirement is redundant because an MA already owes clients a fiduciary duty that would prohibit it from giving unsuitable recommendations. The MSRB said the requirement only applies if an MA is reviewing a recommendation from another advisor and finds it to be an unsuitable recommendation.

Susan Gaffney, executive director for National Association of Municipal Advisors, said NAMA is still concerned about confusion with Rule G-42 as it relates to prohibiting MAs from working on principal transactions related to the bond sale. She said that "in order to ensure compliance to the reasonable diligence and standards of conduct provisions "the MSRB should provide further interpretative guidance or through examples on how to meet these standards" either in the rulemaking or separately.

Bond Dealers of America general counsel and managing director of federal regulatory policy Jessica Giroux said BDA is still reviewing the board's letter but is "pleased that the MSRB and SEC are in communication about the need for continued dialogue with the industry."

Michael Decker, managing director and co-head of municipal securities for the Securities Industry and Financial Markets Association, said SIFMA is still reviewing the MSRB's letter but that the group is "disappointed that the MSRB seems to have rejected some reasonable suggestions that we and others made to refine the proposed rule."

NAMA, BDA and SIFMA all said they would be submitting new comment letters to the SEC to address the MSRB's changes.

THE BOND BUYER

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