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SEC Urged to Disapprove Rule on MA Core Conduct.

WASHINGTON – Dealer, issuer and investment company groups are urging the Securities and Exchange Commission to disapprove a Municipal Securities Rulemaking Board rule that would impose core duties on municipal advisors, warning it is overly burdensome and anti-competitive. The groups made the requests in comment letters sent to the SEC regarding the MSRB's Rule G-42 on core duties of municipal advisors.

"The MSRB has made important strides in making proposed Rule G-42 workable since its original draft proposal," said Leslie Norwood, associate general counsel and co-head of municipal securities for Securities Industry and Financial Markets Association. But "SIFMA continues to have significant concerns regarding certain aspects of [the rule], which render it unreasonably burdensome and anti-competitive in ways that do not clearly promote the fundamental policies of the municipal advisor provisions of the [Securities and] Exchange Act" of 1934.

The rule states that MAs would owe a fiduciary "duty of loyalty" to their municipal issuer clients, requiring them "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 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 a client's request before deciding whether to proceed; and undertake a "reasonable investigation" to determine their advice is not based on bad information.

The SEC previously published the proposal for comment on May 8, but asked for an extension of up to 90 days on Aug. 6. The MSRB then published revisions to the rule and responded to earlier comments on Aug. 12. But Norwood said the MSRB response "in most regards simply dismissed commenters' concerns with conclusory and superficial responses that simply restate the MSRB's view that the particular provision is appropriate" without going further.

Several groups, including SIFMA, used their comment letters to address their ongoing complaint about the rule banning an MA from 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. The ban is meant to prevent conflicts of interest.

Norwood said the ban is "more restrictive and inflexible than fiduciary obligations under any other financial regulatory regime." She added that the MSRB rejected proposed modifications to the ban, like limiting it to principal transactions that are directly related to the advice provided by the MA, including a separate registered municipal advisor exception, and allowing for incidental advice related to brokerage services.

Mike Nicholas, chief executive officer of Bond Dealers of America, suggested in BDA's comment letter the MSRB and commission would be better off addressing conflicts of interest through a

disclosure and consent process, as is done with investment advisors and attorneys. Government Finance Officers Association Director Dustin McDonald agreed with Nicholas, saying the proposed rule removes issuers from the conflict review process. McDonald also reiterated an earlier concern that the ban would force small issuers to enter into more expensive arrangements with outside advisors.

GFOA, SIFMA, BDA, and the Investment Company Institute each urged the SEC to disapprove the rule.

SIFMA also said that the ban on principal transactions is already leading to a decrease in competition in the market as some firms associated with broker-dealers have stopped providing muni advisory services because they believe "the inability to enter into other business with the client makes the cost of providing municipal advisory services too high."

BDA and SIFMA also said they are concerned about a lack of clarity in the rule's documentation requirements, specifically those on documenting an advisor's work to ensure a recommendation is suitable for its client. SIFMA said the rule does not make clear what constitutes a recommendation and thus what documents an advisor would need to retain to prove to a regulator that its recommendations were suitable for its client.

Nicholas said the MSRB should "state exactly what is expected of firms in the way of documentation" to help advisors engaged in deals that take multiple years to conclude. The suitability standard and documentation of recommendations is also one of multiple areas the National Association of Municipal Advisors requested additional clarity on from the MSRB and SEC, saying the clarifications "are essential for MAs to abide by the law because of the potential differences in interpretation that could occur between MAs and SEC examiners."

NAMA did not ask the SEC to disapprove the rule, but said the rule should not go into effect until the MSRB gives additional guidance.

The group asked the MSRB to offer supplementary material, interpretive guidance and/or non-exclusive examples to help advisors understand the way they are expected to conduct and document reasonable due diligence, as well as alternative financings, and the duty of care provision. It also asked for clarification on any overlap between G-42 and Rule G-23, which prohibits firms from acting as advisors and underwriters on the same muni transactions. Without those clarifications, NAMA said the MSRB would place an undue burden on small advisors and violate the Exchange Act.

The Investment Company Institute also took issue with the documentation requirements, saying the requirement that an MA "affirmatively investigate the veracity of information provided to it" by its clients would be burdensome and "completely disruptive" to the long-term relationships that MAs advising on 529 college savings plans have with their clients.

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