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Written Statement of

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Submitted to
the
Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises
United States House of Representatives

Hearing on the Impact of Dodd-Frank on Municipal Finance

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I. Introduction

I am Mike Marz, the Vice Chairman of FirstSouthwest, and a member of the Board of Directors of the Bond Dealers of America (BDA). I am also a former Chairman of the BDA. I have attached to this statement a brief personal resume as well as a general description of FirstSouthwest.

This statement is submitted on behalf of the Bond Dealers of America. The BDA appreciates the opportunity to participate in this hearing. The BDA, with fifty three members

headquartered coast to coast, is the Washington, DC, based organization that represents securities dealers and banks focused on the U.S. fixed income markets. The BDA is the only organization representing the unique interests of national, middle-market, sell-side, fixed-income dealers. In addition to federal advocacy, the BDA hosts a series of meetings and conferences specific to domestic fixed income, and spearheads industry cooperation on economic surveys and on market practice documents. Additional information about the Bond Dealers of America can be found at www.bdamerica.org.

Today I will speak from the perspective of fixed-income dealers about why it is so important to get the implementation of Dodd-Frank "right," including striking the right balance in defining and regulating municipal advisors. While our discussion today is about fairly complex rules, I would like to put my job in simple terms to help emphasize why bond dealers like me play an important role in this policy discussion. Bond dealers are a bridge between the infrastructure that serves the public day in and day out, and investors who seek financial security in purchasing the bonds that make public works possible. For example, in my home state of Texas, FirstSouthwest helped the Dallas Independent School District save $150 million in interest payments through a carefully structured issue of Build America Bonds. We also coordinated bonds that will finance three light rail lines in Houston's inner city, and helped the city of Dallas with a cost effective bond issue that will allow them to make improvements to water sewage projects. These types of projects happen every day across the country and if the issuances occur with the prudent advice, structuring and marketing of bond issuances that BDA members provide, governments and their citizens save money while enjoying the benefits of public infrastructure.

II. Regulation of Municipal Advisors

The BDA has concerns regarding how the Dodd-Frank Wall Street Reform Act of 2010 (Dodd-Frank or DFA) is being implemented, and we are working with regulators to ensure the "Volcker Rule" does not create unintended consequences for the municipal securities market. I will focus this testimony, however, on our support for DFA Section 975 that requires the Securities and Exchange Commission (SEC or Commission) to adopt rules mandating that municipal advisors register with the SEC. Section 975 also requires the Municipal Securities Rulemaking Board (MSRB) to adopt rules governing the behavior and activities of municipal advisors. Our comments are focused on the differences between the comprehensive regulatory regime applicable to broker dealers, particularly those acting as financial advisors ("regulated dealer advisors"), and the continuing complete lack of regulation of independent financial advisors ("unregulated municipal advisors").

Almost two years after the enactment of Dodd-Frank and despite the requirement for new rules for municipal advisors, virtually anyone can act as a non-dealer municipal advisor to an issuer of municipal securities, regardless of qualifications, political contributions, or conflicts of interest, while more and more restrictions are focused on broker dealers, including regulated dealer advisors. This seems exactly the opposite of what Dodd-Frank intended. We believe that in the case of rules for financial advisors, regulators of the municipal securities industry should

create a level playing field for currently unregulated municipal advisors and broker dealers acting as advisors, recognizing that both provide important services -- in some cases, the same services -- that issuers desire.

By way of background, in October 2009, SEC Commissioner Elisse Walter delivered a speech where she said she found the conduct of some municipal advisors "alarming" and that they were engaging in "pay to play" practices, that there were undisclosed conflicts of interest, that advice was rendered by advisors without adequate training or qualifications, and that there was a failure to place the duty of loyalty to their clients ahead of their own interests. Commissioner Walter asked for the authority to regulate these independent municipal advisors and in Section 975 of Dodd-Frank, the Commission received such authority. Supporting this sense of urgency, unregulated municipal advisors have represented clients in high-profile public finance disasters, such as the bankruptcy of Jefferson County, Alabama and New Mexico bond deals that were fraught with pay-to-play improprieties and bid rigging that led to the convictions of CDR Financial Products executives - unregulated municipal advisors – on wire fraud and conspiracy charges.

The SEC has not made progress to date in resolving the problems that alarmed Commissioner Walter. The first step is for the SEC to issue a definition of municipal advisor that is narrowly and appropriately focused on those who advise on the issuance of municipal bonds and on the investment of bond proceeds. Until that occurs, the Commission cannot undertake step two: regulate independent municipal advisors to stop pay to play, require conflicts to be disclosed, and impose adequate professional standards. In BDA's view, defining

"municipal advisor" and regulating those advisors should be the focus of the Commission's rulemaking initiative.

A. Definition of Municipal Advisor

BDA has joined with many in the municipal bond community pointing out that the definition of municipal advisor proposed by the SEC pursuant to Dodd-Frank is overly broad and ambiguous. While the SEC has indicated they recognize this, they have yet to correct it. For example, the SEC's proposed regulations (Release No. 34-63576) fail to exclude appointed and volunteer municipal board members from the definition of municipal advisors. Moreover, the proposed regulations do not define the term "advice," which has implications for bond dealers and municipalities alike. Volunteer and appointed members of the boards of a municipal entity would be subject to considerable doubt as to whether their activities result in "advice." Likewise, it would not be clear whether underwriters provide information constituting "advice" which could require registration as a municipal advisor. On the other hand, Dodd-Frank exempts underwriters from the term "municipal advisor" -- but it isn't clear how to distinguish between a municipal advisor and an underwriter.

The goal for the SEC should be to provide a simple mechanism for regulators and industry participants to determine if they are acting as a municipal advisor. BDA recommends that the SEC and other applicable regulators implement an approach that permits a party to use a disclaimer to disclose to other parties that it is not acting as an advisor. The fundamental

characteristic of an advisor under Dodd-Frank is that there is not an arm's length relationship. If the client is provided with a disclaimer that the relationship is in fact arm's length, then it has no basis for assuming an advisory relationship. Similar to the approach taken under the swap rules, a broker dealer would not be considered to be a municipal advisor if (1) the broker dealer is acting in the capacity of an underwriter, (2) the broker dealer is not being separately compensated to provide financial advice, and (3) the broker dealer discloses to the issuer that it is participating in the transaction on an arm's length basis and is not a fiduciary to the issuer. We believe that the rule should make it very clear when such a disclaimer must be presented. We also believe the disclaimer should be required no earlier than when an underwriter provides its materials to an issuer for a proposed issuance or in a response to a request for proposals.

B. Regulating Municipal Advisors

Once the SEC has identified a more narrow and appropriate definition of municipal advisor, the next step is for the SEC and MSRB to appropriately regulate the current unregulated municipal advisors. The regulatory approach should include testing and licensing, supervision, compliance examinations, record keeping, restrictions on political contributions and other requirements that already apply to regulated dealer advisors.

i. Roles of Regulated Dealer Advisors, Underwriters and Unregulated Muni Advisors

To explain why regulation is needed, it may be helpful to describe the roles that regulated

dealer advisors and underwriters (functions performed by BDA members) and unregulated municipal advisors play in public finance transactions. A great many issuers use either dealer advisors or unregulated municipal advisors and underwriters in combination. The underwriter can purchase a bond issue in order to sell those bonds to investors, thus directly facilitating the issuer's efficiency in raising funds. An unregulated municipal advisor can help to structure the bond issue, determine the fair value price for the issuer and help to select the underwriter, as well as provide investment advice, swap advisory services or arbitrage rebate. Dealer financial advisors can play those roles as well, but have the advantage over unregulated financial advisors of being part of firms that participate in the buying and selling of municipal securities every day, thus having real-time current market knowledge. While unregulated financial advisors may serve as a pricing agent for the bond, they lack the real-time market data to directly or most accurately determine the price. The value to issuers of the market experience of broker dealers should not be underestimated and is the reason many issuers choose to hire regulated financial advisors.

ii. Closing the Regulatory Gap

Although underwriters or dealer financial advisors and unregulated muni advisors all play roles together and even similar roles, their level of regulation is dramatically different. Let me describe the differences between the compliance and regulatory measures required of bond dealers, including dealer financial advisors, and what is required of unregulated municipal advisors that lack the same obligation dealers have for fair dealing (although unregulated muni

advisors have a fiduciary duty at the state level and per the Dodd-Frank bill). The chart below outlines standards imposed upon broker dealers by the MSRB and SEC and which are not required of unregulated municipal advisors.

Regulatory Requirements	Regulated Broker-Dealer Advisors	Unregulated Municipal Advisors
MSRB Regulation	x	
SEC Regulation	x	
Regular and Random Audit Compliance Reviews	x	
Licensing Requirements	x	
Continuing Ed Testing	x	
Written Supervisory Procedures	x	
Restrictions on Political Contributions	x	
Restrictions on Gifts and Entertainment	x	
Record Retention Requirements	x	
Obligations and Requirements for Fair Dealing	x	
Disclosures on Compensation, Third Party Fees and Conflicts of Interest	x	
FINRA*	X	

*Provides additional requirements for broker dealer firms handling customer money.

As this chart demonstrates, dealer advisors are heavily regulated even beyond the regulations that apply due to handling customer accounts. Municipal advisors simply lack regulation, and while it does not make sense to subject them to all of the restrictions applicable to broker dealers, a similar set of comprehensive regulations must be implemented. Municipal

advisors do have a state level fiduciary duty but that is not a replacement for regulation as can be seen by the Jefferson County case and other cases of bad actors in the public finance arena. And, while Dodd-Frank states that municipal advisors have a fiduciary obligation, it has in no way been given practical effect in the case of unregulated municipal advisors. As one example, the protection provided to a party who engages a fiduciary, if that fiduciary fails to carry out its fiduciary obligation, is compensation for losses for which the fiduciary is responsible. But without advisor capital requirements, and given that many of these unregulated firms have minimal assets, the fiduciary standard can not impose consequences that make the advisor's fiduciary responsibility to an issuer have practical meaning.

III. SEC Rulemaking Initiative and H.R. 2827

As mentioned above, on December 20, 2010, the SEC issued proposed rules to implement the provisions of Section 975 of the DFA. As also set forth above, the BDA is of the view that the SEC's proposed rules went far beyond the narrowly focus definition of municipal advisor intended by Congress. Even SEC Chairman Schapiro acknowledged as such in testimony before the House Financial Services Committee.

It is past time for the Commission to get this rulemaking initiative back on track. Many members of this Subcommittee signed a letter to Chairman Schapiro on December 19, 2011, recommending that "the Commission should promptly scale back the scope and application of the proposed rules to define the term 'municipal advisor' as Congress intended." The BDA

agrees.

Last year, Congressman Dold introduced H.R. 2827, which emphasizes that the Commission should bring its municipal advisor rulemaking initiative back on track as soon as practicable. H.R. 2827, which is now cosponsored by 35 other House Members, would clarify the language of DFA Section 975 to more clearly specify the scope and limits of the SEC's municipal advisor rulemaking definition. The BDA supports H.R. 2827, especially the part of Section 1 that would exclude already regulated dealer advisors, elected or appointed members of state or local governing bodies and others from the definition of municipal advisor. We also support the part of Section 2 that clarifies what funds constitute the types of funds and investments that are subject to the municipal advisor rules.

Clarification of the definition of a municipal advisor under H.R. 2827 is a strong step in the right direction if combined in the future with step two: a set of regulations parallel to those already embraced by regulated dealer advisors. These two steps will ensure that unregulated municipal advisors act in the interest of their clients. This will help prevent fraud that has, under the Jefferson County and CDR examples, harmed cities and the citizens they serve.

IV. Conclusion

The SEC needs to move forward on a definition of municipal advisor so that investors and state and local governments can receive the protection that Congress intended in Dodd-Frank. The first step to fix this situation is for the SEC to define who is a municipal advisor,

appropriately and narrowly. The second step, simply stated, is for unregulated municipal advisors to be appropriately regulated.

By significantly cleaning up the ambiguous definition of municipal advisor under Dodd-Frank, we believe that H.R. 2827 may provide the SEC with the boost they need to proceed with the rulemaking initiative required by Section 975 of Dodd-Frank almost two years ago.

Again, the Bond Dealers of America appreciates the opportunity to submit this written statement to the Subcommittee on Capital Markets and Government Sponsored Enterprises. If you have any questions or need any further information, please either contact myself, or contact Mike Nicholas, the Chief Executive Office of the BDA, at 202-204-7901 or at mnicholas@bdamerica.org.