Bond Dealers of America

21 Dupont Circle, NW • Suite 750
Washington, DC 20036
202.204.7900
www.bdamerica.org

November 16, 2011

The Honorable Elisse B. Walter
Member
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 200549

Re: Underwriters and Financial Advisors

Dear Commissioner Walter:

I am writing on behalf of the Bond Dealers of America (BDA) with two purposes - first, to give our views of the role played in the municipal market by underwriters, which has been the subject of recent media coverage and regulatory proposals, and second, to urge you to make it a priority of the Securities and Exchange Commission (SEC) to finalize the definition of municipal advisor so that the SEC and the Municipal Securities Rulemaking Board (MSRB) can move forward with the regulation of an unregulated portion of the municipal finance market, as intended by the Dodd-Frank Wall Street reform and Consumer Protection Act (Dodd-Frank). The BDA is the only national trade association representing middle-market and regional broker-dealers whose primary focus in the US fixed-income markets.

As noted above there has been recent discussion of the role of underwriters in the municipal securities market, which has also included discussion of the role of financial advisors. Some of that discussion has contained a number of very inflammatory statements concerning broker dealers that our members and we found to be both untrue and offensive.

Underwriters have traditionally provided a variety of services to their clients that are integral to and inseparable from the basic underwriting function. Their clients have also requested, aware of the arm's length nature of the underwriter-client relationship, other services and information concerning the municipal market to help make their decisions. For example, issuers frequently request structuring "recommendations" from underwriters in Requests for Proposals used to select underwriters. Some of what underwriters provide overlaps with services offered by financial advisors, which is what many issuers desire. Criticisms of underwriters by non-dealer advisors should not form the basis of limiting the services that many issuers would like their underwriters to provide.

Underwriters have long been subject to registration, testing, licensing, periodic compliance examinations, supervision, record retention, disclosure, restrictions on political contributions and financial disclosure. Among the obligations they have to their clients, including issuers, are those of fair dealing and best execution. Underwriters are, and have long been, subject to the scrutiny of the SEC, MSRB and FINRA to ensure that they comply with these requirements and they are well aware of their obligations. Broker dealers, whether acting as underwriters or financial advisors, have long been monitored by the regulatory authorities as to their compliance with these standards and the disclosures required.

In addition to the legal requirements to which underwriters are subject, there is also the practical imperative of good business practice. There are many underwriting firms and they compete vigorously for business. A firm would not be in business for long if it did not treat its clients well and provide them with its best efforts in the underwriting of that client's securities.

That background and framework underlies our objection to what we perceive as the unfounded view that underwriters take advantage of and mislead their clients; that their clients are unaware of the arm's length nature of the relationship, and that unregulated financial advisors are somehow intrinsically better, and disinterested, providers of information to issuers.

That view has manifested itself in regulatory proposals, such as the changes to MSRB Rule G-23, to which the BDA objected, the recent MSRB proposal on disclosures to issuers under Rule G-17, and the revisions to that proposal, which we expect the SEC will put out for public comment. That view has also manifested itself in allegations that underwriters urge issuers not to engage financial advisors.

We do have serious concerns about the current state of financial advisors. For them there are no standards for testing, licensing or competency. There are no restrictions on financial contributions to the public officials who might hire them. There are no standards for record retention, no periodic examinations and no obligation for fair dealing. There are also no standards for disclosures, such as how a financial advisor's form of compensation (such as being paid on the closing of a transaction) might induce it to recommend transactions that might not be in an issuer's interest, but instead be in the interest of the financial advisor. A financial advisor may have a number of other services it offers to its issuer clients such as investment advice, swap advisory services, arbitrage rebate services and recruiting services for municipal professionals, which it may or may not disclose and which have the potential to influence its advice. While Dodd-Frank states that municipal advisors have a fiduciary obligation that has in no way been given practical effect. As one example, the protection that 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 are small firms with minimal assets, how does the fiduciary standard impose consequences that make the advisor's fiduciary responsibility to an issuer have practical meaning?

We are not aware of any underwriter urging an issuer not to engage a financial advisor. Moreover, we understand that some have stated that underwriters urge issuers to engage only those financial advisors that are associated with broker-dealers. Again, we do not know of any such instances.

However, dealer financial advisors are subject to MSRB and SEC regulation, while non-dealer financial advisors have not had and currently do not have any regulatory oversight. In addition, financial advisors are engaged to provide advice to an issuer on the financial markets. A non-dealer financial advisor does not participate in those markets and thus does not have the direct and intimate knowledge that a dealer financial advisor would have. Broker dealer financial advisors have the advantage of being part of firms that participate in the buying and selling of municipal securities every day, thus having real-time current market knowledge, which simply is not the case for non-dealer financial advisors. The value to issuers of this type of market experience should not be underestimated and is the reason many issuers choose to hire broker dealer financial advisors.

Dodd-Frank, enacted over a year ago, requires the regulation of municipal advisors. The intent of Dodd Frank in this area was to regulate an element of the municipal industry that has been unregulated – non-dealer financial advisors.

We believe that the rules called for in the Dodd-Frank Act to regulate financial advisors are long overdue. The key to moving forward in this area is a definition of "municipal advisor." We previously submitted comments on the SEC's proposed definition of "municipal advisor" and, although we will not restate the concerns expressed in those comments, those concerns have not gone away.

Fundamentally, BDA believes that the SEC needlessly complicated the definition. There is a set of core activities that constitute municipal advice. The SEC should move forward on those and not delay its definition because of possible concerns on the margins.

It is important that the SEC and MSRB develop an approach to regulating non-dealer advisors that includes testing and licensing, supervision, compliance examinations, record keeping, restrictions on political contributions and other requirements that apply to broker-dealers.

Dodd-Frank exempts underwriters from the term "municipal advisor" so one aspect of the definition will be how to distinguish between a municipal advisor and an underwriter. The goal should be to provide a simple mechanism for regulators and industry participants. We believe that it is important for the SEC and other regulators to 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 statement, a disclaimer, that the relationship is in fact arm's length, then it has no basis for assuming an advisory relationship.

For example, under the proposed rules related to the business conduct requirements for special entities engaging in swap transactions, the SEC would permit a swap dealer to avoid advisor status if three criteria are satisfied: (1) the special entity states in writing that it will not rely on the advice of the swap dealer and that it will rely on advice from a qualified independent representative; (2) the dealer has a reasonable basis to believe that the special entity is advised by a qualified independent representative (a requirement of the Dodd Frank Act); and (3) the dealer discloses to the special entity that it is not undertaking to act in the "best interests" of the special entity.

We believe that a similar approach should be adopted with respect to the definition of "municipal advisor." Specifically, under this approach, 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[1], and (3) the broker dealer discloses to the

---

[1] Customary management fees paid to underwriters should not be considered compensation for providing financial advice.

issuer that it is participating in the transaction on an arm's length basis and is not a fiduciary to the issuer.[2] We note that Rule G-23 requires a broker dealer to make clear that it is serving as an underwriter.

We also believe that the rule should make it very clear when such a disclaimer must be presented and that the same standard should be applied to Rule G-23. We believe the disclaimer should be required no earlier than when an underwriter provides promotional materials to an issuer for a proposed issuance or in a response to a request for proposals.

More than one year after the enactment of the Dodd-Frank Act, the rules continue to permit virtually anyone to become a non-dealer financial 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. This seems exactly the opposite of what Dodd-Frank intended. The key to bringing an end to that situation is for the SEC to finalize its definition of municipal advisor. We believe that in the case of rules for financial advisors, regulators of the municipal securities industry should create a level playing field for financial advisors and broker dealers, recognizing that both provide important services that issuers desire. The BDA is willing to participate with your staff in discussing these and other issues affecting the municipal securities market. Thank you for your consideration and please feel free to contact me at any time.

Sincerely,

Michael Nicholas
Chief Executive Officer

cc: Chairman Mary Schapiro
Commissioner Luis Aguilar
Commissioner Troy Paredes
Commissioner Dan Gallagher
Senate Banking Committee Chairman Tim Johnson
Senate Banking Committee Ranking Member Richard Shelby
House Financial Service Chairman Spencer Bachus
House Financial Services Ranking Member Barney Frank

[2] We note that Proposed Guidance under Rule G-17 would require that underwriters disclose that they do not have a fiduciary duty to an issuer.

House Financial Services Capital Markets Subcommittee Chairman Scott Garrett

House Financial Services Capital Markets Subcommittee Ranking Member
Maxine Waters
MSRB Chairman Alan Polsky
MSRB Executive Director Lynnette Hotchkiss