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# Muni groups disagree on role-switching prohibition

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Muni market groups are at odds on whether or not a Municipal Securities Rulemaking Board rule that contains a prohibition against financial advisors switching roles and serving as underwriters on the same deal should be tossed.

The MSRB reopened the discussion in May in a retrospective review of its Rule G-23 on activities of financial advisors and a 2011 amendment to that rule that prohibits a dealer from serving as a financial advisor and underwriter on a transaction. In comment letters, stakeholders asked for a plethora of changes to the rule ranging from having it absorbed into other rules, creating new exceptions to its prohibitions, and taking out the term "financial advisor."

Some opposed significantly changing the rule at all.

"NAMA strongly believes that, as amended in 2011, Rule G-23 has been effective in eliminating the conflicts of interest that would arise if a firm acting as municipal advisor to an issuer were to then become the underwriter in the transaction," wrote Susan Gaffney, the National Association of Municipal Advisors' executive director.

Issuers and non-dealer advisory firms generally told the MSRB they oppose major changes to the rule, while groups representing broker-dealers want the board to consider changes that would allow role-switching under certain circumstances.

NAMA executive director Susan Gaffney

The Securities Industry and Financial Markets Association wants an exception in the rule that would apply when a dealer MA, after providing issue-specific advice, leaves due to termination or the end of a contract term, and the issuer then hires a new MA.

“Once an issuer engages a successor municipal advisor, the predecessor dealer municipal advisor that provided issue-specific advice should be able to engage in underwriting activities for that issue,” SIFMA wrote in its letter.

However, if an issuer does not hire a new MA, then the dealer MA should be subject to a one-year cooling-off period before it could underwrite the transaction, SIFMA proposed.

“We believe that these exceptions would provide clarity to market participants about the obligations, or lack thereof, owed to issuers when a dealer municipal advisor is disengaged after providing issue-specific advice,” SIFMA wrote.

It’s unclear what would come of the MSRB deciding to eliminate either all of or the role-switching prohibition of Rule G-23, which like all MSRB rule changes would require the approval of the Securities and Exchange Commission. The SEC has said that under federal law a broker-dealer acting as an MA has a fiduciary duty to the issuer with respect to that issue, and "must not take any action inconsistent with its fiduciary duty to the municipal entity."

Underwriters are considered to be engaging in "arm's length" transactions with issuers, and under the MSRB's Rule G-17 on fair dealing provide issuers with disclosures saying so.

Leslie Norwood, a managing director, associate general counsel and head of municipals at SIFMA, told The Bond Buyer that SIFMA believes that the SEC prohibits role-switching relating to an issuance of municipal securities, not all issuances of that issuer.

If the issuer hires a new MA, relevant conflicts of interest are addressed by the presence of a successor MA, Norwood said.

SIFMA also noted in its comment letter that a municipal advisory framework for dealer and non-dealer MAs along with Rule G-23 for dealer financial advisors only has created role-clarity confusion.

In October 2018, PFM, a large non-dealer municipal advisory firm, asked the SEC for interpretive guidance that since it is subject to a fiduciary standard, it can perform certain tasks to facilitate private placements of municipal debt.

SIFMA and BDA sent responses, objecting to the PFM request. Dealers consider such activity to be placement agent activity requiring that a firm be a registered broker-dealer. Dealers complained that allowing MAs to be placement agents, which PFM and NAMA have repeatedly said is not their aim, would essentially benefit only non-dealer MAs because G-23 prohibits dealers with a "financial advisory relationship" with an issuer from acting as a placement agent for that issuance.

“We want to ensure that the rules treat all regulated parties fairly,” Norwood said.

BDA wants to consolidate underwriter and MA rulemaking guidance and address the rule’s restrictions on private placement.

“We also highlight the need for the MSRB to address G-23's private placement restriction if the SEC acts on the misguided requests for non-dealer MAs to perform placement agent activities,” wrote BDA CEO Mike Nicholas in a statement.

NAMA opposes any significant changes to the rule.

“In general, G-23 has been working well since the changes in 2011 and we don’t see the need to make significant changes to the rulemaking,” Gaffney said.

Gaffney does want to see the MSRB replace any references to "financial advisors" with the term "municipal advisors" in the rule. In the letter, Gaffney

writes that NAMA thinks both terms mean the same thing, and want to be sure MSRB also knows that to be true.

“We believe that they mean the same thing, we want to make sure that the MSRB thinks they mean the same thing,” Gaffney said. “That change probably should move forward.”

SIFMA wants to eliminate the term financial advisor as well.

NAMA said it isn’t aware of small and infrequent issuers having problems with hiring MAs and being able to sell their bonds since the 2011 amendment, which is an argument the dealer community has sometimes employed.

NAMA doesn’t think Rule G-23 should be eliminated and folded into Rule G-42, which is the core conduct rule for municipal advisors. NAMA believes that Rule G-23 speaks to a specific subset of MAs that are broker-dealers and so that sets it apart from Rule G-42.

NAMA told the MSRB it opposes allowing a firm to resign from being an MA and become the underwriter, even if another MA is hired. Nor does the group support the idea of a cooling-off period.

The Government Finance Officers Association encouraged the MSRB to prohibit role-switching and said that an underwriter’s responsibility is to the investor, not the issuer.

“Prohibiting role switching ensures that the issuer is represented throughout the transaction by a municipal advisor whose sole responsibility is to issuers,” wrote Emily Brock, director of GFOA’s federal liaison center.

The MSRB could now choose to propose changes to its rules, or could choose to leave them as they are.