



March 12, 2015

Mary Jo White, Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Placement Agent Activities of Municipal Advisors

Dear Chair White:

The Securities Industry and Financial Markets Association (“**SIFMA**”)¹ would like to take the opportunity to provide its views in response to the letter to you from the National Association of Municipal Advisors (“**NAMA**”) dated December 15, 2014 (the “**NAMA Letter**”). In the NAMA Letter, NAMA requests that the Securities and Exchange Commission (the “**Commission**”) exempt registered municipal advisors from being required to register as broker-dealers or as investment advisers in connection with specified municipal advisory activities.

SIFMA **strongly disagrees** with NAMA’s position that a financial advisor should be exempt from registration as either a broker-dealer or investment adviser solely on the basis of its registration as a municipal advisor. NAMA’s request reflects a fundamental misunderstanding of the investor protection goals of broker-dealer and investment adviser regulation. Providing the exemptions that NAMA requests would create significant gaps in the regulatory protections that are currently afforded to potential investors in municipal securities and to municipal entities seeking advice regarding the investment of bond proceeds.

I. An Exemption from Broker-Dealer Registration is Not Appropriate

A. The Municipal Advisor Regulatory Scheme Protects Issuers, Not Investors

NAMA appears to believe that an exemption from broker-dealer registration is warranted because municipal advisors are otherwise registered and regulated and have a

¹ SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over \$2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over \$16 trillion in assets and managing more than \$62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

fiduciary duty to municipal entities and otherwise have a general duty of “fair dealing.” SIFMA opposes unnecessarily duplicative regulatory schemes, but NAMA’s request proceeds from a mistaken premise that the two schemes of regulation have similar purposes or effects, and reflects a flawed view of the function that broker-dealer registration and regulation serves in our system of regulation.

While broker-dealers have extensive duties under Commission and self-regulatory organization rules and common law to their issuer clients, the overarching purpose of broker-dealer regulation is to protect investors.² This protection is accomplished through an extensive system of regulation, which includes, among other things, qualification and testing requirements of a broker-dealer’s sales force, a duty to supervise its personnel (under risk of liability for failure to do so) and the requirement to be a FINRA member and subject to FINRA (and, in the case of municipal securities, Municipal Securities Rulemaking Board (“MSRB”)) sales practice, communications and other rules that protect investors³ as well as rules ensuring that investors receive adequate disclosures and that brokers are financially sound.⁴

The structure of municipal advisor regulation in the Securities Exchange Act of 1934 (the “**Exchange Act**”) has a singular focus on protecting issuers, not investors. For example:

- Section 15B(c)(1) provides that a municipal advisor and any of its associated persons have a fiduciary duty *to any municipal entity* for whom it acts as a municipal advisor;
- Section 15B(a)(5) prohibits a municipal advisor from making use of the mails or any means or instrumentality of interstate commerce *to provide certain advice to or on behalf of a municipal entity, or undertake a solicitation of a municipal entity*, in connection with which such municipal advisor engages in any fraudulent, deceptive or manipulative act or practice;
- Section 15B(b)(2) requires that the MSRB must propose and adopt rules to effect the purposes of Section 15B of the Exchange Act with respect to

² See, e.g., Final Rule: Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 47364 (Mar. 26, 2003).

³ See *id.* (citing Statement of the U.S. Securities and Exchange Commission Concerning Bank Securities Issues to the Subcommittee on Oversight and Investigations, Committee on Commerce, U.S. House of Representatives Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning Financial Modernization Legislation, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (February 24, 1999)).

⁴ See Persons Deemed Not to be Brokers, Exchange Act Release No. 20943 (May 9, 1984).

advice provided to or on behalf of municipal entities by municipal advisors with respect to municipal financial products, the issuance of municipal securities, *and solicitations of municipal entities* undertaken by brokers, dealers, municipal securities dealers, and municipal advisors;

- Section 15B(b)(2)(L) requires that the MSRB establish rules with respect to municipal advisors that, among others, (i) prescribe means reasonably designed to prevent acts, practices and courses of business that are not consistent with a municipal advisor’s fiduciary duty to its clients; (ii) provide continuing education requirements for municipal advisors; and (iii) provide professional standards.

These statutory directives establish the parameters for rules that the MSRB has adopted and proposed concerning municipal advisors. Specifically, while MSRB Rule G-17 generally requires all registrants to “deal fairly with all persons,” draft MSRB Rule G-42 sets forth the duties of non-solicitor municipal advisors with a focus on a municipal advisor’s duty to its clients, not investors.⁵

Acting as a broker between issuers and investors involves inherent conflicts of interest that broker-dealer regulation’s investor protections are structured to address through an extensive scheme of regulation concerning communications, fair pricing, disclosure, suitability, personnel qualifications, and other safeguards. Where municipal advisors engage in activities that constitute acting as a broker, the investors with whom they deal should be entitled to the same protections they receive when dealing with a registered broker—protections not provided by municipal advisor regulation.

B. Placement Agents Must Be Registered Broker-Dealers

1. Broker-Dealer Regulatory Scheme

Applying this principle to the specific example of acting as a placement agent for an issue of municipal securities, which NAMA describes in their letter, it is obvious that a municipal advisor’s registration as such is insufficient to provide appropriate investor protection to purchasers and offerees.

Section 15(a) of the Exchange Act generally prohibits a broker from using U.S. jurisdictional means to effect, or induce or attempt to induce transactions in securities, unless the broker is registered with the Commission. Section 3(a)(4) of the Exchange Act,

⁵ See Request for Comment on Revised Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors, MSRB Regulatory Notice 2014-12 (July 23, 2014).

in turn, defines “broker” as a person “engaged in the business of effecting transactions in securities for the account of others.”⁶

Rather than provide bright lines concerning who is a broker, the Commission and courts have looked to the overall “facts and circumstances” and various factors (with no one factor being dispositive) to determine whether a person is engaged in broker activity—including the following (“**Broker Indicia**”):⁷

1. assisting an issuer to structure a prospective securities transaction;
2. helping an issuer to identify potential purchasers of securities;
3. soliciting investors for securities transactions;
4. negotiating between the issuer and the investor;
5. making valuations as to the merits of an investment or giving advice; and
6. handling funds or securities.

The Commission has focused on the receipt of compensation based on the success and/or size of a securities transaction (so called “**transaction-based compensation**”) in connection with a securities transaction, which it views as creating a “salesman’s stake” in the transaction.⁸ The Commission’s concern has been that, when a person’s compensation is dependent on the success or the size of a securities transaction, the person has the incentive to make sure the transaction occurs, creating a conflict of interest between the person and the parties to the transaction which must be addressed by broker-dealer registration and regulation.

The role of a municipal advisor is primarily to advise and interact with issuers—not investors. While there may be some ambiguity as to what actions may trigger “broker” status in the context of traditional municipal advisory activities (and otherwise), and there may be circumstances in which market participants should be able to take the position that the receipt of transaction-based compensation, alone, should not cause them to be a

⁶ “Dealers” who engage in the business of transacting securities as principal must also register with the Commission; however, in light of the context of municipal advisors intermediating between issuers and investors, this letter focuses on the definition of broker.

⁷ See, e.g., Robert L.D. Colby, Lanny A. Schwartz and Zachary J. Zweihorn, *What is a Broker-Dealer?* (July 1, 2014).

⁸ See, e.g., 1st Global, Inc., SEC Partial Denial of No-Action Request (May 7, 2001); Brumberg, Mackey & Wall, P.L.C., SEC Denial of No-Action Request (May 17, 2010).

broker and subject to broker-dealer registration,⁹ being a placement agent is not among them.

As a result, at one extreme, a municipal advisor should be able to engage in some of the Broker Indicia activities above without being deemed to be a broker—such as advising an issuer on structuring a prospective securities transaction. At the other extreme, however, a municipal advisor that solicits or negotiates with investors on behalf of an issuer of municipal securities and receives transaction-based compensation is acting as a broker. In the context of a municipal securities issuance, acting as an intermediary between issuers and investors with sufficient regularity and as part of a regular business, while receiving transaction-based compensation, raises the conflicts of interest that broker-dealer registration was meant to resolve. While further Commission guidance may be necessary for firms to know where the line falls between these extremes, guidance is not needed to confirm that, in the ordinary course, acting as a placement agent for an issue of municipal securities falls squarely within broker activity.

In particular, SIFMA believes that assisting an issuer with solicitation of potential investors or negotiation of terms with investors—whether or not coupled with transaction-based compensation—places the municipal advisor in a role vis-à-vis potential investors that call out for the protections afforded by the broker-dealer regulatory scheme. If the municipal advisor receives transaction-based compensation in this specific context, then it compounds the municipal advisor’s conflict and makes the need for investor protection even clearer.

2. MSRB Regulatory Scheme

An exemption from broker-dealer registration for municipal advisors acting as placement agents would also compromise a critical anti-conflict safeguard in the MSRB’s rules. MSRB Rule G-23 provides that (subject to exceptions) “no broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to the issuance of municipal securities shall . . . act as agent for the issuer in arranging the placement of such issue.” This prohibition on role switching is a fundamental safeguard for both municipal entity issuers and investors. If non-dealer municipal advisors were exempt from broker-dealer registration, then presumably they could skirt the requirements of MSRB Rule G-23.

3. NAMA’s Arguments Based on Language in the Exchange Act’s Municipal Advisor Provisions are Erroneous

In arguing that a municipal advisor should be exempt from registration as a broker-dealer, NAMA observes that under Section 15B(e)(4)(B), “placement agents,

⁹ See, e.g., *SEC v. Kramer*, 778 F. Supp. 2d 1320 (M.D. Fla. 2011) (holding that receipt of transaction-related compensation is not necessarily dispositive of whether a person is acting as a broker).

solicitors, finders” are specifically given as examples of persons that are within the definition of “municipal advisor.”¹⁰ As such, NAMA believes that finding and negotiating with investors for an issuer client are “core” municipal advisory activities that should not require separate registration as a broker-dealer. This is a fundamental misreading of the Exchange Act provision. As the Commission has recognized in adopting Form MA, the reference to “placement agents, solicitors, finders” in Section 15B(e)(4)(B) refers to persons who *solicit* municipal entities on behalf of unaffiliated third party clients—not persons that, as part of advising on an issuance of municipal securities, also find investors on behalf of a municipal entity.¹¹

II. An Exemption from Advisers Act Registration is Also Not Appropriate

NAMA also requests that the Commission exempt a registered municipal advisor from being required to register as an investment adviser under the Investment Advisers Act of 1940 (the “**Advisers Act**”) as a result of providing advice regarding the investment of the proceeds of municipal securities—an activity that requires municipal advisor registration. In particular, NAMA argues that, as municipal advisors are already required to register with the SEC under the Exchange Act and subject to a fiduciary duty in connection with their municipal advisory services, they should not need to separately register as investment advisers. SIFMA does not believe such an exemption from registration as an investment adviser is necessary or appropriate.

NAMA is essentially seeking to permit municipal advisors to operate regular investment advisory business with regard to bond proceeds without registration as an investment advisers. This is not consistent with the regulatory framework enacted by Congress. By providing in the Exchange Act an exclusion in the definition of “municipal advisor” for federally-registered investment advisers, but not a parallel exemption for registered municipal advisors from registration as investment advisers, Congress effectively said that the regulation of federally registered investment advisers adequately protects municipal entity issuers, but that the new municipal advisor scheme was not structured to be a substitute for the more robust protections afforded by investment adviser regulation, where it would otherwise be required.¹²

¹⁰ See NAMA Letter at note 6.

¹¹ See Form MA, Part I, Item 4(L)(7) (providing “placement agents, solicitors, and finders” as an example of a municipal advisor’s line of business relating to the “[s]olicitation of investment advisory business from a municipal entity or obligated person ... on behalf of an unaffiliated broker, dealer, municipal advisor or investment adviser”).

¹² Municipal advisors are already permitted under a 2000 Staff Bulletin (“**Staff Bulletin 11**”) issued by the staff of the Commission’s Division of Investment Management to provide incidental advice concerning the investment of bond proceeds without registration as investment advisers so long as they do not do so regularly or for compensation and do not hold themselves out as investment advisers. In effect, Staff Bulletin 11 stands for the proposition that advising on the investment of bond proceeds for compensation is necessarily an investment advisory activity and must be subject to the full scope of (...continued)

NAMA focuses on the fact that both municipal advisors and federally-registered investment advisers are subject to a fiduciary duty. However, the contours of such a duty are developed in view of their particular roles. The municipal advisor provisions in the Exchange Act and the Commission's rules do not contain significant substance concerning the fiduciary duties of municipal advisors in providing advice concerning the investment of bond proceeds, nor are they specific in their direction to the MSRB in regard to rulemaking in this area. The MSRB has released Draft Rule G-42, relating to the duties of municipal advisors when advising clients.¹³ But the Draft Rule G-42 focuses primarily on matters relating to municipal advisors providing advice regarding the issuance of municipal securities—*not advice regarding making investments in securities*.

By contrast, the regulation of persons providing advice on the investment of securities, for compensation, is the focus of the Advisers Act and the regulation of investment advisers is properly subject to that regulatory scheme. The Advisers Act and the Commission's rules and guidance thereunder provide for an extensive system of regulation, with detailed duties and prohibitions pertaining to the rendering of investment advice, compensation, advertising, disclosures, reporting, self-dealing, custody, testimonials, ethical practices and other matters—all designed to protect investors (including municipal entities) who obtain investment advice for compensation. Perhaps the MSRB could, in the fullness of time, develop a rule structure, and the SEC could develop an examination and enforcement program, that would replicate in an appropriate way the entire body of regulation, case law, guidance and administrative infrastructure that exists today under the Advisers Act, in order to ensure that municipal entities are protected when they are advised by municipal advisors for compensation in relation to the investment of bond proceeds—but they have not done so to date. Moreover, because the Exchange Act does not explicitly direct them to do so, it is unlikely that they will do so in the foreseeable future.

III. Conclusion

SIFMA believes that investors should not lose important protections by permitting municipal advisors to act as placement agents without registration as broker-dealers. SIFMA further believes that the Commission should not provide for an exemption from the Investment Advisers Act for registered municipal advisors, as such an exemption would leave municipal issuers without the significant protections provided for under the Investment Advisers Act, as to which there is no adequate substitute in the municipal advisor regime.

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investor protections afforded by the Advisers Act. There is no reason to believe that Congress intended to change this status quo.

¹³ See Request for Comment on Revised Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors, MSRB Regulatory Notice 2014-12 (July 23, 2014)

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SIFMA appreciates your consideration of these views. Please do not hesitate to contact me at (212) 313-1130 or SIFMA's counsel, Lanny A. Schwartz, at Davis Polk & Wardwell LLP at (212) 450-4174 with any questions.

Sincerely yours,



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Managing Director and
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cc: **SEC**

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