Thank you for this opportunity to comment on the Commission's proposed exemption from dealer regulation of municipal advisors participating in private placements for issuer clients.

Although I am now recently retired, I have been involved in the municipal bond market for four-and-a-half decades, since the early to mid-1970s. As a result of consultations with a national bond counsel firm and the Government Finance Officers Association in the 1970s, I am the author and co-author of seminal articles and papers, as well as more recently several books, and more than 80 articles, regarding the municipal bond market, and regarding the application of the securities laws to municipal bond issuers and bond issues. As a member of committees, and as a drafter, I have participated in the preparation of nationally-recognized guidance on disclosure and due diligence published by GFOA, the American Bar Association/National Association of Bond Lawyers, and the National Federation of Municipal Analysts. I served for several years as a member of the Board of Directors of what was then known as the National Association of Independent Public Finance Advisors, now the National Association of Municipal Advisors.

I have served as a bond counsel, issuer counsel, underwriter, underwriter counsel, and for 23 years, financial advisor to municipal issuers, a role that now is within the regulation of municipal advisors. I have been in the past a registered municipal advisor. I participated in the conduct of several billions of dollars of successful transactions in municipal securities offerings, workouts of defaulted and other troubled municipal bond issues conducted by others, and corporate finance transactions benefiting local governments and private corporations in approximately two dozen states across the nation. I have consulted as an expert on more than 160 litigation matters regarding municipal bond disclosure, due diligence and roles and responsibilities of parties in municipal bond issues, including municipal advisors and their fiduciary duties.

I believe that I am qualified to provide the views that I now express, without any bias toward one or another type of professional firm.

I have typically been supportive of the Commission's regulatory efforts in the municipal bond market. I cannot say that about this proposal.

The proposed exemption most likely will be used by tens of thousands of issuers of small and medium-sized bond issues. Large numbers of those issuers do not issue bond issues of more than a few tens of millions of dollars, which for better or worse, will accommodate private placement. With this proposal, those issuers may never again have a need to enter the public debt market. Municipal advisors, with their eyes on the contingent private placement compensation, will steer the issuers toward private placements. Not only institutional investors, but also many small investors, including myself, who invest in mutual funds and other investment vehicles, will be impacted.

Municipal advisors will be able to convince their issuer clients to retain the advisors for the purpose of private placement on the ground that there will be a "cost saving" by avoiding underwriting fees, which I note have been declining significantly and steadily for decades. Municipal advisors will, of course, increase their contingent fees to compensate them for this "additional service."

In addition, an inefficiency is inherent in the requirement that one hundred percent of the bonds of each bond issue must be sold to a single sophisticated investor. That means different maturities cannot be directed to the investors most likely to desire them and to pay optimal prices for them. For example, short-term maturities will not be sold to short-term buyers that will pay the best prices for those maturities. That inefficiency alone may over-ride any cost saving. There has been no apparent consideration of the not uncommon circumstances in which a bond issue includes both senior and subordinate bonds or tax-exempt and taxable bonds. Again, the best pricing would prevail when those are sold to different investors.

It will be easy for municipal advisors to mislead issuers regarding transactional efficiency and purported cost savings.

In reality, the largest "cost saving" will come not from excluding dealers from bond issues, but from issuer avoidance of provision of information—official statements and continuing disclosure—to the market.

I have substantial concerns about the proposal for the foregoing reasons and others described below. While I see a role for municipal advisors in assisting issuers in bond sales directly to local banks— essentially local bank loans—this proposal extends far, far beyond that type of transaction. In contrast with other investors, a local bank often has access through personal relationships to the local issuer and more direct access to information about it.

The proposal has the potential seriously to erode, and even to reverse, 45 years of improvement in disclosure, due diligence and municipal advisor regulation—including the fiduciary duty. It will impact specifically those smaller and medium-sized issuers who are least sophisticated and most in need of unbiased professional financial advice. There is a very real potential that a significant proportion of bonds in aggregate principal amounts of up to $50 million to $75 million or more will be sold without the transparency now available.

This proposal therefore has the potential—I believe the likelihood—of returning a substantial proportion of the municipal bond market to the dark days before the New York City Crisis in the 1970s pre-dating the Commission's first regulatory involvement in the municipal market. In those days, over four decades ago, when I began my involvement in the municipal bond market consulting with a national bond counsel firm and then serving as General Counsel to the Government Financial Officers Association, large numbers of municipal bond issuers sold their bonds with no official statement at all, or with sketchy information collected and presented in half-hazard form.

With this proposal, no longer will many members of a huge sector of the municipal market issue official statements or provide continuing disclosure. Further, in the absence of the discipline imposed by expectations of future entrance into the market, many issuers even will have no motivation to comply with existing continuing disclosure agreements.

That dearth of information concerning those local governments will have impacts extending well beyond the municipal bond market. Organizations that collect, analyze and publish data on the municipal bond market and municipal bond issuers will be denied ready access to information. They will be required to utilize cumbersome public records requests,

which effectively means many of them will cease, or at least reduce significantly, their current data gathering and analytical efforts.

Literally, the municipal bond market very well could find that information and due diligence largely will disappear for those issuers.

Moreover, municipal advisors—now retained primarily on the basis of the quality of their advice—will begin to emphasize, and to be retained on the basis of, their capabilities to sell bonds privately in place of underwriters. In that respect, they will replace small and medium-sized dealers, many of which may cease conducting municipal bond business. That loss of trading capabilities and competition will harm individual investors.

The same conflicts that formerly were the province of dealers that also sought under MSRB Rule G-23 in its prior form both to underwrite or place bonds and to serve as financial advisors now will be the conflicts of the municipal advisors that, in fact, will be doing both and that—as fiduciaries—are supposed to avoid such fundamental conflicts.

Municipal advisors will be able to—and will—market themselves on the basis of their capabilities to sell bonds. The larger firms will offer their services on the basis of their specialized internal sales forces and sales desks having "books of business" with banks, mutual funds, insurance companies, hedge funds, pension funds, investment advisors, and other institutional investors.

It is one thing to allow municipal advisors to assist issuers in obtaining loans from local banks. It is another thing entirely for the advisors to become alternative underwriters and placement agents on a broad national basis, without dealer regulation.

The proposal completely fails to discuss the disclosure and due diligence responsibilities of municipal advisors engaging in these activities. Given the Commission's deafening—and disturbing—silence, it appears that the Commission does not consider those responsibilities to be relevant.

I note that in 1988, the Commission stated in SEC Rel. 34-26100, 53 FR 37778, 37790 at n. 92 (Sept. 28, 1988), that:

> In a competitively bid offering, the task of assuring the accuracy and completeness of disclosure is in the hands of the issuer, who usually will employ a financial adviser, which frequently is a broker-dealer. *Ordinarily, financial advisers in competitively bid offerings publicly associate themselves with the offering, and perform many of the functions normally undertaken by the underwriters in corporate offerings and in municipal offerings sold on a negotiated basis. Thus, where such financial advisers have access to issuer data and participate in drafting the disclosure documents, they will have a comparable obligation under the antifraud provisions to inquire into the completeness and accuracy of disclosure presented during the bidding process*. Emphasis added.

In 1988, when the Commission issued its release, competitive bids were the primary transactions in which issuers used financial advisors. Today, advisors are common in all types of

municipal bond transactions, and with this proposal, they would assume the leading professional financial roles in private placements.

In Rule 15c2-12, the Commission defined the official statement concept to encompass multiple documents ("a document or set of documents prepared by an issuer of municipal securities or its representatives"). That multiple document approach is likely the most common format to be utilized in private placements conducted pursuant to this proposal. Municipal advisors will be delivering, as intermediaries to investors, on behalf of the advisors' issuer clients, that form of disclosure documentation.

In 1989, the Commission made clear that dealers, even in limited offerings and private placements, had due diligence responsibilities, stating in SEC Rel. No. 34-26985, 54 FR 28799, 28811 (July 10, 1989), that:

> The Interpretation [of underwriter investigatory responsibilities] applies to all offerings of municipal securities, regardless of whether the offering is subject to the provisions of Rule 15c2-12.

That statement was intended to notify dealers that, even in private placements and limited offerings, the dealers had due diligence responsibilities. I recognize that, under the proposal, municipal advisors are to notify investors that the municipal advisors represent the issuers, not the investors, but as the Commission stated in 1988, as quoted above, that should not absolve municipal advisors of responsibility for the quality of disclosure. Yet, this proposal totally ignores any such responsibilities.

Given that, under the proposal, municipal advisors do not appear to have responsibilities to investors of any nature—even as essential participants in the disclosure and due diligence process, who is to conduct due diligence upon which investors rely? Is this now solely to be done by investors themselves, although when dealers were involved, that was not the case? Is it to be performed by solely the issuers, many of whom do not have the capabilities to do so? Is it to be done by the advisors as part of their due diligence to support their advice to issuers to close such private placements?

This has not been thought through.

Although municipal advisors negotiating with investors pursuant to the Commission's proposal inevitably will, in the Commission's words in its 1988 release, "have access to issuer data and participate in drafting the disclosure documents," the Commission's complete silence on disclosure and due diligence in this proposal suggests that it does not believe the advisors will have disclosure or investigatory responsibilities.

Yet, it must be recognized that the principal issuers who retain municipal advisors utilizing this approach will be the least able and sophisticated issuers in the market, those with the smaller and medium-sized bond issues.

That throws the entire responsibility for due diligence on the backs of the investors purchasing the bonds. Nevertheless, while those investors are able to conduct due diligence by reviewing and asking questions about information provided to them, they are not able to conduct

the face to face, on site, due diligence that is required for conducting careful bond issues. See the attached pages from **DISCLOSURE ROLES OF COUNSEL IN STATE AND LOCAL GOVERNMENT SECURITIES OFFERINGS** (2009) published by the American Bar Association and the National Association of Bond Lawyers, enumerating a lengthy list of "basic" due diligence activities in municipal bond issues.

The National Federal Federation of Municipal Analysts has made clear that sophisticated institutional investors rely on underwriters, even in private placements, to conduct that due diligence. See National Federation of Municipal Analysts, *White Paper on Best Municipal Bond Issuance Practices* (June 2014), stating:

> Investors expect placement agents to conduct due diligence in accordance with general market practices. This is the case unless all of the following conditions exist:
>
> - The placement agent(s) function solely in an introductory role between obligors and investors,
> - The agents do not participate in the preparation or delivery of offering documents,
> - The agents do not place their names on the offering documents, and
> - The agents explicitly inform investors that they are not verifying information provided by the obligor or otherwise in the offering documents.

Under the Commission's proposal, however, municipal advisors negotiating directly with investors will perform far more significant roles than merely introducing investors and issuers. They will be participating pervasively in all financial aspects of the bond issues from beginning to end over periods of many weeks, and even months, negotiating with investors, providing disclosure information to investors, reviewing and negotiating transactional documentation, and closing the transactions. Investors will be forced to rely on the "quality" of municipal advisory firms that have no responsibility to the investors.

It appears that the Commission believes such reliance by the buy-side of the market on the sell-side of the market for that activity no longer is necessary, that from now on the investor side of the market is on its own. That is exactly how conditions existed in the 1960s and 1970s in the municipal bond market before the New York City Crisis.

Especially under current municipal bond market conditions in which there is high demand for municipal bonds, this proposal essentially will force undesirable responsibilities on the investor side of the market. The investor side of the market lacks the time and direct access throughout bond transactions to conduct all due diligence that dealers, as underwriters and placement agents, are expected to conduct. Yet, mutual funds and other investors must continue to buy bonds in order to survive. They will be forced to do so with less volume of information and less reliable information.

As an investor in municipal bond funds, I believe that this proposal is extremely adverse to my own interests.

This proposal deserves very careful re-consideration. It should be cut back substantially.

This proposal is potentially very disastrous for the municipal bond market as a whole, including for small investors, such as myself.

**Note:** I have not discussed the very troublesome contingent sales fees that municipal advisors will be paid under this proposal and my opinion that such a fee structure presents a conflict of interest that is seriously disadvantageous for issuers in relation to other potential fee structures.

Robert Doty

# DISCLOSURE *Roles of* COUNSEL

In State and Local Government Securities Offerings

THIRD EDITION

ABA Section of State and Local Government Law
ABA Section of Business Law,
Committee on Federal Regulation of Securities
National Association of Bond Lawyers

draft bond purchase agreements that impose on the issuer an updating obligation that extends through the Rule 15c2-12(b)(4) period.[16]

In light of the diversity of municipal transactions, it is not possible to provide precise guidance as to the particulars of adequate due diligence that can be applied in every instance. It is important to note that in 1973, at the SEC's request, the NASD proposed a Rule of Fair Practice that would have set forth the basic investigation an underwriter should conduct in connection with a public offering. The rule was not adopted out of concern that the use of a checklist would make the due diligence investigation too systematic and inflexible and unresponsive to the unique characteristics of each transaction. Several organizations, however, have developed voluntary disclosure guidelines. For example, GFOA has issued extensive voluntary guidelines for primary offerings of municipal securities. NFMA has published voluntary disclosure guidelines[17] covering industry-specific sectors, including, among others, housing, student loans, transportation, health care, water and sewer, and hospital transactions. Standard & Poor's *Municipal Finance Criteria* provides a detailed analysis of the criteria that the rating agency examines in providing its ratings for a wide variety of municipal financings, and also provides a useful sector-by-sector analysis.

It is not possible to provide a comprehensive checklist. There are certain basic categories of actions, however, that should be considered in connection with most financings, although the importance or relevance of any particular item will depend upon the facts and circumstances of the particular financing. Some are clearly more relevant to a revenue financing than a general obligation issue, and other distinctions will make these items, and others not mentioned, more or less important:

- Discussions with key executive and financial officials, department heads, or personnel
- Discussions with board members, if appropriate
- Inquiry into possible conflicts of interest
- Rating agency guidelines and requests

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16. In addition, MSRB Rule G-32 requires underwriters of new issue municipal securities to deliver Official Statements (if prepared) to customers no later than the settlement date. Such delivery may be accomplished by advising the customer how to obtain the Official Statement from EMMA.

17. National Federation of Municipal Analysts, Compilation of Recommended Best Practices in Disclosure (2004).

- Examination of board minutes, and executive and other key committee minutes and reports, for an appropriate period of time (frequently, five years)
- Examination of current budgets and past performance against budgets
- Examination of audits (including management letters) for five years, or other time period determined to be appropriate for the transaction, and income tax returns (where relevant), and discussions with external auditors
- Review of unaudited stub period financial statements
- Review of (1) changes in auditors by the issuer, if applicable, within the preceding five-year period, or other time period determined to be appropriate for the transaction, and (2) the reasons therefor
- Examination of litigation documents and litigation letters submitted in connection with audits, and discussions with general and litigation counsel
- Examination of indentures, relevant borrowing agreements, lending agreements, major leases, major or key contracts, and other material purchase and sale contracts
- Review of retirement plans and other postemployment benefits, including unfunded liabilities, and actuarial reports
- Review of off-balance sheet items
- Physical examination of key tangible assets and real property
- Review of tax status and tax-exemption of interest on the securities
- Weighing the materiality of the information based upon the security for the bonds—e.g., full faith and credit, airport revenues, etc.
- Review of "industry" background material to discover problems facing the "industry"
- Review of current economic trends and forecasts that may bear on the ability of the issuer to repay its debt
- Review of prior offering documents, and an explanation of any revisions
- Review of any annual financial information or material event notices filed pursuant to Rule 15c2-12

This list is not intended to be exhaustive, and care and judgment are called for in framing and pursuing the due diligence inquiry. In the event that at any point during the due diligence process, or at any time through the end of the underwriting period, an underwriter or its counsel uncovers an issue that may be material, whether as a financial matter or because of its reflection on management, the underwriter and its counsel should make whatever additional inquiry and review whatever additional documents are necessary to make their own preliminary determination. If after discussing this issue

with other members of the financing team, the underwriter and its counsel conclude that the issue must be disclosed, then disclosure should be made; if it is not, the underwriter may need to resign. The effect of any material event on the contractual obligations of the underwriter will depend upon, among other factors, (1) whether it is a new event or a prior event recently discovered (see chapter 10, section B.3.b, "Duty to Update; Duty to Correct"), (2) when the disclosure determination is being made—before the Preliminary Official Statement is mailed; after the Preliminary Official Statement is mailed but before the final Official Statement is printed; after the final Official Statement is printed but before the closing date; after the closing date but the underwriting period continues because there were unsold bonds, etc.;[18] and (3) what contractual provisions are included in the bond purchase agreement.[19]

In addition to the general due diligence items outlined above that are common to most financings, counsel should give careful consideration to more particular inquiries that are dependent upon the type of financing involved, as described below.

#### a. General Obligation Debt

With respect to general obligation debt, the best disclosure addresses not only the issuer's authority to raise revenue to repay the obligations proposed to be issued, but also the range of financial, economic, and demographic factors that may affect the issuer's willingness and ability to exercise those powers and realize tax receipts and other revenues sufficient to pay debt service charges (after paying expenses of government) at the times and in the amounts required.[20] The underwriter of general obligation debt and the underwriter's counsel usually rely on bond counsel for the preparation of those portions of the disclosure document describing the authority for and enforceability of the pledge of the issuer's "full faith and credit" to secure the payment of debt service charges. With respect to the financial, economic, and demographic factors bearing on the likelihood of the issuer's realization of tax and other receipts at adequate levels, however, the investigating parties are advised to design procedures for eliciting the best available relevant information.

Beyond an examination of historical data regarding the level of receipts from the tax levies in question, the investigating parties may conduct a review of data with respect to a number of factors: any overlap in tax jurisdictions;

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18. *See* chapter 1 (providing analysis of Rule 159).

19. *See generally* FIPPINGER ch. 4.

20. In some states, general obligation bonds are payable solely from tax levies. Other states allow issuers to anticipate other revenues and reduce or ignore annual levies; *see* Allison v. City of Phoenix, 33 P.2d 927 (Ariz. 1934). Many cities that have substantial revenues from sources other than taxes may do away with the levy altogether. In this case, the source of the revenues becomes a disclosure issue.