



Municipal Securities Rulemaking Board

December 9, 2019

Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: Proposed Exemptive Order (File No. S7-16-19)**

Dear Ms. Countryman:

The Board of Directors of the Municipal Securities Rulemaking Board (MSRB or Board) appreciates the opportunity to provide comments to the Securities and Exchange Commission (Commission) on its proposed exemptive order that would permit registered municipal advisors to engage in certain solicitation activities in connection with the direct placement of municipal securities without registering as a broker (the “Proposed Exemption”). The Commission published the Proposed Exemption in Exchange Act Release No. 87204 (the “Proposing Release”) requesting comment on all aspects of the Proposed Exemption.<sup>1</sup>

### **Background**

The MSRB is a self-regulatory organization created by Congress with the statutory mandate under Section 15B of the Securities Exchange Act of 1934 (the “Exchange Act”) to promulgate rules for the municipal securities market that protect investors, state and local governments and other municipal entities, obligated persons and the public interest.<sup>2</sup> The MSRB fulfills its mission to safeguard the nearly \$4 trillion municipal securities market by, among other activities, establishing rules for brokers, dealers, municipal securities dealers (collectively, “dealers”) and municipal advisors that engage in municipal securities and advisory activities. MSRB rules are designed to prevent fraud and manipulation and promote fair dealing and a fair and efficient market. To further promote a fair and efficient market, the MSRB operates the Electronic Municipal Market Access (EMMA<sup>®</sup>) website, which increases the transparency of the municipal securities market by providing free public access to municipal securities disclosures and data. The EMMA website provides investors, state and local governments and other market participants with key information and tools to effectively use that information.

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<sup>1</sup> Exchange Act Release No. 87204 (Oct. 9, 2019), 84 FR 54062 (File No. S7-16-19).

<sup>2</sup> Pursuant to Section 15B(b)(2)(C) of the Exchange Act, such rules must not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. 15 U.S.C. 78o-4(b)(2)(C).

## **Introduction**

It has been a long-standing practice, pre-dating the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>3</sup> for municipal advisors to assist their municipal entity clients seeking proposals for, and negotiating and structuring debt with, depository institutions, and the MSRB believes it is important for the Commission to provide needed clarity to preserve that traditional function. Subject to the comments and suggestions below, the MSRB supports the Commission's goal of providing regulatory clarity on the scope of activities in which a registered municipal advisor may engage to assist municipal issuers that rely on direct placements and direct loans from banks and other lenders as an alternative to public offerings of municipal securities for capital formation.<sup>4</sup> However, the MSRB is concerned that if the Proposed Exemption is issued as drafted, the benefits to municipal issuers could be outweighed by the detrimental impact to market transparency and the potential collateral consequences for retail investors.

Recognizing its mandate to promote a fair and efficient municipal securities market, the MSRB felt compelled to provide input in response to certain of the questions the Commission posed in the Proposing Release and to address the impact the Proposed Exemption would have on MSRB rules. Accordingly, this letter does not provide exhaustive comment on the Proposed Exemption or respond to each itemized question as presented in the Proposing Release.

## **Response to Request for Comment**

### **Has the Commission appropriately defined Qualified Provider? If not, what would be a more appropriate definition and why?**

The Commission proposes to define "Qualified Provider" as "(i) a bank, savings and loan association, insurance company, or registered investment company; or (ii) an investment adviser registered with the Commission or a state; or (iii) any other institution with total assets of at least \$50 million." The Board recognizes that this definition generally tracks the definition of a sophisticated municipal market professional under MSRB rules,<sup>5</sup> but believes the definition of

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<sup>3</sup> Pub. Law No. 111-203, 124 Stat. 1376 (2010).

<sup>4</sup> For example, the MSRB has previously noted that such placements, ". . . as an alternative to a public offering could provide potential advantages for issuers, among other things, lower interest and transaction costs, reduced exposure to bank regulatory capital requirements, simpler execution process, greater structuring flexibility, no requirement for a rating or offering document, and direct interaction with the lender instead of multiple bondholders." MSRB Regulatory Notice 2015-03 (Jan. 29, 2015). See also Municipal Market Bank Loan Disclosure Task Force, Considerations Regarding Voluntary Secondary Market Disclosure about Bank Loans (May 1, 2013), available at <http://www.nfma.org/assets/documents/position.stmt/wp.direct.bank.loan.5.13.pdf> and National Association of Bond Lawyers, *Direct Purchases of State or Local Obligations by Commercial Banks and Other Financial Institutions* (July 2017), at 2, available at [https://www.chapman.com/media/publication/783\\_Chapman\\_NABL\\_Direct\\_Purchases\\_State\\_Local-Obligations\\_Banks\\_Financial\\_Institutions\\_072617.pdf](https://www.chapman.com/media/publication/783_Chapman_NABL_Direct_Purchases_State_Local-Obligations_Banks_Financial_Institutions_072617.pdf).

<sup>5</sup> 84 FR 54062 at fn. 27; see also MSRB Rule D-15, sophisticated municipal market professional. As noted in the Proposed Order, Rule D-15's definition of sophisticated

“Qualified Provider” is broader than necessary to achieve the Commission’s goal and to eliminate the ambiguity about whether the borrowing is a loan or a security.<sup>6</sup> The MSRB believes the definition should be limited to a “Depository Institution,” which should be defined as: (i) a bank, savings and loan association, trust company or similar institution, including an institution wholly owned by a bank, savings and loan association or trust company that is engaged in commercial lending; or (ii) a federally or state-chartered credit union.<sup>7</sup> If the definition of Qualified Provider is limited to a Depository Institution, the MSRB suggests that the restriction that the entire issuance be placed with a single Qualified Provider is no longer necessary and, similarly, it would be unnecessary to impose any restriction of a specific size threshold.<sup>8</sup> The MSRB believes that issuers will be better served if the Proposed Exemption preserves the traditional role of municipal advisors by modifying the definition of a Qualified Provider and increasing the number of Depository Institutions that can participate in the direct placement of the issuance without imposing a specific size threshold.<sup>9</sup>

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market professional (SMMP) also includes natural persons with total assets of at least \$50 million. The MSRB believes that excluding natural persons from the definition of Qualified Provider is an appropriate policy determination. However, it should be noted that even in determining if an entity is an SMMP, Rule D-15 requires a dealer to have a reasonable basis to believe that the entity is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities. In addition, in undertaking a reasonable basis analysis, consideration should be given to the amount and type of municipal securities owned or under management by the entity.

<sup>6</sup> As the MSRB has previously noted, the use of financing structures other than publicly sold municipal securities can raise a number of important questions under the federal securities laws, including whether the nature of the financing instrument is a security or a loan. The Board understands that the implication of these questions can lead to uncertainty in certain transactions and this ambiguity may chill certain discussions and thereby disincentivize municipal issuers’ use of placements as a financing alternative. See MSRB Regulatory Notices 2016-12 (Apr. 4, 2016), 2016-11 (Mar. 28, 2016), and 2015-03 (Jan. 29, 2015) and MSRB Notice 2011-37 (Aug. 3, 2011).

<sup>7</sup> This is also responsive to the Commission’s question as to whether the definition of Qualified Provider should include credit unions.

<sup>8</sup> 84 FR 54064 (“The proposed exemption would apply only to a registered municipal advisor’s activities in connection with the ‘direct placement’ by a Municipal Issuer of an entire issuance of municipal securities with a single ‘Qualified Provider’ . . .”).

<sup>9</sup> This is also responsive, in part, to the Commission’s questions regarding whether the exemption should be expanded to include transactions in which multiple Qualified Providers purchase portions of the entire municipal securities offering and whether the exemption should be limited to direct placements of a specific size threshold.

**Does the possibility of the resale of the municipal securities offered in a direct placement contemplated by the proposed exemptive order raise any investor protection concerns? How should the Commission address those concerns?**

As stated above, the MSRB believes that other institutions such as insurance companies, registered investment companies, registered investment advisors, and other entities with total assets of at least \$50 million should not be included in the definition of Qualified Provider. The MSRB is concerned that these types of institutional investors do pose a risk, even if such Qualified Provider was “purchasing the entire issuance for its own investment purposes.”<sup>10</sup> While it would be beneficial to have further clarification as to what is meant by “investment purposes,” obtaining a representation from the Qualified Provider as to their investment intent should be a requirement.

Expanding the types of Qualified Providers beyond Depository Institutions, which are seeking an alternative to bank loans, creates a greater likelihood that the directly placed municipal securities would be sold in the secondary market where they are likely to be purchased by unsophisticated investors without the benefits of primary market disclosure and continuing disclosure requirements.<sup>11</sup> This would likely result in a bifurcated market between municipal securities that have disclosures and those that do not, which would have a detrimental impact on investors and, in turn, issuer interests. This concern is exacerbated if there are no resale restrictions applicable to the securities that were the subject of the direct placement to ensure the debt remains with sophisticated commercial lenders, and no constraints on the general solicitation of these Qualified Providers, such as that imposed for certain Regulation D offerings.<sup>12</sup> Additionally, the Proposed Exemption does not require that the securities be structured with a minimum denomination of \$100,000 or more or that the securities that were the subject of the direct placement not be reoffered at a lesser denomination without triggering the legal requirements of a new primary offering.<sup>13</sup>

The Proposed Exemption is conditioned on, among other things, the Qualified Provider making a written representation that the Qualified Provider is capable of independently evaluating the investment risks of the transaction. In light of the concern of a bifurcated market resulting from the resale of these securities, the MSRB believes it would be prudent to also require the Qualified Provider to make a written representation that (i) it has a present intent to hold the securities to maturity or earlier redemption or mandatory tender,<sup>14</sup> and (ii) should there

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<sup>10</sup> 84 FR 54065 at fn. 27 (“This is consistent with the Commission’s preliminary view that for purposes of the exemption permitted transaction participants should be limited to an institutional investor purchasing the entire issuance for its own investment purposes.”).

<sup>11</sup> This is also responsive, in part, to the Commission’s questions regarding the risk of secondary market trading and whether the participation of multiple purchasers necessitates additional or different conditions or presents heightened investor protection concerns.

<sup>12</sup> See, e.g., 17 C.F.R. § 230.506(b).

<sup>13</sup> See 17 CFR 240.15c2-12(d)(1)(i).

<sup>14</sup> See Rule G-34 (a)(ii)(A)(3) that provides an exception if the issuance is being purchased directly by a bank, any entity directly or indirectly controlled by the bank or under

be a subsequent sale of the securities, the securities shall be sold only to another Qualified Provider after the selling Qualified Provider obtains the same written representations the selling Qualified Provider was required to make for the initial purchase of the securities that were the subject of the direct placement.

**Has the Commission appropriately identified the activities in which a registered municipal advisor would be able to engage when representing a municipal entity or obligated person in connection with direct placements pursuant to the exemption?**

The MSRB believes that a registered municipal advisor who, without the participation of a registered dealer, places municipal securities directly with a Qualified Provider should be required to comply with MSRB rules necessary and appropriate to foster market transparency. Therefore, if the Commission issues the Proposed Exemption clarifying what is permitted municipal advisory activity, it would warrant the MSRB proposing amendments to certain rules to ensure that applicable regulatory protections are preserved,<sup>15</sup> including:

- MSRB Rule G-34, on CUSIP Numbers, New Issue, and Market Information Requirements, which requires a dealer when acting as a placement agent, including in a direct placement, to, with limited exception, apply for assignment of a CUSIP number or numbers to such new issue;
- MSRB Rule G-32, on Disclosures in Connection with Primary Offerings, which requires a dealer when acting as a placement agent, including in a direct placement, to, among other things, submit to the EMMA website a completed Form G-32 with information regarding the offering; and
- MSRB Rule G-14, on Reports of Sales or Purchases, which requires a dealer when acting as a placement agent, including in a direct placement, to, with limited exception, report the purchase transaction to the MSRB's Real-Time Transaction Reporting System (RTRS) for publication on the EMMA website.

If transactions in the types of direct purchases contemplated under the Proposed Exemption were exempt from applicable MSRB rules, market transparency would be materially and adversely diminished, effectively creating an opaque segment of the municipal securities market where the availability of information for investors, other market participants and regulators alike is significantly weakened. The MSRB believes the threat to market transparency, which is critical to a fair and efficient municipal market, is inconsistent with the goal of the Proposed Exemption. However, this threat is minimized if the definition of Qualified Provider is

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common control with the bank, other than a broker, dealer or municipal securities dealer registered under the Securities Exchange Act of 1934, or a consortium of such entities and if the underwriter or municipal advisor reasonably believes (*e.g.*, by obtaining a written representation) that the present intent of the purchasing entity or entities is to hold the municipal securities to maturity or earlier redemption or mandatory tender.

<sup>15</sup> This is consistent with the Commission's view that the conditions of the Proposed Exemption be "in combination with applicable regulatory protections." 84 FR 54066.

limited to Depository Institutions, and the MSRB believes that the obligations under Rule G-34 and Rule G-14 would likely not be applicable.<sup>16</sup>

In addition to the above noted rules, the MSRB also evaluated the potential impact the Proposed Exemption could have on its other general rules.<sup>17</sup> The MSRB believes that, should the Proposed Exemption be issued as drafted, it would be necessary to consider amendments to the following rules to ensure they reflect current and permitted market practices, remain effective in their principal goal of protecting investors, issuers and the public interest, and do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>18</sup>

### Professional Qualification Rules

G-3	Professional Qualification Requirements
G-5	Disciplinary Actions by Appropriate Regulatory Agencies; Remedial Notices by Registered Securities Associations

### Regulated Entity Administration

G-8	Books and Records to be Made by Brokers, Dealers, and Municipal Securities Dealers and Municipal Advisors
G-9	Preservation of Records

<sup>16</sup> If the Commission were to modify the proposed definition of Qualified Provider, the MSRB would need to amend Rule G-34(a)(ii)(A)(3) to harmonize the current exception for a “a bank, any entity directly or indirectly controlled by the bank or under common control with the bank, other than a broker, dealer or municipal securities dealer registered under the Securities Exchange Act of 1934, or a consortium of such entities” with the definition of Depository Institution. If so amended, neither a dealer or municipal advisor would be obligated to obtain a CUSIP for a (i) bank, savings and loan association, trust company or similar institution, including an institution wholly-owned by a bank, savings and loan association or trust company that is engaged in commercial lending or (ii) a federally or state-chartered credit union . . . if the underwriter or municipal advisor reasonably believes (*e.g.*, by obtaining a written representation) that the present intent of the purchasing entity or entities is to hold the municipal securities to maturity or earlier redemption or mandatory tender.

<sup>17</sup> The MSRB’s general rules are classified into subcategories: professional qualification rules that establish qualifications for conducting municipal securities or municipal advisory business; fair practice rules that protect investors, municipal entities, obligated persons and the general public; uniform practice rules that ensure consistent behavior of regulated entities in the marketplace; market transparency rules that provide for full and timely flow of information to the marketplace; and regulated entity administration rules that set internal requirements for firms.

<sup>18</sup> See 15 U.S.C. 78o-4(b)(2)(C).

**Uniform Practice Rules**

G-15	Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers
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**Fair Practice Rules**

G-17	Conduct of Municipal Securities and Municipal Advisory Activities
G-23	Activities of Financial Advisors
G-25	Improper Use of Assets
G-30	Prices and Commissions
G-39	Telemarketing
G-42	Duties of Non-Solicitor Municipal Advisors
G-44	Supervisory and Compliance Obligations of Municipal Advisors
G-48	Transactions with Sophisticated Municipal Market Professionals

**Conclusion**

The Board appreciates the opportunity to provide these comments to the Commission on the Proposed Exemption. The MSRB supports the Commission addressing an ambiguity in the regulatory framework that will serve municipal issuers in responding to the increasing demand for direct purchases of municipal securities from banks and other lenders and believes that municipal entities will benefit by permitting municipal advisors to solicit Depository Institutions to facilitate a direct purchase, without a size threshold or a limitation on the number of Depository Institutions that can participate in the direct placement, so long as the securities have strict resale restrictions. If we can provide additional information, please do not hesitate to contact me or the Board's staff, Mark Kim, Chief Operating Officer, or Gail Marshall, Chief Compliance Officer, at 202-838-1500.

Sincerely,



Edward J. Sisk  
Chair

cc: Rebecca Olsen, Director, Office of Market Supervision  
Brett Redfearn, Director, Division of Trading and Markets