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May 18, 2007

Municipal Securities Rulemaking Board
Attention: Christopher A. Taylor, Executive Director
1900 Duke Street Suite 600
Alexandria, VA 22314

Re: MSRB Rule G-23

Ladies and Gentlemen:

As President of the Board of Directors of the National Association of Independent Public Finance Advisors ("NAIPFA"), I am writing on behalf of NAIPFA to request your consideration of modifications to MSRB Rule G-23. Our request is made with the sincere belief that the suggested modifications will increase the integrity of the municipal market.

In summary form, our request includes the three following items with respect to negotiated municipal securities offerings:

1. Require that a dealer resigning from the role of financial advisor to an issuer in order to serve as underwriter for the subject offering, explicitly inform the issuer's policy makers in writing that there *are* (not "*may* be") conflicts of interest resulting from the fundamental change in roles, and the nature of those conflicts of interest;

2. Require that the dealer receives explicit formal consent from the issuer's policy-makers to the fundamental change in roles and acknowledgement of the conflicts of interest; and

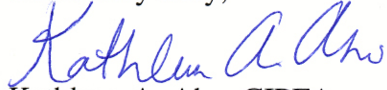
3. Require, unless the issuer contemporaneously employs more than one financial advisor, that the advisory contract between the dealer as advisor and the issuer-client be terminated completely.

The balance of this document provides explanation and substantiation of our request. Included for your review is:

- NAIPFA Request Relative to MSRB Rule G-23
- Appendix A – Excerpt from Frankel Paper
- Appendix B – Inaccurate Sound Bites
- Attachment 1 – Resolution adopted by the NAIPFA Board of Directors
- Attachment 2 – "Let Me Advise You on How Much to Pay Me" – Subverting Fiduciary Duties and Roles, by Dr. Tamar Frankel, Boston University School of Law

NAPIFA's interest is in supporting quality and integrity in the provision of financial advisory services to issuers of municipal securities. We feel that our purpose is in lockstep with the mission of MSRB and respectfully request your consideration of our request.

Yours very truly,



Kathleen A. Aho, CIPFA
President
National Association of Independent Public Finance Advisors

Cc: Securities and Exchange Commission

NAIPFA REQUEST RELATIVE TO MSRB Rule G-23

NAIPFA is a national association that has sought actively for almost 20 years to strengthen the financial advisory profession. Moreover, our members firms are significant in the market. Each year, NAIPFA member firms rendered advice to governmental issuers on significant number of municipal securities issues with a significant market share.

For your information, I am enclosing the following documents:

1. A Resolution adopted by the Board of Directors of NAIPFA on October 4, 2006; and

2. A paper entitled *"Let Me Advise You on How Much to Pay Me"—Subverting Fiduciary Duties and Roles*, prepared by Dr. Tamar Frankel of the Boston University School of Law, a noted author on issues of honesty and conflicts of interest in the financial markets. The paper was commissioned by NAIPFA. Selected excerpts from Dr. Frankel's paper appear in Appendix A to this letter.

Since its inception, the Municipal Securities Rulemaking Board ("*MSRB*" or the "*Board*") has been a positive force and a leader in improving municipal securities dealer practices. NAIPFA applauds the MSRB for its efforts and many successes, such as early MSRB actions against pay-to-play practices. NAIPFA itself joined the MSRB in that initiative when NAIPFA members voluntarily entered into a contemporaneous agreement not to engage in pay-to-play activities. Most recently, the MSRB radically enhanced market informational access through real-time trade reporting, an extremely valuable contribution.

<u>Responsibilities as Advisors</u>

MSRB Rule G-23 stands in sharp contradiction to the positive steps taken by the Board. It is materially misleading for dealers to "disclose," as Rule G-23 contemplates, simply that conflicts of interest "may" exist, when they definitely do exist in underwriter-issuer relationships. By accommodating those materially misleading statements by dealers to issuers about whether, and the extent to which, conflicts of interest exist when dealer financial advisors resign to underwrite their issuer clients' bond issues, Rule G-23 represents a severe policy lapse in the municipal securities market.

The role of advisors is to advise. The role of advisors is not to engage in conflicted business transactions with issuer clients. So that there is no confusion, the conflicts exist in the adversarial issuer-underwriter relationships that result from dealer resignations pursuant to the Rule. The resignations directly facilitate the creation of those conflicts between the issuers and their trusted advisors. Until the resignations are fully effective, the dealer-advisors remain just that—trusted nonadversarial advisors with duties affirmatively to advise their issuer clients, in the issuers' best interests, about conflicts of interest fundamentally affecting the relationships. In seeking the resignations, the dealers, *while still wearing their advisor hats*, are representing, implicitly, if not explicitly, to the issuer clients that the dealers are the best parties whom the issuers are able to employ as underwriters. That advice has anticompetitive characteristics, as well, because at times, it disadvantages more able underwriters.

Generally, until an advisory relationship is completely terminated, an advisor retains its duty affirmatively to advise the issuer client about the existence and the nature of material conflicts of interest implicated in the business transaction and relationship proposed by the financial advisor to the issuer client. The advisor violates its duty to the issuer-client by suggesting that conflicts of interest may not exist, when the conflicts definitely do exist.

Changes Needed in Rule G-23

In light of the deficiencies in MSRB Rule G-23 as it currently exists, NAIPFA respectfully strongly urges the following modifications to Rule G-23 with respect to negotiated municipal securities offerings:

4. Require that a dealer resigning from the role of financial advisor to an issuer in order to serve as underwriter for the subject offering, explicitly inform the issuer's policy makers in writing that there *are* (not "*may* be") conflicts of interest resulting from the fundamental change in roles, and the nature of those conflicts of interest;

5. Require that the dealer receives explicit formal consent from issuer's policy-makers to the fundamental changes in roles and acknowledgement of the conflicts of interest; and

6. Require, unless the issuer contemporaneously employs more than one financial advisor, that the advisory contracts between the dealer as advisor and the issuer-client be terminated completely.

Rule G-23 is an anachronism that requires significant policy modification. In the three decades since the original adoption of Rule G-23, there has been a continual improvement in the principles of honesty, and disclosure practices, in the municipal securities market and a greater awareness of the responsibilities that professionals owe to issuers, as well as investors. Rule G-23 has failed to maintain pace with those positive market developments.

Maturing Industry Products Blur Lines between Independent & Self-Serving Advice

Throughout the 30-year period since Rule G-23's adoption, there has been increased sophistication in the municipal financial transactions undertaken—swaps, caps, variable rate debt, *etc*. At the same time, there is a blurring of the roles of various service providers. For example, a dealer may serve as a "financial advisor" to a governmental issuer, but then become the seller of a swap to the issuer client, as well. When that occurs, the dealer's advice no longer is independent, but the issuer may not recognize that important change in the relationship. Rule G-23 speaks only to underwriter and remarketing agent relationships, and says nothing of those other types of roles, leaving the common law (and for that matter, the pending investigations) to deal with them.

During those 30 years, the vast majority of financial advisors, dealers and other professional firms involved in the municipal securities market have significantly improved their practices and their sensitivity to such complex issues.

Recognized Market Data Sources Evidence Need for Changes in Rule G-23

Despite recent publicity and a rash of investigations, only a small number of firms contradict that encouraging trend. That small number of firms is the principal problem. It is necessary to modify Rule G-23 because the tens of thousands of small and often unsophisticated municipal securities issuers—estimates are in the tens of thousands—are commonly unskilled in public finance and are highly dependent upon, and trust, their financial advisors. That trust should not be violated. Issuers need to know when their "financial advisor" is providing independent advice and, on the other hand, when services principally provide sales profits and a competitive advantage to the "financial advisor" advocating the sale.

NAIPFA fully understands that the Board reviewed Rule G-23 last winter and failed to take the necessary action to revise the Rule to eliminate the abuses that the Rule fosters. That was the wrong decision for the integrity of our market and the public's perception of it. NAIPFA once more respectfully requests that the MSRB review and amend Rule G-23.

In connection with that earlier request, NAIPFA provided the MSRB extensive lists from two recognized market data sources of literally many hundreds of transactions, often (if not always) reported by dealer firms themselves. Those lists from those recognized data sources establish clearly that a small number of dealers in limited regions of the country routinely serve as financial advisors and underwriters in the same transactions. The lists reflect that those practices occur repeatedly in large numbers of transactions each year.

Despite aggressive assertions arguing that the lists from those two recognized data sources somehow are not accurate,, no inaccuracy has been demonstrated in those data. Further, no explanation has been given as to why or how the transactions would have been reported systematically in so many transactions inaccurately by those dealers themselves (or anyone else) to both those data sources.

Current Market Scrutiny Supports Need for Changes in Rule G-23

The municipal securities market is now under substantial scrutiny, this time by the Justice Department, the Internal Revenue Service and the Securities and Exchange Commission with respect to allegations of conflicts of interest, collusion, illegal and hidden payments and other issues of honesty that have serious potential to damage our market. In such a context, the MSRB simply cannot fail to ignore the deeply troubling abuses that are accommodated by Rule G-23 in its present form.

The municipal securities market and municipal securities issuers deserve a market that is free from such disturbing conflicts of interest and even the appearance of such conflicts. Everyone in the market is tainted by the accommodation of these conflicts of interest and the public's perception of the manner in which the market operates. The damage that issuers suffer from conflicted advice is too great. The costs to issuers are too great.

Evidence of Harm to Issuers Supports Need for Changes in Rule G-23

Evidence provided by local governmental securities issuers supports the need for changes in Rule G-23. When NAIPFA first requested a review of Rule G-23, legal counsel to communities in

several states sent letters to the MSRB describing how the communities had been greatly damaged by the conflicts of interest of dealers serving as financial advisors and underwriters in the same transactions. Those conflicts of interest, which were not isolated occurrences, led the dealers to recommend transactions that were not in the best interests of those communities. Some communities lost hundreds of thousands, and even millions, of dollars

NAIPFA recognizes that a number of parties also sent to the MSRB what essentially were often form letters opposing changes in Rule G-23. Those letters, especially as form responses, demonstrate the strong hold that certain investment banking firms in certain regions of the country exercise over their clients pursuant to continuing financial advisory contracts that remain in effect, even while the dealers serve the issuers as underwriters.

The letters, generated by dealers who appear to wish to avoid full and accurate disclosure to their issuer clients, also demonstrate that sound bites, not analysis, formed the basis for those communications. Examples of those sound bites are enumerated in Appendix B to this letter.

Despite the inaccurate sound bites, dealers who intend to, or as a common business practice, resign as financial advisor in order to serve as underwriter or in another role that is not truly independent (and investors to whom the dealers owe fiduciary duties), do in fact have, in *every* transaction in which these practices are followed, direct and fundamental conflicts of interest with the dealers' issuer clients.

Conflicts of Interest between Underwriters and Issuers

The pervasive conflicts of interest between underwriters and issuers, resulting from the adversarial nature of underwriter-issuer relationships, require disclosure of material information to the policy-makers of affected issuers, when the dealers resign from financial advisory roles. Generally, consideration should be given to disclosures in at least in the following subject areas:

Financial Conflicts

- How much should the underwriter be paid? How does that compensation compare to compensation received by other underwriters?
- What are reasonable bond prices, discounts, premiums and bond yields? What is available elsewhere in the market?
- What expenses should be paid by the issuer? What expenses, and how much, would other underwriters expect to be paid?

Conflicts Relating to Bond Terms

- What is the security for the bonds? How will the proposed security affect future issuer flexibility, operations and financing plans?
- What are acceptable maturity structures and call provisions?
- What is acceptable coverage in revenue issues? What are acceptable additional bonds tests?

- How should other bond terms be resolved (*e.g.*, issuer covenants, representations and warranties, flows of funds)?

Procedural Conflicts

- Are the bonds best offered in negotiated or competitive sales? What are the relative advantages of a negotiated or competitive sale for the particular issuer and the particular offering?
- In a negotiated sale, is the underwriter the best qualified firm to utilize?
- What are the underwriter's capabilities to sell this particular bond issue?
- Is the underwriter actually selling the bonds, or is the underwriter merely passing the bonds to intermediaries who skim profits that the issuers could obtain through lower interest yields? If the bonds do not come to rest after the underwriter has finished its work, did the underwriter truly earn its compensation and perform adequately for the issuer? Who is available to evaluate and give the issuer's policy-makers nonconflicted, independent advice on the quality of the underwriter's work?
- Who should prepare the issuer's disclosure documents for which the issuer is "primarily responsible" and "ultimately liable,"—underwriter counsel whom the underwriter employs or parties with whom the issuer has a direct contractual relationship?
- How well do the issuer's policy makers understand the existence and nature of the conflicts of interest? Who is available to give the issuer's policy-makers nonconflicted, independent advice on such matters?

Additional Products

- When are investment contracts, interest rate swaps and other derivatives or other products advantageous for the issuer?
- What are suitable prices and pricing procedures for those products?
- Are there conflicts of interest inherent in the sale of those other products?
- What are the dealers' profits relating to those products?

Issuers Need Protections

More than ten years ago, the Securities and Exchange Commission emphasized its concerns about "disclosure of potential conflicts of interest and material financial relationships among issuers, advisers and underwriters … ."[1] Like investors, issuers deserve critical protections from the detrimental effects of conflicts of interest. We note that the securities laws protect sellers of securities, as well as purchasers.[2]

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[1] SEC Rel. 33-7049, 34-33741, 59 F.R. at 12748 (March 9, 1994).

[2] We note that SEC Rule 10b-5 prohibits, making, "in connection with the purchase … of any security,"

If the advice issuers are receiving from their purported "advisors" is not independent, issuers need to be told that is the case and need to be provided with material information regarding the specifics of how the issuers are disadvantaged.

Therefore, it is essential that an issuer's policy makers—the governing body or issuer officials with policy making authority to approve bond issues and their terms—be informed that conflicts of interest *definitely* exist from the moment that a dealer contemplates the potential for underwriting its advisory issuer client's bond issues or providing other noncompetitive services for which dealers will not be independent. That very contemplation is the precise point at which a dealer's interests begin to conflict seriously with the interests of the issuer client. From that point onward in the progression of the transaction, the issuer's policy makers need to be made aware that the issuer no longer is receiving advice from a completely disinterested advisor.

SEC Action Supports Need for Change in Rule G-23

The Securities and Exchange Commission has stated a disclosure principle strongly reinforcing the need for change in Rule G-23. Recently, the SEC rendered its decision in *In the Matter of Dolphin & Bradbury, Inc*.[3] That action underscores, in the paraphrased words of an SEC Staff member involved in the action, that "Municipal bond issuers and other transaction participants cannot just disclose to investors in bond offering documents that something might happen that will threaten the bonds when they know that it definitely will happen … ." [4] Issuers, as sellers of securities, should have corresponding protections.

Rule G-23 stands in stark contrast to the disclosure principle at the heart of the *Dolphin & Bradbury* decision. Rule G-23 allows dealers merely to inform issuers that a conflict "*may*" exist as a result of a resignation as financial advisor, when numerous serious and pervasive conflicts of interest *definitely* do exist in the issuer-underwriter relationships that are created, sometimes even while dealer-underwriters retain advisory contracts and titles. By accommodating incomplete, ambiguous and materially misleading "disclosure," Rule G-23 stands in direct contrast to that key disclosure principle inherent in the Commission's opinion in the *Dolphin & Bradbury* action.

This is no time for a lack of sensitivity to serious conflicts of interest issues in the market. This is no time for an important market organization—the MSRB—to accommodate less than the highest and best principles of honesty regarding disclosure of conflicts of interest.

For the reasons set forth above, NAIPFA respectfully re-asserts its request that the MSRB review and modify Rule G-23 to eliminate the abuses Rule G-23 accommodates.

> any untrue statement of a material fact [and omitting] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

[3] *In the Matter of Dolphin & Bradbury, Inc., et al*., SEC Rel. Nos. 33-8721, 34-54143 (July 13, 2006).

[4] Hume, "*SEC Enforcement Case Shows General Disclosure Not Enough*," The Bond Buyer Online (Apr. 27, 2004), paraphrasing comments of Mark Zehner.

APPENDIX A

EXCERPTS FROM FRANKEL PAPER

Dr. Frankel concludes in her paper that "This situation requires a change." She outlines her analysis of requirements applicable to conflicted financial advisors, as follows:

> Dealers, acting as principals, who advise clients have conflicts of interests. The dealers may at times give clients inappropriate advice even if they do not clearly violate the law. Such an advise may result in the sale to clients of securities or products that may not be in the clients' interest, or to sell clients securities or products at higher prices than others might offer. However, clients who receive the dealers' "advice" are not misled. They know that the advice is "sales advice" which salespersons provide prospective buyers. That advice is taken with a grain of salt, or is ignored altogether.
>
> But clients who receive advisers' advice, and who do not know that the advisers will resign and change their status to become underwriters ***with respect to the same transactions,*** have been misled. Those advisers had conflicts of interest ***while acting as advisers, even though they seemed to have no conflicts.*** In fact, these so-called advisers harbored conflicts from the first moment they began to serve as advisers. Their conflicts of interest are pernicious because they have expertise and information that the client lacks. As advisers, their expertise and information is offered to the clients for the clients' sole benefit. As dealers and underwriters, the expertise and information is used either for the sole benefit of the dealers and underwriters or in part for their benefit. Perhaps the dealers are not greedy and offer advice that may not harm the clients as much as the dealers could. But human nature being what it is we can assume that the dealers offer the clients the best deal for the dealers and not the best deal for the clients, unless the two deals are identical.
>
> Assume that the so-called "advisers" did not intend to resign and become dealers or underwriters. Assume that the idea occurred to them only later, after they had been hired as advisers. Even then, they may not change their position and become underwriters without explaining to the clients clearly that (1) as underwriters they are dealing solely as principals with their advisee-issuer clients, and (2) that they have conflicts of interest with the interests of the clients and (3) what the nature and extent of the conflicts may be. Unsophisticated clients might believe that these underwriters are still devoted fully to the clients' interest (especially so, if the advisory contracts remain in effect), while in fact the underwriters are not, and cannot be, so devoted. They are likely to prefer themselves to those of the clients. The conflict of interest taints their judgment. [Emphasis in original.]

* * *

Dr. Frankel adds:

> The third way in which the dealers can offer advisory services to municipal issuers is to offer the services first, then resign as advisers, and then put on their underwriter hats. Thus, the rule prohibits anyone from serving as adviser and dealer at the same time.
>
> The rule, however, allows dealers to do so sequentially with respect to the same transaction. They can advise first, and when they finish advising they can resign and become overnight

underwriters to perform the same transaction. They need only make disclosure to, and obtain consent of, some issuer official (not necessarily a policy maker). They need only disclose that a conflict of interest "may" exist, not that there actually is a conflict. They need not disclose the nature of the conflict or what it means for the issuer client.

Further, that metamorphosis can be achieved in an instant. Adviser finishes its advisory role and in the next minute it can offer services in a dealer or underwriter role. What effect could this change have on an issuer who is used to the adviser? My assumption is that with the right form of presentation the effect is zero. The issuer continues to view the adviser with trust that this adviser did not earn.

What are the consequences for the issuer of this "technicality"? An adviser to municipal issuers is expected to represent the issuers in their negotiations with the underwriters. In this case the "technicality" enables the adviser to represent himself and the issuer at the same time, and conduct the negotiations on both sides of the table. The more expert this adviser-underwriter is, the more helpless the municipal issuer becomes because the gap of expertise between the issuers and the adviser-underwriter becomes wider. There is no way in which most municipal issuers can examine the terms of the underwriting and bargain with the new-old underwriter who the day before was their trusted adviser on the same issuance. There is no way in which the citizens who are paying for this tainted arrangement can protect themselves from expert underwriters who wear the advisory clothes and negotiate for the citizens and for themselves at the same time.

* * *

According to Dr. Frankel:

A salesperson that appears in an adviser's clothes and acts as a consultant, gaining the issuer's trust, might retain the issuer's trust even after changing his status into a salesperson who would benefit from getting the brokerage business. That occurs even though, as adviser, he advises the issuer about the dealers and underwriters that the issuer should employ. Personal trust and confidence in a relationship lingers on, even when the adviser reappears in another capacity. Thus, acting in the capacity of an adviser, a salesperson can gain the issuer's deeper trust. After he "resigns" and reappears the next moment as an underwriter he has a good chance of gaining the business about which he advised the issuer.

Issuers might question the true commitment of underwriters that introduce themselves as independent advisers first, and then change their status to that of underwriters. But these so-called advisers do not represent themselves as potential underwriters. They represent themselves first as advisers to be entirely trusted, without any suspicion of conflicting interests. Once the relationship is established, unsophisticated issuers cannot easily reduce their reliance. The personal trust in the relationship takes over. Then, and only then, do these so-called advisers change their status to become the dealers and underwriters.

APPENDIX B

INACCURATE SOUND BITES

The following are among the inaccurate sound bites expressed in letters generated by conflicted dealers in opposition to changes in Rule G-23 to require accurate and meaningful disclosure:

- *Inaccurate sound bite:* Rule G-23 already requires "full disclosure."

  Correction: As this letter demonstrates, that simply is not the case. Rule G-23 actually accommodates the provision of materially misleading information by dealer-advisors to issuers, allowing dealers to suggest, through ambiguous purported "disclosures," that conflicts of interest *may not* exist. The Rule also fails to require disclosure to issuers' policy makers. It does not require that issuers be informed of the nature or the extent of the very real conflicts, particularly with the complex roles that may be present in a given transaction.

- *Inaccurate sound bite:* Changes in Rule G-23 would reduce or restrict issuer choices.

  Correction: Disclosure would instead enable issuers to make materially informed choices about their advisors and underwriters. Issuers would remain fully able to employ any financial advisors and underwriters they wish.

- *Inaccurate sound bite:* Changes in Rule G-23 would increase costs for issuers.

  Correction: Disclosure by dealer-advisors who utilize such practices would do nothing to increase issuer costs. Elimination of conflicts of interest and abuses would instead reduce issuer costs and increase issuer flexibility and protections.

- *Inaccurate sound bite:* Changes in Rule G-23 would prevent dealer-advisors from underwriting their clients' bond issues, from bidding in competitive bond sales, or from engaging in private placements.

  Correction: The modifications for which NAIPFA is arguing would require disclosure of material information to and consents of issuer policy makers, but would not prohibit any of those activities.

- *Inaccurate sound bite:* Requiring disclosure to issuers would regulate issuer policy options.

  Correction: Again, the modifications for which NAIPFA is arguing would require disclosure of material information to and consents of issuer policy makers. By informing issuers, disclosure would enhance and result in more informed issuer policy choices. No restrictions whatsoever would be placed upon issuers.

- *Inaccurate sound bite:* Because NAIPFA members, as independent financial advisors, compete with dealer advisors, NAIPFA members are seeking to prevent dealers from serving as financial advisors.

  Correction: Nothing proposed by NAIPFA would restrict or inhibit dealers in any manner whatsoever from serving honestly as financial advisors rendering independent advice. That independent advice, in contrast to conflicted advice, would benefit issuers significantly. Further, dealer-advisors would remain completely free, subject only to a requirement of material disclosure and consents, to resign in order to underwrite their issuer clients' securities.

- *Inaccurate sound bite:* Independent financial advisors are not regulated, so the serious abuses against issuers that Rule G-23 accommodates should be ignored.

  Correction: This assertion is wholly unrelated to the question of whether dealer-advisors should be permitted by an MSRB Rule to make materially misleading statements to their issuer clients or to operate with undisclosed conflicts of interest. In fact, financial advisors who also provide investment advice, or who serve as broker-dealers, are regulated in those capacities. Moreover, financial advisors, as advisors to issuers, are subject to the securities laws and common law responsibilities, and a number (who are not, NAIPFA is happy to say, members of NAIPFA) have been the subject of Securities and Exchange Commission actions. If opponents of change to Rule G-23 wish for Congress to regulate independent financial advisors still further, they are free to ask Congress to do so.

  In any case, taking its own affirmative action, NAIPFA many years ago established rules and requirements applicable to its members. NAIPFA administers tests and imposes qualifications for, and certifies, qualified independent public finance advisors, known as Certified Independent Public Finance Advisors ("CIPFAs"). NAIPFA also requires that those CIPFAs participate regularly in continuing education in order to maintain their CIPFA status, and conducts annual substantive conferences to educate our members and to enhance our professionalism. Further, as already noted NAIPFA members have agreed voluntarily not to engage in pay-to-play practices.

NATIONAL ASSOCIATION OF
INDEPENDENT PUBLIC FINANCE ADVISORS

BOARD OF DIRECTORS RESOLUTION ON
MUNICIPAL SECURITIES RULEMAKING BOARD RULE G-23

WHEREAS, underwriters of municipal securities are direct purchasers of those securities from the governmental issuers thereof; and

WHEREAS, the interests of the underwriters of municipal securities are directly and materially adverse to and conflict materially and fundamentally with the interests of issuers in every negotiated municipal securities offering; and

WHEREAS, in negotiated offerings, the underwriters are directly and materially adverse parties to the issuers pursuant to complex bond purchase agreements negotiated between issuers and underwriters; and

WHEREAS, underwriters have interests that are directly and materially adverse to the interests of the issuers in many areas involved in the financing transactions underwritten by the underwriters, including without limitation, purchase price, interest rates, prepayment provisions, security and other terms; and

WHEREAS, underwriters sell those securities to investors, and commonly have fiduciary responsibilities to those investors; and

WHEREAS, investors, who are served by underwriters, also have interests that are directly and materially adverse to the interests of issuers in many areas involved in the financing transactions underwritten by the underwriters, including without limitation, purchase price, interest rates, prepayment provisions, security and other terms; and

WHEREAS, significant and substantial evidence has been provided to the Municipal Securities Rulemaking Board demonstrating serious repeated abuses by dealers of Rule G-23; and

WHEREAS, Municipal Securities Rulemaking Board Rule G-23 allows dealers to serve issuers as financial advisors and then to resign from that status in order to serve as underwriters in the same transactions, while merely informing issuers that "there *may* be a conflict of interest in changing from the capacity of financial advisor to purchaser of or placement agent for the securities with respect to which the financial advisory relationship exists;" and

WHEREAS, in the context of such resignations by dealers from the roles of issuers' financial advisors to serve in the roles of underwriters of the issuers' securities in negotiated offerings, there *definitely* are material and fundamental conflicts between the interests of the underwriters and the interests of the issuers; and

WHEREAS, changes in roles from issuers' financial advisors to those of underwriters with important and direct pricing and other interests directly adverse to the interests of the issuers are material and fundamental changes in the relationships between issuers and dealers; and

WHEREAS, information regarding material and fundamental changes in roles is material information requiring disclosure to issuers under federal and state securities laws by dealers resigning as financial advisors; and

WHEREAS, Rule G-23 permits underwriters, through vague and ambiguous statements facilitated by Rule G-23, to suggest to issuers of municipal securities that conflicts of interest *may not* exist in connection with the material and fundamental change in roles; and

WHEREAS, it materially misleads issuers, as sellers of such securities, when there is a suggestion to the issuers that conflicts of interest *may not* exist when they *definitely* do exist; and

WHEREAS, Rule G-23 therefore permits dealers to mislead issuers materially in the context of such resignations and material and fundamental changes in roles; and

WHEREAS, it is unseemly, and a violation of the public policy purposes for which the Municipal Securities Rulemaking Board was created, for the Board to permit, and even to facilitate, through the dealer self-regulatory process, such materially misleading statements to issuers;

NOW, THEREFORE, BE IT RESOLVED, that the National Association of Independent Public Finance Advisors ("NAIPFA") respectfully asserts once again that it is absolutely essential for the Municipal Securities Rulemaking Board to amend its Rule G-23 to require that dealers resigning from the role of issuers' financial advisors in order to serve as underwriters in negotiated municipal securities offerings explicitly inform the issuers' policy-makers that there *definitely* are conflicts of interest resulting from such changes in roles and to require that the dealers receive explicit consents from such issuer policy-makers to such material and fundamental changes in roles and to such direct underwriter conflicts of interest; and

BE IT RESOLVED FURTHER, that NAIPFA continues to urge the Securities and Exchange Commission, the National Association of Securities Dealers, Inc., and the Municipal Securities Rulemaking Board to review the MSRB's Rule G-23, interpretations thereunder, and enforcement thereof, to prevent and remedy abuses of the relationships of dealers with issuers.

Adopted by the Board of Directors of the National Association of Independent Public Finance Advisors on October 4, 2006

"Let Me Advise You on How Much to Pay Me." Subverting Fiduciary Duties and Rules

Tamar Frankel[•]

Approximately 50,000 local governments and districts finance their projects and expansion by issuing municipal bonds, which are generally tax-exempt.[1] Some of these bond issuers, such as the cities of New York or Chicago, are represented by sophisticated finance personnel. These staff members understand well how these markets work and what the function and cost of underwriters are. But thousands of these bond issuers are small municipalities, school districts or water districts that do not have the sophisticated staff to design their bonds and evaluate the underwriters or their sales pitches.

The municipal bonds market has unique features. The market and the issuance are not regulated as any other public issuance of bonds. They are subject to a special regulatory regime.[2] In addition, these bonds are tax exempt, and attract investors who seek such bonds. Underwriters or dealers engage in buying the bonds, selling the bonds to investors, and often offering the investors liquidity by acting as dealers. Thus, underwriters and dealers play a significant role in this market. While the markets and the ways they function are becoming more complex, the small issuers of these bonds are the same small government units as in the past. The people who pay the added costs or fees or bear the unfavorable terms of the bonds are the citizens of the small municipalities, school districts or water districts and the like. It is not surprising that the underwriters and dealers in these bonds are interested in controlling such issuers. They are not interested that a sufficiently sophisticated adviser would represent these issuers in the sole interests of these issuers.

Such a group of knowledgeable and uninterested advisers has emerged throughout the years. This group of consulting advisers can guide these issuers through the complexity of issuing their bonds. The difference between these advisers and "advisers" who are related to dealers or underwriters is that these uninterested advisers do not serve in any capacity except as advisers. They do not underwrite the bonds nor have connection with any of the dealers or underwriters of the bonds. Not surprisingly, these advisers have the power to preclude certain dealers or underwriters from consideration, if the underwriting charges are too high, bond terms are unfavorable to the issuer, or services

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[1] Lisa M. Fairchild & Nan S. Ellis, *Municipal Bond Disclosure: Remaining Inadequacies of Mandatory Disclosure Under Rule 15c2-12,* 23 IOWA J. CORP. L. 439, 440 (1998) ("Over 1.5 million distinct issues are sold by more than 50,000 different state and local government entities.").

[2] Issuers of municipal bonds are generally exempt from the filing and disclosure requirements of the Securities Act of 1933. 15 U.S.C. § 77c(a)(2) (Supp. IV 2004). Municipal securities brokers and dealers are regulated by the Municipal Securities Rulemaking Board (MSRB). 6 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3103.39-.42 (3d ed. 2002). In addition, the Government Accounting Standards Board (GASB) promulgates voluntary accounting principles for municipalities. 3 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1172 (3d ed. 1999). Rule 15c2-12 under the Securities Exchange Act of 1934 generally imposes further disclosure requirements on a broker or dealer acting as underwriter in a primary offering of municipal securities of $1,000,000 or more. 17 C.F.R. § 240.15c2-12 (2005).

are inadequate. Many of the consulting advisers are members of the National Association of Independent Public Finance Advisers (NAIPFA).Some dealers offer independent advisory services. Not surprisingly, however, dealers have a strong incentive to perform both the advisory and the underwriters' functions. In such a case even if they compete among themselves, there are usually no price wars among retail or wholesale dealers. Rather, they wage their wars on accessing the issuers, and maintaining the clients' personal contacts and dependence.

To be sure, even unsophisticated issuers understand the difference between a salesperson's advice and a professional adviser's advice. At least at the beginning of the relationship, the issuer will treat a salesperson differently, because it is clear at that point that the sales talk is tilted to induce sales for the benefit of the salesperson. Advice, in contrast, is designed to benefit the issuer because an adviser has no personal interest except to increase the well-being of the issuer.

The practice in this area, however, is a combination of the two modes of services. Some dealers and underwriters approach issuers as advisers, and design the bond issues and the terms of the bond distributions. Thereafter, however, some of them resign as advisers and reappear as dealers and underwriters for the same bond issue that they designed as advisers and the same issuers that they served as advisers. This metamorphosis produces serious conflicts of interest not only when the change occurs but at the start of the process.

A salesperson that appears in an adviser's clothes and acts as a consultant, gaining the issuer's trust, might retain the issuer's trust even after changing his status into a salesperson who would benefit from getting the brokerage business. That occurs even though, as adviser, he advises the issuer about the dealers and underwriters that the issuer should employ. Personal trust and confidence in a relationship lingers on, even when the adviser reappears in another capacity. Thus, acting in the capacity of an adviser, a salesperson can gain the issuer's deeper trust. After he "resigns" and reappears the next moment as an underwriter he has a good chance of gaining the business about which he advised the issuer.

Issuers might question the true commitment of underwriters that introduce themselves as independent advisers first, and then change their status to that of underwriters. But these so-called advisers do not represent themselves as potential underwriters. They represent themselves first as advisers to be entirely trusted, without any suspicion of conflicting interests. Once the relationship is established, unsophisticated issuers cannot easily reduce their reliance. The personal trust in the relationship takes over. Then, and only then, do these so-called advisers change their status to become the dealers and underwriters.

When issuers recognize that a conflict of interest exists at the outset, the issuers are less likely to rely on the salespersons, and more likely might to seek additional independent opinion. But if the issuers do not recognize a conflict of interest, they are more likely to rely on the advice. In sum, advisers who plan to become dealers and

underwriters misrepresent who they truly are and defraud the issuers into trusting that is not justified.[3]

The conflict between independent advisers and the underwriters and dealers has been fierce and politicized. For example, a South Carolina legislator proposed to require "municipal bond issuers in the state to use only dealers, and not independent firms, as financial advisers."[4] "The [proposal] was ostensibly designed to ensure that state and local issuers would use only firms that are knowledgeable and qualified in the financial advisory business."[5] Clearly it would have given the dealers the exclusive monopoly in this market and would have excluded independent advisers from the market. Having caused a "furor," the proposal was withdrawn.

However, "NAIPFA recently lost a bid to get the MSRB to overhaul its Rule G-23 on dealer-financial advisers, which it claimed was being circumvented by dealers in some states. The rule allows a dealer-FA to resign as FA and serve as underwriter on the same bond deal as long as the dealer discloses potential conflicts of interest to the issuer and gets the issuer's permission for the role switch. The disclosure does not include disclosure about actual conflicts of interests nor the nature and extent of these conflicts. Moreover, the rule does not require that the disclosure be made to the issuers' policy makers or that those policy makers consent to the fundamental change in roles of the adviser to a dealer or underwriter. The rule does not require resignation and termination of the relationship between the issuer and the so-called adviser turned dealer. The rule requires only termination of the relationship with respect to specific, but allows advisory relationship to continue with respect to other transactions. . Thus, the rule allows the dealers to be clothed simultaneously in two sets of garments. The same dealers can be advisers who have no relationship to dealers and underwriters and dealers. They can thus have no relationship to themselves which they obviously do. Needless to say, this is a very confusing situation for unsophisticated issuers. In f act, this is confusing for sophisticated issuers as well. Dealers opposed any changes to the rule, and MSRB decided in February of 2006 that "revisions were not warranted at the time." [6] The Board offered no explanation for this decision. Arguably, MSRB could be influenced by dealers because the membership of the board includes some dealers.[7] But I will assume that that these

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[3] See generally, Tamar Frankel, *TRUST AND HONESTY, AMERICA'S BUSINESS CULTURE AT A CROSSROAD* 59-78 (2006).

[4] Lynn Hume, *SC Lawmaker Defuses Furor over Financial Advisers,* BOND BUYER, May 19, 2006, LEXIS, News Library, Curnws File; Lynn Hume & Tedra DeSue, *Bill Would Promote Dealer FAs,* BOND BUYER, Apr. 24, 2006, LEXIS, News Library, Curnws File.

[5] Lynn Hume, *SC Lawmaker Defuses Furor over Financial Advisers,* BOND BUYER, May 19, 2006, LEXIS, News Library, Curnws File ("The amendment, which drew strong opposition from the National Association of Independent Public Finance Advisors and added fuel to the group's fight with dealers over the Municipal Securities Rulemaking Board's Rule G-23, stated: 'Only a municipal securities broker or dealer may provide financial advisory services to issuers.' Issuers were defined as any state or local political divisions or subdivisions in South Carolina.").

[6] *Id.*

[7] Municipal Securities Rulemaking Board, *About the Board,* http://www.msrb.org/msrb1/whatsnew/default.asp (last accessed Nov. 6, 2006) ("The Board consists of 15

dealers are concerned about the integrity of the municipal bonds markets and have no conflicts of interest in this matter.

The legal status of advisers who convert to dealers and underwriters

Fiduciaries and sales persons: Misleading mixed status. The world of advisers is varied and their liabilities and responsibilities differ.[8] While definitions of fiduciaries differ, all definitions describe fiduciaries as persons or organizations which are entrusted with power or property. Let us call those that entrust fiduciaries with power or property "entrustors." The power can be the power of expertise, or power to bind others to legal liabilities, or power to offer advice on which others must rely, by the nature of the relationship.

Why would anyone entrust others with power or property? The answer is that our country's prosperity is built on trust and specialization. If we could not trust the food prepared by others, the houses built by others, the advice of the doctors and lawyers and investment consultants, we would have to do all things ourselves and learn all professions ourselves. Since no one can do all this in a lifetime each of us would have to focus on the essentials to survive: food and shelter. The rest of the services would not be offered or received. Reliance on others is essential to our standard of living and way of life. Reliance on others, however, does not mean trusting others under all circumstances. We can rely and yet check the truth of what others say and performance of others' promises. And in some cases we can indeed do that with little effort. When buying a newspaper we can check the name and date of the paper and pay for it in an immediate exchange for paper. But if we wish to know how to invest our life savings reliance cannot be accompanied by verification. We must rely and trust the organizations that give us advice. That is sometimes because we lack the expertise of the advisers, and because acquiring the expertise is costly and time-consuming.

It must be emphasized, however, that before we hire an adviser our bargaining power is greater than, or at least equal to, that of the adviser. After all, the adviser depends on us for its livelihood. But after the deal is struck, and after I decide to rely on the advice, the balance of power changes. I must rely on the advice or pay anyway. My weakness vis-à-vis the adviser stems from the very nature of our relationship. Without trust the advice cannot be used at all. Even experts might wish to hire advisers if the experts are engaged in other activities. To examine the advice would undermine the very utility of the relationship.

Public policy is designed to support some services, such as lawyers' services, medical treatment, teaching, and investment advice. Hence, the law supports the trust in, and reliance on, advisers by imposing fiduciary duties on advisers. Not all advisers are

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members- five representatives of bank dealers, five representatives of securities firms, and five public members not associated with any bank dealer or securities firm.").

[8] *See generally* Tamar Frankel, *Fiduciary Law,* 71 CAL. L. REV. 795 (1983); Robert W. Doty, *Issues in Debt Management,* GOV. FIN. REV., Aug. 1, 2001, at 38.

required to follow the same duties. The existence of the status and consequent duties are linked to the nature, complexity, and seriousness of the services.

Advisers to small municipalities and government districts should be bound to a high level of duties within the scope of the employment for a number of reasons. First and foremost, those who make the decision whether to engage an adviser in connection with the issuance of municipal bonds are themselves fiduciaries. They represent the populations of the municipalities and districts. The money they are raising and spending is not their money. It is the power and money of the residents of the municipalities and districts, who have voted for the government representatives. These representatives were entrusted with power to raise funds and use the funds for the benefit and better life of the residents. Thus, these leaders of the communities are required and expected to do the best for their communities: receive the best advisory services for the least amount of cost. Further, the leaders must select the advisers who are most trustworthy and qualified. That is especially so when the leaders are not experts in the design of bonds, the markets for the bonds and the cost of distributing the bonds.

Second, advisers who help such leaders must follow strict fiduciary duties. By definition, being advisers renders them fiduciaries, regardless of how sophisticated their clients are.

Third, fiduciary duties differ from the contract duties. That difference exists even though both contract and fiduciary relationships are based on the consent of both parties. No one may force the fiduciary and entrustor, or the parties to a contract, to enter the relationship. Besides, most contracts involve some degree of trust. The difference, however, is crucial. In contract the parties understand that they have conflicting interests even as they desire to enter into a relationship. A seller wants the most for his product and the buyer wants to pay the least for the product. The seller may want to be relieved of any guarantee as to the quality of the product, while the buyer may require a guarantee. And so on.

Fiduciary relationships are based on an entirely different understanding. **With respect to the entrusted property or power** the parties understand that the fiduciary acts for the sole benefit of the entrustor. The adviser may not give advice which benefits the adviser. The adviser has an affirmative duty to advise the client and act in the in the client's best interests. The money manager may not manage the entrustor's assets that benefits the adviser. The doctor may not perform an operation except for the sole benefit of the patient. The lawyer may not handle the client's legal affairs except in the client's best interests.

There are two exceptions to this rule. One exception is by the law that permits the fiduciary to benefit from the relationship. The second exception is by the entrustor that permits the fiduciary to benefit from the relationship. That permission is valid only after the fiduciary provides the entrustor with full information. Under some circumstances the adviser may not benefit even if the entrustor agrees to the benefits. There is no exception

for those who masquerade as advisers free of conflicts of interest if in fact they do have such conflicts in mind. These advisers are gaining the clients' trust by deceit.

Dealers' advice offers a good example. Dealers, acting as principals, who advise clients have conflicts of interests. The dealers may at times give clients inappropriate advice even if they do not clearly violate the law. Such an advise may result in the sale to clients of securities or products that may not be in the clients' interest, or to sell clients securities or products at higher prices than others might offer. However, clients who receive the dealers' "advice" are not misled. They know that the advice is "sales advice" which salespersons provide prospective buyers. That advice is taken with a grain of salt, or is ignored altogether.

But clients who receive advisers' advice, and who do not know that the advisers will resign and change their status to become underwriters ***with respect to the same transactions,*** have been misled. Those advisers had conflicts of interest ***while acting as advisers, even though they seemed to have no conflicts.*** In fact, these so-called advisers harbored conflicts from the first moment they began to serve as advisers. Their conflicts of interest are pernicious because they have expertise and information that the client lacks. As advisers, their expertise and information is offered to the clients for the clients' sole benefit. As dealers and underwriters, the expertise and information is used either for the sole benefit of the dealers and underwriters or in part for their benefit. Perhaps the dealers are not greedy and offer advice that may not harm the clients as much as the dealers could. But human nature being what it is we can assume that the dealers offer the clients the best deal for the dealers and not the best deal for the clients, unless the two deals are identical.

Assume that the so-called "advisers" did not intend to resign and become dealers or underwriters. Assume that the idea occurred to them only later, after they had been hired as advisers. Even then, they may not change their position and become underwriters without explaining to the clients clearly that (1) as underwriters they are dealing solely as principals with their advisee-issuer clients, and (2) that they have conflicts of interest with the interests of the clients and (3) what the nature and extent of the conflicts may be. Unsophisticated clients might believe that these underwriters are still devoted fully to the clients' interest (especially so, if the advisory contracts remain in effect) , while in fact the underwriters are not, and cannot be, so devoted. They are likely to prefer themselves to those of the clients. The conflict of interest taints their judgment.

The same issue has risen on a large scale in other contexts. When financial planners offered their free planning and collected commissions from any sale of financial products, which they advised the clients to buy, the Securities and Exchange Commission held that these financial planners were advisers, and required them to register as advisers under the Advisers Act of 1940.[9]

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[9] Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092, 1987 SEC LEXIS 3487 (Oct. 8, 1987) (footnote omitted):

The story of Mark Ferber demonstrates the argument.[10] "Mark Ferber, an ex-partner at Lazard Freres, was convicted on 56 counts of fraud and corruption. Ferber failed to disclose a $1 million retainer and fee-splitting agreement that he had with Merrill Lynch to steer clients to Merrill's services."[11]

The conflict between fiduciary law and contract law was debated in this case.

> For some, the Ferber issue was incredibly clear. . . . Financial advisers should act in a fiduciary capacity for their public clients. For others, the issue is murkier. They argue that, in the absence of a demonstrable monetary loss due to fraud, the financial adviser owes the issuer nothing other than what is in the contract. That is, to give stipulated services no matter what might be the mix of loyalties and sources of remuneration.[12]

The contract argument considers the transaction a sale of advice. What the contract argument does not take into consideration is the price that the clients pay for the tainted advice, as much as any clients pay for advice that is tainted with bribery. The service provider, who paid $1 million to get this and other deals, is willing to charge for its services the amount it received from the clients **minus** the $1 million it paid to the bribed fiduciary. The clients pay more than they would have paid had their adviser refrained from receiving the bribe and bargained with the service provider. The clients are harmed to the tune of $1 million, which was diverted to the adviser. Therefore, the adviser did not perform as promised. He recommended a provider that charged more than it would otherwise have. The adviser was not a good adviser after all.

> As a general matter, if the activities of any person providing integrated advisory services satisfy the elements of the definition, the person would be an investment adviser within the meaning of the Advisers Act . . . . A determination as to whether a person providing financial planning, pension consulting, or other integrated advisory services is an investment adviser will depend upon whether such person: (1) provides advice, or issues reports or analyses, regarding securities; (2) is in the business of providing such services; and (3) provides such services for compensation.

See also Certain Dealers Deemed Not to Be Investment Advisers, Investment Advisers Act Release No. 2376 (Apr. 12, 2005), 70 Fed. Reg. 20,424 (Apr. 19, 2005) (to be codified at 17 C.F.R. § 275.202(a)(11)-1(b)(2) (generally denying financial planners exception from Advisers Act registration for "a broker dealer providing advice that is solely incidental to its brokerage services" is excepted from the Advisers Act from Advisers Act registration for broker dealers") .

[10] John E. Petersen, *A Cleaner, Leaner, Meaner Municipal Market,* GOVERNING MAG., Nov. 1996, at 57, LEXIS, News Library, Arcnws File.

[11] *Id.*

[12] *Id.*

In addition, such an adviser is generally unreliable. If he collects bribes in one way or another, by direct favors or by reciprocating for other favors that it received, all these valuable favors are paid at the expense of the clients, in one way or another.

The current scene in the municipal bonds market. Our citizens pay for tainted advice. Rule G-23.

> "[T]he prevailing norm in many areas is for the financial adviser to first advise and then to resign and underwrite the securities or for advisers to also serve as providers of investments. Advisers who play both sides of the market insist that their constant involvement in various parts of the transactions gives them superior skills and information. But advisers who are independents (and only serve as advisers) argue that rotating roles leave the firms vulnerable to conflicts as they are in the position of selecting or being selected by firms with whom they variously compete and cooperate. Rule G-23 of the MSRB allows firms to act in both capacities but not at the same time on the same transaction. Of course, being able to look forward to making money on the underwriting or on the investment agreement (where money-making occurs after the firm has ceased to serve as the adviser) allows the firm to price its advisory services very reasonably. That, of course, can be an effective way to block out competition from those who are only paid for the rendering of advice.[13]

Rule G-23 was established in the early 1970s.[14] The rule's "purpose and intent" was "to establish ethical standards and disclosure requirements for brokers, dealers, and municipal securities dealers who act as financial advisors to issuers of municipal securities."[15] Thus under the rule financial advisers could act as dealers with respect to the advice that they give. In the area of advisory services, financial planners who advise clients on their asset allocation and asset choices offer their advice free and receive their compensation by commissions based on the transactions that they recommend. However, these financial planners must register as advisers under the Advisers Act of 1940. This registration subjects them to disclosure requirements before the engagement as advisers,[16] to fee constraints,[17] as well as to criminal sanctions for misleading and fraudulent activities.[18]

Under rule G-23, there are three ways in which dealers can serve as financial advisers to municipal issuers. One way is for dealers to offer financial advisory services

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[13] *Id.*
[14] *In re* Mun. Sec. Rulemaking Bd., Securities Exchange Act Release No. 15,247, 1978 SEC LEXIS 515 (Oct. 19, 1978).
[15] Rule G-23(a), MUN. SEC. RULEMAKING BD. MANUAL (BNA), ¶ 3611, at 5052, 5052 (July 1999).
[16] 15 U.S.C. § 80b-6(4) (2000); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194, 200 (1963) (citing statute).
[17] 15 U.S.C. § 80b-5(a)(1) (2000) (prohibiting performance fees).
[18] 15 U.S.C. § 80b-6 (2000) (prohibiting fraud); 15 U.S.C. § 80b-17 (2000) (providing for criminal sanctions).

without offering underwriting services. This relationship avoids or minimizes conflicts of interest.

The second way is to offer underwriting services, and in the course of those services to offer advice. In this case the dealers wear their underwriter hats but not the advisers' hats.

The third way in which the dealers can offer advisory services to municipal issuers is to offer the services first, then resign as advisers, and then put on their underwriter hats. Thus, the rule prohibits anyone from serving as adviser and dealer at the same time.

The rule, however, allows dealers to do so sequentially with respect to the same transaction. They can advise first, and when they finish advising they can resign and become overnight underwriters to perform the same transaction. They need only make disclosure to, and obtain consent of, some issuer official (not necessarily a policy maker). They need only disclose that a conflict of interest "may" exist, not that there actually is a conflict. They need not disclose the nature of the conflict is or what it means for the issuer client.

Further, that metamorphosis can be achieved in an instant. Adviser finishes its advisory role and in the next minute it can offer services in a dealer or underwriter role. What effect could this change have on an issuer who is used to the adviser? My assumption is that with the right form of presentation the effect is zero. The issuer continues to view the adviser with trust that this adviser did not earn.

What are the consequences for the issuer of this "technicality"? An adviser to municipal issuers is expected to represent the issuers in their negotiations with the underwriters. In this case the "technicality" enables the adviser to represent himself and the issuer at the same time, and conduct the negotiations on both sides of the table. The more expert this adviser-underwriter is, the more helpless the municipal issuer becomes because the gap of expertise between the issuers and the adviser-underwriter becomes wider. There is no way in which most municipal issuers can examine the terms of the underwriting and bargain with the new-old underwriter who the day before was their trusted adviser on the same issuance. There is no way in which the citizens who are paying for this tainted arrangement can protect themselves from expert underwriters who weak the advisory clothes and negotiate for the citizens and for themselves at the same time.

This situation requires a change. One change can be achieved by media disclosure. Let the citizens of the various municipal districts be aware of the fact that their representatives trust the salespersons as if they were true advisers rather than sales-advisers. Let the citizens demand of their representatives to impose conditions on their advisers and refuse to consent to their conversion into underwriters. When dealers provide advice, the representatives of the public must understand that the advice is tainted with conflicts of interest.

Another change can be achieved if the citizens demand that the Board amend rule G-23 to preclude this deceptive and confusing practice. For example, an adviser who will become an underwriter must notify the issuer in advance of such a possibility at the outset of the relationship and of the conflicts that will result from the changing status, and is disqualified from so underwriting if it failed to give such advance notice. Or barring a notice, the adviser should be disqualified for a specified period from the date on which the services were provided with respect to the same transaction or issuance. There may be other ways in which the issue could be addressed. The point of this paper is to make it clear that the current situation presents unacceptable conflicts of interest, which can be very costly to the citizens of many small towns and districts. Their trust in their advisers should be justified. Their advisers should be true advisers.