

NAIPFA Discussion Paper on MSRB Call for Regulation of FA's

Drafted March 16, 2009

Municipal Market Background:

On January 9, 2009 the New York Times ran an article about the IRS spending an enormous amount of time over the last two years investigating municipal bond price fixing. On the same date, the Municipal Securities Rulemaking Board (MSRB) released a statement regarding regulation of the municipal market concerning "continuing allegations" of behavior by certain participants. An appearance of impropriety taints the market and causes concern about how the municipal market is regulated. The MSRB specifically mentions political contributions and the fact that "pay to play" limitations do not apply to unregulated market participants. The MSRB "strongly recommends... financial advisors, GIC brokers and other unregulated participants be placed under federal regulation."

In the February 10, 2009 staff report from House Committee on Financial Services they report on page 8 they will investigate the effectiveness of SRO's in light of today's market. On page 10 they indicate that the Committee will examine how different segments of the market are regulated including the role of independent financial advisors, including those involved in derivative transactions and disclosure requirements.

On February 11, 2009 the MSRB recommended comprehensive rules for unregulated intermediaries in the municipal market to seek and promote investor confidence. They recommend that financial advisors and investment brokers be subjected to regulation that: (i) prohibits fraudulent and manipulative practices, (ii) requires fair treatment of investors and issuers, (iii) ensures standards of professional qualifications, and (iv) promotes market efficiencies and use of a market-funded, as well as use a market specific Self Regulating Organization (SRO) along with certified standards under federal securities law.

On March 11, 2009, the Bond Buyer reports that the Senate Banking Committee took testimony yesterday on the MSRB's proposal to expand regulation of the municipal market. Thomas Moe, CEO of MMA and a former MSRB member advocated the end of "self regulation" in the municipal market and suggested that the MSRB become merged with the SEC and expand its regulation to other market participants. The MSRB defended its current status.

NAIPFA Overview

NAIPFA History of Professional Standards	NAIPFA is a professional organization of Independent Public Finance Advisors and similar to the MSRB has: <ul style="list-style-type: none">• A political contribution policy similar in form to G-37• Testing• Certification• Continuing education requirements
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<p>Independent Public Financial Advisor (IPFA) have responsibility to represent the issuers best interests</p> <p>NAIPFA needs to take a position</p> <p>Basis for regulation should be IPFA relationship with issuer to provide “Public Financial Advice”</p> <p>Dealers serve different roles, have different responsibilities, have different public entity relationship</p>	<p>NAIPFA is celebrating our 20th anniversary. We also understand however that not all Public Financial Advisor’s are NAIPFA members since some firms do not qualify to be NAIPFA members.</p> <p>Independent Public Financial Advisors owe their clients a duty of undivided loyalty and utmost good faith. They have a fundamental obligation to act in the best interests of their clients who are public entities.</p> <p>NAIPFA recognizes that times have changed and lawmakers are looking at unregulated market participants. While we are opposed to regulation, we also understand that if Congress determines Independent Public Financial Advisor’s should be regulated that NAIPFA wants and needs to be involved in regulatory discussions.</p> <p>Public Financial Advisor’s have an “advisory” relationship with a public entity and provides public finance advice that:</p> <ul style="list-style-type: none"> • Assists the public entity to make an informed public finance decision and • The outcome of the public finance decision benefits the public entity. <p>For debt issuance, the Public Finance Advisor provides advice to the public entity on various ways the public entity can sell debt to the market place (competitive or negotiated sale) and from the public entity’s perspective, the best possible debt terms. Public Finance Advisor’s do not sell a specific product like an unregulated single family housing broker or municipal market broker-dealer. Public Financial Advisors are also not advising on the purchase of a security.</p> <p>Overview: GFOA, which represents public entities(public bodies and/or non-profit organizations) who issue debt:</p> <ul style="list-style-type: none"> • Has thousands of members • Has developed recognized “Best Practices” that have been vetted by their members • Recognizes role of the Public Finance Advisor • Recognizes the value an Public Finance Advisor provides • Recognizes that a conflict “does” exists between the role of the Public Finance Advisor and the broker-dealer • This is unlike the MSRB that believes a conflict “may” exist
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<p>Inherent IPFA's/ broker-dealer conflicting interests can not be regulated within same SRO (Self Regulated Organization)</p>	<p>after reviewing this issue twice in the last four years</p> <p>Due to this inherent IPFA's/ broker-dealer conflict identified by GFOA, it is impossible for the same agency to regulate both the IPFA and broker-dealer. Currently, the SEC regulates investment advisors that provide financial advice to state and local governments. Financial advisors provide financial advice like investment advisors.</p>
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Draft NAIPFA Resolution

Whereas, on February 11, 2009 the Municipal Securities Rulemaking Board (MSRB) called for the regulation of “Financial Advisors” due to alleged abuses including “pay to play” allegations in the municipal market; and

Whereas, the National Association of Independent Public Finance Advisors (NAIPFA), founded 20 years ago, is an organization of financial professionals that provide financial advice as Independent Public Financial Advisors and has a code of ethics as well as professional standards for certification of individuals within firm members; and

Whereas, each NAIPFA member firm specializes in providing independent financial advice to public bodies and/or non-profit organizations (commonly known as a “public entity”); and

Whereas, academic research and evidence suggests that Public Financial Advisors with banking firm/broker-dealer ties were significantly more likely to negotiate bond issues than Independent Public Financial Advisors because negotiated bond issues reduce risk to the banking firm/broker-dealer and the higher average reoffering yields to public entities result in a correspondingly greater demand for bonds; and

Whereas, the Government Finance Officers Associations (GFOA) who represent the views of thousands of public entities recognizes that a conflict does exist between the role of the Public Financial Advisor and banking firm/broker-dealer working on the same bond issue; and

Whereas, there are inherent and fundamental differences between a Public Financial Advisor owned by a banking firm/broker-dealer and an Independent Public Financial Advisor that must always be recognized in that:

- a. “Public Financial Advisors” provide financial advice to a public entity for debt issuance, but also provide public financial advice for capital

improvement programs, budget formulation/ implementation, debt management, economic development, user rates, and other related financial advice needed for the efficient operation of the public entity.

- b. “Independent” Public Financial Advisors provide independent financial advice as described in a. above and in addition:
 - i. Are not employed, given direction or controlled by a banking firm/broker-dealer that participates in the underwriting, trading, purchase, sale or holding of securities;
 - ii. Do not have any agreements to provide financial advice to a public entity based on payment from or direction by a banking firm/broker-dealer or third party;
 - iii. Have a fundamental obligation to act solely in the best interests of the public entity, the seller of securities, and provides financial advice to the public entity rather than representing both the buyer and seller of securities which is a conflict of interest; and
 - iv. Do not sell a specific product or security but solely provides independent advice to the public entity.

Whereas, since its inception NAIPFA has always promoted independence in financial advisory services as well as transparency in decision and market processes; and

Whereas, NAIPFA is aware of recent abuses, primarily related to political contributions and pay-to-play practices, and believes that steps need to be taken to ban such practices and provide enforcement; and

Whereas, NAIPFA standards discourage these practices by its members but recognizes that other market participants do participate in such practices and in fact not all financial advisors are independent public financial advisors that qualify for NAIPFA membership; and

Now therefore be it resolved by the Board of Directors of the National Association of Independent Public Finance Advisors, known as NAIPFA, as follows:

1. That NAIPFA supports:
 - a. Banning political contributions and, additionally, extensions of current provisions banning “pay-to-play.”
 - b. Banning Public Financial Advisors owned by a banking firm/broker-dealer from being hired by the public entity as a Public Financial Advisor and then resigning as the Public Financial Advisor to immediately underwrite and purchase the bond issue, and further;
 - c. Exploring with GFOA state regulation since Public Financial Advisors work for the public entity and all debt issues are products of State laws, and further;

2. If Congress determines that Public Financial Advisors should be regulated, NAIPFA is prepared to work with the SEC, MSRB and any other federal agency to address this topic and develop a responsive structure of oversight; and further
3. NAIPFA believes that any regulatory proposal must include the following concepts; and further
 - a. Regulatory changes need to distinguish between the roles of market participants and apply appropriate standards for each role. The role of Independent Public Financial Advisor enhances the reputation, efficiency and transparency of municipal markets by providing public finance advice to the public entity issuer thereby assisting the issuer in making an informed financial decision and that the outcome of that financial decision benefits the public entity; and further
 - b. Any regulation must ensure that the Public Financial Advisor solely represents the interests of the public entity to insure conflict free advice; and further
 - c. Attorneys, accountants, investment advisors, engineers and others professionals sometimes provide financial advice to public entities that are issuing bonds. Regulatory proposals should not focus on a sole group, independent financial advisors, in providing regulations, and regulations should recognize that there are a number of professionals... Because certain professionals are regulated for other services they perform including the broker-dealer, they should not be exempted with respect to providing financial advice; and further
 - d. Under no circumstances should the MSRB regulate Independent Public Financial Advisors due to the inherent and fundamental conflict between a Banking firm/broker-dealer and Public Financial Advisor. The MSRB does not recognize this inherent conflict. The SEC, which currently regulates investment advisors, would be a more appropriate regulator of Independent Financial Advisors; and further
 - e. Both MSRB and GFOA “Best Practice” concepts should be part of any regulation; and further
 - f. Because Independent Public Financial Advisor s only product is the sale of advice to the public entity, there is no need for audit or net capital requirements as part of regulation; and further
 - g. NAIPFA believes that all municipal market participants need to part of an open and public debate to determine how best to protect and enhance the municipal market and that NAIPFA should be actively involved in any discussion or hearing.

