Commentary . . .For Immediate Publication

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NAIPFA CHALLENGES MSRB RECOMMENDATION FOR FURTHER REGULATORY OVERSIGHT – BUT WHO'S PROTECTING WHOM?

On April 9, 2009, the Municipal Securities Rulemaking Board ("MSRB") released a report entitled "Unregulated Municipal Market Participants – A Case for Reform" (the "Report"). The primary conclusion of the Report is that because there are a large number of unregulated market participants, including Independent Financial Advisors, all market participants should be regulated by the MSRB.

Following is a summary of the Report and my comments as President of the ~~from the~~ National Association of Independent Public Finance Advisors (NAIPFA). After examining the Report, ~~the Association has~~NAIPFA asserts that the data contained in the MSRB's~~S~~ Report does not support ~~their~~ MSRB's conclusions.

The MSRB is a self-regulatory organization created by Congress to regulate the activities of securities firms and banks (dealers) that underwrite, trade, and sell municipal securities. Rather than asking Congress to have the Securities Exchange Commission (SEC) play a role, the MSRB is seeking to expand its powers in order to regulate some market participants. If regulation occurs, NAIPFA argues that the SEC, acting in the best interests of all market participants, should be the regulator.

The MSRB Report points out that "of the 358 financial advisory firms that participated in at least one primary market transaction in 2008, only 98 were registered with the MSRB as dealers." According to the Report, 70% of the total volume of municipal debt (by par amount) issued in 2008 was issued with the assistance of financial advisors. Financial advisors, that are not dealers, were responsible for 62% of these transactions or 43% of all debt transactions. Dealer financial advisors were responsible for 38% of these transactions or 27% of all debt transactions.

Many bonds issued by state and local governments were utility revenue bonds and general obligation bonds sold through competitive bidding. Over the past several decades the municipal market has become increasing complex, in part due to complicated financing structures developed by regulated dealers. As noted in the MSRB Report, "The complexity of municipal securities offerings and their related derivative transactions, and the abundance of issuers, both large and small, that may lack internal expertise, have created a need for financial advisors."

The position of NAIPFA is that Government Finance Officers Association (GFOA) has educated state and local governments who need knowledgeable market professionals to serve as their advocates, independent from the dealer involved in the transaction, to protect the interests of the issuers.

The MSRB's recommendation for regulation raises numerous questions not addressed by the Report: NAIPFA raises the following points.

1) Who Are the Parties that Require Regulation and Why? The media has recently reported pay-to-play practices among a limited number of Swap advisors and losses incurred by state and local governments from derivative transactions. In contrast to Swap advisors, there have been ***no*** media reports of abuses among Independent Financial Advisors. Furthermore, the MSRB's Report does not provide examples of either isolated or systemic abuses by Independent Financial Advisors. Regardless, in the Report, the MSRB lumps market intermediaries together by stating that unregulated parties include "financial advisors and swap advisors (collectively, 'financial advisors')".

2) Will Further Regulation Protect the Interests of Issuers? Throughout the Report, there is an emphasis on regulating financial advisors and providing investor protection. Except with respect to proposed Swap regulation, there are no regulations mentioned for the further protection of issuers' interests.

3) What Are the Abuses Requiring Regulation? As noted above, neither isolated nor systemic abuses by Independent Financial Advisors are noted in the Report.

4) What Rules Does the MSRB Want to Impose? The Report notes that "At a minimum, the new rules for financial advisors and investment brokers should include professional qualification and fair practice standards for firms and their associated persons." The Report fails to acknowledge that many Independent Financial Advisors are members of the National Association of Independent Public Finance Advisors ("NAIPFA"), a professional association of Independent Financial Advisors in which members must adhere to the Association's Code of Ethics, meet ongoing professional education standards as Certified Independent Public Finance Advisors (CIPFA), and be completely independent of any underwriting of municipal securities.

NAIPFA further recommends that, prior to granting additional authority to the MSRB, a further analysis is required of the MSRB's existing rules and recommends they consider the following:

- The Report mentions that among its "fair practice rules," dealers are required to "fairly price transactions" and "avoid conflicts of interest." Is it possible for dealers that represent both the issuers of bonds (who benefit from the lowest bond yields) and the buyers of bonds (who benefit from the highest bond yields) to avoid a conflict of interest?

- The Report noted that "Rule G-23 is a disclosure rule designed to minimize the actual or apparent conflict of interest that exists when a municipal securities professional acts as both financial advisor and underwriter with respect to the same issue." In spite of requests by NAIPFA to modify the rule and recent confirmation by the Government Finance Officers Association that a conflict does exist, the MSRB has failed to modify Rule G-23. Consequently, Rule G-23 allows dealers to switch from serving as financial advisor to serving as the underwriter for the same transaction.

- Rule G-37 is intended to prohibit firms from engaging in the practice known as "pay-to-play" whereby broker dealers make political contributions to issuer officials in order to obtain municipal securities business. In 2005, at The Bond Market Association's 10th Legal and Compliance Conference the SEC's Office of Municipal Securities suggested that contributions for bond referenda are a pay-to-play activity. Then, in December 2008, executives at Citi, JP Morgan and Morgan Stanley urged the MSRB to prohibit bond referenda contributions. At its meeting in April 2009, the MSRB failed to change the rule.

NAIPFA Presents a Different Conclusion

As noted above, the MSRB draws the conclusion that because there ~~is~~are a large number of unregulated market participants, including Independent Financial Advisors, all market participants should be regulated by the MSRB.

~~According to NAIPFA~~However, it is possible that a different conclusion could be drawn from the Report. **Is it possible that the large and growing number of transactions completed with Independent Financial Advisors is the result of municipal issuers making informed decisions?"**

The Government Finance Officers Association (GFOA), who represents the views of thousands of finance professionals serving as chief finance officers for public entities, recognizes that a conflict “does” exist between the role of the Independent Financial Advisor and a dealer hired to work on the same security issue. The Financial Advisor represents the issuer's interests to achieve the lowest possible cost for a security issue. The dealer represents the investors' interests to achieve the highest possible return for a security issue.

As an increasing number of municipal issuers become more informed about this conflict, are they selecting Independent Financial Advisors instead of dealer financial advisors to avoid the conflict? Could the MSRB, a dealer run organization, be seeking to protect the interests of dealers at the expense of the issuers' interests? NAIPFA believes that the MSRB, a self regulatory organization of dealers, cannot effectively regulate both Independent Financial Advisors and dealers, whose interests are inherently in conflict.

NAIPFA, founded 20 years ago, is a professional organization of *Independent* Financial Advisory firms providing financial advice to public entities across the country. NAIPFA members must adhere to the Association's Code of Ethics, meet ongoing professional education standards as a Certified Independent Public Finance Advisors (CIPFA), and be completely independent of any underwriting of municipal securities.