

TESTIMONY OF ROBERT DOTY ON H.R. 2827

Before the

**UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES**

**SUBCOMMITTEE ON CAPITAL MARKETS
AND GOVERNMENT SPONSORED ENTERPRISES**

Hearing on The Impact of the Dodd-Frank Act on Municipal Finance (July 20, 2012)

Chairman Garrett, Representative Waters and Members of the Committee, thank you for inviting me to testify before you this morning regarding H.R. 2827 and its potential impacts upon local governments across the nation. I am Robert Doty, a municipal advisor. For almost 40 years, I have dedicated my career to working with local governments both as a dealer representative and a nondealer financial advisor, as well as a bond counsel and issuer counsel in municipal securities transactions. I have advised and assisted many local governments benefiting from the issuance of billions of dollars of municipal securities in two dozen states. I have worked closely with hundreds of state and local officials and believe firmly that I understand well their interests and needs.

With all due respect, I wish to raise certain very serious concerns that you may wish to consider and regarding which you may wish to exercise substantial care before proceeding with this legislation.

I urge you to recognize the municipal market's self-regulatory structure through the Municipal Securities Rulemaking Board as the best way to resolve issues and to define appropriate municipal advisory roles and relationships by means of negotiation among representatives of the varying market sectors. The members and staff of the MSRB are experienced market professionals and business people who understand very well how to balance costs against benefits of self-regulatory decisions. (Incidentally, there are more than twice as many dealer representatives on the MSRB as there are nondealer advisors.)

In particular, based upon my almost 40 years of experience in working directly with local governments, I am concerned that local governments will lose extremely important protections from which they benefit through municipal advisor regulation, if H.R. 2827 is passed by Congress in its present form.

The municipal advisory role is intended to be a role of providing competent and unbiased advice to local governments, and tied very closely to that, includes a fiduciary duty to the issuer. This is quite different and distinct from serving in the adverse roles of an underwriter, a bond trader or a financial product marketer. That is one important reason why separate and robust municipal advisor regulation is needed.

Please understand that I consider many representatives of both dealers and nondealer advisors to be honorable and competent providers of municipal advice. I also recognize, however, that there are financial advisors both affiliated with and separate from dealers who lack

the necessary competence and, in a few cases, who may be conflicted in providing advice, sometimes unfortunately without disclosure. Some dealers and nondealer municipal advisors sometimes do not always act with their clients' best interests at heart. The forthcoming rulemaking by the MSRB in this area will go a long way to address these issues and develop a truly level playing field in which the same rules apply to both dealer and nondealer advisors.

Without that true level playing field, I fear that local governments and investors will suffer substantial harm. That can, in turn, create substantial economic damage to local economies and detract from the prospects for national economic recovery.

To understand better the nature of the municipal advisory role, you may wish to hear about some of the municipal advisory services that I have provided to clients over the years. Because I have not accepted contingent fees for almost 20 years, I have been able to advise my clients in an unbiased manner NOT to issue bonds and NOT to incur more debt when doing so would have been unwise. My services have included—

- Assisting local government clients in obtaining efficient, economical financing
- Assisting local government clients in structuring sound securities issues
- Assisting local government clients in employing strong, competent underwriters, bond counsel and other finance professionals
- Assisting local government clients in avoiding unwise covenants and structures that would have placed the clients at great risk
- Warning a local government client NOT to attempt an acquisition of a private utility company, when doing so would have been costly and highly risky
- Assisting a small local government client, newly formed, but with sound revenues, to obtain financing
- Warning another local government client NOT to borrow for a project the client could not afford, even when a lender was willing to loan funds
- Assisting several clients in working out defaulted bond issues that were causing the clients substantial economic harm, when earlier advisors had failed to warn about significant risks

I am convinced that effective municipal market self-regulation—with informed and full participation by dealer and nondealer advisors, issuers and investors—is the best way to define appropriate relationships, to resolve issues and to implement appropriate rules.

Because not all municipal advisors—whether dealers or nondealers—are not fully competent and some fail to recognize, or even ignore, conflicts of interest and their local government clients' best interests, I believe that testing the advisors' competence and knowledge

of their advisory responsibilities, as well as providing continuing education and professional standards to guide them, are extremely crucial for the protection of state and local governments.

The Municipal Securities Rulemaking Board has been very constructive in its approach, currently waiting for the SEC's finalization of the municipal advisor definition prior to acting with rulemaking over municipal advisors. Once the SEC acts, the true level playing field can be implemented appropriately through the MSRB's market self-regulation.

Who are the people who are protected by this municipal market self-regulation?

The SEC estimated that there are 50,000 municipal issuers in the country. The Municipal Securities Rulemaking Board estimated 80,000. Joseph Mysak, a noted municipal expert with Bloomberg, indicated based upon Census data that there are more than 90,000 municipal entities in the country, although not all of them are issuers of municipal securities. The officials of the vast majority of the issuers are not sophisticated regarding municipal finance.

So, the MSRB's rules will help protect numerous governmental entities. Ensuring that bonds issued by these jurisdictions is done properly, with competent assistance from financial advisors, and at the lowest yield possible, also helps reduce the burden to taxpayers. One central goal is to minimize state and local property taxes and local utility rates, for example.

The officials of these local governments—hundreds of thousands of officials charged with protecting the public interest—are elected or appointed on the basis of their commitment to the public interest including, among other things, concerns such as the following—

- Reducing taxes
- Eliminating budgetary deficits and balancing budgets
- Spending taxpayers' money wisely
- Efficient and economical management and operation
- Reducing utility rates
- Filling pot holes
- Fighting crime
- Controlling traffic
- Collecting garbage
- Preventing and fighting fires
- Improving education for our children, and
- Many more local agendas determined at the local level by local citizens

With few exceptions, they definitely are NOT municipal finance experts. After all, municipal finance is a highly arcane area of expertise that very few people understand.

These public officials are mayors, city council and county commission members, school superintendents and school board members, managers and board members of local agencies and special districts. They are in every congressional district. They are Republicans and Democrats. They are people of all political persuasions. They are people upon whom you rely for advice and support. Overwhelmingly, they believe that, when they perform their roles appropriately—through due diligence looking into experience and backgrounds of the municipal advisors they employ—they have performed their roles as they should and have served the public interest.

Many members of this honorable body have served as local officials and have made decisions such as those outlined above. The SEC's proposed municipal advisor definition, erroneously in my opinion, included appointed members of state and local governing boards. The inclusion of these board members, really gets it wrong.

Those officials place great trust in the municipal advisors they select. Not being municipal finance experts they make decisions to employ, and therefore must rely, out of sheer necessity, upon the municipal advisors they choose. They are led to believe and expect competent, disinterested and honest advice solely in the local governments' best interests. This is why a fiduciary standard on advisors is so essential.

The fiduciary duty of municipal advisors—including the duty to exercise due care, the duty of loyalty to avoid conflicts of interest, and the duty to provide sound advice solely in the local governments' best interests—is absolutely essential to the municipal advisory function.

For emphasis, unlike underwriting and trading relationships, the fiduciary duty is the very heart of a municipal advisor's role and responsibilities.

Without the fiduciary duty, tens of thousands of local governments, hundreds of thousands of local officials, and hundreds of millions of local taxpayers and ratepayers would be at significant risk—as they have been in the past—of snake oil sales pitches made in disguise by municipal advisors posing falsely as honorable advisory professionals serving solely in the local governments' best interests.

When these people are unmasked—usually when their unsound advice already has caused harm to local communities—most of the time it is far too expensive for local governments and local officials, with severely limited budgets, to spend literally millions of dollars in seeking to correct these wrongs. Almost always, local governments, realizing the substantial costs and risks of litigation, make the difficult and painful choice simply to move on and to lick their wounds. The losses, of course, are borne unfortunately by local taxpayers and ratepayers.

Such mistakes harm not only local citizens and taxpayers. The mistakes also harm investors when unwise securities offerings are brought to market. Two-thirds of municipal securities are owned by retail investors directly or through mutual funds.

These investors can lose their savings when unsound, poorly-considered municipal securities are released into the market. Municipal advisors have the responsibility of warning local governments against such transactions, and at the same time, also protecting investors.

It is far better for these wrongs simply to be prevented through competency testing and continuing education of all municipal advisors and through reasonable professional standards. It is far better, through market self-regulation on a true level playing field, to weed out those municipal advisors—both dealers and nondealers—who would abuse their relationships of trust with local governments in your congressional districts and other districts across the nation.

I urge you to give full, careful consideration to all of the implications of H.R. 2827. I urge you to support the municipal securities market's self-regulatory mechanism. I urge you to support a true level playing field in which all municipal advisors serve solely the best interests of tens of thousands of local government clients in your districts and across the nation. I urge you to consider carefully the potential for harm that would result for local governments, taxpayers, ratepayers, investors, and the public interest by failing to recognize the essential character of the municipal advisors' fiduciary duty and by restricting the municipal market's self-regulation of all municipal advisors.

Thank you again for your courtesy and for inviting me.