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Testimony for the Record

On H.R. 2827

Submitted to the Subcommittee on Capital Markets, U.S. House of Representative, Washington, D.C.

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Introduction

Mr. Chairman and Members of the Subcommittee:

On behalf of the National Association of Independent Public Financial Advisors and its members, we are pleased to submit written testimony for the record in opposition to bill H.R. 2827 – To amend the Securities Exchange Act of 1934 to clarify provisions relating to the regulation of municipal advisors, and for other purposes ("H.R. 2827" or the "Bill"). The National Association of Independent Public Finance Advisors respectfully urges Congress to not pass H.R. 2827. We propose, instead, leaving unchanged those portions of the Securities Exchange Act of 1934 that would be affected by H.R. 2827.

The National Association of Independent Public Finance Advisors ("NAIPFA") was founded in 1990 as a professional organization representing the interests of independent public finance advisory firms who provide public finance advice to municipal entities and obligated persons. Our membership is comprised of thirty-two member firms representing clients on approximately 3,000 bond issues equating to nearly $75 billion in municipal securities issuances annually. These firms are considered "independent" by virtue of their lack of affiliation with any broker, dealer or municipal securities dealer. As distinguished from brokers, dealers, and municipal securities dealers, our member firms are able to offer a wide variety of consulting services to both issuer and obligated persons without the underlying conflicts of interest that accompany these other market participants while performing similar functions.

Background

Prior to the enactment of Section 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act" or the "Act"), any individual, regulated and otherwise, could provide advice to or on behalf of municipal

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entities or obligated persons with respect to municipal financial products or the issuance of municipal securities (including advice with respect to the structure, timing, terms and other similar maters concerning such financial products or issues). This led to the widespread reliance by municipal entities and obligated persons upon the advice they receive from broker-dealers who were free to, and did, act without regard to the interests of these entities when providing advice. In response, Congress determined through their enactment of the Dodd-Frank Act, which thereby amended the Securities and Exchange Act of 1934 (the "Exchange Act"), that all individuals who provide advice to or on behalf of municipal entities or obligated persons with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms and similar matters ("Municipal Advisory Services"), including broker-dealers, should to be classified as "Municipal Advisors" and have accompanying fiduciary duties vis-à-vis the advice they provide to municipal entities or obligated persons. Notably, under the Act, broker-dealers would only be considered Municipal Advisors to the extent that they provide Municipal Advisory Services. In fact, the Act specifically excludes broker-dealers from the definition of Municipal Advisor when the broker-dealer is engaged by a municipal entity or obligated person as an "underwriter" as that term was defined in Section 2(a)(11) of the Exchange Act. In this regard, the Act makes clear that broker-dealers serving as underwriters would be excluded from the definition of Municipal Advisor and corresponding fiduciary responsibilities.

The Act's amendments to the Exchange Act were largely in response to concerns that individuals, some of whom may have already been regulated in one capacity or other, were essentially unregulated with respect to the advice they provided to municipal entities and obligated persons. Prior to enactment of the Dodd-Frank Act, many market participants would provide advice to the issuer with respect to the structure, timing and terms of a securities issuance in order to lead the issuer towards the issuance of a particular kind of security or manner of sale without regard to what may have been in the issuer's best interest. Various broker-dealers acted in this manner to effectively engage in self-dealing; broker-dealers who provided what now would be considered Municipal Advisor Services were under no obligation to provide these services in a manner designed to serve the municipal entity's or obligated person's interest and instead were able to unduly influence these entities into undertaking a course of action designed to benefit the broker-dealer's own interests. In addition, broker-dealers providing Municipal Advisory Services engaged in practices, documented by regulatory actions and court cases, which could be considered inappropriate in light of the reliance placed upon these entities by municipalities and obligated persons, such as:

- Failing to clearly disclose fees charged to municipal entities and obligated persons;
- Charging excessive fees to municipal entities and obligated persons;

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- Pay-to-play arrangements and excessive gift giving to employees and officials of municipal entities or obligated persons;
- Excessive or impermissible political contributions to municipal officials;
- Utilizing and recommending exotic, synthetic or otherwise inappropriate financial products to unsophisticated municipal entities or obligated persons;
- Rigging bidding processes to win business from municipal entities and obligated persons; and
- Recommending the issuance or refinancing of bonds without a justifiable benefit to the municipal entity or obligated person.

We believe that these practices led to unnecessarily high interest rates as well as the issuance of variable rate demand obligations and derivatives by unsophisticated market participants. The issuance of these unsuitable products by municipalities and obligated persons allowed broker-dealers to expand the underwriting fee they obtained upon issuance. These higher rates and fees negatively impacted issuers as well as the taxpayers and ratepayers responsible for making payments on this debt. At the time of enactment, it was hoped that the Dodd-Frank Act would curtail the worst of these abusive practices.

Commentary on H.R. 2872

In essence, H.R. 2827 codifies the environment that existed prior to the enactment of the Dodd-Frank Act in which broker-dealers were given the unfettered ability to influence municipalities and obligated persons without regard to the interests of those entities. The Bill accomplishes this by leaving in place the Act's definition of Municipal Advisor while revising the exclusion from the definition for broker-dealers. The Act, although specifically excluding any broker, dealer, or municipal securities dealers, limited this exclusion to those broker-dealer serving as underwriters as that term is defined in Section 2(a)(11) of the Securities Act of 1933 (the "Securities Act"). By contrast, H.R. 2827 eliminates the limiting language contained within the Dodd-Frank Act and instead creates a broad exclusion from the definition of Municipal Advisor for any broker-dealer by virtue of their role as underwriter.

This revision is extremely troubling as it will essentially put in place a regulatory system whereby the prior offenders are given free reign to return to the abusive practices of the past. As in the past, municipal entities will again rely upon the advice they receive from broker-dealers, which could lead to the same improper self-dealing, and the higher interest rates and fees were which customary in the pre-Dodd-Frank Act environment, all of which will be detrimental to the municipal entities and, ultimately, their taxpayers.

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What is more, the exclusion carved out by H.R. 2827 for broker-dealers is hard to justify in light of the other exclusionary measures of the Dodd-Frank Act as well as the Bill. Shortly after enactment of the Dodd-Frank Act, the Securities and Exchange Commission ("SEC") put forth Release No. 34-63576 – Registration of Municipal Advisors ("Release"). In this Release, the SEC attempted to clarify the provisions of Section 15B(e)(4)(C) of the Exchange Act, which set forth an illustrative list of individuals excluded from the definition of municipal advisor. This section, for all intents and purposes, mirrors that of H.R. 2827, except for those provisions relating to broker-dealers.

In the Release, the SEC clarified the type of advice that can be provided by the various market participants without fear of classification as Municipal Advisor. The Release includes precise unequivocal statements regarding the exclusions contained within § 15B(e)(4)(C) of the Exchange Act, a sampling of which are as follows:

> *Investment Advisers*. Investment advisers were excluded under §15B(e)(4)(C) if the advice they provide falls within the Investment Advisers Act. The SEC went on to state that "a registered investment adviser or an associated person of a registered investment adviser would not have to register as a 'municipal advisor' with respect to the provision of any *investment* advice subject to the Investment Advisers Act." Conversely, an investment adviser "must register […] as a municipal advisor if the adviser or associated person engages in any municipal advisory activities that would not be investment advice subject to the Investment Advisers Act."
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> *Commodity Trading Advisors*. Commodity trading advisors were excluded under §15B(e)(4)(C) if the advice they provide is advice related to swaps, but "a commodity trading advisor […] must register with the Commission as a municipal advisor if the commodity trading advisor […] engages in municipal advisory activities that do not include advice related to swaps."
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> *Attorneys*. Attorneys were excluded under §15B(e)(4)(C) if they are providing legal advice or if they provide services that are of a traditional legal nature, and are excluded from classification as Municipal Advisor "*unless* the attorney engages in municipal advisory activities."
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> *Engineers*. Engineers were excluded under §15B(e)(4)(C) if the advice provided is engineering advice. However, the Commission concluded that the "exclusion does not include circumstances in which the engineer is engaging in municipal advisory activities […] even if those activities are incidental to the provision of engineering advice."

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> _Accountants_. Although not specifically excluded under §15B(e)(4)(C), the Commission stated that accountants, like individuals specifically excluded under §15B(e)(4)(C), are exempt if they provide non-municipal advisory services. The SEC noted that some accountants do engage in municipal advisory activities and therefore an exclusion would not be appropriate. However, accountants who provide services, such as "preparing financial statements, auditing financial statements, or issuing letters for underwriters for, or on behalf of, a municipal entity or obligated person," are not engaged in municipal advisory activities and are therefore excluded from the definition of municipal advisor.

When providing Municipal Advisory Services, broker-dealers should be classified as Municipal Advisors and treated no differently under the law than other market participants performing similar functions who would be classified as Municipal Advisors. Like some of the other market participants, broker-dealers are already regulated with respect to particular kinds of conduct, and like other market participants, broker-dealers may have interactions with municipal entities and obligated persons in which advice is provided and relied upon by the municipal entities or obligated persons. However, under H.R. 2827, unlike these other market participants, broker-dealers would not be classified as Municipal Advisors with corresponding fiduciary duties when they provide Municipal Advisory Service.

It is not in the interest of the municipal market, or municipal entities or their taxpayers to create an exclusion for broker-dealers that breaks from the clear delineations put forth by the SEC in connection with the other exclusions contained within §15B(e)(4)(C) of the Exchange Act. That is, every exclusion existing under §15B(e)(4)(C) and those set forth in H.R. 2827, except for the new proposed exclusion for broker-dealers, is inapplicable where the individual provides Municipal Advisory Services. Whereas, the broad exclusion for broker-dealers will open the door for potential improprieties and will allow virtually any individual wishing to escape their fiduciary responsibilities to simply register as a broker, dealer, or municipal securities dealer, including, financial advisors who otherwise would clearly fall within the definition of Municipal Advisor. As such, NAIPFA is very concerned that this rule will undermine each and every protection put in place by the Dodd-Frank Act as individuals will be able to circumvent the fiduciary duties that otherwise would be owed to municipal entities.

In addition, the revisions outlined in H.R. 2827 are unwarranted given that the regulations set to be promulgated as a result of the Act have either not been enacted or have yet to be written. As such, the proposed adoption of H.R. 2827 is premature as the full impact, or lack thereof, of the Dodd-Frank Act and corresponding regulations has yet to be felt. Therefore, at this time, NAIPFA would urge restraint on the part of Congress to allow for

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the full implementation of the Dodd-Frank Act. In turn, this will allow for a more full and accurate analysis of the impact of the Act as well as the potential benefits or ramifications of adopting a bill such as H.R. 2827.

Enforcement

The delineations set forth in the Dodd-Frank Act and the Release with respect to the exclusions from the definition of Municipal Advisor, allow for proper enforcement of the law by virtue of individuals' obtainment of fiduciary duties. In other words, as enacted, the Act provides for the SEC or other enforcement agency to hold individuals accountable when they act inappropriately or without the requisite knowledge or experience when providing Municipal Advisory Services. Under H.R. 2827, no similar mechanism exists with respect to broker-dealers; broker-dealers are excluded from the definition of Municipal Advisor regardless of their activities. This Bill throws into question whether a broker-dealer can ever be held accountable, let alone obtain fiduciary responsibilities, as a result of the advice it provides to a municipal entity or obligated person. This has in the past and, upon passage of H.R. 2827, will again in the future lead to abuses which will ultimately be detrimental to the municipal market, municipal entities and their taxpayers.

Further, in light of the recent revelations with respect to the massive trading losses at J.P. Morgan Chase and the Barclays Capital LIBOR scandal, now more than ever, our Country needs to have in place strong regulatory measures to curtail the abuses and harmful business practices of the past while, on a going forward basis, protecting the interests of investors and taxpayers.

Conclusion

NAIPFA does not support the passage of H.R. 2827 and would instead encourage Congress to allow for the full implementation of the Dodd-Frank Act prior to enacting any revisionary measures relating thereto. Furthermore, NAIPFA is concerned that the enactment of H.R. 2827 will give immunity to broker-dealers to freely engage in the practices of the past that led to one of the worst financial crises in this Country's history. This tacit endorsement of the past will be detrimental to not only municipal entities and their tax/ratepayers, but also the Country as a whole. As such, NAIPFA urges Congress to reject H.R. 2827 and allow the provisions of the Dodd-Frank Act relating to Municipal Advisors to remain unchanged at this time.