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June 12, 2019

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Joanne C. Rutkowski, Esq., Senior Special Counsel
Division of Trading and Markets

Rebecca Olsen, Esq., Director
Office of Municipal Securities

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Request from PFM Financial Advisors LLC for Interpretive Relief from Broker-Dealer Registration for Registered Municipal Advisors Acting in connection with Direct Placements

Dear Mr. Redfearn, Ms. Rutkowski, and Ms. Olsen:

The Securities Industry Financial Markets Association (SIFMA)[1] has been sent a copy of a letter, dated October 30, 2018, mailed by PFM Financial Advisors LLC ("PFM") to you, the addressees listed above, requesting (the "Request") that the staff of the Division of Trading and Markets and the staff of the Office of Municipal Securities (together, the "Staff") of the U.S. Securities and Exchange Commission (the "Commission" or "SEC") provide interpretive guidance ("Guidance") that PFM would not be required to register as a broker-dealer under

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

Section 15 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), if PFM engages in the placement agent activities described in the Request. SIFMA believes the Request, if granted, has the potential to harm investors, which is contrary to the Commission's mission. Furthermore, as described below, the Request is unsupported by the law, contrary to Commission precedent and inconsistent with Municipal Securities Rulemaking Board ("MSRB") rules. Moreover, there is no compelling need for the requested relief, as issuers and obligated persons are currently able to, and do regularly, enter into the types of transactions described in the Request. Accordingly, for the reasons stated herein, we recommend that the Staff not provide the requested Guidance but instead reiterate the longstanding and well-established principle that acting as a placement agent in municipal securities transactions requires registration as a broker-dealer.

A. The Nature of the Relief Sought

Municipal advisors are registered with the SEC under section 15B of the Exchange Act. The industry routinely refers to two types of municipal advisors: (1) broker-dealers registered and regulated as broker-dealers under section 15 of the Exchange Act, who are also required to register and be separately regulated as municipal advisors under section 15B because they also engage in municipal advisory activity ("broker-dealer municipal advisors"); and (2) persons who engage in municipal advisory activity and register as municipal advisors, but are not separately registered as broker-dealers ("non-dealer municipal advisors").

PFM is, of course, among the largest non-dealer municipal advisory firms, and is not representative of the vast majority of firms that consist of a small number of municipal advisory personnel. Nevertheless, the Request appears to be drafted not seeking a No-Action Letter for PFM itself but rather as one seeking interpretive guidance that would apply to all non-dealer municipal advisors.[2]

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[2] But see Appendix B to the Request, which is written as if the relief sought would apply to PFM only and be subject to certain conditions, including undertakings by PFM.

If a broker-dealer engages in municipal advisory activity, it must register as a municipal advisor, but the Request is asking for an interpretation that would allow municipal advisors to engage in certain broker-dealer activity without having to register as broker-dealers. PFM argues that the activities described in the Request are neither broker-dealer activity nor placement agent activity. It argues that, should the SEC "force" it to register as a broker, it would have a conflict with its fiduciary duty to its issuer client. Thus, while the Request speaks of municipal advisors generally, in fact, the relief it is seeking would benefit only municipal advisors that are non-dealer municipal advisors. That conclusion is because – as PFM itself has pointed out and as described later in this letter - broker-dealer municipal advisors are precluded by the MSRB under Rule G-23 from engaging in the activities described in the Request because they present an unmanageable conflict.[3]

B. The Policy of Exchange Act Regulated Entity Registration

A large part of municipal advisory activity involves providing advice to municipal entities and obligated persons in connection with the issuance of municipal securities, as further described and defined in section 15B of the Exchange Act. The financing outlined in the Request involves municipal securities structured as direct placements of securities to banks and other institutions ("Direct Placements"). The Request seeks an interpretation that the non-dealer municipal advisor, without having to register as a broker-dealer, could engage in activity that, in fact, is placement agent activity that would subject a person to the broker-dealer registration requirements under the Exchange Act. Among the activities described in the Request are (i) identifying and assessing the terms of the institutional investor offered in the Direct Placement, (ii) negotiating the terms of the transaction with the institutional investor on behalf of the issuer, and (iii) coordinating the meetings and documents between the issuer and the investor in order to "document and complete the financing." As expressed in the Request, the non-dealer municipal advisor would serve the

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[3] Comments on MSRB Notice 2010-27 (August 17, 2010**);** Public Financial Management, Inc., Letter from F. John White, Chief Executive Officer, dated September 29, 2010.

needs of the issuer "at all key stages of the transaction through taking the financing 'over the finish line.'"[4]

The over-arching theme of securities law rules for the registration of regulated entities is that if a person engages in an activity that requires registration for a particular category of regulated entity, the person must register under those provisions. For example, a broker-dealer that engages in investment adviser activity must register under the Investment Advisers Act regardless of its registration under the Exchange Act as a broker-dealer. For many years, it has also been recognized that if a municipal advisor engages in investment adviser activity it must register as an investment adviser.[5] An investment adviser to a municipal entity, who additionally engages in non-exempt municipal advisory activity, must register as a municipal advisor regardless of the fact that the investment adviser already has a fiduciary duty to the municipal entity under the Investment Advisers Act.

The SEC staff has clearly stated that a person who is engaged in the business of effecting transactions in securities for the account of others, including participation in securities transactions "at key points in the chain of distribution," is a broker.[6] The Broker-Dealer Guide on the Division of Trading and Market's website includes in its list of likely brokers, "persons that act as 'placement agents' for private placements of securities," and suggests a person making the determination consider whether he or she "participate[s] in important parts of a securities transaction, including solicitation, negotiation, or execution of the transaction …" Simply put, a broker is a person who is involved in the distribution of product in the securities marketplace.[7]

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4 Request at pp. 2-3.

5 SEC No-Action Letter, The Knight Group (Nov. 13, 1991); Division of Investment Management: Staff Legal Bulletin No. 11, Applicability of Advisers Act to Financial Advisors of Municipal Securities Issuers, Sept. 19, 2000.

6 *See* e.g. BDAdvantage, Inc., 2000 WL 1742088 (S.E.C. Oct. 11, 2000).

7 Note that, in addition to the Exchange Act, state law issues regulating broker-dealers may be implicated, and that a person involved in the distribution of securities may be an agent of the issuer under the Securities Act of 1933 section 2(a)(11) definition of "underwriter."

C. Issuers and Obligated Persons are not Disadvantaged Under the Current Structure

The Request focuses on a specific type of transaction – the Direct Placement – and insinuates that issuers and obligated persons are unable to enter into those transactions because municipal advisors are constrained by what PFM refers to as "regulatory uncertainty" and the "fear of unwarranted regulatory repercussions." In fact, Direct Placements are commonplace in the market, with ample participation in transactions by municipal advisors, dealer and non-dealer alike. Issuers seeking to fund a project or otherwise raise money are not obliged to retain the services of either a municipal advisor or a broker-dealer. However, issuers can and do regularly employ municipal advisors to assist them in making decisions about how to structure a transaction to best accomplish their goals. In some of those structures, there is no need for participation by a broker-dealer. PFM's complaint seems to be that, when the best structure for an issuer involves placement of municipal securities with private investors, a placement agent should be required.

Notwithstanding the statement in the Request that the activities "for which PFM seeks relief in connection with Direct Placements would not include serving as 'placement agent' for municipal securities," this is precisely what the Request seeks. If the debt obligations that are being issued are not municipal securities, PFM would not be constrained by the federal securities laws from finding banks or similar investors, negotiating the terms of the transaction and even receiving compensation for its efforts.[8] It is only if the debt obligation is, in fact, a security that engaging in those activities would require registration as a broker-dealer.

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[8] Both the MSRB and FINRA have repeatedly emphasized that participants in the "bank loan" or "direct purchase" markets review their regulatory obligations and provided guidance on the "security or loan analysis." *See* e.g. MSRB Notice 2016-12 (April 4, 2016), MSRB Notice 2011-37 (Aug. 3, 2011), MSRB Notice 2011-52 (Sept. 12, 2011), and FINRA Regulatory Notice 16-10 (April 2016).

D. The Fiduciary Duty Argument in the Request Doesn't Work

A major theme of the Request is that, because a municipal advisor has a statutory fiduciary duty under the Dodd Frank Act to protect municipal entities, the municipal advisor must "fulfill its fiduciary obligations to its [municipal entity] issuer clients and obligated persons in connection with direct placements by performing the following…" There follows a list of activities mentioned above that go beyond advice. The thrust of the argument is that the fiduciary duty makes it necessary for the Staff to expand permissive municipal advisory activity to include broker placement activity, i.e., effecting a securities transaction from its commencement to closing.

1. Municipal Entities and Obligated Persons

PFM wants the Guidance to cover both municipal advisors advising municipal entities and municipal advisors advising obligated persons, but the municipal advisor's fiduciary duty to municipal entities does not extend to obligated persons. The MSRB, in Rule G-42, limits the municipal advisor's duty owed to an obligated person to a duty of care.[9] The duty owed a municipal entity is a fiduciary duty that includes a duty of loyalty.[10] Because the obligation of loyalty to act in the client's best interests extends only to municipal entities, the body of the Request relates only to municipal entities and not to obligated persons. An appendix to the Request attempts to include obligated persons in the analysis of the main part of the Request,

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[9] Rule G-42(a) states: "(i) A municipal advisor to an obligated person client shall, in the conduct of all municipal advisory activities for that client, be subject to a duty of care.
(ii) A municipal advisor to a municipal entity client shall, in the conduct of all municipal advisory activities for that client, be subject to a fiduciary duty that includes a duty of loyalty and a duty of care."

[10] Rule G-42 Supplementary Material .02 describes the duty of loyalty: "Municipal advisors must fulfill a duty of loyalty in performing their municipal advisory activities for municipal entity clients. The duty of loyalty includes, but is not limited to, the obligations discussed in this paragraph .02. A municipal advisor must deal honestly and with the utmost good faith with a municipal entity client and act in the client's best interests without regard to the financial or other interests of the municipal advisor. A municipal advisor must not engage in municipal advisory activities for a municipal entity client if it cannot manage or mitigate its conflicts of interest in a manner that will permit it to act in the municipal entity's best interests."

which is dependent on the fiduciary duty, by cryptically stating the duty of care owed to obligated person clients is "similar in many ways to a [municipal advisor's] obligations to [municipal entity] clients." If the only topic of the Request were obligated persons, the whole argument would falter even faster.

2. The Due Diligence Obligation of a Placement Agent

The Request repeatedly emphasizes the municipal advisor's fiduciary duty to act in the best interests of its clients, but not in the best interests of the institutional investors in the Direct Placements. In fact, the Request emphasizes that the non-dealer municipal advisor has no obligation to the institutional investors who are to fend for themselves. However, the contemplated activities for the municipal advisors constitute placement agent activity, and the Exchange Act imposes due diligence obligations on placement agents of municipal securities.[11] The SEC's position on whether a placement agent in a private placement offering has a due diligence obligation was clearly stated in its 2016 civil complaint filed in the Rhode Island federal district court against the Rhode Island Commerce Corporation, Wells Fargo Securities, LLC, acting as placement agent for the offering of private activity bonds, and certain officials of the issuer and the placement agent.[12] In paragraph 44 of the complaint, the SEC asserted:

> 44. The EDC [Rhode Island Commerce Department, f/k/a Rhode Island Economic Development Corporation] retained Wells Fargo as the lead placement agent on the 38 Studios Bond Offering. A "placement agent" in a private placement like the 38 Studios Bond Offering has a role similar to that of an underwriter in a public bond offering. Wells Fargo had an obligation under the federal securities laws to conduct an investigation into the 38 Studios Bond Offering, in order to obtain a reasonable belief in the truthfulness and completeness of the key

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[11] *See also*, FINRA Regulatory Notice 10-22, "Regulation D Offerings: Obligations of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings" (April 2010) emphasizing the importance of suitability rules.

[12] SEC v. Rhode Island Commerce Department (f/k/a Rhode Island Economic Development Corporation), Wells Fargo Securities, LLC, Peter M. Cannava, Keith W. Stokes, and James Michael Saul, Civ. Action No. 16-cv-00107 (March 7, 2016).

> representations in the Bond Placement Memo. This investigation is commonly referred to as "due diligence."

The due diligence obligation of a placement agent is to protect investors, and the Request is asserting that the municipal advisor would act solely in the interest of the issuer. The Request thus creates the very conflict of interest that the Exchange Act's functional regulation is designed to avoid.

The importance of the due diligence responsibility is apparent when the nature of the proposed institutional investors is considered. The Request does not limit the investors in the Direct Placements to banks that are unlikely to (but indeed may) trade, but extends the proposed market to persons that "fall within the definition of Sophisticated Municipal Market Professionals in MSRB Rule D-15" ("SMMPs").[13] The institutional investors in the Rule D-15 definition of SMMPs include:

> (1) a bank, savings and loan association, insurance company, or registered investment company;
> (2) an investment adviser registered either with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or
> (3) any other person or entity with total assets of at least $50 million.[14]

These institutions may very well trade the municipal securities without there having been any broker-dealer due diligence and without any assurance that there is a disclosure document with all material information.[15] In most Direct Placements, there is no offering document providing material information such as that found in an official statement.

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[13] Request at II.D.

[14] It is worthy to note that the request did not reference the definition of sophisticated investors under Regulation D, which differs from that of a SMMP.

[15] It is also noteworthy that the Request uses the broad definition of a SMMP rather than the narrow definition used by the MSRB in Rule G-34 for an exemption from the requirement of a broker-dealer or municipal advisor to obtain CUSIP numbers if the municipal securities are being purchase by a bank, or control person, if the underwriter or municipal advisor reasonably believes (*e.g.*, by obtaining a written representation) that the present intent of the purchasing entity or entities is to hold the municipal securities to maturity or earlier redemption or mandatory tender.

The reference to the definition of SMMPs is misleading because there is nothing in the Request that requires a sophistication analysis. Rule D-15 lists the above-institutions in Rule D-15(a), but Rule D-15(b) requires a broker-dealer confirmation of the customer's sophistication for the institution to be within the SMMP definition, and Rule D-15(c) requires the customer to confirm, among other indicia of sophistication, that it is exercising independent judgment of the quality of execution of the transaction by the broker-dealer. No such requirements to determine sophistication are in the Request's description of "Qualified" Providers.

We note that many investors in Direct Placements are community banks, which may lack the requisite sophistication to be characterized as SMMPs and avoid the application of MSRB Rule G-19's customer-specific suitability analysis. [16] By removing any registered broker-dealer from engaging in the placement of the securities, all investor protection rules, which are required of broker-dealers, are eliminated. This change would run directly counter to longstanding law and SEC guidance that the securities laws provide protection for institutional investors as well as retail investors.[17]

The result is that, under the Request, any person with $50 million of assets can be considered a Qualified Provider, regardless of the person's sophistication and need for due diligence or suitability review by the placement agent. In fact, what the Request would allow is for unsophisticated issuers, such as villages and towns, to sell municipal securities to unsophisticated investors through an intermediary, who does not have the qualifications necessary

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[16] For example, under MSRB Rule G-19, dealers retain product-specific suitability obligations even to qualifying SMMP's.

[17] PFM references the staff's M&A Brokers No-Action Letter (Feb. 2, 2014) to justify its statement that, "The Staff has previously recognized that the nature of the investor can alleviate the need for [broker-dealer] registration." (Request at note 12). The no-action letter, in fact did not involve an "investor". The staff stated the letter related to the "transfer of ownership and control of a privately-held company … to a buyer that will actively operate the company …" in which the securities evidenced ownership. The letter involved a business combination and not an investment in securities and is inapposite in this case.

under the securities laws to effect the placement of the securities, or the obligation to protect the investors.

3. The Fiduciary Duty Argument is Based on Status Rather than Activity

By justifying the extension of permissible municipal advisory activity into broker-dealer activity by the repeated references to the municipal advisor's fiduciary duty, the Request is arguing that the municipal advisor's status as municipal advisor, with the accompanying fiduciary duty owed to a municipal entity, allows the municipal advisor to engage in broker activity without broker-dealer registration.

This theory can be tested by examining investment adviser law, and the no-action correspondence under the Investment Advisers Act that have considered the extent to which an investment adviser, who also has a fiduciary duty to its investor clients, can engage in broker-dealer activity on the theory that the proposed activity is necessary to protect its clients. The test is particularly pertinent because in many cases both a broker-dealer and an investment adviser have a fiduciary duty to the investor, and, in some circumstances, the broker-dealer and the investment adviser could have similar duties owed to the investor.

Broker-dealers have qualifications and are regulated under a very different securities law regime and, if an investment adviser attempts to engage in broker-dealer activity without qualification and registration as a broker-dealer, its efforts are likely to be prevented. For example, a no-action request of an investment adviser for relief from broker-dealer registration was denied where the investment adviser to an institutional investor would locate prospective REIT issuers and negotiate the terms of the private placement transactions on behalf of the investment adviser's client in order to provide product for the client. No broker-dealer was to be involved in the transaction.[18] Denial of the no-action request meant that the investment adviser

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[18] PRA Sec. Advisors, L.P., SEC No-Action Letter (Mar. 3, 1993).

went beyond investment adviser activity by engaging in broker-dealer activity that would require registration as a broker-dealer under the Exchange Act. An investment adviser's fiduciary duty to its clients is an attribute of being an investment adviser. It is part of the investment adviser's status as an investment adviser, and it creates obligations, but it is *not* a license to extend investment adviser activity into broker-dealer activity that is separately regulated.

E. Municipal Advisory Activity under the Commission's Adopting Release

On September 20, 2013, the Commission adopted final rules for municipal advisor registration ("Adopting Release" and "Final Rules").[19] Among other things, the Final Rules interpret the statutory definition of the term "municipal advisor" and "municipal advisory activity." A municipal advisor includes a person that provides advice to or on behalf of a municipal entity or obligated person with respect to the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such issues of municipal securities or municipal financial products. Municipal advisory activity is activity that would require a person to register as a municipal advisor.

The Adopting Release gives particular attention to the "advice standard" that constitutes municipal advisory activity. "Advice" means advice that is particularized to the specific needs, objectives, or circumstances of a municipal entity or obligated person with respect to the issuance of municipal securities. The boundary of municipal advisory activity is providing advice to municipal entities or obligated persons.

Under section 15B(e)(4) of the Exchange Act, and under the Final Rules, municipal advisors include, among other persons who engage in municipal advisory activity, financial advisors, third-party marketers, placement agents, solicitors, and finders, to the extent that such persons otherwise meet the requirements of the municipal advisor definition. In the absence of

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[19] Registration of Municipal Advisors, Release No. 34-70462 (September 20, 2013), 78 FR 67467 (November 12, 2013).

any relevant exemption or exclusion, if a person engages in municipal advisory activity, it must register as a municipal advisor; if the person engages in investment adviser activity, it must register as an investment adviser; and if a person engages in broker-dealer activity, it must register as a broker-dealer. A municipal advisor is a person that provides advice, not a person that "effects" transactions. It follows that if a municipal advisor is engaged in activity that goes beyond advice under the municipal advisor "advice" standard, it is probably engaging in activity that is not solely municipal advisory activity and may be activity that should be regulated under a relevant separate regulatory system.

The Adopting Release addresses placement agent activity in the context of the underwriter exclusion to the definition of municipal advisor in the Exchange Act. The Commission notes that broker-dealers are subject to registration under the Exchange Act "regardless of whether they act as principal or agent in a municipal securities offering."[20] The Commission, therefore, concludes that a registered broker-dealer, acting as a placement agent, would not have to register as a municipal advisor if it performs activities that would otherwise be within the underwriter exclusion.[21] Again, it can be fairly concluded that there is activity in the placement of municipal securities that is broker activity. Engaging in such activity is broker-dealer activity requiring registration under section 15.

F. SEC Staff No-Action Correspondence on Broker-Dealer Activity

The SEC staff has developed much of its analysis of the line between activity that does not require broker-dealer registration and activity that does require registration by its recognition of a narrow exception to broker-dealer registration for certain "finders."[22] A finder is a person who

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[20] 78 FR at 67515.

[21] *Id.*

[22] *See* e.g. Hallmark Capital Corp., SEC denial of no-action request (June 11, 2007); incoming letter (Feb. 26, 2007); Brumberg, Mackey & Wall, PLC, SEC denial of no-action request (May 15, 2010).

places potential buyers and sellers in contact with each other for a fee.[23] The true finder generally steps away from the transaction after introducing the parties to each other, and participates only in the earliest stages of a transaction. Often the determination of whether a person is a finder and not a broker-dealer is made through a negative analysis, i.e., by considering the activities they do not perform.[24] A person required to register as a broker-dealer has gone beyond this limited finder activity by negotiating the terms of the financing and otherwise "effecting a transaction." A placement agent generally must register as a broker-dealer because it effects transactions in securities.

The analysis of the activities of municipal advisors to municipal entities is consistent with the analysis of finders.[25] When the staff in 2000 revoked its prior no-action letter to Dominion Resources in connection with financial advisory services to municipal entities, it stated: "Since issuing the August 22, 1985 letter to Dominion Resources, the staff has frequently considered the question of when a person is a broker that must register as a broker-dealer under Section 15 of the Exchange Act, and when the person is merely a "finder" that is not subject to registration… In light of these developments, the staff has reconsidered the no-action position taken in the August 22, 1985 letter to Dominion Resources. The staff no longer believes that an entity conducting the activities described in that letter would not have to register as a broker-dealer under Section 15 of the Exchange Act."[26] The revocation did not specify which of the Dominion Resources activities crossed the line, but the 1985 correspondence indicated that Dominion Resources intended to be an active participant in negotiating transactions.[27]

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[23] Robert L.D. Colby, Lanny A. Schwartz and Zachary J. Zweihorn, "What is a Broker-Dealer," in Clifford E. Kirsch, *Broker-Dealer Regulation,* (PLI, 2018) at 2:2.7[A].

[24] Laura S. Pruitt, "Brokers, Dealers and 'Finders,'" *Id.* at section 3;2.4.

[25] *Id.* at section 3:4.5.(*citing,* Peyton Sec. Co., SEC No-Action Letter (Dec. 4, 1975).

[26] Division of Market Regulation, Revocation of Prior No-Action Relief Granted to Dominion Resources, Inc. (March 7, 2000).

[27] The revocation letter listed the proposed activities, including: "It . . . planned to participate in negotiations. In addition, Dominion Resources anticipated that it would introduce an issuer to a commercial bank to act as the initial purchaser of securities and as a stand-by purchaser if the securities could not be readily marketed by a broker-

A district court has stated that a finder will be performing the functions of a broker-dealer, triggering registration requirements, if activities include: involvement in negotiations, discussing details of securities transactions, making investment recommendations, and having prior involvement in the sale of securities.[28]

A New York district court reviewed a number of prior court decisions to make the following observations:

- A finder finds potential buyers or sellers, stimulates their interest, and brings parties together, while a broker brings parties together on particular terms.
- Finders, unlike brokers, do not play a role in the negotiation, drafting, and signing of a purchase agreement and closing documents.
- A finder introduces and brings the parties together, without any obligation or power to negotiate the transaction, in order to earn a finder's fee, while a broker, who may perform that same introduction task, also ordinarily brings the parties to an agreement.[29]

PFM's list of proposed activity for which it seeks Guidance can be compared to the finder jurisprudence, and it is clear that it falls on the broker side of the registration rules for regulated entities. The Request states that the municipal advisors will:

- **Identify and assess qualified providers**. Outreach to previously identified qualified providers, often in a competitive bidding process or referred by the ME client and evaluation of the differential terms proposed by qualified providers.
- **Interact with qualified providers.** Management leading to acceptable structuring of the material terms and conditions associated with the direct placement (negotiation of terms with providers). Negotiation on behalf of the ME client with one or more qualified providers selected by the ME with respect to the terms approved by the ME.

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dealer. Dominion Resources represented that the only contact it would have with any potential purchaser was the possible introduction of an issuer to a commercial bank standby purchaser. In exchange for those services, Dominion Resources planned to receive a negotiated fee that would generally not be payable unless the financing closed successfully."

[28] Cornhusker Energy Lexington, LLC v. Prospect St. Ventures, Fed. Sec. L. Rep. (CCH) ¶ 93974, Exchange Act Release No. 43,709, 73 SEC Docket 2831, 2000 WL 1818415 (S.E.C. Rel. No. 2000).

[29] Found. Ventures, LLC v. F2G, Ltd., 2010 WL 3187294 (S.D.N.Y. 2010).

- **Perform coordination necessary with selected qualified provider(s).** Coordination of meetings and communications, documents and information between the ME client and, as applicable, their respective counsel, with the qualified providers, and, as applicable, their respective counsel and other advisors in order to document and complete the financing.[30]

G. The Basis of Compensation

Non-dealer municipal advisors ordinarily bill their clients in the form of transaction-based compensation. Transaction-based compensation refers to compensation based, directly or indirectly, on the size, value or completion of a securities transaction, and, when a person charges transaction-based compensation, it often indicates that the person is engaged in effecting a securities transaction.[31] The staff explained its reasoning in a partial denial of a no-action request by 1st Global, Inc. in 2001:

> Receipt of transaction-based compensation related to securities transactions is a key factor that may require an entity to register as a broker-dealer. As we noted in the Birchtree line of responses to requests for no-action relief. The Division "has taken the position that the receipt of securities commissions or other transaction related compensation is a key factor in determining whether a person or an entity is acting as a broker-dealer. Absent an exemption, an entity that receives commissions or other transaction-related compensation in connection with securities-based activities that fall within the definition of 'broker' or 'dealer' ... generally is required to register as a broker-dealer." Persons who receive transaction-based compensation generally have to register as broker-dealers under the Exchange Act because, among other (citing Letter re: Birchtree Financial Services. Inc. (Sept. 22, 1998)) reasons, registration helps to ensure that persons with a "salesman's stake" in a securities transaction operate in a manner consistent with customer protection standards governing broker-dealers and their associated persons. such as sales practice rules.[32]

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30 Note that the description of the proposed activities as written in the body of the Request is not identical with the description in Appendix B of the Request.

31 Colby, Schwartz, and Zweihorn, "What is a Broker-Dealer?" in Kirsch, *Broker-Dealer Regulation,* at section 2:2.6.

32 Division of Market Regulation, Partial Denial of No-Action Request of 1st Global, Inc. (May 7, 2001).

PFM does not mention the basis on which municipal advisors will expect to be compensated for their proposed placement agent activity. We surmise that they are aware of the implications of transaction-based compensation on the broker-dealer registration analysis, and perhaps they can envision an alternative basis of compensation in some circumstances, but they do not discuss it in the Request and, ultimately, cannot speak for all municipal advisors on the compensation issue. When most non-dealer municipal advisors act as placement agents, they will probably seek and receive transaction-based compensation in some manner.

H. MSRB Rule G-23 Conflicts and Policy

Rule G-23 prohibits broker-dealer role switching from first acting as a municipal issuer's financial advisor[33] to subsequently acting as an underwriter of an issue of municipal securities for the issuer on the same transaction. The rule prohibits the dual activity not only when the broker-dealer attempts to switch from advisor to underwriter in an arms-length principal capacity, but also when it attempts to act in an agency capacity on behalf of the issuer in a placement of municipal securities:

> no broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to the issuance of municipal securities shall … act as agent for the issuer in arranging the placement of such issue.[34]

A broker-dealer financial advisor, therefore, may not be a placement agent on the same transaction. The Request, however, seeks Guidance that a non-dealer municipal advisor may act as a placement agent on the same transaction for which it is acting as municipal advisor.

Rule G-23 in its current form was approved by the SEC in 2011. The 2011 amendment changed a prior rule, which had allowed role switching if notice were given to the issuer (and

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33 A "financial advisor" is one type of "municipal advisor" under Section 15B(e)(4)(B) of the Exchange Act.

34 Rule G-23(d).

consent received from the issuer), to an outright prohibition. The MSRB stated the policy concerns that led to the amendment in its filing of the proposed rule change with the SEC:

> The proposed rule change resulted from a concern that a dealer financial advisor's ability to underwrite the same issue of municipal securities, on which it acted as financial advisor, presented a conflict that is too significant for the existing disclosure and consent provisions of Rule G-23 to cure. Even in the case of a competitive underwriting, the perception on the part of issuers and investors that such a conflict might exist was sufficient to cause concern that permitting such role switching was not consistent with "a free and open market in municipal securities," which the Board is mandated to perfect. The imposition by Dodd-Frank of a fiduciary duty upon municipal advisors, which includes financial advisors, made the existence of such a conflict a greater concern.[35]

Later in 2011, the MSRB released an information notice that was intended to alert all financial advisors of the reach of Rule G-23, as amended:

> financial advisors that have not traditionally viewed themselves as brokers could unintentionally become subject to MSRB Rule G-23, which, effective November 27, 2011, generally precludes financial advisors that are broker-dealers from becoming underwriters or placement agents for issues of municipal securities for which they have been serving as financial advisors. Therefore it is crucial that financial advisors are aware of the SEC rules that can result in their being viewed as placement agents as a result of their activities. …
> The repeal of the Dominion Resources no-action letter and the reasons given by the SEC for the repeal should be considered by all financial advisors when they choose to engage in certain activities with regard to the placement of municipal securities, particularly if they will introduce potential investors to an issuer or negotiate with potential investors, in either case coupled with the receipt of transaction-based compensation. Financial advisors should consult with their counsel for advice on whether such activities may require them to register with the SEC as "brokers" and subject them to MSRB rules applicable to broker-dealers, as well as those applicable to municipal advisors. All financial advisors, including those that are already registered as broker-dealers, should also consult with their counsel on whether engaging in such activities could trigger the application of MSRB rules that apply to placement agents. All financial advisors may also find an SEC publication called "Guide to Broker-Dealer Registration" helpful. It

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[35] File No. SR-MSRB-2011-03 at p. 9.

> contains answers to frequently asked questions, including "Who is required to register?"[36]

In its 2011 filing of the proposed rule change to Rule G-23, the MSRB reviewed comment letters it had received, including a letter from the National Association of Independent Public Finance Advisors.[37] The MSRB noted:

> A trade association for non-dealer financial advisors stated that there is an unacceptable and/or inherent conflict of interest when a dealer financial advisor for an issue becomes an underwriter for the same issue.[38]

In its request for comments prior to the proposed rule filing, the MSRB received a comment letter from PFM in which PFM argued:

> In our view, the principles which inform the proposed revision of Rule G-23 compel a prohibition against a broker holding the confidential role of financial advisor at the same time it is negotiating and designing to its own benefit a separate securities issuance for the same client.[39]

The same principles should compel a prohibition of the activities proposed by PFM in its Request without complying with the relevant regulatory framework. A non-dealer municipal advisor

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[36] MSRB, Financial Advisors, Private Placements and Bank Loans, MSRB Notice 2011-37 (Aug. 3, 2011).

[37] *Id.* at p.13.

[38] See National Association of Independent Public Finance Advisors, Letter from Steven F. Apfelbacher, President dated September 30, 2010.

[39] Comments on MSRB Notice 2010-27 (August 17, 2010**);** Public Financial Management, Inc., Letter from F. John White, Chief Executive Officer, dated September 29, 2010. PFM, in subsequent comment letters has similarly emphasized that there are differences between municipal advisory activity and broker-dealer activity. For example, in arguing that a municipal advisor should not be required to obtain CUSIP numbers for transactions under Rule G-34, PFM stated, in reference to municipal advisors obtaining CUSIPs, that it would be "activity that falls outside the purview of their scope of service and epitomizes traditional broker-dealer type activity." Comments on MSRB Notice 2017-11 (June 1, 2017); Letter from Leo Karwejna, Chief Compliance Officer, Cheryl Maddox, General Counsel, and Catherine Humphrey-Bennett, Municipal Advisory Compliance Officer, dated July 3, 2017.

should not be allowed to act as placement agent for an issue on which it is serving in the capacity of a municipal advisor.[40]

I. PFM Inconsistencies and Inaccuracies in the Request

There are a number of statements made by PFM in the Request that are either inconsistent with other statements made or simply inaccurate, including:

- PFM states that the Guidance is "essential" for PFM and other [municipal advisors] "to fulfill their statutory mandate." There is no statutory mandate for municipal advisors to act as placement agents.
- PFM claims it is only seeking clarification of the extent of permitted advice under permitted municipal advisory activity, and that it does not intend to engage in broker activity. The bottom line of the Request is that PFM is asking that municipal advisors be allowed to act as placement agents without appropriate registration.
- The Request refers to "previously qualified buyers" that have been referred to the municipal advisor by the municipal entity. In fact, purchasers of Direct Placements are, in many cases, solicited by broker- dealer placement agents. Also many commercial banks have teams seeking such opportunities and self-identify themselves to issuers. At any rate, a "previously qualified buyer" does not mean they are a currently qualified buyer for a different transaction.
- The Request claims that the Guidance is necessary in "avoiding duplicative and overlapping regulation." In fact, the policy of the securities laws is to require regulation under a particular regulatory regime if a person engages in the activity that is the subject of the regulation.

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[40] We note that the MSRB has a request for comment outstanding on issues related to Rule G-23 in light of the MSRB's rulemaking activity in Rule G-17 and Rule G-42, as well as current practices in the municipal securities marketplace. MSRB Notice 2019-13 (May 20, 2013).

- The Request states that the "narrow scope of the requested Guidance addresses the investor protection concerns of the Commission and Staff." The Request, in actuality, completely disregards investor protection policy, and makes clear that the municipal advisor will be acting solely in the interests of its issuer client.
- The Request emphasizes the sophistication of what are described as "Qualified Providers," but, in reality, the investor may be any entity with $50 million in assets that is solicited to invest in the placement of securities without any of the investor suitability or other protection activities required of a broker-dealer.
- The Request makes the assertion that the use of municipal advisors would better ensure that offering materials are accurate and complete. There is no unique skill set that a municipal advisor brings to this task, and unlike a placement agent, no clearly defined regulatory duty (other than antifraud rules of general applicability) absent a specific contractual commitment to the issuer.

J. Conclusion

The Request should be denied. There is no evidence that issuers (or obligated persons) are presently disadvantaged since issuers and obligated persons are currently able to, and do regularly, enter into the types of transactions described in the Request. Indeed, all evidence points to a robust and functioning market for the Direct Placements that are the subject of the Request. SIFMA urges the SEC, instead, to take the opportunity to remind municipal advisors that they may not engage in broker activities without registering as broker-dealers and being subject to the regulatory scheme that applies to persons engaged in broker activity. In doing so, the SEC will act consistently with the guidance it has provided to market participants over the past decades and

ensure that investors in securities transactions have the protections afforded to them under the federal securities laws.

Sincerely Yours,

Leslie M. Norwood
Managing Director and
Associate General Counsel

cc: ***Municipal Securities Rulemaking Board***
Gary Hall, Chair
Lynnette Kelly, President and Chief Executive Officer
Michael Post, General Counsel
Lanny Schwartz, Chief Regulatory Officer