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MSRB Proposes Amendments to Rule G-23 to Prohibit Financial Advisors from Underwriting, Remarketing

On August 17, 2010, the Municipal Securities Rulemaking Board (the "MSRB") announced that it is considering amendments to MSRB Rule G-23 to prohibit a dealer from underwriting or acting as remarketing agent for new issues of municipal securities if it also acts as the issuer's financial advisor in the transaction, with narrow exceptions. The proposed rule change was released less than a month after the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, under which financial advisors will, beginning October 1, 2010, have a fiduciary duty to municipal issuer clients.

Underwriting Prohibition

Current Rule. Currently, Rule G-23 allows a financial advisor for a new issue of municipal securities, which is also a broker, dealer, or municipal securities dealer (a "dealer"), to also act as underwriter (alone or in a syndicate), private purchaser, or placement agent for the transaction upon satisfaction of certain conditions, which vary depending on whether the transaction is negotiated or competitively bid.

In negotiated transactions, the dealer must in writing (a) terminate the financial advisory relationship with regard to the issue; (b) receive express consent from the issuer to the dealer's new role as underwriter, private purchaser, or placement agent; (c) disclose to the issuer that there may be a conflict of interest in the dealer changing roles and receive the issuer's written acknowledgement of such disclosure; and (d) disclose to the issuer the source and anticipated amount of all compensation the dealer will receive as underwriter, private purchaser, or placement agent, and receive the issuer's written acknowledgement of such disclosure.

In competitively bid transactions, the dealer must receive the issuer's written consent prior to bidding on the transaction.

In each case, the dealer must disclose its financial advisory relationship to any customers who will purchase the securities from the dealer. Records of written disclosures, consents, and acknowledgements must be kept.

The same requirements and limitations apply where another dealer (an "affiliate") which controls, is controlled by, or is under common control with the dealer acting as financial advisor wishes to underwrite, privately purchase, or act as placement agent for the transaction.

Proposed Amendments. The proposed amendments to Rule G-23 would prevent a dealer that acts as a financial advisor to an issuer for a new issue of municipal securities, whether sold on a negotiated or competitive basis, from underwriting (alone or in a syndicate), privately purchasing, or acting as placement agent in the transaction, with two very narrow exceptions. First, such a dealer would not be prohibited from acting as placement agent to place the issue with a governmental entity as part of a plan of financing by the governmental entity on behalf of the issuer, but only if the dealer does not receive any compensation for such placement or for underwriting any contemporaneous related financing transaction undertaken by the governmental entity. Second, such a dealer would not be prohibited from purchasing the issue from an underwriter of such issue so long as such purchase is not made to circumvent the purpose and intent of Rule G-23.

This broad prohibition and the narrow exceptions would also apply where another dealer which is an affiliate of the issuer's financial advisor wishes to underwrite, privately purchase, or act as placement agent for the transaction.

Remarketing Prohibition

Current Rule. Currently, Rule G-23 allows a dealer acting as a financial advisor to an issuer with respect to a new issue of municipal securities to act as remarketing agent for the issue if the dealer (a) provides written disclosure to the issuer stating (i) that there may be a conflict of interest in acting as both financial advisor and remarketing agent for the securities and (ii) the source and basis of the compensation the dealer could earn as remarketing agent on the issue and (b) receives the issuer's (i) express written acknowledgement of receipt of such disclosure and (ii) consent to the dealer acting in both capacities and to the source and basis of compensation.

Proposed Amendments. The proposed amendments to Rule G-23 would prohibit a dealer acting as financial advisor to an issuer with respect to a new issue of municipal securities from acting as the remarketing agent for the issue. The proposed amendments would also prohibit the dealer from acting as successor remarketing agent for the same issue unless the financial advisory relationship in connection with such issue had been terminated for a period of at least one year.

Request for Comment

The MSRB is requesting comments generally on the proposed amendments to Rule G-23. The MSRB has also enumerated various specific topics with respect to which it is requesting comments, including:

- Whether exceptions to the broad underwriting prohibitions of the proposed amendments should exist for competitively bid transactions, including whether there are specific circumstances that should give rise to such exceptions (e.g., if a failed bid occurred, or if the notice of sale is made available 5-7 business days before the competitively bid transaction to allow additional time for competing firms to conduct due diligence);
- What are current practices relating to activities of financial advisors in competitively bid transactions (e.g., whether there are instances in which a financial advisor should resign in order to bid on a transaction, and whether there are times when the financial advisor does not conduct the bid process for the issuer);
- Whether a dealer that underwrites a prior offering of securities should be prohibited from entering into a financial advisory relationship with the issuer for a specific timeframe;

- Whether it is appropriate for a dealer to act as financial advisor for a certain issue at the same time it acts as underwriter for a separate issue of the same issuer; and
- The impacts of the proposed amendments on small and/or infrequent issuers.

The full text of the proposed amendments and topics with respect to which the MSRB has solicited comments can be viewed at www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-27. Comments must be submitted no later than September 30, 2010.

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