March 10, 2014

Mr. Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

Re: Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors; MSRB Regulatory Notice 2014-01

Dear Mr. Smith:

The National Association of Health and Educational Facilities Finance Authorities (*"NAHEFFA"* or the *"Association"*) appreciates the opportunity to submit its comments on the above-referenced notice (the *"Notice"*) and draft proposal for MSRB Rule G-42 (the *"Proposed Rule"* or the *"Rule"*).

The Association is a national association of mostly statewide tax exempt bond issuing authorities (each an *"Authority"* and, collectively, the *"Authorities"*) which are created and empowered by state laws and recognized by the Internal Revenue Code to provide conduit financing for nonprofit healthcare and education institutions and other nonprofit organizations. (Some of the Authorities also issue bonds for governmental purposes and other private activities.) NAHEFFA's mission is to support access to readily available, low-cost capital financing options for these institutions. The Association promotes the common interests of its member organizations and seeks to enhance the effectiveness of all such organizations and their programs. The Association focuses its efforts on issues which directly influence the availability of, or access to, financing options, including tax-exempt financing, for health and educational institutions.

I. OVERVIEW

Our comments on the Notice are focused on (i) the ability of an Authority's financial advisor to advise the borrower in conduit financing transactions, (ii) the ability of a conduit borrower's financial advisor to advise the Authority in conduit financing transactions, (iii) whether the borrower and an Authority can use the same municipal advisory firm and (iv) the distinction between the duty of loyalty and other obligations set forth in the Proposed Rule. These comments stem in part from the request in the Notice for comment on whether the MSRB should extend the fiduciary duty owed by municipal advisors to municipal clients to a municipal advisor's obligated person clients, which, in our case are our conduit borrowers.

We appreciate that the MSRB has highlighted and requested comment on how the Rule should apply in conduit financings. The Association is supportive of the basic purpose behind the Proposed Rule and the underlying statutory provisions. The final Rule should work effectively to protect issuers and, in conduit financings, borrowers and we offer in that spirit a proposal in this submission that we believe will ensure this. We also are sensitive, however, to the special structure and considerations which apply in our sector where the issuer and borrower are separate entities. To the extent the present system and structure works efficiently, we do not want this Rule to disrupt valuable information received by borrowers or to impose inordinate costs on non-profit institutions. The Proposed Rule's draft economic impact analysis understandably does not yet analyze this specific scenario but the Association believes that its comments highlight the need to do so.

First, the Association is concerned that the Proposed Rule could inhibit the current, beneficial practice of some of its members of hiring a financial advisor to provide advice that ultimately benefits the conduit borrower. The Association believes it is critical to the cost-effectiveness of conduit financings that Authorities, who so wish, be able to continue this practice.

Second, the Association believes and requests MSRB's confirmation that there is no unmanageable conflict when there are advisors for both the municipal entity and the conduit borrower or when the conduit borrower has a municipal advisor who provides advice on the municipal financing. The Proposed Rule does not provide any clarification or guidance on these matters which could have significant impact on the current practices of the Association's members and how they assist their conduit borrowers.

Third, the Association is concerned that certain obligations owed by a municipal advisor to an obligated person client under the Proposed Rule in effect, inappropriately impose a fiduciary duty on municipal advisors providing advice to obligated persons who are not otherwise municipal entity clients. The Association respectfully submits that imposing a fiduciary duty (whether implicitly or explicitly) on a municipal advisor that provides advice to an obligated person is contrary to the specific legislative intent expressed in the Dodd-Frank Act and unnecessarily complicates a municipal advisor's role in conduit financings.

Finally, the Association proposes that it may be prudent for the MSRB to create a separate rule (or an interpretation under Rule G-17) that sets forth the duties and obligations of municipal advisors with respect to obligated persons or to revise the Proposed Rule to specifically and clearly set forth such obligations. Such a rule should be based on existing MSRB rules for other professionals involved in municipal financings concerning the level of care and fair dealing.

Overall, the objective of the Rule should be to be properly protective but to provide Authorities, borrowers and advisors with enough flexibility to achieve their objectives in conduit financings, including containing costs.

II. SINGLE FINANCIAL ADVISOR

As noted, the Association's members consist of various financing authorities that are organized as public instrumentalities of the respective states in which they are organized, or a similar type of municipal or other public entity. These state financing authorities frequently act as issuers in conduit financings on behalf of borrowers that consist of both large and small not-for-profit healthcare and educational institutions and other nonprofit entities.

Current Practice of Authority Retaining Financial Advisor. Practices among our member Authorities vary greatly. Some of the Authorities retain a financial advisor (either for a particular transaction, or on a long-term basis), that provides advice to the Authority which the Authority makes available to the borrower as well. In addition, the Authority's financial advisor sometimes provides advice directly to the conduit borrower. For certain of the Authorities, the hiring of the financial advisor is part of its efforts to meet statutory or policy directives that specifically provide that the Authority's responsibility is to assist its borrowers in obtaining the most appropriate financing. Borrowers often rely on the Authorities for guidance and assistance throughout the transaction, and may rely to a large extent on the Authority's financial advisor. This practice has been very helpful particularly for "small" borrowers, *i.e.,* those that have limited funds and limited or no access to other financing resources. Some Authorities are also able to achieve additional economies of scale by retaining a financial advisor that serves on a long-term basis with respect to all of its conduit borrowers. By doing so, the Authority is able to obtain more favorable pricing from the financial advisor, which in turn saves the borrowers money.

Concerns Raised by the Proposed Rule. The Association is concerned that the Proposed Rule, in its current form, could potentially inhibit an Authority's practice of engaging a single financial advisor who advises the Authority as well as its borrower.

The affirmative obligations imposed in sections (c) and (d)(i)-(iii) of the Proposed Rule are examples. These provisions would mandate specific agreements and discussions between the municipal advisor and the obligated person in addition to the Authority. Such discussions could be burdensome to clients and would impose additional time and other charges. The Association believes it is important that the Authorities who retain the financial advisors be able to continue to determine the scope of the municipal advisor relationship, and that they are in a position to do so effectively.

Also, the complete prohibition on principal transactions set forth in subsection (f) of the Proposed Rule could serve as a disincentive for municipal advisors to work with the Authorities and their borrowers, particularly large municipal advisory firms with many affiliates that could be acting as principals with respect to a borrower on a different transaction. The transaction costs to

determine whether any affiliates are acting as principal in other transactions not just with respect to the issuer, but also the obligated person, could be prohibitively expensive.[1]

Further, section (b)(ii) of the Proposed Rule would require advisors to disclose, not just to conduit issuers, but also to borrowers, "*any affiliate*…that provides *any* advice, service, or product to or on behalf of the client that is directly *or indirectly* related" to the services being provided [emphasis added]. This kind of open-ended directive, which is both vague and extremely broad, makes compliance exceptionally difficult — particularly when applied to conduit borrowers in addition to the Authorities.

The Association is very concerned that these and other obligations of advisors under the Proposed Rule will (i) destroy the economies of scale some Authorities have been able to create by retaining financial advisors for conduit financings in the manner described above, (ii) effectively cause financial advisors that do business with the Authorities to no longer provide such services and/or (iii) in many cases force borrowers to obtain their own financial advisors, thus duplicating costs and effort (assuming, of course, that advisors are not constrained by the operation of the Rule and cease to be available to conduit issuers as described above).

The municipal advisor engaged by an Authority already has a fiduciary responsibility to that entity and it is unnecessary to impose complicated standards on the firm simply because the conduit borrower is benefiting from the advice provided by the municipal advisor who also advises the conduit issuer. As pointed out by the SEC in its rules, it is only when the municipal entity is notified of the proposed financing by the obligated person that the municipal advisor rules become applicable to the obligated person. Also, in a conduit financing, the Authority and the conduit borrower have substantially similar interests when it comes to structuring the best financial transaction for the conduit borrower. Therefore, it would seem, there is little need to have additional duties also run to the obligated person on the same transaction.

III. Multiple Advisors in a Transaction or an Advisor Hired by the Conduit Borrower.

There are also times when a conduit borrower wishes to retain its own financial advisor in addition to the municipal entity issuer having its own advisor. In such situations, two municipal advisors may be working on the same municipal financing and could either be from different firms or the same firm. At other times, there are transactions when the conduit borrower retains the municipal advisor, and the issuer has chosen not to retain an advisor.

Since there are different levels of responsibility a municipal advisor owes to a municipal entity and obligated persons, conflicts and confusion could be created under the Proposed Rule.

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[1] The blanket prohibition on principal transactions could also be harmful to small conduit borrowers who may not have other options for the services being provided by the entity acting or purporting to act as principal.

For example, the Proposed Rule does not address whether municipal advisors from the same firm representing each of the Authority and the borrower presents an unmanageable conflict that would prohibit such an arrangement. As another example, the Proposed Rule leaves unanswered whether a municipal advisor hired by the conduit borrower, but who gives advice on the municipal financing, also has a fiduciary responsibility to the municipal entity[2] and whether the municipal advisor needs to make the required disclosures to the municipal entity even though they are initially hired by the conduit borrower.

The Association believes that the potential conflicts and confusion created by the Proposed Rule are unwarranted and do not serve the purposes of the law. The Association believes that the interests of the Authority and borrower in a conduit financing transaction are sufficiently aligned such that either (i) a single municipal advisor could provide advice to the borrower and an Authority in the same transaction, or (ii) municipal advisors from the same firm could represent each of the Authority and borrower and, in each case, still fulfill their respective duties owed to its client, so long as the advisors make appropriate conflicts disclosures and take any other necessary measures (*e.g.*, establishing a "screen" between the two advisors within the firm, if necessary).

It is important that the MSRB provide guidance on what the advisors must do in these situations and we request a confirmation that there is no unmanageable conflict or other issue in these situations that would prevent an advisor from advising both an Authority and borrower, or two advisors from the same firm from representing an Authority and borrower separately.

IV. FIDUCIARY DUTY

The Proposed Rule correctly limits a municipal advisor's explicit fiduciary duty to only municipal entity clients/issuers. We see no legal basis for any other conclusion nor did the SEC. Nonetheless, many of the obligations imposed upon a municipal advisor under the Proposed Rule as well as imposing a duty of care appear by implication to impose a fiduciary duty on municipal advisors with respect to obligated person clients.

For example, the Proposed Rule imposes upon municipal advisors who advise obligated persons a duty of care. Under traditional fiduciary law analysis, a duty of care has long been viewed as part of the fiduciary duty. The Proposed Rule further imposes general duties to disclose in detail any conflicts of interest and document the municipal advisory relationship and sets forth principal transaction prohibitions. Such obligations are typically reserved for fiduciaries holding a duty of loyalty to their principal, not obligations that are generally required of all parties. A municipal advisor should only be required to manage or mitigate such conflicts to the extent required to fulfill the municipal advisor fair dealing obligation under Rule G-17

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[2] This concern is further complicated by the fact that, in many cases, the borrower's municipal advisor is paid from bond proceeds.

Furthermore, the typical duty of care only entails requirements such as possessing the requisite knowledge and expertise.

Although the Proposed Rule does not explicitly label these obligations as part of the fiduciary duty, many of these obligations are fiduciary in nature, requiring a municipal advisor to undertake responsibilities and actions on behalf of its obligated person clients that are typically reserved for fiduciary relationships. By imposing these duties generally across all municipal advisor client relationships, the Proposed Rule arguably has, in effect, extended a fiduciary duty to a municipal advisor's relationship with its obligated person clients.

The Association respectfully submits that imposing a fiduciary duty (whether implicitly or explicitly) on municipal advisors providing advice to obligated person clients is outside of the statutory authority granted to the MSRB in the Dodd-Frank Act. Under Section 15B of the Securities Exchange Act of 1934, Congress directed that the MSRB establish rules regarding a fiduciary duty for municipal advisors only to their municipal entity clients.[3] As the SEC acknowledged in its adopting release of the final municipal advisor rules, municipal advisors do not owe a fiduciary duty to obligated persons, but rather only a fair dealing duty under MSRB Rule G-17.[4] The Proposed Rule's implicit imposition of fiduciary duties to obligated person clients is inconsistent with the MSRB's congressional directive. The duty of care and general duties in paragraphs (b) through (f) of the Proposed Rule should be revised to reflect Congress's intent that only a municipal advisor's relationship with its municipal entity clients be subject to a fiduciary duty.

If the MSRB does not believe that the obligations prescribed by the duty of care and paragraphs (b) through (f) of the proposed Rule amount to a fiduciary duty, the Association requests that the MSRB provide clarification on the legal and practical distinctions among the duty of loyalty, the duty of care and the duties owed under the other obligations imposed under Proposed Rule paragraphs (b) through (f).

For example, the Proposed Rule is unclear on whether the MSRB intends to follow the long-established precedent that alleged breaches of a duty of care are reviewed under a negligence standard, while alleged breaches of the duty of loyalty require intent. There is wording in the Proposed Rule that suggests that the MSRB intends to retain this traditional distinction, but the Proposed Rule should be revised to make clear that the duty of care imposes a negligence standard of conduct while the duty of loyalty requires intent.

Further, the distinction between the duties owed under a duty of loyalty on the one hand, and the prohibition on principal transactions and duty to disclose conflicts of interests on the other needs clarification. In requiring such similar duties of municipal advisors to all clients, it is

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3 15B U.S.C. § 78o-4(c)(1).

4 *See* Adopting Release at 156.

difficult to determine how a municipal advisor's conduct towards its municipal entity clients would differ from its conduct to all clients.

Finally, the distinction between the duties outlined under the duty of care and the recommendation obligations outlined under paragraph (d) of the Proposed Rule need clarification. Similar to the suggestion discussed above, as the Proposed Rule is currently drafted, it is difficult to assess the difference between the recommendation obligations under paragraph (d) and the obligations imposed by the duty of care.

V. PROPOSED SOLUTION

The Association strongly believes that in order for a number of its Authorities to continue to provide cost-effective and accessible financing options for conduit borrowers, it is critical that these Authorities be able to continue the practice of engaging financial advisors that can provide advice that benefits borrowers from time to time. The MSRB needs to provide guidance on the roles and responsibilities of municipal advisors when multiple advisors are involved in a transaction.

The Association suggests that the MSRB either propose a separate rule that (or a Rule G-17 interpretation) sets forth the duties and obligations of municipal advisors with respect to obligated persons (particularly in the context of conduit financings) or revise the Proposed Rule to specifically and clearly set forth such obligations. In either case, the Association respectfully submits that the disclosure and other obligations of municipal advisors with respect to private obligated persons must accurately reflect the arms-length duty of fair dealing. As discussed in Section III above, such duties and obligation should not rise to the level of the duties and obligations currently set forth in the Proposed Rule which improperly amount to a fiduciary duty.

Rather than imposing the numerous and detailed obligations currently contained in the Proposed Rule, the disclosure and other obligations municipal advisors should have with respect to private obligated persons should be simplified to clearly reflect a duty to exercise its best professional judgment and expertise in providing its services and to deal fairly with its clients rather than be held to a fiduciary duty. For example, such obligations could include the obligation (i) to deal fairly with the obligated person and not engage in any deceptive, dishonest or unfair practice; (ii) to disclose actual or potential material conflicts of interest as already contemplated in Rule G-17; (iii) to disclose its role in the financing, the fact that it owes a duty to deal fairly with both the Authority and the borrower under MSRB Rule G-17 and the fact that it owes a fiduciary duty to the Authority but not to the borrower; (iv) to disclose actual or likely conflicts arising from the form of compensation being used; (v) to discuss the material financial characteristics of a complex financings and any incentive of the advisor to recommend such a financing; and (vi) if the advisor believes the Authority or borrower lacks knowledge or experience with the financing structure being used or comes to believe that the Authority or borrower does not understand the financing structure or its key elements, to provide advice, to the extent it deems necessary and appropriate, to assist the Authority and/or borrower in

understanding the financing structure or its key elements. Except where it is absolutely critical to provide individualized disclosures (*e.g.*, with respect to conflicts), the various disclosures could be standardized.

From a conceptual standpoint, the Association suggests that the new rule or revised Proposed Rule outlined above provides Authorities, borrowers and advisors with enough flexibility to achieve their objectives in conduit financings, including containing costs by allowing them to use a single advisor or two advisors from the same firm, while still satisfying the duty of fair dealing.

VI. CONCLUSION

The Association supports the efforts of the MSRB to clarify the role and responsibilities of municipal advisors and to protect Authorities and obligated persons. The Association believes that the framework for regulation of municipal advisors as to obligated persons should accurately reflect the duty of fair dealing, adequately distinguish it from the duty of loyalty and eliminate the burdensome elements of the current Proposed Rule.

The Association appreciates the opportunity to comment on the Notice and the Proposed Rule. Please do not hesitate to contact Pamela Lenane, President of the Association at (312) 651-1340.

Respectfully Submitted by,

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