TEXAS COMPTROLLER *of* PUBLIC ACCOUNTS

SUSAN COMBS

February 22, 2011

Ms. Elizabeth M. Murphy
Secretary
United States Securities and Exchange Commission
100 F St., NE
Washington, D.C. 20549-1090

re: File Number S7-45-10
SEC Release No. 34-63576, 76 FR 824 (January 6, 2011) (the "Release")

Dear Ms. Murphy:

I respectfully submit this letter in response to a request by the Securities and Exchange Commission (Commission) for comments regarding the above referenced Release. I concur with the recommendations made by the Texas Attorney General and, by this letter, provide additional information that is specific to my office.

As the Texas Comptroller of Public Accounts, I am the chief steward of the state's finances. Under Texas law, I am the state's tax collector, chief accountant, chief revenue estimator and treasurer for Texas state government. I am the sole shareholder and director of the Texas Treasury Safekeeping Trust Company (Trust Company), which manages and invests state funds, Trust Company funds, escrowed funds and pooled funds. The Trust Company receives guidance from the Tobacco Settlement Permanent Trust Account Investment Advisory Committee (Tobacco Account Committee) in its management of the assets of the Tobacco Settlement Permanent Trust Account. The Trust Company receives guidance from the TexPool Investment Advisory Board (TexPool Board) in its management of the assets of the Texas Local Government Investment Pools, TexPool and TexPool Prime. The Trust Company receives guidance from the Comptroller's Investment Advisory Board (CIAB) in its investment of state funds. I also chair and manage the operations of the Texas Prepaid Higher Education Tuition Board (Prepaid Board) which governs the state's Section 529 college savings and prepaid tuition plans. These boards are composed almost entirely of appointed members who are neither ex-officio board members nor state employees, but who dedicate their time and perform a valuable state service.

I agree with the Commission's efforts to balance the interests of the market and the public to provide transparency and accountability in the issuance and investment of municipal securities. I offer these comments to address areas where I believe the Commission either should provide additional guidance or should reconsider its approach.

Recent amendments to Section 15B of the Exchange Act of 1934 (as amended, the Exchange Act) require that "municipal advisors" register with the Commission and

with the Municipal Securities Rulemaking Board (MSRB) and become subject to other statutory and regulatory requirements. The Exchange Act expressly excludes municipal entities and employees of municipal entities from the definition of "municipal advisors."[1] The Commission interprets this statutory exclusion to exempt elected officials who are ex- officio board members, but not to exempt appointed members of municipal boards.[2] The Release solicits comment on several topics, including whether the Commission's distinction between unelected board members (who would be required to be registered and regulated as "municipal advisors" if they provide the "advice" to their governmental entity) and elected board members (who would be exempt from registration and regulation as "municipal advisors") is appropriate.

1. Appointed Members of Municipal Boards and Committees

The Commission would interpret the term "municipal advisor" as including non ex-officio appointed members of a governing body, because they are not exempt as "employees of a municipal entity." Specifically, the Commission states: "The Commission does not believe that appointed members of a governing body of a municipal entity that are not elected ex-officio members should be excluded from the definition of 'municipal advisor.'"[3] The Commission offers a two-step explanation for its belief. First, it states "this interpretation is appropriate because employees and elected members are accountable to the municipal entity for their actions."[4] Second, it adds: "the Commission is concerned that appointed members, unlike elected officials and elected *ex officio* members, are not directly accountable for their performance to the citizens of the municipal entity."[5]

I suggest the better approach for the Commission is to interpret any person elected to, appointed to, or employed by a municipal entity, governing body, or advisory board under state or local law as "a municipal entity or an employee of a municipal entity."

Such an interpretation would not impede any remedial purpose of Dodd-Frank identified by Congress or the Commission as necessary among appointed members of municipal entity boards.

a) Boards and their members are a single legal entity.

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1 15 U.S.C. § 78o-4(e)(4)(A).
2 76 F.R. 824, 834 (Jan.6, 2011)
3 76 F.R.at 834.
4 *Id.*
5 *Id.*

Board members are inextricably intertwined with the municipal entity they serve, and the Commission's failure to exclude board members as an integral part of the municipal entity ignores their statutory framework. A municipal entity cannot advise itself any more than a private individual can. The giving of advice necessarily requires two or more persons. In an analogous line of cases, courts have held that it is elementary that an entity cannot conspire with itself. A board and its members are a single legal entity, thus a Section 1985 claim alleging conspiracy between a board and its members must fail.[6] Further, separate actions of board members are not sufficient to bind the board as an entity.[7] Members of collegial bodies do not have standing to perfect an appeal the body itself has declined to take.[8] Further, a suit against a board member in their official capacity is not a suit against the official, but rather is a suit against the state itself. Board members sued in their official capacity would be entitled to Eleventh Amendment sovereign immunity.[9]

The facts are that a board and its members are a single legal entity. As such, the Commission should interpret the statutory exemption of municipal entities to necessarily exempt appointed members of municipal entity governing and advisory boards.

b) Appropriate regulations are already in place.

In looking to accountability as the determinative distinction between elected and appointed board members, the Commission overlooks the many different ways appointed officials may be and are held accountable under state law. Board members are appointed under statutory schemes by various state or local government officials exercising the executive, legislative or other powers provided under the state constitution. Such schemes provide the means for removal as well as appointment and identify the obligations and limitations that apply during tenure.

Direct accountability for performance to citizens of the municipal entity is likewise a narrow indicia of accountability. Certainly its absence does not equate with an absence of accountability among appointed officials. Rather, appointment of individuals to authorities, boards and commissions by elected officials is imbedded in the very concept of representative government as it exists at both federal and state levels.

In addition, I believe that Congress did not intend to regulate entities that are already regulated. With minor limitations, Congress generally excluded brokers, dealers,

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[6] *Floyd v. Amite County Sch. Dist.*, 581 F.3d 244, 251 (5th Cir. Miss. 2009)
[7] *Burns v. Harris County Bail Bond Bd.*, 139 F.3d 513, 520-521 (5th Cir. 1998)
[8] *Bender v. Williamsport Area Sch. Dist.*, 475 U.S. 534 (U.S. 1986).
[9] *Starkey v. Boulder County Soc. Servs.*, 569 F.3d 1244 (10th Cir. 2009)

municipal securities dealers serving as underwriters, registered investment advisers and their associated persons, commodity trading advisors and their associated persons, attorneys and engineers.[10] These exempted groups are already regulated. Likewise, it is unnecessary for the proposed regimen to regulate appointed members of state governing and advisory boards. State boards are already regulated by state laws that are tailored appropriately for each board's structure and function.

The definitions embodied in the proposed rule determine what persons or entities will be governed by a statutory and regulatory regimen for municipal advisors that will address qualifications, conflicts of interest, fiduciary duties and anti-fraud standards of conduct. With respect to appointed members of governing and advisory boards of municipal entities, these areas are already appropriately addressed by state statute. Two of the boards described above have thorough statutory protections in place that are redundant of the protections contained in the new, proposed regimen. One of the boards is composed of members who have an interest in the funds invested and are analogous to a client of an advisor rather than an advisor. One of the boards has a combination of experienced public and participant members.

i) Regulated Boards

Texas Prepaid Higher Education Tuition Board

State law establishes qualifications and standards of conduct and prohibits conflicts of interest for appointed board members of its municipal entities. Members of the Prepaid Board are state officers who are required to file personal financial statements with the Texas Ethics Commission.[11] With the exception of the Comptroller, board members are appointed by elected officials who are required to ensure their appointees possess the necessary background and experience to fulfill the board's statutory obligations.[12] Board members must possess knowledge, skill and experience in higher education, business or finance.[13]

In addition to the qualification requisites, state law contains appropriate conflict of interest provisions. A person is ineligible to serve if they or their spouse (1) is employed by or participates in the management of a business entity receiving funds from the board, (2) owns or controls, directly or indirectly, more than a 10 percent interest in a business entity receiving funds from the board, or (3) uses or receives a substantial amount of

[10] 15 U.S.C. § 78o-4(e)(4)(C).
[11] Tex. Gov't Code §§ 572.002, 572.021
[12] Tex. Educ. Code § 54.606.
[13] *id.*

tangible goods, services, or funds from the board.[14] A person is ineligible to be a board member or an executive board employee if they are an officer, employee or paid consultant of a Texas trade association in the field of higher education, banking, securities or investments.[15] A person may not be a board member or the board's general counsel if they are a lobbyist for a professional field related to the board's business.[16] Failure by a board member to continue to satisfy these statutory requirements is grounds for removal.[17] The board is required to adopt an ethics policy that addresses, among other things, conflicts of interest, including disclosure and recusal requirements and the acceptance of gifts and entertainment.[18] The board is subject to Texas open meetings law and procurement law.[19] Board members are required to take an oath of office and to undergo training prior to voting or deliberating.[20] As trustees, board members already have fiduciary duties with respect to the funds they invest.[21]

Thus the Prepaid Board is thoroughly regulated by state law in a manner tailored to its structure and function. Regulation by federal law would be redundant and would only serve to create a financial and personal risk to members who generously contribute their time to benefit the prepaid tuition and college savings plans for this state.

Comptroller's Investment Advisory Board

Members of the CIAB are appointed by the Comptroller.[22] Board members must have knowledge or experience in finance, including the management of funds or business operations.[23] A person is ineligible to serve if they or their spouse (1) is employed by or manages an entity that receives funds from the Trust Company, (2) owns or controls more than 10 percent of an entity that receives funds from the Trust Company or (3) receives money from an entity that receives funds from the Trust Company that exceeds 5 percent of the person's gross income.[24] Failure by a board member to continue to satisfy these statutory requirements is grounds for removal.[25] Board members are required to undergo training.[26] Board meetings are subject to open meetings law.[27]

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[14] Tex. Educ. Code § 54.608(a).
[15] Tex. Educ. Code § 54.608(b).
[16] Tex. Educ. Code § 54.608(c).
[17] Tex. Educ. Code § 54.609.
[18] Tex. Educ. Code § 54.6085.
[19] Tex. Educ. Code § 54.614, Tex. Gov't Code § 2155.063
[20] Tex. Educ. Code § 54.610.
[21] Tex. Educ. Code §§ 54.634(b), 54.636, 54.704, 54.766.
[22] Tex. Gov't Code § 404.108(b).
[23] Tex. Gov't Code § 404.108(c).
[24] Tex. Gov't Code § 404.109.
[25] Tex. Gov't. Code § 404.110.
[26] Tex. Gov't. Code § 404.111.
[27] Tex. Gov't Code § 404.113

The CIAB's role is unlike that of a traditional investment advisor. The CIAB does not assist with the selection of specific investments, nor does it assist with the selection of other investment professionals. This board exercises no control over what purchases and sales are made with state funds. The CIAB provides very general investment guidance to the Comptroller and Trust Company during four meetings per year that last approximately three hours.

While appointed members of the CIAB have, in the traditional sense of the term, no fiduciary duty, they likewise have no decision-making power.[28] State law does not impose traditional fiduciary duties upon these board members, who are powerless to act. Traditional fiduciary duties include the duty to invest and manage funds as a prudent investor would, the duty to diversify investments, the duty to delegate prudently and the duty to incur costs prudently. These board members assist the Comptroller by providing guidance on investment philosophy.[29] They possess no authority to invest funds or delegate duties, no ability to ensure investments are diversified or costs are reasonable. They have only the power to provide guidance, a power which is appropriately regulated. The Comptroller has the ability to screen appointees for conflicts of interest. And the Texas Legislature, by statute, has outlined specific conflicts that render persons ineligible to serve. An assigned fiduciary duty to these board members is unnecessary because state law has appropriate protections in place.

Thus the CIAB is thoroughly regulated by state law in a manner tailored to its structure and function. Regulation by federal law would be redundant and would only serve to create a financial and personal risk to members who generously contribute their time to benefit the citizens of this state.

ii) Beneficiary Boards

Tobacco Settlement Permanent Trust Account Investment Advisory Committee

Members of the Tobacco Account Committee are generally appointed by the entities that are beneficiaries of the fund.[30] One member represents a public hospital or hospital district for a small county or city. Six members represent the political subdivisions that receive larger distributions from the account. Four members represent the Texas County Judges and Commissioners Association for their area of the state. Because the committee

[28] Tex. Gov't Code § 404.108
[29] Tex. Gov't Code § 404.108(a).
[30] Tex. Gov't Code § 403.1042.

members are leaders from the local government entities that receive income directly from the fund, they represent beneficiaries of the Tobacco Trust Account and are essentially clients who receive advice from professional investment advisers hired by the Comptroller and who provide input on investment philosophy, risk tolerance levels and beneficiary preferences. The Tobacco Account Committee does not possess the authority to invest funds or to make any investment or management decisions.[31] Neither the Comptroller, Trust Company staff nor outside investment professionals view the guidance received from the Committee as professional investment advice. Committee meetings are essentially meetings where professional investment advisers can update the Committee, as their clients, on their investments and clients can express their needs and preferences. This advisory committee provides the true customers of the investment services an organized voice in a public forum to receive information and express needs and concerns. The Commission's rationale for proposing to regulate appointed members of municipal boards is an assumed lack of accountability.[32] These committee members are directly accountable to the entities they represent. While none of the committee members are ex officio members, several of the members who have been appointed are elected officials in their region of the state. These board members have an interest in the funds that are invested and are not the ultimate decision makers for the fund.

Thus the Tobacco Account Committee is a committee created by state statute to perform a state service, which is effectively regulated by state law in a manner tailored to its structure and function. Defining "municipal advisor" to include such committee members would be redundant and creates a financial and personal risk to members who generously contribute their time to benefit beneficiaries of the Account.

iii) Blended Boards

TexPool Investment Advisory Board

The TexPool Board is composed of eight members, half of whom are participants in the pool and half of whom are not participants. State law requires that members who are nonparticipants must be qualified to advise the pool and must not have a business relationship with the pool.[33] Current members who are participants include employees and elected officials from school districts, cities and counties. This board is not statutorily authorized to invest funds or to make any investment or management decisions.[34] Similar to the Tobacco Account Committee, the participant members of this

[31] Tex. Gov't Code § 403.1042(a).
[32] 76 F.R. at 834.
[33] Tex. Gov't Code § 2256.016(g).
[34] Tex. Gov't Code § 2256.016(g).

board are essentially representative clients who provide participants an organized voice in a public forum to receive information and express needs and concerns. Participant members have an interest in the funds that are invested. Nonparticipant members offer a balance according to their experience but make no investment decisions.

Members of the TexPool Board have no fiduciary duty and no decision-making power. Public discussions are transparent and state law governs conflicts. Defining these board members as municipal advisors serves no regulatory purpose, is redundant and creates a financial and personal risk to members who generously contribute their time to benefit the pool.

c) Proposal would interfere with state governance.

Exempting elected board members and not exempting appointed board members from the definition of "municipal advisor" seems to ignore the laws and rules among the states that have long been in place for appointed board members and potentially undermines the authority of state and local government in this area. The Commission has identified nothing in Dodd-Frank or elsewhere that either authorizes or justifies the intrusion into the authority of a state to manage its own affairs that would result from the Commission's proposed interpretation. The federal government may not direct, compel or commandeer state officials.[35]

i) Appointments by State Elected Officials

State law creates governing and advisory boards and committees to lend expertise to the Comptroller's office and Trust Company. Open dialog is essential to the state's statutory scheme and integral to the operations of traditional state functions. Including board and committee members described herein in the proposed rule would interfere with state governance. For example, the rule would interfere with appointments to state municipal advisory and governing boards. As described above, state law establishes the qualifications of the persons eligible to serve as board members. The proposed rule would require appointed board members to register and would allow the MSRB to establish qualifications of persons eligible to register as municipal advisors. This regulatory scheme effectively usurps state law and the discretion of state officials to appoint qualified members. If the MSRB were to deny an appointed board member the ability to register as a municipal advisor, this action would result in the rejection of appointments made by state elected officials.

[35] *Printz v. United States*, 521 U.S. 898, 932 (U.S. 1997)

ii) Increased Costs

The proposed rule would cause municipal entities to incur additional costs. Municipal entities that are able to retain their board members would find it necessary to pay the $100 application fee and the $500 annual fee on behalf of their board members, who would not incur the regulatory fees but for the contribution of their board service. In addition, municipal entities would incur the cost of special counsel to train and advise board members in securities law if they are able to recruit members.

d) Proposal would discourage participation.

i) Deliberation During Meetings

The proposed rule would discourage deliberation during board meetings. Without clear guidance, board members will fear that statements they make during official meetings could constitute advice that would subject them to registration requirements. A board member may refrain from making any statements that might benefit the state but could result in a registration requirement or worse sanctions for failing to register. Further, requiring appointed board members to register with the Commission prior to fulfilling their legal duty to advise would cause delays, stifle transparency and conflict with the board member's legal obligations to the municipal entity. The result would be a chilling effect on open deliberations that is contrary to the intent of Dodd-Frank.

ii) Board Membership

The proposed rule would discourage qualified citizen volunteers from serving as appointed board members. Appointed board members sacrifice their time to donate their insights and expertise to municipal entities. The rule would subject volunteer board members to additional burdens such as registration requirements and expense, nebulous criminal liability and federal securities law liability. Many boards will be unable to function if the number of vacancies rises to a level that prevents a quorum required by state law, which may force municipal entities to abandon their use of governing and advisory boards. Our office has already received feedback from appointed board members who stated that they would not continue to serve if required to register.

e*) Board structure benefits state government.*

The proposed inclusion of appointed board members of municipal entities in the definition of municipal advisor would severely limit the state's access to volunteer board

members with financial expertise and to the independent guidance they provide, potentially causing irreparable harm to the state.

The Commission should encourage, rather than discourage, the municipal governing board and advisory board structure. Volunteer appointed board members provide valuable knowledge to municipal entities. The use of governing boards and advisory boards in addition to elected officials and state employees provides additional transparency to the investment process. Because of these boards, an increased number of persons are aware of the investment activities of municipal entities. These boards conduct their business during meetings that are open to the public and their documents are open to public inspection, except where state law makes documents confidential.

2. Bright Line Exemptions

When a board member asks, "Am I required to register?" the question should be easy and clear to answer; and the answer should be no. Because failure to register creates potential criminal liability,[36] anything less than a bright line exemption would result in board member resignations. I strongly urge the Commission to exclude from the municipal advisor definition, appointed board members who are similarly situated to the members described in this comment letter. The Commission possesses the authority to do so pursuant to the statute as it is written and pursuant to the Commission's exemptive authority.[37] To the extent that the Commission determines that regulation is necessary, I urge the Commission to establish clear guidelines for appointed board members of municipal entities.

a) All activities within the scope of board membership should be excluded.

The Commission should adopt a bright-line exemption for all activities within the scope of a board or committee member's duties. This exemption should clearly include, but not be limited to:

- All activities of a board member during official meetings, whether open or closed, including all communications and voting.
- Communications between board members and attorneys, including staff attorneys and outside counsel.

[36] 15 U.S.C.§ 78u(d)(1) "Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter."

[37] 15 U.S.C. § 78o-4(a)(4).

- Communications between appointed board members and staff and outside professionals of the municipal entity.
- The fulfillment of any duties as appointed board members

Appointed board members of municipal entities could then easily determine whether they are required to register as municipal advisors.

This office has been informed of current, unofficial guidance from Commission staff that it does not consider voting, debating, discussions or questions by a governing board member at a meeting of the board on which he or she serves to be advice for the purposes of the registration requirement. If the final rules only go so far as to adopt an exclusion for those particular activities, such an exclusion will not be enough to prevent a mass exit from board service. I urge the Commission to make it easy and clear for appointed board members to determine with certainty whether their registration is required.

b) Municipal employees should always be exempt.

In addition to advising their employer, many Comptroller employees advise other municipal entities on behalf of the Comptroller's office. The Comptroller's office is frequently called upon to assist local governments with information and expertise. As employees of the state of Texas centralized accounting agency, Comptroller employees should be free to provide assistance without reservations that certain statements may make them subject to the registration requirement. The statute applies to "a person" who is not a municipal entity or an employee of a municipal entity,[38] but there is no requirement that the "person" be employed by the municipal entity that receives the advice. To argue that the exemption for municipal employees applies only when the municipal employee is advising his or her own employer would be to argue that municipal entities are only exempt when advising themselves. Congress intended to exempt all municipal entities, even where one municipal entity is advising another. Likewise, Congress intended to exempt all municipal employees, regardless of whether such employees are advising municipal entities other than their employer.

c) Municipal advisory activities should be clearly defined.

I encourage the Commission to provide additional detail and guidance on what constitutes advice on investment strategies and to answer the following questions if possible: Would discussion of asset allocation constitute advice? Would advice include the selection of an investment advisor? Would acceptance of an actuary's cash flow

[38] 15 U.S.C. § 78o-4(e)(4)(A).

model constitute advice? Does use of advanced knowledge of finance to explain the rationale for selecting one investment advisor over another constitute a municipal advisory activity? Would advice include discussions over the selection of investment managers for underlying investments? Would advice include the selection of mutual funds or unregistered securities?

d) All attorney communications should be excluded.

The Commission should exclude all attorney communication from the definition of municipal advisor. Congress excluded "attorneys offering legal advice or providing services that are of a traditional legal nature" from the definition of municipal advisor.[39] The Commission proposes to limit this exclusion where an attorney "engages in municipal advisory activities other than the offer of legal advice or the provision of services that are of a traditional legal nature to a client of the attorney that is a municipal entity or obligated person."[40] This limitation would sever the state's access to pro bono and informal assistance from industry legal professionals and would prevent the state from receiving full counsel and guidance that is routinely provided by attorneys who practice in this area of law. Further, it would require attorneys to violate the Texas rules of professional conduct by limiting the advice they give to purely technical legal advice. To preserve the constitutionality of the Act, the Commission should exclude all licensed attorneys from the definition of municipal advisor. To do otherwise would interfere with state governance. The practice of law is regulated by the states.

The rule would inhibit the free flow of information between attorney and client. If outside counsel to one of our boards advises that a particular course of action is not legally permissible, outside counsel should be free to suggest alternatives and to discuss the pros and cons of different options, including practical consequences that are financial in nature. This type of advice, in the practice of securities law, is in fact service of a traditional legal nature and is consistent with Dodd-Frank. An attorney is obligated by state law to serve as a counselor and advisor.

> A client is entitled to straightforward advice expressing the lawyer's honest assessment. ...Advice couched in narrow legal terms may be of little value to a client, especially where practical considerations, such as costs or effects on other people, are predominant. Purely technical legal advice, therefore, can sometimes be inadequate. ... Matters that go

[39] 15 U.S.C. § 78o-4(e)(4)(C).
[40] 76 F.R. at 882.

> beyond strictly legal questions may also be in the domain of another profession.

Tex. Disciplinary R. Prof'l Conduct 2.01, cmt 1, 2 and 4. If the SEC rules require attorneys to limit the advice they provide our boards in order to avoid violating the registration requirement, then the rules conflict with state law that governs attorney conduct.

Further, the exclusion of attorney communications should not be limited to communications within a formal attorney-client relationship. Attorneys who are industry experts frequently volunteer their time for the benefit of the state by answering questions on a pro bono basis for municipal entities.

e) The exemption for associated persons of Registered Investment Advisers should be clarified.

The proposed rule limits the exception for associated persons of Registered Investment Advisers to investment advice "that would subject such adviser or person associated with such adviser to the Investment Advisors Act of 1940."[41] I encourage the Commission to expand the type of investment advice that may be provided without registration as a municipal advisor to *any* investment advice, even where such advice is not made on behalf of the associated person's primary business.

A person is subject to the Investment Advisers Act of 1940 if they provide investment advice as a business for compensation. Associated persons of Registered Investment Advisors may volunteer to serve on the board of a municipal entity. If they provide investment advice to the municipal entity, it is unclear whether the exception would apply. Such investment advice would not be for compensation and would not be a part of the associated person's primary business. An exclusion of associated persons of Registered Investment Advisors who provide investment advice of any kind would assist appointed board members in determining whether they are required to register.

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Thank you for the opportunity to comment on the Commission's proposed rules. Your decisions have significant implications to this office and could cause irreparable harm if imposed for the purpose of regulation rather than to encourage transparency as prescribed by state law. Our staff is available to provide further input and assistance to your office.

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[41] 76 F.R. at 882.

If you have any questions regarding the foregoing comments, please contact Victoria North at (512) 463-6273 or by e-mail at Victoria.North@cpa.state.tx.us or Marianne Dwight regarding Trust Company boards at (512) 936-7957 or by e-mail at Marianne.Dwight@cpa.state.tx.us.

Sincerely,

Susan Combs

cc: Victoria North
Marianne Dwight