



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org

September 18, 2013

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Notice of Filing of Proposed Rule Change to Amend MSRB Rule A-3, on  
Membership on the Board, to Modify the Standard of Independence for Public  
Board Members (File No. SR-MSRB-2013-06)

Dear Ms. Murphy:

The Investment Company Institute (“ICI”)<sup>1</sup> supports the Municipal Securities Rulemaking Board’s (“MSRB”) proposal to alter the membership criteria for public representatives on the MSRB Board (“Public Members”).<sup>2</sup> The proposal would modify the standard applied to determine whether an individual is sufficiently independent so as to be eligible to serve as a Public Member. As discussed below, it does so in a manner that would increase the opportunity for employees of certain advisers to registered investment companies (“fund advisers”) to serve as Public Members. Fund advisers are active participants in the municipal markets, providing the means through which many retail and institutional investors participate in these markets. We support the MSRB working toward enhancing the representation of these investors, which should help to ensure the maintenance of fair and efficient municipal markets.<sup>3</sup>

### ***Background***

Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) amended Section 15B(b)(1) of the Securities Exchange Act of 1934 to require that a

---

<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$15.4 trillion and serve more than 90 million shareholders.

<sup>2</sup> Securities Exchange Act Release No. 70004 (July 18, 2013) (“Release”).

<sup>3</sup> Although our request is with respect to fund advisers, the rationale for treating them as Public Members applies to other investment advisers and therefore we would support the MSRB extending the requested treatment to other investment advisers.

majority of MSRB Board members be independent, or Public Members, while the remainder be associated with regulated entities (“Regulated Members”). Accordingly, MSRB Rule A-3 provides for ten Regulated Members, comprised of representatives from brokers, dealers, municipal securities dealers and municipal advisors and eleven Public Members. The Public Members must include at least one representative each of retail or institutional investors, issuers, and members of the public.<sup>4</sup>

Public Members are those that are independent of any regulated entity, meaning that the individual has “no material business relationship” with any broker, dealer, municipal securities dealer, or municipal advisor (“regulated entity”).<sup>5</sup> Pursuant to MSRB Rule A-3, an individual does not have a material business relationship if he or she is not or was not “associated with” a regulated entity within the last two years. In addition, the person must not have a relationship with any regulated entity that reasonably could affect his or her independent judgment or decision making. Although the Dodd-Frank Act defined non-public MSRB members to include individuals “who are associated with a broker, dealer, municipal securities dealer, or municipal advisor,” it did not define the term, “associated with.”

The MSRB has explained that, in practice, the “associated with” standard is without limitation and has “precluded consideration of otherwise viable candidates.” It encompasses, for example, individuals who serve as independent directors on the boards of companies within the same corporate family as broker-dealers. It also includes employees of fund advisers if the adviser is affiliated with a municipal advisory firm or with a broker-dealer that engages in the sale of municipal securities or Section 529 College Savings Plans.

### ***MSRB Proposal***

To address this shortcoming, the MSRB’s proposal would amend MSRB Rule A-3 to provide a more function-oriented approach to defining independence. Specifically, under the proposal, the term “no material business relationship” would require that an individual is not, and within the last two years was not, an officer, director (other than as an independent director), an employee or controlling person of any regulated entity. The Release explains that this change would allow the MSRB to consider candidates who are currently deemed ineligible to be Public Members due to the corporate structure of their employer.

The twenty-one members of the MSRB Board are charged with the significant responsibility of protecting municipal entities, investors, and the public interest. Each of them should bring to the table experience and expertise to effectively serve the interests of their constituents. As a starting point, there is only one Public Member position reserved for investors — both retail and institutional. The pool of

---

<sup>4</sup> The current composition of Public Members includes six public officials, two institutional investors, two members of academia, and one bond attorney.

<sup>5</sup> See Securities Exchange Act Release 63025 (September 30, 2010).

applicants is then narrowed by the “associated with” language within the Public Member standard of MSRB Rule A-3. As currently written and interpreted, MSRB Rule A-3 permits an employee of a fund adviser that is not associated in any way with a broker-dealer to become a Public Member, but does not so permit an employee of a fund adviser associated with a broker-dealer.<sup>6</sup> There is no indication that Congress intended this inequitable outcome among the class of institutional investors. The proposal offers the potential to address this inequality and improve the quality of representation for both institutional and retail investors, which would enhance the MSRB’s ability to satisfy its investor protection mandate.

The proposal is appropriately limited in a manner consistent with the Dodd-Frank Act. First, the modified definition of “no material business relationship” retains the prohibition on an individual having relationships with regulated entities that reasonably could affect his or her independent judgment or decision making. It provides the MSRB with broad authority to exclude a potential candidate from the Public Member pool if, for example, potential conflicts of interest appear too great or difficult to overcome. This element should ensure that Congressional concerns related to influence or control are mitigated.

Second, the proposal’s function-oriented approach is preferable to a single-minded focus on affiliated entities. There is precedent for this approach. The Financial Industry Regulatory Authority (“FINRA”) similarly determines the independence of its board members using a function-oriented approach.<sup>7</sup> This approach allows the MSRB to consider candidates who technically may be “associated with” a regulated entity solely because of corporate structure. We believe investors are disadvantaged if a segment of fund advisers are ineligible to be Public Member candidates solely because their corporate structure includes, for example, a municipal dealer. Claims that an employee of an advisory affiliate will be unable to make independent decisions because the profits of the corporate group are directly tied to the performance of another affiliate such as a municipal dealer affiliate are unreasoned. To the contrary, a fund adviser is required to make decisions in the best interests of the fund and its shareholders (*i.e.*, institutional and retail investors).<sup>8</sup>

Third, as explained by the MSRB in the Release, all Board members have a fiduciary duty to the MSRB and are bound by a duty of loyalty and a duty of care and are obligated to act in the best interests

---

<sup>6</sup> As discussed, *infra*, not only is this segment of fund advisers unable to serve as Public Members, they also are unable to serve as Regulated Members of the MSRB Board.

<sup>7</sup> We agree with MSRB that it is appropriate to look to FINRA’s approach to defining independence for its board composition even though FINRA’s board is not required to have a majority of public members. The responsibilities of board members in serving a self-regulatory organization warrant comparison, as opposed to other less relevant uses of the term “public” or “non-public” in FINRA’s rulebook.

<sup>8</sup> An adviser’s fiduciary duty to its clients is a fundamental tenet of the regulatory framework for investment advisers. *See, e.g.*, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 184-85 (1963).

of the organization and to avoid conflicts of interest. These duties and obligations should not be discounted or dismissed. Further, the MSRB Board and municipal market investors it serves should not be denied the expertise of an important portion of fund advisers as is currently the case.

Fourth, and finally, when it comes to employees of fund advisers serving as Public Members, there are already significant regulatory and institutional safeguards that complement the fiduciary duty owed to the MSRB and the other eligibility restrictions proposed to be retained in MSRB Rule A-3 for Public Members. Fund advisers must have firewalls between the asset management and banking/underwriting divisions of commercial and investment banks. Also codes of ethics and restrictions on communications further ensure the functional independence of investment advisers.<sup>9</sup>

Together, all of these factors strongly support approval of the proposed change to MSRB Rule A-3.<sup>10</sup>

### ***Fair Representation Opportunity for All Investment Advisers***

If the MSRB's proposed change to Rule A-3 is not approved, we urge the MSRB to consider an alternative approach to address the current disparate treatment of fund advisers within the same corporate entity as a regulated entity and stand-alone investment advisers. We recommend that, to better promote a fair and efficient municipal market, MSRB clarify that the "associated with" language would permit employees of a fund adviser within the same corporate entity as a regulated entity to qualify and be considered as candidates for the pool of Regulated Members.<sup>11</sup> This would equalize the ability of employees of fund advisers to serve on the MSRB Board regardless of their corporate structure. Otherwise, this important segment of fund advisers is "between a rock and a hard place" in that their employees are excluded from Board membership entirely. This seems a patently unfair result, one that seems at odds with investor protection and the public interest.

\* \* \* \*

---

<sup>9</sup> See, e.g., Rule 204A-1 under the Investment Advisers Act of 1940 (requiring advisers to adopt a code of ethics including, among other things, a standard of business conduct that reflects the adviser's fiduciary obligations; and Section 204A under the Advisers Act (requiring advisers to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information).

<sup>10</sup> In addition, as proposed, MSRB Rule A-3 would retain the requirement that Public Members not have been employed by a regulated entity for 2 years. This period provides a meaningful cooling off period from relationships with regulated entities without diminishing the expertise of the potential candidate through the passage of too much time. The SEC highlighted this provision in its approval of the MSRB's 2010 amendments to MSRB Rule A-3 as being stricter than the one-year cooling-off period used by other self-regulatory organizations in determining the independence of board members. See *supra* note 5.

<sup>11</sup> See Rule A-3(a)(ii) (defining Regulated Representative).

Ms. Elizabeth M. Murphy

September 18, 2013

Page 5 of 5

We look forward to working with the SEC as it continues to examine these critical issues. In the meantime, if you have any questions, please feel free to contact me directly at (202) 218-3563 or Jane Heinrichs, Senior Associate Counsel, at (202) 371-5410.

Sincerely,

/s/ Dorothy Donohue

Dorothy Donohue  
Deputy General Counsel—Securities Regulation

cc: John Cross, Director  
Office of Municipal Securities

Lynnette Kelly, Executive Director  
Municipal Securities Rulemaking Board