MSRB
Municipal Securities
Rulemaking Board

September 6, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20540-1090

Re: Response to Comments on File No. SR-MSRB-2013-06

Dear Ms. Murphy:

On July 3, 2013, the Municipal Securities Rulemaking Board ("MSRB") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change to amend MSRB Rule A-3, on membership on the board, to modify the standard of independence for public board members. The proposed rule change would address a limitation under the current rule that precludes consideration of otherwise viable board candidates, particularly those who may be representative of investors in municipal securities, from serving as public members of the board. The SEC received seven comments regarding the proposed rule change.[1] This letter addresses the comments.

The Proposed Rule Change Preserves the Independence of Public Board Members

The central issue raised by those commenters opposed to the proposed rule change is whether the meaning of the term "independent" is capable of multiple permissible interpretations. For the reasons set forth below, the MSRB believes that it is and that the standard proposed by the MSRB is one of those that is reasonable and consistent with the Securities Exchange Act of 1934 (the "Exchange Act"). In proposing this standard, the MSRB is highly cognizant of the critical role of public members in the Board composition envisioned by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank

[1] The SEC received and forwarded to the MSRB comment letters from Americans for Financial Reform ("AFR"); American Federation of State, County and Municipal Employees ("AFSCME"); Consumer Federation of America ("CFA"); Government Finance Officers Association ("GFOA"); National Association of Independent Public Finance Advisors ("NAIPFA"), National Federation of Municipal Analysts ("NFMA") and Gerald Gold ("Gold"). While many of the comments in the Gold letter address statements made by NFMA, this response to comments addresses only those that pertain directly to elements of the MSRB's proposed rule change.

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Act").[2] The MSRB believes that the proposed rule change well preserves the vital independence of public members. Indeed, while the modification is, as explained below, modest in the context of the Board's current, Commission-approved definition of "independence," the change would have a significant corresponding benefit by increasing the Board's flexibility in identifying candidates with the knowledge of and experience in the municipal securities markets best suited to address the many complex issues facing the market, including candidates with an investor's perspective.

The MSRB proposes to amend the independence standard for its public board members under MSRB Rule A-3.[3] Congress empowered the MSRB to establish standards for independence when it amended Section 15B of the Exchange Act through the adoption of the Dodd-Frank Act.[4] Significantly, the Exchange Act does not evince an intent to promote the independence of public members without any countervailing considerations. Rather, the Exchange Act requires *all* Board members to be knowledgeable of matters related to the municipal securities markets.[5] It is permissible under the Exchange Act to employ an independence standard that strikes a reasonable balance among these considerations.

In implementing the Dodd-Frank Act, Rule A-3 establishes criteria for eligibility on the Board of the MSRB. Consistent with the statutory scheme, Rule A-3 categorizes members into two broad categories: Public Representatives and Regulated Representatives. Public Representatives are defined as individuals who are *independent* of any MSRB-regulated entity. The term is further defined to mean having "no material business relationship" with an MSRB-regulated entity.

The proposed rule change would modify MSRB Rule A-3(g)(ii) to provide a more function-oriented approach to defining independence by looking at the office, role, or activity of the applicant rather than relying solely on the more vague "associated with" standard. Importantly, the proposed rule change would not change the prong of the current independence definition that requires that the applicant have no relationship with a regulated entity, compensatory or otherwise, that could reasonably affect the independent judgment or decision making of the individual. Nor would the proposal change the two-year look back for ascertaining one's status as independent. In any event, the proposal, in the context of the current, Commission-approved standard of independence, offers a modest change. As noted, having "independence" means having "no material business relationship" with a regulated entity. The proposed rule change would only remove the automatic disqualification of persons that may be found to be associated with a regulated entity based on being under common control. Those who are associated based on their being an officer, director (other than an independent director),

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2 Pub. L. 111-203 (2010).

3 Exchange Act Release No. 70004 (July 18, 2013),78 FR 44607 (July 24, 2013).

4 15 U.S.C. 78o-4(b)(2)(B)(iv).

5 15 U.S.C. 78o-4(b)(1).

employee, or controlling person of a regulated entity would continue to appropriately be ineligible. A person who, on the other hand, may be associated based merely on being under common control with a regulated entity simply does not have (on that basis alone) a material business relationship with that regulated entity.

Commenters suggest that the new definition is contrary to congressional intent and the public interest (AFR, AFSCME, CFA, NAIPFA), undermines the intent of the Dodd-Frank Act (AFSCME, CFA), weakens the standard for independence (CFA), and sets a subjective standard (AFR, CFA, GFOA). Commenters also contend that the existing standard should not be changed because it is clear, straightforward and reasonable. The MSRB appreciates the opportunity to respond to these comments.

The Proposed Definition Is Consistent With Congressional Intent

As noted in the rule filing, Congress did not specify the requirements for independence of public representatives. Rather, the Dodd-Frank Act empowered the MSRB to propose and adopt rules that "shall establish requirements regarding the independence of public representatives."[6] Commenters' essential assertion that the existing standard – using the "associated with" language – is the only permissible standard is incorrect. In not defining "independence," Congress entrusted the MSRB to develop standards. Notably, Congress likewise entrusted the MSRB with the flexibility to address other major aspects of board structure and composition, such as the number of municipal and investor representatives (above a minimum requirement), the length of terms and the overall size of the board.

The current independence standard, which was first adopted in 2010, employs as a factor "associat[ion] with" a regulated entity, which in turn, relies on Exchange Act definitions of an associated person, which expansively include persons directly or indirectly controlling, controlled by, or under common control of a regulated entity.[7] After several years of experience, that standard has proven to be unexpectedly inflexible and difficult to administer in practice. The use of the term "associated with" under Rule A-3 is also more expansive than the term is generally used under other MSRB rules. In the Notice of Approval of Fair Practice Rules (Oct. 24, 1978) (quoted under Rule D-11), the MSRB stated: "Although the statutory definitions of associated persons include individuals and organizations in a control relationship with the securities professional, the context of the fair practice rules indicates that such rules will ordinarily not apply to persons who are associated with securities firms and bank dealers solely by reason of a control relationship." As such, those under common control with MSRB-regulated entities typically would not be subject to the MSRB's fair practice rules without some type of conduct in respect of the municipal activities of the MSRB-regulated entities, and so should not be constrained by the board membership rule.

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6 *Id.*

7 15 U.S.C. 78c(a)(18)

Moreover, the current standard is overbroad as there is no definition of the term "under common control" and no consideration given to the activities of the individuals.[8] As experience has confirmed, the practical effect of the current standard is to treat any person that possibly could be viewed as "associated" as *per se* disqualified, *irrespective* of that person's office, role, or activity in relation to the regulated entity. The MSRB does not believe that Congress, simply by requiring public members to be "independent," mandated such an expansive interpretation.[9]

This view is also reflected in the Dodd-Frank Act itself. The category of individuals who are not public representatives are collectively defined as "regulated representatives." The proposed rule change is entirely consistent with that categorization in that the proposed rule changes would not treat an individual who is *regulated* by the MSRB as public. Rather, it would allow persons who are *not*-regulated and "who have no relationship with a regulated entity, compensatory or otherwise, that could reasonably affect the independent judgment or decision making of the individual, to be considered a public representative."[10]

Further, the legislative history of the amendments to Exchange Act Section 15B under Section 975 of the Dodd-Frank Act makes clear that Congress intended that the MSRB not be required to rely on the "associated person" standard in defining what would constitute an independent board member but instead could establish the appropriate requirements regarding the independence of public members by rule. Prior to the amendment, the statutory language describing public board members explicitly defined them as "individuals *not associated with* any broker, dealer or municipal securities dealer". The original version of the legislation that would ultimately result in the Dodd-Frank Act, as passed by the Senate in May 2010 as the Restoring American Financial Stability Act of 2010, contemplated the reconstitution of the board as majority public but continued to refer to public members as "individuals *not associated with* any broker, dealer, municipal securities dealer, or municipal advisor." The accompanying Senate Banking Committee Report also used this language to describe the provision and never used the term "independent" to describe public members. However, this language ultimately was amended to the current formulation of "individuals who are *independent of* any municipal securities broker, municipal securities dealer, or municipal advisor", and the Conference Report accompanying the Dodd-Frank Act as enacted referred to such members as "*independent* of the municipal securities industry." Furthermore, this reformulation of the public membership

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8 This point was highlighted by AFR in the statement that complex, "modern financial holding companies … frequently have hundreds or even thousands of legal entities within the corporate structure." There is no reasonable basis to conclude the Congress intended to exclude *all* persons within such entities from serving as public representatives on the board irrespective of their office, role, or activity.

9 Further, the MSRB believes that the proposed definition of "independent" effectively ensures that persons who would be found, under the commonly understood meaning of the term, to be "associated persons," would correspondingly fail to meet the definition of "independent."

10 Rule A-3(g)(ii).

language was accompanied by new MSRB rulemaking authority to "establish requirements regarding the independence of public representatives." Congress evinced a clear intent to provide the MSRB flexibility to determine such independence standard that was not required to be tied to the concept of associated person.

The Proposed Rule Change Would Not Permit Industry Representatives to be Public Board Members

Commenters suggest that the proposed standard would permit persons affiliated with banks and other financial institutions to be eligible for public membership on the board (AFR, AFSCME, CFA, NAIPFA), that those with financial interests will dominate the board (AFSCME), that such a standard may not represent the best interests of issuers, investors or the general public (GFOA), that the proposed standard will be difficult to manage (AFR, AFSCME), and that such a standard could lead to bias in the nominating process (GFOA).

These comments ignore the second prong of the independence definition which categorically excludes any person having any relationship with a regulated entity, compensatory or otherwise, that reasonably could affect the independent judgment or decision making of the individual. In addition, experience with a similar standard employed by the Financial Industry Regulatory Authority ("FINRA") for six years has not been thought to have resulted in a dealer-dominated board.

And, to be clear, the proposed rule change is designed to have the opposite effect. By allowing a broader pool of applicants to be considered for election to represent the interests of investors, the proposed rule change would help the Board maintain the balance intended by Congress. As noted by the NFMA, the MSRB's mission includes the protection of investors, but has relatively few members from "buy-side" investment firms. NFMA believes that the proposed rule change would offer the potential to increase representation for both institutional and retail investors.[11]

Commenters suggest that individuals affiliated with regulated entities will be conflicted due to the complexity of modern financial holding companies, the sharing of profits and the promotion of inter-affiliate business opportunities (AFR, AFSCME). The MSRB believes it is overly simplistic to conclude that an individual employed by an affiliate of a holding company that also has a separate regulated affiliate is so aligned with the regulated affiliate that he or she is incapable of exercising independent judgment. Such individuals, and the affiliates that employ them, may receive no direct financial benefit from the success of a corporate affiliate, may view policy issues with fundamentally different interests at stake, and, in fact, may compete with such affiliates.

As for the concern that the proposed standard would be difficult to manage, the very thrust of the proposed rule change is to improve the manageability of the standard, as compared with the current one that experience has shown to lack clarity and be inflexible. To gauge

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[11] NFMA at 2.

independence, in part, based on whether a person is an officer, non-independent director, employee, or controlling person is a much more precise and clear standard than the "associated with" standard. Notably, FINRA has administered this same clear standard without apparent difficulty.

The Current Standard for Public Members Has Been Approved by the Commission and Is Not Too Lenient

Commenters further assert that only one institutional or retail investor is required under the statute (AFR, AFSCME, NAIPFA), that the standard is already lenient because of the two-year cooling off period after a public member disassociates from a regulated entity (GFOA), that a five-year cooling off period is more appropriate (NAIPFA), that the MSRB is distinguishable from other self-regulatory organizations because it is a creature of statute (NAIPFA), and that public members representing the issuer community should have spent the vast majority of their career as an issuer (GFOA).

While only one institutional or retail investor representative is required, the MSRB should have the flexibility to draw from the wider pool of candidates that the proposal would provide to meet this important objective. In favoring satisfaction of just the statutory minimum, these commenters take a position that is potentially adverse to greater investor representation on the Board. The role of the MSRB in protecting investors should not be understated. Institutional investors are well positioned to identify fraudulent or abusive practices in the municipal securities market, as well as enhancements that will improve the municipal securities market. And the Exchange Act generally requires MSRB rules to be "designed to prevent fraudulent and manipulative acts and practices" and, in general, to protect investors, municipal entities, obligated persons, and the public interest.

As for the cooling off period between employment by a regulated entity and service as a public board member, the MSRB reviewed best practices in corporate governance before it amended Rule A-3 in 2010. As it stated at the time, the two-year cooling off period was more stringent than that of other self-regulatory organizations. Similarly, a standard that an issuer representative has spent the vast majority of his or her career as an issuer would be difficult to administer and potentially would have unintended consequences in excluding candidates who have made career changes irrespective of their qualifications. The principle espoused by GFOA, however, is an appropriate factor in assessing candidates for board membership.

The analogy to FINRA's arbitration standards is inapposite. Arbitrations are final adjudicatory proceedings that demand the rigor of due process. There is only very limited judicial review and the decisions of the arbitrators are, for the most part, final.[12] By contrast, the

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12 *See* FINRA Rule 12904. Awards.

MSRB does not have any adjudicatory functions[13] and its rulemaking activities are subject to the approval standards in the Exchange Act. Thus, FINRA's independence standards for purposes of its corporate governance are more applicable. The standard of independence proposed by the MSRB was modeled on FINRA's, and with a two-year cooling off period is even more stringent than FINRA's, even though FINRA has examination and adjudicatory responsibilities. There is no basis for requiring the standard for independence for the entity that writes rules to be more restrictive than the standard for the entity that enforces those same rules. The fact that FINRA's independence standard is governed by the SEC rather than by statute is not a compelling reason for such different interpretations. In this connection, the MSRB believes that NAIPFA's suggestion that the current two-year period be extended to five years would create an unnecessary impediment to board membership.

There is Sufficient Rationale for the Proposed Rule Change

Commenters assert that the MSRB has not set forth sufficient justification for the proposed rule change (AFR, AFSCME, CFA), that there is no shortage of available public board member candidates (AFR, NAIPFA), that the MSRB should improve its outreach (AFR, AFSCME, CFA, GFOA, NAIPFA), that the MSRB could elect institutional investors to serve as regulated board members (GFOA), that the fiduciary duty of board members is an insufficient check on conflicts of interest (AFR, NAIPFA), and that there is a lack of analysis as to whether the proposed rule change would have a negative impact on the MSRB's ability to protect issuers, investors and the public interest (NAIPFA).

While the MSRB received approximately one hundred eighty applications for its most recent board openings, experience has demonstrated that a wider pool of candidates and additional flexibility is needed. This type of refinement has been fully contemplated by both the MSRB and the Commission. In the 2010 proposal for Rule A-3, the MSRB emphasized that it would monitor the operation of Rule A-3 and consider whether any changes might be necessary or appropriate. In approving the transitional rule in 2011, and in approving the MSRB's later proposal to make the provision permanent, the Commission cited with approval the MSRB's intent to evaluate experience with the rule and to consider appropriate changes.[14]

In addition, the focus of the types of issues the MSRB is likely to address has changed since Rule A-3 was last revised. In July 2012, the SEC issued its Report on the State of the Municipal Securities Market, which recommends that the MSRB study a number of significant issues, including many market structure initiatives. To help the board be as informed as possible

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13 Exchange Act Section 15B allows for the MSRB to provide for arbitration, but it has not done so – and any arbitration forum would require a set of standards and procedures, which would impose appropriate standards for independence of arbitrators.

14 *See* Exchange Act Release No. 63025 (September 30, 2010), 75 FR 61806 (October 6, 2010); Exchange Act Release No. 65424 (September 28, 2011), 76 FR 61407 (October 4, 2011).

and balanced in its perspective on key issues, the MSRB believes that greater flexibility is warranted to help elect knowledgeable candidates with an investor's perspective.

Since the adoption of the Dodd-Frank Act and the amendment of Rule A-3, the MSRB has pursued outreach at an unprecedented level to attract qualified board candidates. During the most recent application period, it sent out email notifications of the board openings to over 8,000 individuals and groups, requested that groups re-disseminate the call for applications, and engaged in other outreach efforts. The MSRB expanded its advertising of the board openings to a financial journal having general national circulation. The MSRB also modernized its public application web portal and provided more public information on its website regarding the application process. Finally, it provided a list of all applicants on its website after the selection process was concluded. In short, the process has been highly transparent and effective within the confines of the current definition of "independent," and the process will be more effective, and certainly would not result in a diminishment of MSRB outreach efforts, with the broader pool of well qualified candidates that would result from the proposed rule change. The MSRB firmly believes that the proposed rule change is needed to increase the board's flexibility and to further protect municipal entities, investors and the public interest.

As for the suggestion that the board could elect institutional investors as regulated board members, the MSRB does not believe that such a solution would be consistent with the Exchange Act requirement that broker-dealer and bank representatives not only be associated with a broker-dealer or bank but also *representative* of, with the result that investors in an affiliate of a broker-dealer or bank would not normally be representative of the broker-dealer or bank interests, but instead of the investor interests of the affiliate.

Finally, two commenters (NAIPFA and Gold) suggest that association or affiliation with an industry group or trade association essentially should disqualify a candidate as a material business relationship. The MSRB does not believe that the affiliation with industry groups should be grounds for automatic disqualification as a public board member or as any member. The MSRB does take into consideration the role of the individual applicant in such group or association in the application process and has policies and procedures to address actual and perceived conflicts arising from the practices of board members vis-à-vis industry groups and trade associations.[15]

The MSRB believes that the foregoing fully responds to the comments received on this important proposal. The proposed standard would "establish fair procedures for the nomination and election of members of the Board and assure fair representation in such nominations and

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15 Gold additionally suggests that the board should be reduced from 21 members back to 15 members to lower costs to the MSRB. The proposed rule change does not seek to alter the size of the board as that has not been identified by the MSRB as an area in need of reform. Gold also notes that Rule A-3 paragraph (c) does not reflect the current composition of the board. The MSRB will review this provision and consider options to promote consistency with the post-Dodd Frank Act board structure.

elections,"[16] is consistent with the Exchange Act,[17] preserves the independent nature of public representation, and would aid the MSRB in effectively carrying out its mission. If you have any questions regarding this matter, please contact me at (703) 797-6600.

Sincerely,

Gary L. Goldsholle
General Counsel

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16 15 U.S.C. 78o-4(b)(2)(B).

17 15 U.S.C. 78s(b)(2)(C)(i).