INVESTMENT COMPANY INSTITUTE

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September 11, 2015

Mr. Brent Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. SR-MSRB-2015-03
Rule G-42, Duties of Municipal Advisors

Dear Mr. Fields:

The Investment Company Institute[1] is writing in response to the Securities and Exchange Commission's request for comments on proposed Municipal Securities Rulemaking Board ("MSRB") Rule G-42. This rule would establish standards of conduct for municipal advisors.[2] This is the second time the Commission has sought comment on this proposal[3] and the second time we have commented

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $18.2 trillion and serve more than 90 million U.S. shareholders.

[2] *See Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors,* SEC Release No. 34-75628, File No. SR-MSRB-2015-03 (August 6, 2015) ("SEC Release"). Consistent with the scope of the proposed rule, as used in this letter the term "municipal advisor" or "advisor" refers to a "non-solicitor municipal advisor."

[3] *See Notice of Filing of a Proposed Rule Change Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records To Be Made by Brokers, Dealers, and Municipal Securities Dealers, and Municipal Advisors,* SEC Release No. 34-74860 (May 4, 2015).

on it.[4] We continue to comment on this rule because we are concerned with the impact it will have on our members that are municipal advisors as a result of the advisory services they have long provided, and continue to provide, to the states on their 529 college savings plan.[5]

Since the MSRB first proposed the rule, we have consistently supported its adoption. However, we also have expressed consistently our dismay with one key aspect of it – the requirement that a municipal advisor affirmatively investigate the veracity of information provided to it by its municipal advisory clients.[6] While this requirement is likely problematic for all municipal advisors, it is particularly problematic for those municipal advisors that render advice to states regarding the operations of their 529 college savings plans. Unlike discrete bond offerings, the relationship between a municipal advisor and a state's 529 college savings plan tends to be long term and involve regular and ongoing communications regarding the plan and its operations. Requiring a municipal advisor to investigate the veracity of every piece of information it receives from or on behalf of the plan on an ongoing basis prior to continuing to render advice to the plan would be completely disruptive to these relationships and would serve no public purpose. Because the rule continues to include this requirement, notwithstanding commenters' opposition to it and concerns with it, we recommend that the Commission disapprove Rule G-42. Our continuing concerns with this requirement are discussed below.[7]

**DUTY TO INVESTIGATE**

Rule G-42(d) would require a municipal advisor to have "a reasonable basis to believe" that any municipal securities transaction or product it recommends to a municipal client is "suitable for the client." To fulfill this requirement, the Rule's Supplementary Material .01 would require municipal advisors to undertake a "reasonable investigation" to avoid basing recommendations on "materially inaccurate or incomplete information," provided by a municipal advisory client. According to the SEC

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[4] *See* Letter from the undersigned to Mr. Brent J. Fields, Secretary, SEC, dated May 29, 2015 commenting on File No. SR-MSRB-03 (the "Institute Letter"). To the extent relevant, we would appreciate the comments in that letter being considered in conjunction with those in this letter.

[5] As noted in our previous comment letters, our comments on the rule are limited to its impact on our members that must register as municipal advisors due to their involvement in a state's 529 college savings plan. We note that our members that are registered under the Investment Advisers Act of 1940 and render advice to municipal entities other than 529 college savings plans are not required to register as municipal advisors and therefore will not be subject to the rule.

[6] The amendments the MSRB recently filed with the SEC do not address our concerns. *See Notice of Filing of Amendment No. 1 to Proposed Rule Change Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors,* SEC Release No. 34-75737 (Aug. 19, 2015).

[7] Should the Commission approve this rule, we also seek clarification regarding Rule G-42's application to existing advisory contracts and agreements.

Release, four commenters – including the ICI – expressed concern with this requirement.[8] As noted in the Institute Letter, we oppose this requirement because:

- It is not reasonable for the MSRB to require such investigation unless it believes that, in the normal course of business, municipal advisory clients routinely provide materially inaccurate or incomplete information to their municipal advisors;
- This requirement is impractical and inconsistent with the suitability obligations imposed on other financial professionals;
- It presumes that a municipal advisor will have access to the information it needs to assess the veracity and completeness of information provided by the client;
- It is inconsistent with the rule's overarching principle "that the [municipal] client should be empowered to determine the scope of services and control the engagement with the municipal advisor"; and
- It imposes absurd liability on the municipal advisor because, under the proposed rule, it is the advisor's obligation to determine the false nature of any information provided by a municipal client and, if it does not, it is the *advisor* who has violated the rule by basing a recommendation on the inaccurate information and by failing to discern its accuracy.[9]

The comments submitted by the others commenting on this provision expressed similar concerns.

On August 12, 2015, the MSRB filed a letter with the Secretary of the Commission responding to the comments the SEC previously received on Rule G-42.[10] With respect to this issue, the MSRB Letter states:

> The MSRB received similar comments during the development of Proposed Rule G-42 and believes that the response to those comments in the proposed rule change sufficiently addresses the comments submitted . . .. *The MSRB determined that a municipal advisor should be required to conduct a reasonable investigation of the accuracy and completeness of the information on which it is basing its recommendation and that the requirement will likely not result in an unreasonable and unnecessary burden for municipal advisors or their clients.* Under the proposed rule, municipal advisors would not be

[8] SEC Release at pp. 23-24. Other requirements in the rule did not result in a similar number of comments.

[9] Institute Letter at pp. 4-5. The Institute letter noted that this "seems patently unfair." It also noted that, while we concur with the MSRB empowering the municipal client, such empowerment "comes with responsibility and, in our view, this responsibility includes the client dealing fairly and honestly with the municipal advisor and the advisor, in turn, being able to rely on the information provided to it by the client." Institute Letter at p. 5.

[10] *See* Letter from Michael L. Post, General Counsel – Regulatory Affairs, MSRB, to Secretary, SEC, dated August 12, 2015 (the "MSRB Letter").

> required to go to the impractical lengths suggested by some commenters. If the information necessary to determine whether a municipal advisor is basing its recommendation on materially inaccurate or incomplete information is non-public, entirely created or controlled by the client or is otherwise not accessible through a reasonable amount of effort by the municipal advisor, then, in such instances, the determination of what would constitute a reasonable investigation would be reflective of those and other relevant facts and circumstances. [Emphasis added.]

We are dismayed and disappointed by the MSRB's response. Noticeably absent from this response is *any* explanation of *why* such investigation is warranted or necessary in the public interest and *why* the MSRB is imposing upon municipal advisors, alone among all financial professionals, a duty to verify the veracity and completeness of information provided by their clients. Indeed, as noted by commenters, "this requirement is inconsistent with 'standards applicable to broker-dealers and investment advisers' because neither 'are required to challenge the statements of their clients.'"[11] In the absence of such explanation, it is difficult to discern why only those financial professionals who render advice to a government entity have a regulatory obligation to investigate the information provided to them by their clients.

It bears noting that, throughout the promulgation of Rule G-42, which began with MSRB Notice 2014-01 in January 2014, the MSRB has failed to publish *any* meaningful information regarding why this requirement is necessary in the public interest. The MSRB has also consistently failed to document that the benefits of these investigations will outweigh the costs and burdens associated with them. The MSRB has explained, however, as noted above, that a municipal advisor that lacks access to information necessary to undertake the required investigation will, in essence, be deemed to have undertaken a "reasonable investigation [that] would be reflective of those and other relevant facts and circumstances." While we question the public or regulatory value of such investigations in those circumstances, this commentary indicates that, under any circumstances, these investigations are likely to be futile and of little, if any, value.[12]

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[11] SEC Release at p. 8. While the SEC Release quotes SIFMA's comment letter, the ICI's Letter expressed a similar concern. *See* ICI Letter at p. 4.

[12] For example, assume an advisory client deliberately provides materially inaccurate information to a municipal advisor and, due to the non-public nature of the information, the municipal advisor is unable to verify the accuracy of such information. We question what public purpose is served by the municipal advisor documenting that it could not verify the accuracy of the information provided by its client. We also question how a municipal advisor is expected to document its lack of access to information in connection with its investigation. If the municipal advisor is unable to protect itself from relying on materially inaccurate information in such extreme instances, we fail to understand what purpose these investigations will serve when the municipal client is not intent on misleading the municipal advisor and does, in fact, provide complete and accurate information.

As regards the economic impact of this requirement, the MSRB merely asserts – without any substantiation or proof – that it "will likely not result in an unreasonable and unnecessary burden for municipal advisors or their clients." We question the basis for and validity of this assertion, particularly in the context of advice rendered in connection with 529 college savings plans. As noted above, 529 college savings plan involve ongoing communications between the plans and the advisors over the course of their long-term relationship.[13] Requiring the plan's advisor to investigate the veracity of every piece of information it receives from or on behalf of the plan during the course of their relationship would indeed impose unreasonable and unnecessary burdens and would be completely disruptive to these relationship. Accordingly, we take strong exception to the MSRB's comments to the contrary and we recommend that the Commission disapprove the rule unless the MSRB is able to substantiate its assertions with objective analysis rather than unsupported statements dismissing commenters' concern. Should the Commission decide to approve the rule notwithstanding our concerns and objection, we strongly recommend that, prior to such approval, it require the MSRB to: share the reasoning underlying the MSRB's determination that municipal advisors, alone among all financial industry professionals, should have a duty to investigate their clients; explain the regulatory or public purpose served by requiring such investigations; and document its assertion that such a requirement is not likely to result in unreasonable or unnecessary burdens, particularly in the context of relationships involving a state's 529 college savings plan.

**RETROACTIVE APPLICATION OF THE PROPOSED RULE**

Should the Commission approve Rule G-42, we recommend that it require the MSRB to clarify with greater details its application to existing advisory relationships. The ICI Letter recommended that the MSRB clarify that Rule G-42 will only apply prospectively – *i.e.,* when a municipal advisor either enters into a new advisory relationship with an municipal client or when it recommends a new municipal securities transaction or new municipal financial product to an existing municipal client.[14] Our letter noted that, due to the nature of the advisor's relationship with 529 college savings plans and the duration of existing 529 plan contracts, this clarification is particularly important to avoid disrupting existing relationships and contracts."[15]

In response to this recommendation, the MSRB Letter states:

- Rule G-42 "would not require a [new] contract between the parties."
- "[S]o long as the content of the documentation [of the advisory relationship] adheres to the requirements of Proposed Rule G-42, municipal advisors and their clients would have some latitude in deciding the exact form of the documentation and writing."

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[13] It is not uncommon for the agreement between the municipal advisor and a state's plan to have a term of 10-15 years.

[14] ICI Letter at p. 5. According to the MSRB Letter, SIFMA made a similar recommendation. *See* MSRB Letter at p. 22.

[15] ICI Letter at p. 5.

- "Documents in place prior to the effective date that are in some way deficient are not required to be withdrawn. Instead, they may be supplemented by the municipal advisor by the delivery of additional documentation that satisfies any remaining requirements of Proposed Rule G-42."
- "[U]pon the proposed rule change taking effect, municipal advisors will become subject to the applicable standards of conduct (e.g., Proposed Rule G-42's specified duty of care and duty of loyalty) with regard to all of their municipal activities, regardless of whether the relevant engagement began prior to the effective date of the rule."[16]

We appreciate the MSRB clarifying that the rule's duty of care and duty of loyalty will apply to existing municipal advisory relationships regardless of when they began. We also appreciate the MSRB clarifying how municipal advisors can avoid violating the rule in connection with their existing contracts and relationships. We recommend, however, that the MSRB better clarify how each of the new obligations the rule and its Supplementary Material impose on municipal advisors will apply to existing contracts, relationships, and municipal advisory activities.

For example, Subsections (b), (c), and (d) of the rule, which govern disclosure, documentation, and recommendations, respectively, would not appear to apply retroactively.[17] Similarly, provisions such as that in Supplementary Material .01, which governs municipal advisors' recommendations, would appear only to apply to recommendations made *after* the rule's adoption. Also, the provisions in Supplementary Material .05 and .06, governing disclosure of conflicts of interests and relationship documentation, respectively, would also not appear to apply to existing agreements and relationships.[18] By contrast, other sections of the Supplementary Material, such as Supplementary Material .02, relating to a duty of loyalty, and .13, clarifying the rule's application to college savings plans and other municipal fund securities would appear to apply to existing agreements and relationships based on their language and the nature of the duty imposed on municipal advisors.[19]

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[16] MSRB Letter at p. 23.

[17] Subsection (b), relating to the disclosure of conflicts of interest and other information, only applies "prior to or upon engaging in municipal advisory activities," which, for existing relationships, presumably occurred prior to the rule's adoption. Subsection (c), relating to documentation of the municipal advisory relationship, only requires delivery of documents "prior to, upon or promptly after the establishment of the municipal advisory relationship," which, for existing relationships, would have occurred prior to the rule's adoption. Subsection (d), relating to recommendations and the review of recommendations of other parties only applies when the municipal advisor "makes a recommendation," which presumably is a recommendation made after the rule's adoption.

[18] By their terms, these provisions impose duties that arise "prior to or upon" entering into or engaging in municipal advisory activities.

[19] With respect to Supplementary Material .11, relating to excessive compensation under MSRB Rule G-17, it seems odd to include a provision defining a municipal advisor's obligations under MSRB Rule G-17 in Rule G-42. We recommend that the MSRB move this Supplementary Material to Rule G-17 to better alert registrants to the MSRB's interpretation of their duties under that rule.

In light of the fact that application of the various provisions within the new rule and its Supplementary Material appear to depend upon the text of the provisions and the duties they impose on municipal advisors, we recommend that the MSRB provide additional clarification regarding how each of the rule's subdivisions and Supplementary Material will apply to existing agreements and relationships. This clarification will better facilitate the compliance efforts of municipal advisors.

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The Institute appreciates the opportunity to provide these comments to the Commission on proposed Rule G-42. If you have any questions about our comments or would like additional information concerning any of them, please do not hesitate to contact the undersigned by phone at [redacted].

Regards,

/s/

Tamara K. Salmon
Associate General Counsel