FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

September 11, 2015

Robert W. Errett
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: **File Number SR-MSRB-2015-03, Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change**

Dear Mr. Errett:

On August 6, 2015, the Securities and Exchange Commission (SEC) published its request for public comment on an Order Instituting Proceedings on the Municipal Securities Rulemaking Board's (MSRB) proposed new rule on the duties of non-solicitor municipal advisors (Proposed Rule).[1] The Proposed Rule defines the fiduciary duty imposed on municipal advisors when providing advice to a municipal entity client. The SEC specifically requested comment on whether the Proposed Rule is consistent with Sections 15B(b)(2), 15B(b)(2)(C), and 15B(b)(2)(L)(i) of the Securities Exchange Act of 1934 (the Act).

The Financial Services Institute[2] (FSI) appreciates the opportunity to comment on this important proposal. As we stated in our comment letter submitted May 29, 2015, FSI supports the continued effort to impose a regulatory regime on advisors to municipal entities and obligated persons.[3] However, FSI has concerns with the impact of the Proposed Rule on securities execution services offered to municipal entities by regulated financial advisors and broker-dealers. As such, we believe that the Proposed Rule, as currently drafted, is not consistent with Sections 15B(b)(2)(C) and 15B(b)(2)(L)(i) of the Act.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all

[1] 80 Fed. Reg. 48355 (Aug. 12, 2015).
[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.
[3] Letter from David T. Bellaire, Esq., Executive Vice President & General Counsel, FSI, to Brent J. Fields, Secretary, SEC (May 29, 2015).

producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

Discussion

FSI believes that the prohibition on principal transactions between a municipal advisor and a municipal entity client is inconsistent with certain sections of the Act. Specifically, Section 15B(b)(2)(C) requires MSRB rules to not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter."[4] Also, Section 15B(b)(2)(L)(i) requires MSRB rules for municipal advisors to be "reasonably designed to prevent acts, practices, and courses of business as are not consistent with a municipal advisor's fiduciary duty to its clients."[5] We continue to believe that in light of the referenced sections of the Act, the prohibition is unnecessary in the context of a broker-dealer providing securities transaction execution services to a municipal entity. As such, we propose that Proposed Rule G-42(e)(ii) be amended to include an exception for municipal advisors that are registered broker-dealers providing advice incidental to securities execution services in certain fixed income securities. We believe that such an exception would be consistent with the above referenced sections of the Act as well as the statutory fiduciary duty imposed on municipal advisors. These concerns are discussed in greater detail below.

I. Principal Trading Ban is Not Necessary to Implement the Statutory Fiduciary Duty

A. Introduction

As we noted in our prior comment letter, in most instances FSI members provide a relatively narrow suite of services to municipal entity customers. In almost every case, these services are limited to securities execution for the investment of a municipality's funds. Often, these investments are in liquid, transparent fixed income securities that transact on a principal basis. In addition to being registered as municipal advisors, FSI financial advisors are also registered under the broker-dealer and registered investment adviser regulatory regimes. As such, their sales practices are currently subject to robust regulation.

We believe that prohibiting a municipal adviser dually registered as a broker-dealer from transacting with a municipal entity client on a principal basis, where the advice is incidental to the securities execution services, imposes an unnecessary burden on competition. Municipal advisors

[4] 15 USC 78o-4(b)(2)(C).
[5] 15 USC 78o-4(b)(2)(L)(i).

would still owe their clients a fiduciary duty and be subject to all relevant securities laws. The totality of these requirements will ensure municipal entity clients are protected from potential self-dealing related abuses. Imposing a ban on principal transactions where the advice provided is merely incidental to the execution services is unnecessary.

Furthermore, we believe that Proposed Rule G-42(e)(ii) is not reasonably designed to prevent acts, practices and courses of business not consistent with a municipal advisor's fiduciary duty. As the SEC has determined in the context of dually registered broker-dealers and investment advisers, principal transactions can, when subject to appropriate disclosure, be consistent with a fiduciary duty owed to clients.[6] The Advisers Act Temporary Rule illustrates that authorizing principal trades in certain circumstances is consistent with a fiduciary duty. Therefore, we believe the reasoning behind the SEC rule for dually registered investment advisers should also apply to dually registered municipal advisors.

B. Proposed Rule G-42(e)(ii) Unnecessarily Restricts Access to the Services of a Trusted Independent Financial Advisor

In response to the comments received on the Proposed Rule, the MSRB stated that under the Proposed Rule, a municipal entity may either enter into a fee-based relationship with an investment adviser or utilize the services of an independent broker-dealer to execute trades.[7] Requiring either of these arrangements will inappropriately restrict the ability of a municipal entity to transact with the financial advisor of their choosing. FSI financial advisor members have established personal relationships with their clients based on trust and an acute understanding of their client's needs. We do not believe that restricting access to these financial advisors is consistent with the Act or the intent of the municipal advisor regulatory regime.

Moreover, we wish to reiterate that the relationships between FSI members and their municipal entity clients do not lend themselves to traditional fee-based advisory relationships. As such, we do not believe such an arrangement is a viable option. Often, the transactions effected for a municipal entity that would be subject to the Proposed Rule involve instances in which the municipality is intending to purchase securities and hold them until maturity. Neither the financial advisor, nor the municipal entity expects the ongoing contact and advice that is typically found in an investment advisory relationship. Furthermore, as we also previously explained, transactions for municipalities often settle on a delivery-versus-payment basis. As such the municipality's assets are not under the management of the investment adviser.

Therefore, we believe that the absence of an exception to the principal trading ban presents an unnecessary burden on competition that restricts a municipal entity's access to their preferred financial advisor. Authorizing municipal advisors dually registered as broker-dealers to transact as principal where the advice rendered is incidental to the securities execution would reduce transaction costs and preserve access and choice while still ensuring municipal entities receive the protections afforded by the fiduciary duty.

[6] Advisers Act Temporary Rule 206(3)-3T.
[7] MSRB Letter, 14.

C. Broker-Dealers Dually Registered as Municipal Advisors Should be Subject to Similar Rules as Dually Registered Investment Advisers

Section 15B(e)(4)(C) of the Act excludes from the definition of municipal advisor any investment adviser registered under the Investment Advisers Act of 1940.[8] Congress chose to exclude this class of registrants from the definition of municipal advisor because they already owe a fiduciary duty to their advisory clients. Both Congress and the SEC declined to include an exemption from registration as a municipal advisor for broker-dealers, even when the advice provided is incidental to a securities transaction.[9] We wish to note that we are not requesting an exemption from the municipal advisor registration requirements or the fiduciary duty imposed on municipal advisors. Rather, we are recommending that broker-dealers, dually registered as municipal advisors be subject to comparable regulation to that which governs the interactions between a registered investment adviser and a municipal entity.

As we discussed in our prior letter, the SEC has adopted a temporary rule authorizing principal trades with non-discretionary advisory clients for an entity dually registered as a broker-dealer and investment adviser. In promulgating the rule the SEC recognized the importance of preserving access for investors to securities that primarily transact on principal bases. Moreover, the SEC noted that despite authorizing principal trades, advisory clients would continue to enjoy the protections of the fiduciary duty imposed on investment advisers. As such, an authorization to transact as principal can comport with an intermediary's fiduciary duty to the client.

We believe that the same reasoning supports the adoption of a principal trading exception for municipal advisors that are also registered as broker-dealers. The exception would apply where the advice provided was incidental to transactions in certain fixed income securities and require specific disclosures to be provided prior to the trade.[10] The SEC has determined that the disclosures mandated by the temporary rule offer adequate protection to retail investors. Therefore, we believe that these disclosures should also be deemed to offer adequate protection to institutional investors such as municipal entities.

II. Riskless Principal Transactions

A. Alternative Exception for Riskless Principal Trades in Certain Fixed Income Securities

While we continue to believe that an exception to the principal transactions ban is warranted for transactions between registered broker-dealers and municipal entity clients where the advice rendered is incidental to securities execution services, we suggest that in the alternative the MSRB adopt an exception for riskless principal transactions for certain fixed income securities. Such a narrow, tailored exception would provide some relief to broker-dealers dually registered as municipal advisers while also being consistent with the Act and the implementing regulations.

As we previously noted, FSI members primarily transact in fixed income securities through riskless principal trades. In such a transaction, after receiving a customer order, the broker-dealer purchases a security for resale to a customer to fill the customer's order. Transactions effected on a riskless principal basis do not present the same degree of conflicts as those presented by

[8] 15 USC 78o-4(e)(4)(C).
[9] See 78 Fed. Reg. 67467, 67516 (Nov. 12, 2013).
[10] FSI Letter, *supra* note 3.

principal transactions out of inventory. Riskless principal trades are the functional equivalent of agency trades. The fact that they are effected on a principal basis is simply reflective of current fixed income market structure.

Additionally, riskless principal transactions ordinarily reflect better pricing than principal transactions out of inventory. In effecting a riskless principal trade, the broker-dealer must only account for costs associated with settlement risk and order filling and does not have to account for inventory risk or net capital charges. As such, we believe it is in the interest of municipal entities and consistent with the Act to allow municipal advisors, dually registered as broker-dealers to effect riskless principal transactions with their municipal entity clients when the advice rendered is incidental to securities execution services. Municipal entity clients would still benefit from the protections of a fiduciary duty while they also would maintain the ability to transact with the financial advisor of their choosing.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with both the SEC and the MSRB on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at [redacted].

Respectfully submitted,

David T. Bellaire, Esq.
Executive Vice President & General Counsel