FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

February 19, 2013

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street, Suite 600
Alexandria, VA 22314

RE: Request for Public Comment on MSRB Rules and Interpretive Guidance

Dear Mr. Smith:

On January 11, 2013, the Municipal Securities Rulemaking Board (MSRB) issued a request for public comment on the MSRB Rules and accompanying interpretive guidance.[1] The Financial Services Institute[2] (FSI) welcomes the opportunity to provide comments in connection with the MSRB's rulebook and interpretive guidance, with the goal of improving the MSRB's regulatory oversight of municipal securities and 529 participants.

FSI gathered information from a number of its members that are involved in the municipal securities marketplace and has presented a number of suggested changes to the MSRB Rules that would make the regulatory process more effective and provide greater clarity to market participants.

Background on FSI Members

The independent broker-dealer ("IBD") community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of

[1] MSRB Notice 2012-63, Request for Comment On MSRB Rules and Interpretive Guidance, *available at* http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-63.aspx

[2] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has over 100 Broker-Dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 35,000 Financial Advisor members.

other similar business characteristics. They generally clear their securities business on a fully disclosed basis; engage primarily in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers, or approximately 64% percent of all practicing registered representatives, operate in the IBD channel.[3] These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers 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. Clients of independent financial advisers are typically "main street America" it is, essentially part of the "charter" of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[4] Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to insure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys,

[3] Cerulli Associates at http://www.cerulli.com/.
[4] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisers.

research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

FSI's members are primarily involved in the secondary market for municipal securities, while also operating in the 529 space in certain states. A small number of FSI members underwrite municipal securities and/or are municipal advisors.

Comments

FSI offers the following comments concerning suggested changes to the MSRB Rules that would make the regulatory process more effective and provide greater clarity to market participants.

1. Greater Harmonization Between the MSRB and FINRA Rules

There is considerable overlap between market participants who sell and trade municipal securities (governed by the MSRB) and general securities including stocks and options (governed by FINRA), but very little coordination between the rulebooks of FINRA and the MSRB. Often, the two rule books are inconsistent, and this inconsistency can sow confusion and complicate compliance at the retail level. Moreover, given that FINRA is charged with conducting MSRB examinations of broker dealers, harmonization would streamline the exam process and lend greater clarity in rule interpretation and application. Some of these concerns are presented in the differences in the FINRA and MSRB rules on suitability and transaction reporting, explored in deeper detail below.

Suitability – MSRB Rule G-19[5] - Although the advent of the EMMA service has been valuable for the brokerage community[6], subsequent MSRB guidance on Rule G-19 has indicated that any sale of a municipal bond to a retail client should involve a full review and disclosure of any "material event" relating to a particular bond issue. However, Rule G-19 and its applicable guidance does not explicitly indicate what must be considered a relevant "material event," as the MSRB's guidance indicates that EMMA is

[5] *See* MSRB Rule G-19; *see also* MSRB Notice 2010-37, MSRB Reminds Firms of their Sales Practice and Due Diligence Obligations when selling Municipal Securities In the Secondary Market, September 10, 2010, *available at:* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-37.aspx#_ftnref7

[6] The EMMA service has been useful to the brokerage community for archiving an individual issue official statement, and for access to certain continuing disclosure documents such as official financial updates, changes in rating agency ratings and notices of default, among others.

not considered an exhaustive or complete resource for information on "material events." [7] Instead, the guidance on Rule G-19 indicates that firms must take into account "all material information that is known to the firm or that is available through 'established industry sources,' including official statements [and] continuing disclosures" (mostly available through EMMA) as well as "press releases, research reports and other data provided by independent sources."[8] Given the present state of data aggregation and available information on the municipal bond market and particular municipal bond issues, and with the lack of municipal bond coverage on widely accessible financial websites such as Bloomberg and Yahoo Finance that cover these issues, it is often difficult for advisors to research news, analyst recommendations and basic fundamental financial information about municipal securities. It would be helpful for advisors to understand the necessary scope of their suitability review under Rule G-19, in order for them to be reasonably confident in the disclosures of "material events" that they are providing to the investor. The MSRB should provide explicit guidance as to what will be required to adequately complete a suitability rule that is compliant with Rule G-19. One suggestion for this guidance would be to potentially require issuers to be responsible for the disclosure of all material events, thereby allowing advisors to rely only on the issuer generated disclosures. Another possible solution is to define EMMA as a complete resource for information on "material events." In either case, firms would benefit from the additional clarity concerning their obligations to investors.

Transaction Reporting – MSRB Rule G-14 - Although the availability of real time transaction data is positive for the municipal securities market, there are possibilities for improvement. MSRB Rule G-14 mandates the use of the MSRB's Real-time Transaction Reporting System (RTRS) for trade reporting of each purchase and sale transaction effected in municipal securities.[9] A number of changes could be made to streamline municipal transaction reporting, including consolidation with FINRA's corporate bond reporting system (TRACE). Consolidation with TRACE would lower the systems management burden on the MSRB and help to address inconsistencies between the MSRB and FINRA rulebook. These inconsistencies make compliance complicated for registered representatives utilizing a multitude of products besides municipal securities. Moreover, in regard to the value to

---

[7] MSRB Notice 2010-37, MSRB Reminds Firms of their Sales Practice and Due Diligence Obligations when selling Municipal Securities In the Secondary Market, September 10, 2010, *available at:* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-37.aspx#_ftnref7

[8] *Id.*

[9] MSRB Rule G-14(b).

market participants in a "real time" transaction report for municipal securities, it would be helpful if there was some recognition by the MSRB that the municipal market differs from that of corporate bonds or listed equities. This difference is due to the fact that many municipal bonds trade infrequently and are of relatively small issuance size. Therefore the value of a "real time" transaction report is diminished when this is the only trade occurring in that security in months. Moreover, the focus on contemporaneous pricing (expressed in MSRB Rule G-14(b)(i) and the MSRB's proposal on January 17, 2013)[10] and the approach to a reasonable mark-up and commission is further complicated by lightly traded or infrequently reported issues.

Another concern with transaction report comes from the use of the RTRS system. According to MSRB's guidance[11], "a trade report sent late is not 'correctable.'" Late trades violate the 15 minute trade reporting rule under Rule G-14(a)(ii). In many cases, there may be an inadvertent error in an initial trade report to the MSRB, which results in a new trade report to RTRS to correct the error. Often, a firm's trade review is processed at the end of the day, and a trade correction is made based on the review of the initial report to RTRS. However, this correction is booked by the RTRS system as a late report and therefore violates the 15 minute trade reporting rule under Rule G-14. Essentially, the MSRB and the RTRS system punish the firm for making a change to an already reported trade due to inadvertent mistake in processing. This policy essentially penalizes firms for doing the appropriate thing – notifying the MSRB and the RTRS system of an inaccurately reported trade in municipal securities. The MSRB should provide, at the very least, greater clarity on what changes to trades require a new trade report (and subsequent penalty under Rule G-14) or ideally, some sort of separate way to submit trade corrections without violating the 15 minute trade reporting rule. This approach would encourage the correction of inaccurately reported trades without penalizing firms that choose to do so.

2. The MSRB Rulebook should have focused guidance for particular participants in the municipal securities marketplace.

---

[10] *See* MSRB Notice 2013-02, Request for Comment on More Contemporaneous Trade Price Information Through a New Central Transparency Platform, January 17, 2013, *available at:* http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-02.aspx#_ftnref11

[11] MSRB Notice 2005-08, Questions and Answers Regarding the Real-Time Transaction Reporting System (RTRS): Trade Submission, Error Feedback, RTRS Web and Contacting the MSRB by Phone, Questions 15 & 16, January 26, 2005, *available at:* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2005/2005-08.aspx#_Toc94505294

The current rulebook seems somewhat biased towards underwriters and those involved in the origination end of the market. The municipal securities market would benefit from segmented guidance within the MSRB rules that speak to each particular audience in the marketplace. Moreover, in the current rulebook, a disproportionate focus of the regulatory burden appears to fall on both the issuer/originator segment of the market and the retail representative and their clients respectively, with very little regulation and guidance focusing on the layers of the market in between. This area of the market, including the syndicate members or sellers of new issues, secondary dealers who buy subsequent to the "new issuance" and institutional buy-side firms are less affected by suitability and disclosure requirements and interpretation. The overall market would benefit from a formal sharing of information along the chain of participants from the originator/issuer to the retail purchaser. In this model, each purchaser along the chain of sale would gather information from the selling party, such as information relating to material events and continuing disclosure, and then would aggregate that information and pass it along to the next purchaser. This approach would give improved integrity to the MSRB's disclosure process by giving more responsibility to the operators within the middle layer of the market between origination and retail sale.

3. MSRB Should Make An Effort to Harmonize Pay to Play Rules with FINRA and the SEC.

FSI's members are primarily involved in the secondary market for municipal securities and are not generally involved in the origination and issuance of municipal securities. MSRB Rules G-37[12] and G-38, the MSRB's pay to play rule, are refreshingly focused on the true concerns in the pay to play arena, with a limited compliance burden for firms not involved in originating municipal securities. However, FSI members, who often have a significant number of their representatives that are dually registered as investment advisers, are also caught within the scope of the SEC rule on pay to play.[13] The SEC rule imposes significant costs on firms operating in this space, while also squelching the first amendment rights of the advisors by unnecessarily limiting their political contributions to $350. Moreover, FINRA has also

[12] MSRB Rule G-37(e) requires that each broker, dealer or municipal securities dealer involved in the rule-defined "municipal securities business" must file quarterly reports on Form G-37 regarding political contributions made by its municipal finance professionals or non-MFP executive officers in connection with individuals seeking elected office and for bond ballot campaigns.

[13] *See* SEC Rule 206(4)-5

indicated they wish to craft their own rule on pay to play.[14] These differing standards present significant compliance burdens for firms and investment advisers participating in the municipal securities marketplace, whether in the secondary market or the origination space. If FINRA does adopt their own rule, there will be three differing standards for FSI members to follow. The MSRB should make an effort to work with the SEC and FINRA to harmonize a uniform standard for firms and advisers operating in the municipal space. A targeted approach in a single rule, similar to that already in place in MSRB Rule G-37 would be preferable and have the greatest investor protection impact, while still minimizing the compliance burdens and costs on regulated entities.

4. Direct-Sold 529 Plan Recommendations

The MSRB has recently indicated that financial advisors that advise clients to invest in direct-sold 529 college savings plans may be making a formal recommendation that is governed by suitability rule MSRB Rule G-19.[15] This approach presents concerns for both advisors and investors saving for their child's college education. As is commonly known, there are two types of 529 plans, depending on the state the investor lives in, that are available to investors. Direct-sold 529 plans are those sold directly to investors by a fund management company directly contracted by the state. The other available 529 plan to investors is an advisor-sold plan. In many states, there are significant tax advantages that favor investors that purchase direct-sold plans directly from the state's provider.[16] In many instances, advisors are approached by their clients seeking the best plan for them – or more specifically, seeking the tax benefits of home state 529 direct-sold plans. Advisors, seeking to do right by their clients, and realizing the potential tax benefits available to the client, often recommend their clients purchase the direct-sold plan. In fact, FINRA expressed directly to investors that "broker-sold plans are generally more expensive than direct-sold plans. If you're comfortable going it alone, you can often save money investing in a direct-

---

[14] *See* Final Rule: Political Contributions by Certain Investment Advisers, 75 Fed. Reg. 41042 (July 14, 2010) ("FINRA has informed us that it is preparing rules for consideration that would prohibit its members from soliciting advisory business from a government entity on behalf of an adviser unless they comply with requirements prohibiting pay to play activities.")

[15] Liz Skinner, Direct-sold 529s could put brokers at risk: MSRB, INVESTMENT NEWS, February 13, 2012, *available at:* http://www.investmentnews.com/article/20130213/FREE/130219954?utm_source=indaily-20130213&utm_medium=in-newsletter&utm_campaign=investmentnews&utm_term=text

[16] FINRA Investor Alert, College Savings Plans – School Yourself Before You Invest, *available at:* http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/529Plans/p010756

sold plan."[17] Moreover, FINRA's investor alert instructs investors to ask questions of their advisor regarding the state tax deductions that may be available under the advisor-sold plan versus the state plan.[18] Therefore, the MSRB's approach appears to contradict FINRA guidance to investors.

While there may be data that suggests advisors are increasingly recommending direct-sold plans, this is likely to be in an effort to be helpful to their clients and encourage them to take advantage of the state tax deduction. Advisors do not gain anything financially by recommending a direct-sold plan, and in fact may lose the opportunity cost of a potential sale of an advisor-sold plan to that client. As advisors and their broker dealer do not have a selling agreement with direct-sold plans, it is somewhat difficult to perform due diligence on these products, nor should they be required to do so, as it's not a recommendation for which they are compensated.

Imposing a rule that requires advisors to consider this a formal recommendation would potentially result in brokers and firms no longer steering their clients to an investment (the direct-sold plan) that may be best for them. Therefore, any effort by the MSRB to propose a rule on this issue would fly in the face of FINRA guidance, as well as promote bad policy by decreasing advisors ability to do what is best for their clients. Therefore, the MSRB should explicitly state that these types of recommendations are not formal recommendations under MSRB Rule G-19.

Conclusion

We remain committed to constructive engagement in the regulatory process and welcome the opportunity to work with the MSRB to achieve a sensible balance between investor protection and regulation in the municipal securities market.

Thank you for your consideration of our comments. Should you have any questions, please contact me directly at (202) 803-6061.

Respectfully submitted,

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

[17] *Id.*
[18] *Id.*

cc: Robert Colby, EVP and Chief Legal Officer, FINRA