INVESTMENT COMPANY INSTITUTE

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August 19, 2014

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

Re: MSRB Notice 2014-12 Relating to
Standards of Conduct for Municipal Advisors

Dear Mr. Smith:

The Investment Company Institute[1] appreciates the opportunity to provide comments to the Municipal Securities Rulemaking Board (MSRB) on the revised version of proposed Rule G-42, which would govern standards of conduct for non-solicitor municipal advisors.[2] According to the Notice, the MSRB has made significant modifications to the proposed rule since it was first published for comment in January 2014 and is now seeking additional comment on these modifications. As with our previous comment letter,[3] we support the rule's adoption and again commend the MSRB for pursuing adoption of this rule in order to establish standards of conduct for municipal advisors. Notwithstanding our support, we recommend that the MSRB consider making additional revisions to the rule to better address its application to persons who qualify as municipal advisors as a result of the advice they render

[1] 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 $17.3 trillion and serve more than 90 million shareholders.

[2] *See Request for Comment on Revised Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors,* MSRB Notice No. 2014-12 (July 23, 2014) ("Notice"), which is available at: http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-12.ashx?n=1. 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* Letter from the undersigned to Ronald W. Smith, Corporate Secretary, MSRB, dated March 4, 2014, commenting on MSRB Notice 2014-01 ("ICI's March Letter").

to 529 college savings plans.[4] We also again recommend that the MSRB clarify that the rule only shall apply prospectively. Each of our recommendations is discussed below.

I. THE INSTITUTE'S COMMENTS ON THE PREVIOUS VERSION OF RULE G-42

ICI's March Letter generally supported the proposed rule, but expressed concern regarding the impact of certain of the rule's provisions on municipal advisors that provide advice to states' 529 college savings plans. We are pleased that, in response to such comments, the MSRB has: deleted the provision in Supplementary Material .02 that would have required a municipal advisor to investigate and consider alternatives to the advisor's advice; deleted the provision in proposed Rule G-42(b) that would have required advisors to disclose their insurance coverage; revised the provision in proposed Rule G-42(c) relating to updating disclosures provided to the client to only require such updates in the event of material changes to information; and deleted the provision in proposed Rule G-42(d) that would have required an advisor to recommend only a municipal financial product that is "in the client's best interest."

As discussed below, the Institute continues to be concerned about the following provisions that were in the original proposal and that remain in the revised rule. We previously commented on each of these: the provision in Supplementary Material .01 that would require an advisor to undertake a reasonable investigation to determine that it is not basing any recommendation on materially inaccurate or incomplete information; the provision in Supplementary Material .08[5] that would require municipal advisors to make specified disclosures relating to a conflict of interest to "investors;" and the provision in Supplementary Material .09[6] that lists the factors that must form the basis for a municipal advisor's recommendation to a municipal entity.

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[4] Supplementary Material .12 to the proposed rule expressly affirms that the rule applies to municipal advisors to sponsors or trustees of college savings plans and other municipal fund securities. In light of this and as discussed in more detail in this letter, we believe additional revisions or clarification are needed to better understand how the rule will apply in the context of advice provided to a municipal entity relating to a state's 529 college savings plan.

[5] In the revised version of the rule, Supplementary Material .07 has been renumbered as .08.

[6] In the revised version of the rule, Supplementary Material .08 has been renumbered as .09.

II. THE INSTITUTE'S CONTINUING CONCERNS WITH PROPOSED RULE G-42 AS APPLIED TO 529 PLANS

A. Supplementary Material .01, Duty of Care

Rule G-42(a) would define a municipal advisor's standard of conduct to include a duty of care. According to Supplementary Material .01, this duty of care would require, in part, an advisor to "undertake a reasonable investigation to determine that it is not basing any recommendation [made to the municipal client] on materially inaccurate or incomplete information." As noted above, ICI's March Letter objected to the MSRB prohibiting a municipal advisor from being able, without undertaking an investigation, to rely on information provided to it by its municipal entity client. In response to this concern, the MSRB's current Notice merely states, "[t]he Revised Draft Rule does not provide an exception for information that is provided to the advisor by the client."[7] With respect to 529 plans specifically, the Notice continues: "In addition, the MSRB believes that in some circumstances the information may be provided to the advisor by the client in connection with the preparation of the official statement. . . . The MSRB believes at this juncture that the provisions of the Revised Draft Rule are appropriate and does not believe that advisors to 529 plans should be relieved from an obligation to inquire as to material provided by it to its client or other parties in connection with the preparation of an official statement."[8]

We continue to have serious concerns regarding the investigation required by Supplementary Material .01. While Rule G-42(d) would require a municipal advisor making a recommendation to a client to ensure that the recommendation is suitable for the client, the investigation required by Supplementary Material .01 would go far beyond that, and require a municipal adviser to actively investigate the veracity of information provided to it by a client prior to making a recommendation to the client. As discussed below, such requirement is both impractical and inconsistent with the rule's intent. Moreover, we are aware of no other financial professionals registered under the Federal securities laws that are required by law to investigate the veracity of information provided to them by a client prior to making a recommendation to the client.

In our view, an advisor should be able to rely on information provided to it by its state partner. We remain concerned that, in its current form, this provision imposes upon municipal advisors, alone among financial professionals, a duty to investigate information that may be wholly within the client's

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[7] Notice at p. 17.

[8] Notice at pp. 17-18. As discussed below, we are concerned that this discussion in the Notice appears to confuse information provided by a municipal client to an advisor in connection with rendering advice with information provided by the client to the advisor for purposes of preparing the client's official statement.

control. In particular, as discussed in ICI's March Letter, this requirement 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. We respectfully submit that this may not be the case. Indeed, much of the information necessary to confirm the accuracy and completeness of information provided by the client and relied upon by the municipal advisor may be non-pubic information in the client's possession that is not available to the advisor.[9] We question how an advisor can complete the required investigation if it is unable to obtain the information necessary to assess the accuracy or completeness of information provided by its client.

This requirement also appears to be 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."[10] We concur with the MSRB's interest in empowering the municipal client. Such empowerment, however, comes with responsibility and, in our view, this responsibility should include 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. We therefore do not support including in the rule a provision that imposes upon the advisor a burden to uncover any false or misleading information provided by the client.[11]

In addition to our concerns with duty imposed on advisors by Supplementary Material .01, we are troubled by the Notice confusing the type of investigation required by Supplementary Material .01 with the type of investigation that occurs to verify information prior to including it in an official statement. In our view, these are very different activities. Our comments and concerns with Supplementary Material .01 go to the former. With respect to the latter, we understand that, prior to publishing any information in an official statement, prospectus, or other public document, much vetting and due diligence occurs – beyond statements made by the issuer or its representatives – to ensure that investors are provided accurate, full, and fair disclosure of material information. As such,

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[9] For example, in the context of a 529 college savings plan, assume the state will administer the plan but is working with the municipal advisor to design the plan and such design needs to ensure that the plan generates sufficient revenues to cover the state's costs of administration. If, in working with the municipal advisor, the state provides the advisor information regarding the total costs that must be covered by the revenues generated by the plan, the advisor would likely not have access to the non-public information that would be necessary to verify the information provided by the client regarding the total amount or component parts of such costs. We question, therefore, how the MSRB would expect the advisor to determine the accuracy or completeness of the information the state client provides to the municipal advisor.

[10] Notice at p. 7.

[11] For example, consider a hypothetical situation in which a municipal entity seeks advice from an advisor and, in doing so, deliberately lies to the advisor or provides the advisor with information the client knows to be false. Under the proposed rule, it is the advisor's obligation to determine the false nature of the information and, if it does not, it is the *advisor* who has violated the rule both by relying on the inaccurate information and failing to discern its accuracy. This seems patently unfair.

the role of an advisor that has been retained to provide advice to a municipal client should not be confused with the role of an advisor that has been retained to assist the municipality in preparing and producing an official statement. Accordingly, we encourage the MSRB not to presume that an advisor that has been retained to provide advice to a municipal entity regarding a 529 plan will also have any role in preparing, drafting, and vetting the plan's official statement as this may not, in fact, be the case.

For all of the above reasons, we again strongly recommend that the MSRB reconsider its decision to impose through Supplementary Material .01 a duty on municipal advisors to investigate information provided by the advisor's municipal client. If Supplementary Material .01 is not revised as we recommend, we request that the MSRB provide guidance regarding how a municipal advisor is to conduct an investigation when the information that would be necessary to verify the accuracy and completeness of the information provided by the municipal client is wholly within the client's control and unavailable to the advisor.

B. Supplementary Material .08, Disclosure of Conflicts of Interest

Supplementary Material .08 provides additional guidance regarding an advisor's disclosure obligations under Rule G-42(b), which requires disclosures of conflicts of interest and other information. Among other things, Supplementary Material .08 would require a municipal advisor to "provide written disclosure to investors" of certain affiliations that must be disclosed pursuant to the rule.

ICI's March Letter opposed advisors to 529 plans being required to provide disclosures "to investors" regarding the advisor's affiliations. The Notice includes two responses to the Institute's recommendation that this requirement be deleted: (1) this disclosure requirement "would be satisfied if the advisor's affiliate were to provide written disclosure of the affiliation to investors" and (2) the MSRB believes such disclosure is warranted "because advisors to 529 plans may have material conflicts of interest including those that may arise in connection with affiliates of an advisor that may be registered investment companies that are included in one or more of the investment options in the 529 plan to or on behalf of which the advisor is providing advice."[12]

We respectfully submit that neither response addresses our concerns with this requirement. Our concerns are two-fold: (1) it seems wholly inappropriate to require the advisor to a municipal entity to make disclosures to persons investing in securities issued by that entity; and (2) this requirement is premised on the advisor to a 529 plan having access to the names and contact information for the plan's investors.

[12] Notice at p. 18.

With respect to our first concern, the Institute fully understands the importance of Rule G-42(b) requiring a municipal advisor to make specified written disclosures to the municipal client (*i.e.,* the 529 plan) relating to the advisor's conflicts of interest, including information on any affiliates of the advisor that provide any advice, service, or product to, or on behalf of, the municipal entity. We support this requirement because such disclosures are necessary for the municipal client to be able to assess the advisor's conflicts of interest and determine whether they might inappropriately or improperly impact the municipal entity's relationship with the advisor. We fail to understand, however – and the Notice fails to explain – why such information is relevant to a person *investing* in 529 plan securities. Indeed, if all material terms and conditions of the 529 plan offering already are disclosed in the offering document that is provided to investors and potential investors, this supplemental disclosure would not provide any additional protection to investors.[13]

We expect that the municipal entity entering into a contract with the advisor already has determined that any conflicts of interest presented by the advisor's affiliates do not impair the ability of the advisor to render impartial advice to the municipal entity. This being the case, we question why the MSRB believes that *investors in the plan* need to be able to assess independently the conflicts that the municipal advisor has already considered and resolved or addressed. We also question what the MSRB expects an investor to do with this information since, aside from deciding not to purchase a particular's state's 529 plan, the investor lacks any ability to influence the plan's structure or alter the services provided to the plan by the advisor's affiliates. For all of these reasons, such disclosure seems both unnecessary and of questionable value to investors.[14]

With respect to our second concern, the Notice fails to explain how an advisor to a municipal entity is expected to know the identities of and contact information for investors in a state's 529 plan so that the advisor can provide the required disclosure to such investors. As explained in ICI's March

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[13] We note that the disclosure principles of the College Savings Plan Network have long recommended that the official statement for a 529 plan include: the name of any private program manager or investment manager; the identity of the State administrator and, if applicable, of principal private contractors with direct investment management or program management experience and the current expiration date of any such contracts; and the identity of any trustee for or custodian of account assets. *See College Savings Plan Network Disclosure Principles No. 5* (Adopted May 3, 2011) at Items 3.A., 3.B., and 3.J. Item 2 of the *Principles* recommends that "State issuers should provide interim supplements to the Offering Materials as deemed necessary by the State Issuer in order to prevent the Offering Materials from containing an untrue statement of material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." We believe the disclosure provided to a plan's investors amply addresses the MSRB's concerns.

[14] While it is very common for states to retain affiliates of a municipal advisor to the states' 529 plans to provide services to their plans, we are not aware of instances – and the MSRB provides no examples of such instances – where these affiliated relationships have adversely impacted 529 plan investors. The efficiencies resulting from these affiliated relationships benefit investors, which is why the states often utilize a municipal advisor's affiliates in their 529 college savings plans.

Letter, because of the structure of 529 plans and Federal and state restrictions on the ability of financial institutions to share their customers' non-public personal information, a municipal advisor likely has no access to information about the plan's investors or how to contact them. Also, as we previously noted, even if the advisor could obtain such information and contact investors in the plan, such investors would likely be confused by such disclosure, as they may have no relationship with the advisor and question why the information is being provided to them. While we appreciate the MSRB permitting such disclosure to be provided in the plan's official statement, this accommodation fails to recognize that the advisor may have no involvement in or influence or control over the contents of the official statement used by the plan or its underwriter so it would be unable to require the plan or its underwriter to include the required disclosure in such document.

Accordingly, we strongly recommend that the MSRB either delete Supplementary Material .08 in its entirety or clarify that its disclosure and delivery requirements do not apply to advisors that provide advice to 529 plans. If the MSRB determines to retain this Supplementary Material in its current form, we recommend that the MSRB better explain why this information is necessary for investors and also provide guidance regarding how municipal advisors that lack access to information regarding the plan's investors are to provide such disclosures to such investors if the plan's official statement does not include the required disclosure.

C. Supplementary Material .09, Suitability

Rule G-42(d) imposes a suitability standard on the advice rendered by a municipal advisor to its municipal entity client. Supplementary Material .09 lists the factors on which this determination must be based as follows:

> . . . the client's financial situation and needs, objectives, tax status, risk tolerance, liquidity needs, experience with municipal securities transactions or municipal financial products generally or of the type and complexity being recommended, financial capacity to withstand changes in market conditions during the term of the municipal financial product or the period that municipal securities to be issued in the municipal securities transaction are reasonably expected to be outstanding and any other material information known by the municipal advisor about the client and the municipal securities transaction or municipal financial product, after reasonable inquiry.[15]

[15] The suitability factors listed in Supplementary Material .09 are substantially similar to those listed in FINRA Rule 2111(a). FINRA Rule 2111(a) prohibits a FINRA member from recommending a transaction or an investment strategy to a customer unless the member determines the recommendation is suitable based on the customer's investment profile, which includes the customer's "age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member . . .." Importantly, however, unlike the MSRB's proposal, subsection (b) of FINRA's rule tailors the rule's application to "an institutional account." Also, it bears noting that FINRA's rule does not require a broker-dealer to verify

We continue to have concerns with the application of Supplementary Material .09 to 529 plans. We note that this provision remains unchanged from its previous version and the MSRB's Notice contains no mention or discussion of the concerns with it that were raised in ICI's March Letter.

While factors such as the municipal client's tax status,[16] risk tolerance, liquidity needs, and financial capacity to withstand changes in market conditions during the term of the offering may be relevant to advice rendered in connection with a bond offering, they would appear largely irrelevant in the context of rendering advice to a 529 plan. Similarly, the client's "financial situation and needs" would also appear to be largely irrelevant in the 529 plan context as these plans are not designed and sponsored to satisfy the client's financial situation and needs, but rather to implement a statutory program that enables retail investors to save for higher education.

Imposing this requirement on municipal advisors without regard to the product they are advising a client on – *i.e.,* a traditional bond as compared to a 529 plan – overlooks fundamental differences in these products and the advice related to them. Indeed, 529 plans are quite different from bond offerings. For example, 529 offerings are not discrete offerings with a limited number of bonds offered to the public for a limited period of time; they are unlimited ("evergreen") offerings with no predetermined duration. Also, unlike bond offerings, 529 plan offerings are not dependent upon external sources of revenue or funding in order to satisfy the claims of investors. The value of an investor's interest in a 529 plan is not negotiated between the buyer and seller and the price of 529 shares do not fluctuate intraday based on such negotiations. Instead, proceeds from the sale of 529 plan interests are pooled and invested in securities consistent with the plan's investment objectives and limitations. On each business day, after the plan's expenses and fees are deducted from the plan's assets under management, the net asset value ("NAV") of the plan is determined. This NAV determines the price that is paid to an investor redeeming an interest in the plan or purchasing an interest in the plan on that day. The calculated NAV is applied to all investors' transaction that are processed effective that day. Also, unlike bonds, which are issued to raise revenue for specific public works projects or activities, 529 plans are created by states to provide an investment vehicle to assist families in saving for qualified higher education.

We believe the differences between advice rendered in connection with municipal securities and that rendered in connection with 529 plans should be recognized in Supplementary Material .09. Because it is not, we again recommend that the MSRB address our concerns by either affirming that the

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the accuracy or completeness of the information the investor provides to the broker-dealer for purposes of determining the suitability of the broker-dealer's recommendations.

[16] We question the inclusion of a municipal client's "tax status" since we presume all government clients would be exempt from any state or federal taxes.

suitability factors listed in Supplementary Material .09 do not apply to advice relating to such plans or clarifying how the MSRB intends the listed factors to apply to such plans in light of their unique structure vis-à-vis bonds and our concerns.[17]

III. PROSPECTIVE APPLICATION OF RULE G-42

Finally, we note that the Notice is silent regarding a proposed compliance date for the revisions to Rule G-42. We again recommend that the MSRB clarify that, once adopted, Rule G-42 will only apply prospectively. As such, a municipal advisor will only be required to comply with the relevant requirements of Rule G-42 when it either enters into a new advisory relationship with a municipal client or when it recommends a new municipal securities transaction or municipal financial product to an existing municipal client. With respect to 529 plans, due to the nature of the advisor's relationship with the plan and the duration of existing 529 plan contracts, this clarification is particularly important in order to avoid disrupting existing relationships and contracts.

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We appreciate the opportunity to provide these comments and your consideration of them. If you have any questions, please contact the undersigned at (202)326-5825.

Sincerely,
/s/
Tamara K. Salmon
Senior Associate Counsel

[17] Alternatively, the MSRB could address our concerns by revising Supplementary Material .09 to read, in relevant part "... must be based on the following factors to the extent applicable to the nature of the advisory relationship or to the product or service being recommended to the advisory client: the client's financial situation and needs, ..." [Underscoring indicates the language we recommend be added to this provision.}