



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org

March 4, 2014

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

Re: MSRB Notice 2014-01 Relating to  
Standards of Conduct for Municipal Advisors

Dear Mr. Smith:

The Investment Company Institute (ICI)<sup>1</sup> appreciates the opportunity to provide comments to the Municipal Securities Rulemaking Board (MSRB) on its proposal to adopt a new Rule G-42 to govern standards of conduct for non-solicitor municipal advisors.<sup>2</sup> Inasmuch as the new rule will expressly apply to municipal advisors to sponsors or trustees of 529 college savings plans,<sup>3</sup> the Institute has reviewed the rule from the perspective of such advisors and, based on our review, supports its adoption. We commend the MSRB for giving deliberate consideration to the duties that a municipal advisor should owe to its municipal clients and for taking the lead in setting standards of conduct for this new category of registrants. Notwithstanding our support for the rule, we recommend several revisions to it to clarify how these new standards will apply in the context of 529 college savings plans. We also recommend that the MSRB clarify that the rule shall only apply prospectively.

---

<sup>1</sup> 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 \$16.3 trillion and serve more than 90 million shareholders.

<sup>2</sup> See *Request for Comment on Draft MSRB Rule G-42, on Duties of Non-Solicitor Municipal Advisors*, MSRB Notice No. 2014-01 (Jan. 9, 2014), which is available at: <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2014-01.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.”

<sup>3</sup> See Supplementary Material .10 to proposed Rule G-42. We appreciate the MSRB including this clarification in the rule. 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.

## **I. OVERVIEW OF PROPOSED RULE G-42**

As proposed, the new rule would subject a municipal advisor to a duty of care as well as to a fiduciary duty that includes a duty of loyalty. The rule would also: impose disclosure requirements on municipal advisors; require documentation of the terms and extent of the advisor's relationship with each municipal client; prohibit recommending a municipal securities transaction or product unless the advisor has a reasonable basis for believing that it is suitable for the client; requiring the advisor, upon request of a client, to review another party's recommendation to the client; prohibit principal transactions except in limited circumstances; and prohibit specified conduct. The rule includes Supplementary Material to provide additional guidance on its provisions.

We recommend that, prior to finalizing its proposal and filing it with the U.S. Securities and Exchange Commission for adoption, the MSRB address each of the issues discussed below, which arise as a result of the rule's application to those municipal advisors whose activities as a municipal advisor are limited to serving as a sponsor or advisor to one or more state 529 college savings plans.

## **II. ISSUES RAISED BY THE RULE'S APPLICATION TO ADVISORS TO 529 PLANS**

### **A. Subsection (a) and Supplementary Material .01 and .02, Standards of Conduct**

Subsection (a) of Rule G-42 would define a municipal advisor's standard of conduct as a (1) duty of care and (2) fiduciary duty that includes a duty of loyalty and a duty of care. According to Supplementary Material .01, the advisor's duty of care would require the 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." In the context of 529 college savings plans, it is not uncommon for the municipal advisor that is acting as a plan sponsor to work with the appropriate representatives of a state's plan to design a plan that best meets the needs and requirements of the state and complies with any state or Federal laws governing the plan's operations. As part of this process, the advisor oftentimes relies upon its state partner to provide the advisor information that is necessary for the advisor to fulfill its obligations and duties to the plan. We believe that, in such circumstances, a municipal advisor should not be required to verify the veracity or completeness of information provided to it by those state employees or officials who are authorized to act on behalf of the plan. We recommend that the MSRB expressly affirm in Supplementary Material .01 that a municipal advisor is not required to investigate whether information provided to it by persons who are authorized by a municipal client to act on behalf of a state's 529 plan is materially inaccurate or incomplete.

Supplementary Material .02, which is also related to this subsection of the rule, would require, in part, that a municipal advisor "investigate and consider other reasonably feasible alternatives to any recommended municipal securities transaction or municipal financial product that might also or alternatively serve the municipal entity client's objectives." We are uncertain how this requirement

would apply in the context of a municipal advisor advising a state on its 529 plan. In particular, we question what other “securities transactions or municipal financial products” such advisor is expected to investigate or consider as part of its duty of loyalty. Indeed, this provision seems to have been drafted to address concerns with advisors who render advice regarding municipal securities other than municipal fund securities in mind. We recommend that the MSRB either eliminate this requirement for advisors to 529 plans or clarify that it may not be applicable to all advisory relationships.

### **B. Subsection (b) and Supplementary Material .07, Disclosure of Conflicts of Interest**

Subsection (b) of the rule lists nine different items of information that a municipal advisor must disclose to its client at or prior to the inception of a municipal advisory relationship. As a preliminary matter, we recommend that the prefatory language to this list of items clarify that the advisor is only required to disclose those items that are applicable to its relationship with the client.<sup>4</sup> This would ensure that advisors are not required to provide “negative” disclosure to the client.<sup>5</sup> In addition, we recommend that subdivision (b)(viii), which would require disclosure of “the amount and scope of coverage of professional liability insurance that the municipal advisor carries” and related information, be deleted from this list. We are not aware of any other financial industry professionals that are required to disclose information regarding their insurance coverage to a client, and we do not understand the public purpose of the MSRB imposing such a requirement.<sup>6</sup> Indeed, requiring disclosure of such information to each and every municipal client would appear to be both unprecedented and unnecessary.<sup>7</sup> For these reasons, we recommend deleting this information from the list of required disclosures.

Supplementary Material .07 provides additional guidance regarding an advisor’s disclosure obligations. Among other things, it requires a municipal advisor to “provide written disclosure to investors” of certain affiliations that must be disclosed pursuant to Rule G-42(b). We do not understand why the MSRB would include in a rule that governs the standards applicable to an advisor’s relationship with a municipal client, a provision that requires the advisor to make specified disclosures

---

<sup>4</sup> In particular, we recommend that this prefatory language read in relevant part [new language indicated by underscoring]: “. . . including disclosure of each of the following as applicable:”. We also recommend deleting the “as applicable” qualifier from subdivision (b)(i) of the rule because it would be unnecessary if you follow our recommended edit to this provision.

<sup>5</sup> This approach would be consistent with the requirements of the SEC’s “brochure rule.” Rule 204-3(d) under the Investment Advisers Act, which permits an adviser to omit “inapplicable information” from the disclosure it is required to provide to clients.

<sup>6</sup> We note that, when the MSRB enhanced the disclosure that underwriters must provide to their clients under MSRB Rule G-17, relating to fair dealing, to alert them to conflicts of interest, among other information, it did not require disclosure of insurance coverage. See *Interpretive Notice on Duties of Underwriters to Issuers*, MSRB Notice 2012-25 (May 2012).

<sup>7</sup> It also seems as though this disclosure is an implicit invitation for a municipal client to sue an advisor up to the limit of its liability insurance, which seems inappropriate.

“to investors.” It is unclear, for example, how this provision is intended to apply in the context of a municipal advisor interacting with a state on its 529 plan. Indeed, 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 and would, therefore, be unable to provide such investors the written disclosure required by this provision.<sup>8</sup> Moreover, the advisor may have no 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 .07 in its entirety or clarify that its disclosure requirements do not apply to advisors that provide advice to 529 plans.

### **C. Subsection (c), Documentation of the Municipal Advisory Relationship**

This provision in the rule would require a municipal advisor to provide its municipal client written disclosure of certain terms of its advisory relationship, including the compensation arrangements. It would further require the advisor to promptly amend or supplement the required disclosure “to reflect *any* change in or addition to the terms or information.” [Emphasis added.] The only exception to this is if there is a change to the amount of reasonably expected compensation. In such event, updated disclosure is only required if the change is “material.” It seems unnecessarily burdensome to require *all* changes to an advisor’s written disclosure to be revised except material changes to the compensation disclosure. A more reasonable approach that would not adversely impact the client would be to utilize the materiality standard as the trigger for all updates to the disclosure, not just those relating to compensation. This approach would be more consistent with the updating requirements the SEC imposes on the disclosure documents of Federally-registered investment advisers.<sup>9</sup> We therefore recommend that the rule be revised to require updating of the written disclosure only when there is a material change to information previously disclosed, regardless of the nature of the change.

### **D. Subsection (d) and Supplementary Material .08, Recommendations**

Subsection (d) of the rule imposes a suitability standard on advisors. In particular, it provides that a municipal advisor “may only recommend a municipal securities transaction or municipal financial product that is in the . . . best interest” of the municipal entity client. It is not clear how this requirement would apply to an advisor to a 529 plan. As noted above, 529 plans are typically

---

<sup>8</sup> Even assuming the advisor could contact investors in the plan, such investors would likely (1) be confused by such disclosure as they may have no relationship with the advisor and (2) question why the information is being provided to them.

<sup>9</sup> See Instruction 4 to SEC Form ADV, which requires an adviser to amend the disclosure document it provides to investors when the material in such document becomes “materially inaccurate.” The instructions to Form ADV are available on the SEC’s website at: <http://www.sec.gov/about/forms/formadv-instructions.pdf>.

authorized and established by state law with a state office or agency assigned responsibility for the plan's creation, operation, and oversight. Due the nature of the relationship between the plan and the municipal advisor in establishing, operating, and overseeing the plan, we are uncertain which recommendation(s) in this relationship would be subject to the proposed suitability requirement. The mismatch between a suitability requirement and the conduct or responsibilities of municipal advisors in a 529 plan context is further demonstrated when one considers the factors that Supplementary Material .08 requires to be taken into account in making this suitability determination. According to Supplementary Material .08, the advisor's suitability determination

. . . must be based on 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.

These factors do not make sense in the context of the relationship between a municipal advisor and a 529 college savings plan. Indeed, they appear to contemplate situations in which a municipal advisor provides advice or recommends a municipal security to an individual or retail investors rather than in the context of providing advice to a state offering a 529 plan. We recommend that the MSRB address this incongruity by either affirming that these suitability factors do not apply to municipal advisors advising 529 plans or, alternatively, clarifying how the MSRB intends them to apply in this context.

### **III. PROSPECTIVE APPLICATION OF RULE G-42**

Finally, the Institute recommends 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. This clarification, which will avoid disrupting existing relationships and contracts, is particularly important to advisors advising 529 plans due to the nature of the advisory relationship and the duration of existing contacts.

Mr. Ronald W. Smith, Corporate Secretary

March 4, 2014

Page 6 of 6

■ ■ ■ ■ ■

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