FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

May 29, 2015

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

Re: File No. SR-MSRB-2015-03, 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, Municipal Securities Dealers, and Municipal Advisors

Dear Mr. Fields:

On May 8, 2015, the Securities and Exchange Commission (SEC) published its request for public comment on the Municipal Securities Rulemaking Board's (MSRB) Proposed Rule G-42 defining the duties and standards of conduct 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 Proposed Rule includes, amongst other provisions, a prohibition on principal transactions between a municipal advisor and a municipal entity client.

The Financial Services Institute[2] (FSI) appreciates the opportunity to comment on this important proposal. FSI supports the SEC and MSRB's continued efforts to impose a regulatory regime on advisors to municipal entities and obligated persons, particularly for those advisors that had previously been unregulated. However, FSI has concerns with the application of the Proposed Rule to the securities execution services offered by regulated financial advisors and broker-dealers to municipal entities.

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

[1] 80 Fed. Reg. 26752 (May 8, 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.

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

The Proposed Rule prohibits a municipal advisor and any affiliate of such municipal advisor "from engaging in a principal transaction directly related to the same municipal securities transaction or municipal financial product as to which the municipal advisor is providing or has provided advice."[3] FSI believes this prohibition is unnecessary in the context of a broker-dealer providing securities transaction execution services to a municipal entity. As such, FSI proposes 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 executions services in certain fixed income securities. These concerns are discussed in greater detail below.

I. Principal Transactions

A. Introduction

The Dodd-Frank Act established a new federal regulatory regime for municipal advisors. The statute mandated that municipal advisors owe a fiduciary duty to their municipal entity clients, required municipal advisors to register with the SEC, and granted rulemaking authority over this class of registrants to the MSRB. In establishing this regime Congress explained that during the financial crisis, "a number of municipalities suffered losses from complex derivative products that were marketed by unregulated financial intermediaries."[4] Congress further stated that they sought to extend "current municipal securities market protections to cover previously unregulated market participants and previously unregulated financial transactions."[5]

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 services for the investment of a municipality's funds. While in many cases these funds are neither bond proceeds nor municipal escrow funds, this is not always the case. As the discussions that take place between a financial advisor and a client may amount to advice, FSI members are subject to an additional regulatory regime governing conduct that is already regulated.

FSI supports Congressional efforts to subject previously unregulated financial market participants to this new regulatory regime. However, as FSI members' activities are already subject to robust regulation, we believe these activities do not merit some of the additional regulatory burdens imposed by the Proposed Rule.

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[3] Proposed MSRB Rule G-42(e)(ii).
[4] *See* S. Rpt. 111-176, at 38.
[5] *See id.* at 147.

B. Exception from Principal Transactions Ban for Advice Incidental to Securities Execution Services in Certain Fixed Income Securities

FSI requests that Proposed Rule G-42(e)(ii) be amended to include an exception for a municipal advisor providing advice on investments in certain fixed income securities incidental to securities execution services to transact as a principal with its municipal entity client. Absent such an exception, the Proposed Rule would either prohibit these financial advisors from providing any sort of particularized recommendation to a municipal entity client or require execution of transactions effected for municipal entities to be on an agency basis. This is particularly problematic for fixed income securities, which are primarily effected on a principal basis.

FSI believes such a limited exception is warranted because it will not subject municipal entities to an increased risk of harm. The activities of FSI members whether serving a municipal entity or any other client are already subject to numerous federal laws and regulations that adequately protect a client from wrongdoing by a financial advisor. Furthermore, FSI is not seeking an exception from the fiduciary duty or the definition of municipal advisor. We are only requesting an exception from the principal trading ban. The fiduciary duty imposed by the Dodd-Frank Act does not mandate the imposition of a principal trading ban and as such, we believe it is within the MSRB's authority to promulgate such an exception.

Including a limited exception would comport with the SEC's temporary rule authorizing principal trades with non-discretionary advisory clients for entities dually registered as a broker-dealer and an investment adviser. In deciding to authorize principal trading in certain advisory accounts, the SEC recognized the importance of preserving access for investors to securities that primarily transact on principal bases.[6] The SEC further noted that despite authorizing principal trades, customers would still enjoy the protections of the fiduciary duty imposed on investment advisers.[7] FSI believes that the same reasoning supports the appropriateness of a principal trading exception for municipal advisors that are also registered as broker-dealers.

Furthermore, while a requirement for trading on an agency basis raises several practical concerns, it more significantly creates the opportunity for prices to rise for transactions effected for municipal entities. Typically, municipal entity clients transact in large blocks of liquid fixed income securities. As has been previously acknowledged, large block trades can often result in better prices for customers.[8] Additionally, FSI member firms do not maintain inventory and as such transact solely on a riskless-principal basis. This also results in better prices for customers, as the broker-dealer does not have to account for inventory risk, overhead, or net capital implications.

An exception from the principal trading ban is further warranted to ensure that municipalities maintain the ability to transact with the financial advisor of their choosing. FSI financial advisor members have established long-standing personal relationships with their clients. These relationships are built on trust and an acute understanding of the client's needs. As the services provided by these advisors to municipal entities are limited to securities execution, the Proposed Rule may limit a municipality's ability to utilize the services of their preferred financial advisor. FSI fully supports efforts to ensure that all financial market participants servicing municipalities are

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[6] 72 Fed. Reg. 55022, 55024 (Sept. 28, 2007)
[7] *See id.* at 55025.
[8] *See e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-265, MUNICIPAL SECURITIES: OVERVIEW OF MARKET STRUCTURE, PRICING, AND REGULATION 16-18 (2012).

subject to regulation. However, we do not believe that limiting the access of municipalities to regulated financial advisors is necessarily the appropriate way to protect these entities.

Lastly, while the municipal advisor definition offers an exemption for registered investment advisers, the relationships between FSI members and their municipal clients do not lend themselves to traditional fee-based investment advisory relationships. The transactions effected by FSI members for municipal entity clients often involve instances in which the municipality has funds to invest for a specified period of time, and intends to purchase securities and hold them until maturity. In these instances, neither the financial advisor nor the municipality contemplates the ongoing contact and advice typically found in an investment advisory relationship. Moreover, securities transactions for municipalities often settle on a delivery-versus-payment (DVP) basis, with the municipal entity determining to custody their securities at the bank of their choice. Under this arrangement, the assets held by the municipal entity cannot be deemed assets under management of the broker-dealer as subsequent to settlement there are no assets in the municipal entity's DVP account and the broker-dealer has no ability to monitor the assets held at the bank.

C. Conditions for Utilizing the Proposed Exception

a. Eligible Securities

For purposes of the proposed exception, FSI suggests it be limited to certain fixed-income securities. The categories of fixed income securities meeting this definition would only include debt securities, as defined by Rule 10b-10(d)(4) that are: (1) dollar denominated, issued by a U.S. corporation and offered pursuant to a registration statement under the Securities Act of 1933; (2) U.S. agency debt securities (as defined in FINRA Rule 6710(l)); and (3) U.S. Treasury securities (as defined in FINRA Rule 6710(p)).

The proposed definition encompasses widely held debt securities that maintain a sufficient amount of liquidity and transparency. As such, they pose a lower degree of risk to investors.

b. Required Disclosures

In order for a broker-dealer that is also registered as a municipal adviser to avail themselves of the proposed exception, the MSRB could impose disclosure requirements akin to those required under Advisers Act Temporary Rule 206(3)-3T.[9] This could include up-front written client consent authorizing the municipal adviser to act as a principal as well a requirement for the municipal adviser to obtain either orally or in writing consent to each transaction. FSI believes that these and other disclosure requirements adopted by the SEC for investment advisers reflect a balanced approach that ensures customers maintain the protections of the fiduciary duty while preserving their ability to benefit from principal transactions.

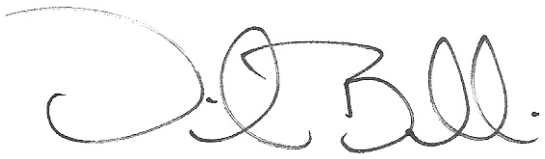
Conclusion

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

[9] 17 C.F.R. § 275.206(3)-3T.

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

Respectfully submitted,



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