

**MEMO# 32191**

February 7, 2020

# **MSRB Requests Comment on Draft Amendments to Rule A-3: Membership on the Board; Comments Due March 30**

[32191]

February 7, 2020 TO: ICI Members

Investment Company Directors

Municipal Securities Advisory Committee SUBJECTS: Municipal Securities RE: MSRB Requests Comment on Draft Amendments to Rule A-3: Membership on the Board; Comments Due March 30

The Municipal Securities Rulemaking Board is seeking comment on draft amendments to MSRB Rule A-3 regarding qualifications for board membership.[\[1\]](#) Among other things, the amendments would tighten the independence standard required of “public representatives,” reduce the size of the board, and impose term limits. According to the Notice, the draft amendments are the product of an in-depth review conducted by the MSRB’s Special Committee on Governance Review. Comments are due by March 30, 2020.

Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) amended Section 15B(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) to require that a majority of MSRB board members be independent (“public representatives”), while the remainder be associated with a broker, dealer, municipal securities dealer, or municipal advisor (“regulated representatives”). Accordingly, MSRB Rule A-3 currently provides for 11 public representatives, including at least one representative each of retail or institutional investors, issuers, and members of the public, and 10 regulated representatives.

## **Independence Standard**

The MSRB defines a public representative as an individual who has “no material business relationship” with any municipal securities broker, municipal securities dealer, or municipal advisor (“regulated entity”). The MSRB defines “no material business relationship” to mean the individual is not or was not “associated with” a regulated entity within the last two years. In addition, the individual must not have a relationship with any regulated entity that reasonably could affect his or her independent judgment or decision making.

The Notice states that since the independence standard was first proposed, some commentators have questioned whether a two-year separation period is sufficiently long.

Accordingly, the MSRB is considering whether a longer separation period would enhance the independence of public representatives who have prior regulated entity associations and better avoid any appearance of a conflict of interest without significantly decreasing the pool of individuals with sufficient municipal market knowledge to serve effectively as public representatives. Specifically, the MSRB seeks comment on the potential effects of extending the separation period to five years.

## **Board Size**

The Exchange Act establishes a 15-member board but permits the MSRB to increase the size, provided the number of board members is an odd number; a majority of the board is composed of public representatives; and the board is as closely divided in number as possible between public and regulated representatives. In response to the Dodd-Frank Act, which established a new registration requirement and regulatory framework for municipal advisors, the MSRB increased the size of the board to 21 members (11 public and 10 regulated). The Notice states that although the larger board was particularly valuable during the period of heightened rulemaking activity required to implement the Dodd-Frank Act, that rulemaking is now complete. Thus, the MSRB believes that it can return to the statutorily prescribed board size of 15 (8 public and 7 regulated).

## **Board Composition**

The Exchange Act requires that within the public representative category, at least one board member must be representative of institutional or retail investors in municipal securities, at least one must be representative of municipal entities, and at least one must be a member of the public with knowledge of or experience in the municipal industry. Within the regulated representative category, at least one board member must be associated with a dealer that is a bank, at least one must be associated with a dealer that is not a bank, and at least one must be associated with a municipal advisor.

Rule A-3 tracks those Exchange Act requirements for board composition in every respect except one: it requires that municipal advisor representation be greater than the statutory minimum. Specifically, Rule A-3 requires that at least one, and not less than 30 percent of the total number of regulated representatives, be associated with and representative of municipal advisors and not be associated with a broker, dealer, or municipal securities dealer. The MSRB is considering two adjustments to the municipal advisor requirement.

First, with a board size of 15 members, the current Rule A-3 requirement that not less than 30 percent of the regulated representatives be associated with municipal advisors would no longer be appropriate as it would require reserving three of the seven regulated slots for municipal advisor representatives. Therefore, the MSRB is considering requiring that the board's regulated representatives include at least two municipal advisors. Second, the MSRB is considering a limited expansion of its definition of the municipal advisor category. Currently, Rule A-3 provides that the required municipal advisor members must not be associated with dealers. Accordingly, individuals associated with municipal advisor firms that have a dealer affiliate to facilitate their advisory businesses do not qualify for the required municipal advisor member positions. The board is considering permitting—but not requiring—one municipal advisor representative to be associated with a dealer, provided that the dealer does not engage in underwriting the public distribution of municipal securities. The MSRB believes that such a requirement could facilitate their efforts to obtain the perspectives of the full range of municipal advisor firms.

## **Transition Plan to Reduced Board Size**

Currently, the board is composed of three classes of five members and one class of six members, with each board member serving a four-year term. In fiscal year 2020, the class of six members is in its fourth year of service, with the result that there will be 15 returning members after the six fourth-year members complete their terms on September 30, 2020. Those 15 returning members will meet the board composition requirements set out in the draft rule. Accordingly, if the MSRB determines to reduce the size of the board, it would plan to implement the change by electing no new members for fiscal year 2021, and thus it would achieve the new board size of 15 in the first fiscal year. A transition plan would be necessary, however, to change the class sizes to three classes of four members and one class of three members.

Specifically, the MSRB is considering a three-year transition plan, at the conclusion of which the board would have three classes of four members and one class of three members. Each of the new board classes would have the same number of public and regulated representatives except for the class of three, which would have two public representatives. All board members elected during the transition would be appointed to four-year terms. The board would resume electing new members, in accordance with the transition plan, for a four-member class with terms commencing in fiscal year 2022.

## **Terms**

The Exchange Act provides that MSRB members “shall serve as members for a term of 3 years or for such other terms as specified by the rules of the Board.” In 2016, the MSRB determined to lengthen the terms to four years and, at the same time, increased the number of board classes from three to four and limited to two the number of consecutive terms that a board member could serve. The MSRB is considering further limiting the amount of time that any individual may serve. The draft amendments would remove the current maximum of two consecutive terms, provide that a board member could serve for a total of no more than six years, and prohibit a board member who had reached the six-year limit from returning to the board, even after a period away.

## **Amendments to Board Nominations and Elections Provisions**

In the course of its review, the Committee also identified certain changes that could improve governance by retaining for the MSRB the flexibility to determine certain matters by board policy or resolution rather than by rule. Specifically, Rule A-3 includes a detailed description of the composition, responsibilities and processes of the board’s Nominating and Governance Committee. No other board committee is described in the board’s rules; rather, these committees are provided for in other governing documents, such as charters, resolutions and policies. To provide more flexibility, the draft amendments under consideration would remove references to the “Nominating and Governance Committee” and replace them with references to a committee charged with the nominating process. The draft amendments also include an update to the notice publication requirements, which the MSRB believes have become antiquated. Specifically, the MSRB replaced the requirement to publish the notice seeking applications for board positions “in a financial journal having national circulation among members of the municipal securities industry and in a separate financial journal having general national circulation” with the more general requirement to publish the notice “by means reasonably designed to provide broad dissemination to the public.”

Although the draft amendments retain a requirement that the board make available on its website the names of all applicants who agreed to be considered by the nominations

committee, the MSRB is reconsidering whether this provision should be included in a final rule. While this provision is intended to increase transparency, the MSRB believes that it also may deter applications by qualified individuals who may be concerned that a failure to be selected will negatively affect their reputations.

### **Public Representative Committee Chairs**

The proposed amendments would give the MSRB greater flexibility in establishing its committee structure through governance mechanisms such as charters and policies. The MSRB believes that irrespective of the board committee structure, responsibility for both nominations and governance should continue to be in a committee or committees chaired by a public representative. Current board policy requires that the audit committee also be chaired by a public representative. In light of the importance of public representative leadership of the audit committee to the board's corporate governance system, the MSRB believes this requirement should be included in the board's rules.

Jane G. Heinrichs  
Associate General Counsel

#### **endnotes**

[1] MSRB Notice 2020-02: *Request for Comment on Draft Amendments to MSRB Rule A-3: Membership on the Board* (January 28, 2020) ("Notice"), available at <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2020-02.ashx??n=1>.

---

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.