

MEMO# 29111

June 19, 2015

MSRB Proposed Amendments to Rule A-3, Membership on the Board; Member Call Scheduled for June 30 at 3:00 PM Eastern

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TO: MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 13-15 RE: MSRB PROPOSED AMENDMENTS TO RULE A-3, MEMBERSHIP ON THE BOARD; MEMBER CALL SCHEDULED FOR JUNE 30 AT 3:00 PM EASTERN

The Municipal Securities Rulemaking Board is seeking comment on proposed amendments to MSRB Rule A-3 regarding qualifications for board membership. [\[1\]](#) The draft amendments modify the standard of independence required by the Securities Exchange Act of 1934 ("Exchange Act") for the one public board member representing institutional or retail investors in municipal securities. The current standard of independence will continue to apply to all other public board members. According to the MSRB, the draft amendments are designed to allow the MSRB to consider a broader group of applicants to serve in that board member position. Additionally, the MSRB is seeking comments on whether it should extend the length of board member service and remove or modify the requirement that the MSRB publish the names of all board applicants. Comments should be submitted no later than July 13, 2015.

We have scheduled a members-only call to discuss the MSRB's request for comment on Tuesday, June 30 at 3:00 pm Eastern. The dial-in information for the call is as follows:

Dial-in number: 888-390-3810

Passcode: 43176

If your firm plans to participate on the call, please send an email to Jennifer Odom at jodom@ici.org and indicate the name of your firm, and who from your firm will participate on the call.

Background

Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") amended Section 15B(b)(1) of the 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 provides for eleven Public Representatives, including at least one representative each of retail or institutional investors, issuers, and members of the public, and ten Regulated Representatives.

Specifically, the MSRB defines Public Representatives as individuals who are independent of any regulated entity, meaning that the individual has “no material business relationship” with any broker, dealer, municipal securities dealer, or municipal advisor (“regulated entity”). [2] 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 MSRB explains that, in practice, the “associated with” test has disqualified individuals solely due to the presence of a regulated entity within their employer’s corporate structure, effectively precluding consideration of otherwise viable candidates. It encompasses, for example, individuals who serve as independent directors on the boards of companies within the same corporate family as broker-dealers. It also includes employees of fund advisers if the adviser is affiliated with a municipal advisory firm or with a broker-dealer that engages in the sale of municipal securities.

The MSRB believes that the current test for evaluating the materiality of a business relationship is unduly restrictive. In July 2013, the MSRB proposed to amend MSRB Rule A-3 to provide a more function-oriented approach to defining independence for all Public Representatives. [3] Specifically, under the 2013 proposal, the term “no material business relationship” would require that an individual is not, and within the last two years was not, an officer, director (other than as an independent director), an employee, or controlling person of any regulated entity. Despite ICI’s comment letter supporting the 2013 proposal, [4] the MSRB withdrew the filing due to other commenters’ concerns with the proposal. [5]

MSRB Proposal

The MSRB proposes to provide an alternative definition of “no material business relationship” to determine whether the prospective investor representative board member is independent. This modified standard of independence would apply only to one investor representative; the MSRB would continue to apply the existing definition of independence to all other Public Representatives. The MSRB explains that the proposed amendments are tailored to allow employees and other representatives of investment advisers—who serve the interests of the adviser’s clients, rather than the regulated entities—to serve as the MSRB investor representative.

The proposed amendments to MSRB Rule A-3(g)(ii)(2) apply a two part test. First, the adviser cannot currently, or within the past two years, be an officer, director (other than independent director), employee, or controlling person of a regulated entity. Second, the test applies a discretionary component to determine if the individual has a relationship with a regulated entity that could affect the individual’s decision making. In making this determination, the board considers a non-exhaustive list of specified factors. The factors are whether: (1) the revenue from the regulated entity accounts for a material portion of the revenues of the consolidated entity that includes the investment adviser [6]; (2) the regulated entity facilitates the origination of municipal securities [7]; and (3) the investment adviser has a fiduciary duty to the investment company or other investor clients. [8]

Other Issues Raised by MSRB

The MSRB also requests comment on whether it should extend the length of the board member service, and, if so, in what manner. Currently, board members are divided into three seven-member classes who serve three-year, staggered terms and can only serve consecutive terms under special circumstances. [9] The MSRB believes allowing members to serve on the board for longer than three years will improve the effectiveness of the board because board members typically take multiple years to fully understand the MSRB's rulemaking process and oversight obligations. [10]

Additionally, the MSRB is requesting comment on whether it should eliminate or modify the current requirement to publicly announce the names of all board member applicants. The MSRB believes that this requirement deters applicants who are concerned that not being selected will negatively impact their professional career. As an alternative to removing the requirement, the MSRB is considering whether it should publish other identifying information, such as the names of the applicants' employer, to maintain the anonymity of the individual applicants.

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Associate General Counsel

endnotes

[1] See MSRB Notice 2015-08 (June 11, 2015) available at <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2015-08.ashx>.

[2] See Securities Exchange Act Release 63025 (September 30, 2010).

[3] See Exchange Act Release No. 70004 (July 18, 2013).

[4] See Letter from Dorothy Donohue, Deputy General Counsel-Securities Regulation, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (September 18, 2013), available at <https://www.iciglobal.org/pdf/27584.pdf>.

[5] See Exchange Act Release No. 70617 (October 7, 2013); 78 FR 62780 (October 22, 2013) (SR-MSRB-2013-06).

[6] According to the MSRB, an employee or other representative of an investment adviser, which has a relationship with a regulated entity that does not account for a material portion of the revenues of the consolidated entity that includes the investment adviser and the regulated entity, is less likely to have an appropriately disqualifying nexus with or be subject to any significant influence from the regulated entity.

[7] If a regulated entity does not underwrite, privately place, or otherwise facilitate the origination of municipal securities, the MSRB suggests that the corporate affiliation with the regulated entity is less likely to affect the independent judgment or decision making of an employee or other representative of the investment adviser.

[8] If the investment adviser has a fiduciary duty or similar relationship of trust to its investment company clients, such as mutual funds, or directly to investors in managed accounts, it has a legal obligation to act in the best interest of those clients.

[9] See MSRB Rule A-3(b)(i). Board members may serve consecutive terms only under two scenarios: (1) by invitation from, and due to special circumstances as determined by, the board; or (2) having filled a vacancy under Rule A-3(d) and, therefore, having served only a partial term.

[10] See MSRB Notice 2015-08 at 17. The average tenure for members on other boards is 8.4 years.

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