

## COMMENT LETTER

May 5, 2013

# ICI Files Comment Letter on Revisions Proposed by MSRB to Rule G-19 Relating to Suitability (pdf)

May 5, 2013 Mr. Ronald W. Smith, Corporate Secretary Municipal Securities Rulemaking Board 1900 Duke Street, Suite 600 Alexandria, Virginia 22314 Re: MSRB Notice 2013-07 Relating to Revising the Suitability Rule Dear Mr. Smith: The Investment Company Institute<sup>1</sup> is pleased to support the Municipal Securities Rulemaking Board's proposal to harmonize its suitability rule, Rule G-19, with FINRA's suitability rule, Rule 2111.2 We support the proposal because it is in the best interest of investors and registrants, as briefly discussed below. We recommend, however, that the MSRB revise its proposal to include within Rule G-19 all suitability obligations of MSRB registrants. The basis for this recommendation is also set forth below. SUPPORT FOR HARMONIZATION As we have previously expressed to the MSRB, as a general matter, we support consistency between the rules of the MSRB and FINRA for two reasons.<sup>3</sup> First, with respect to investors, harmonization ensures that, regardless of whether the product recommended is a municipal security or another type of security, the customer receives the same basic protections under the two regulatory regimes. Second, harmonization benefits registrants because it facilitates compliance by those dealers <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 \$14.96 trillion and serve more than 90 million shareholders. <sup>2</sup> See Request for Comment on Revisions to Suitability Rule, MSRB Notice 2013-07 (Mar. 11, 2013) ("Notice"). <sup>3</sup> See, e.g., Letter from Tamara K. Salmon, Senior Associate Counsel, to Mr. Ghassan Hitti, Assistant General Counsel, MSRB, dated June 2, 2006 (supporting the MSRB's proposal to conform registrants' supervisory responsibilities to those of FINRA registrants). Mr. Ronald W. Smith, Secretary May 5, 2013 Page 2 of 4 that are dually registered with the MSRB and FINRA by enabling them to develop consistent suitability standards from product to product without regard to which regulator's rule applies to comparable conduct.<sup>4</sup> RECOMMENDATION RELATING TO 529 PLAN SUITABILITY REQUIREMENTS Notwithstanding our support for the proposed rule, we recommend that, as part of this rulemaking, the MSRB consolidate into Rule G-19 all duties of MSRB registrants relating to suitability – including those that are found in guidance issued by the MSRB. While the Notice expresses the MSRB's interest in taking this approach as part of its current proposal, it does so only with respect to products other than 529 plans: Over the years, the MSRB has issued guidance on suitability in connection with other issues under Rule G-17

[relating to customer protection] . . . Rather than listing information in the supplementary material to Rule G-19 that may be material to an investor, the proposed revisions include a general requirement for dealers to understand information about the municipal security or strategy and the supplemental material contains an explicit cross- reference to a dealer's obligations under proposed MSRB Rule G-47 (Time of Trade Disclosure). The remaining suitability obligations described in the Rule G-17 guidance are incorporated into revised Rule G-19. A footnote to the last sentence of this excerpt provides: "This does not include suitability obligations with respect to 529 plans. The MSRB proposes including these obligations in a separate rule for 529 plans." Given this language, it is not clear whether the current proposal was intended to apply to MSRB registrants selling 529 plan securities. We understand from talking to the MSRB staff that the revised rule is intended to apply to such registrants' recommendations, and the footnote is intended to alert commenters to the MSRB's plans to publish additional guidance relating to the suitability of recommendations involving 529 plan securities. The Notice seeks comment on the proposed approach. The Institute has long urged the MSRB to clarify in its rules which of its requirements apply to municipal fund securities (e.g., 529 plan securities) versus those applicable only to other municipal securities.<sup>5</sup> Earlier this year, we filed a comment letter with the MSRB strongly recommending that: <sup>4</sup> We note that FINRA has provided its members guidance regarding its interpretation of FINRA Rule 2211. See, e.g., [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=14960&element\\_id=9859&highlight=2111#r14960](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=14960&element_id=9859&highlight=2111#r14960). In its notice adopting the proposed revisions to Rule G-19, we recommend that the MSRB confirm its intent to interpret its rule in a manner that is consistent with FINRA's interpretation. <sup>5</sup> See, e.g., Letter from the undersigned to Ronald W. Smith, Secretary, MSRB, dated Feb. 19, 2013, commenting on MSRB Notice 2012-63. Mr. Ronald W. Smith, Secretary May 5, 2013 Page 3 of 4 . . . when proposing any new rules or rule revisions, or publishing any guidance for registrants, the MSRB expressly state whether such rule or guidance is intended to apply to both types of products and, to the extent the proposal is intended to apply to both products but would impact them differently, the MSRB notice expressly discuss and explain these differences. We believe this recommendation will go a long way toward addressing the current confusion that arises when trying to determine the intended scope and impact on 529 plan offerings of the MSRB's rules governing municipal securities. [Emphasis in original.]<sup>6</sup> In the Notice, the MSRB partially responded to our previous recommendation by making specific reference in the Notice to suitability obligations with respect to 529 plans. We appreciate the MSRB's specific attention to 529 plans. We recommend, however, that, in lieu of adopting another suitability rule that would, presumably supplement Rule G-19 with respect to 529 plan recommendations, the MSRB incorporate provisions specific to 529 plans in Rule G-19.<sup>7</sup> This approach would avoid the inefficiencies and confusion that may result from the MSRB having two distinct rules relating to the same topic – suitability – both of which would apply to 529 plan recommendations. Also, consolidating all suitability requirements in one rule is appropriate because, in large part, the requirements in proposed Rule G-19 will apply to MSRB registrants without regard to the products they are recommending.<sup>8</sup> Moreover, the new structure proposed for Rule G-19, which adds "Supplementary Material" to the rule, would appear to lend itself to incorporating in the Supplementary Material requirements that may be solely applicable to recommendations involving 529 plans. Accordingly, we strongly recommend that the MSRB revise its current proposal to add to Rule G-19 Supplementary Material that sets forth all additional suitability obligations imposed on registrants' recommendations of 529 plan securities. We also recommend, in the interest of internal consistency of the MSRB's rules, that the MSRB rescind all suitability requirements and guidance that have been issued under other MSRB rules relating to recommendations involving 529 plan securities.<sup>9</sup> If the MSRB follows our recommended approach, we request

that it publish for comment a revised 6 Id at pp. 3-4. 7 Alternatively, the MSRB could clarify that Rule G-19 is not intended to apply to 529 plan recommendations and propose a separate rule that applies only to recommendations regarding 529 plans and includes, in one rule, all suitability obligations imposed on such recommendations. This approach may be confusing and inefficient, however, because of the likely overlap between such separate rule and Rule G-19. 8 Moreover, this would avoid dealers recommending 529 plan securities from being sanctioned under two separate MSRB suitability rules for singular conduct, which seems most unfair. 9 Our recommended approach is consistent with the MSRB's proposal to rescind the guidance that it has previously issued under Rules G-15, G-21, and G-32 "that nominally reference suitability obligations." Notice at p. 2. Mr. Ronald W. Smith, Secretary May 5, 2013 Page 4 of 4 version of Rule G-19 and its Supplementary Material that includes any provisions designed to address unique issues that registrants must take into account when recommending 529 plan securities. ■ ■ ■ ■ ■ The Institute commends the MSRB for its ongoing efforts to review its rules to ensure they remain current and to evaluate their consistency with those of the FINRA. We also appreciate the MSRB's movement toward implementing our recommendation to make clear in its rules, where appropriate, which obligations apply to municipal fund securities. If you have any questions concerning these comments, please do not hesitate to contact me at (202)326-5825. Sincerely, /s/ Tamara K. Salmon Senior Associate Counsel Cc: Lawrence P. Sandor, Deputy General Counsel