

## COMMENT LETTER

July 30, 2012

# ICI Files Comment Letter on MSRB Concept to Require Disclosure of Financial Incentives and Conflicts of Interest (pdf)

July 30, 2012 Ronald W. Smith, Corporate Secretary Municipal Securities Rulemaking Board  
1900 Duke Street, Suite 600 Alexandria, VA 22314 Re: MSRB Notice 2012-28 Dear Mr. Smith: The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the recent Municipal Securities Rulemaking Board (MSRB) concept release to provide for public disclosure of those financial incentives paid or received by dealers and municipal advisors that represent potential conflicts of interest.<sup>2</sup> Our members' primary interest in the MSRB's Notice derives from their role as either program managers (i.e. as municipal advisors) to or primary distributors of (i.e., municipal securities dealers selling) states' 529 plans. Our members that serve as recordkeepers for certain government retirement plans also are interested in this proposal in light of the current breadth of the definition of the term "municipal advisor," which may encompass their activities regardless of whether the relationship involves municipal securities. Our comments on the Notice are from these perspectives. The central question the Notice raises is whether the MSRB should require dealers and municipal advisors to submit, for public display through the MSRB's Electronic Municipal Market Access (EMMA) website, disclosures regarding certain payments and receipts in connection with their municipal securities and municipal advisory activities that could potentially represent conflicts of interest. As is apparent from the Notice, the MSRB is clearly—and correctly—concerned with ensuring public disclosure of the potential conflicts of interest that may arise in connection with traditional 1 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 \$12.9 trillion and serve over 90 million shareholders. 2 See Request for Comment on Concept Proposal to Provide for Public Disclosure of Financial Incentives Paid or Received by Dealers and Municipal Advisors Representing Potential Conflicts of Interest, MSRB Notice 2012-28 (May 31, 2012) (the "Notice"). Ms. Ronald W. Smith July 30, 2012 Page 2 of 6 municipal securities offerings. As significant investors in the municipal securities markets,<sup>3</sup> mutual funds and other registered investment companies recognize the benefits associated with public disclosure. In the context of such offerings, we agree that public disclosure of those financial incentives paid or received by dealers and municipal advisors that represent potential conflicts of interest

may benefit market participants and investors. We also agree that EMMA, as a centralized repository of information about such offerings, would be an appropriate medium to publish such information on offerings of municipal securities. By contrast, however, as discussed in more detail below, we have reservations regarding application of the proposed disclosure to offerings of municipal fund securities, such as 529 plans, as well as using EMMA to deliver any such disclosures. In light of the significant differences between offerings of 529 plan securities and traditional bond offerings, we recommend that, prior to imposing the contemplated disclosures on 529 plan offerings, the MSRB determine whether any additional specific disclosures should be required of municipal securities dealers or municipal advisors in connection with such offerings and, if so, identify and seek comment on them in a separate concept release. We also strongly recommend that the MSRB defer proposing rules for municipal advisors until such time as the U.S. Securities and Exchange Commission (SEC) adopts a permanent definition of "municipal advisor." Until there is certainty regarding the universe of municipal advisors, it seems premature to define what disclosure or other regulatory requirements should be imposed on such persons.

**APPLICATION OF THE PROPOSED DISCLOSURES TO MUNICIPAL FUND SECURITIES** Though municipal fund securities, such as 529 plan securities, are not discussed in the Notice, it appears that they would be subject to any disclosure requirements the MSRB imposes on municipal advisors and municipal securities dealers. The concerns expressed in the Notice, however, appear to relate solely to traditional municipal securities. For example, according to the Notice, the disclosures envisioned by the MSRB would address concerns with municipal securities offerings that are "borne from self-interested advice or in the context of conflicting interests or undisclosed payments to third- parties," which are "more likely to be the issues that later experience financial or legal stress or otherwise perform poorly as investments, resulting in significant harm to investors and issuers, including increased costs to taxpayers."<sup>4</sup> The structure, features, and operations of 529 plan offerings are fundamentally different from traditional municipal bond offerings.<sup>5</sup> Similarly, the disclosures provided to investors in connection 3 According to the ICI's data, 26% of investors, many of which are retail investors, invest in the \$3.7 trillion municipal securities market through registered investment companies. See Investment Company Institute, 2012 Investment Company Fact Book, A Review of Trends and Activity in the Investment Company Industry, 52nd Edition. 4 Notice at p. 1. 5 The structure and ongoing nature of 529 plans offerings, and their disclosures to investors, are very similar to those of mutual funds. This similarity is reflected in the MSRB's definition of municipal fund securities, which provides that such Ms. Ronald W. Smith July 30, 2012 Page 3 of 6 with 529 plans differ significantly from those provided in a traditional bond offering.<sup>6</sup> Because of these differences, and the absence of any discussion of 529 plans in the Notice, it is difficult to discern the conflicts of interests associated with 529 plans that may be of concern to the MSRB and extrapolate how the disclosures envisioned by the MSRB in the Notice would apply to 529 plan offerings.<sup>7</sup> For example, the Notice contemplates potential disclosures by underwriters, noting that underwriters "act in a critical role in providing . . . municipal entities with access to the capital markets."<sup>8</sup> The Notice suggests an underwriter could be required to disclose: (1) financial incentives received by the underwriter from any third-party for recommending a municipal securities financing; (2) financial incentives received by the underwriter from any third-party payor in connection with a new issue transaction; and (3) any financial incentives paid by the underwriter to any third-party recipient in connection with a new issue transaction, including those paid for the purpose of obtaining or retaining any such new issue transaction. The types of arrangements involving the financial incentives of concern to the MSRB do not appear to be present with 529 plan offerings. securities are securities that "but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company" within the

meaning of the Investment Company Act. By contrast, traditional bond offerings tend to be discrete offerings of a fixed amount of securities with unique financing structures and features. The proceeds of such offerings are used to finance public works projects and investors' returns are dependent upon the funding mechanisms in place to support the bonds. 6 Generally speaking, the official statement for a traditional bond offering discusses issues such as the amount, maturities, interest rates, and payment information for the securities being offered and briefly describes their source of repayment, their tax status, the expected delivery date, and ratings. It also typically includes an overview of the purpose of the financing, the sources and uses of funds for the financing, the issuer and its financial condition, especially the financial and operating data relevant to the payment of the securities and any other obligations of the issuer. By contrast, the official statement for a 529 plan offering is more similar to a mutual fund prospectus. These official statements typically discuss the key features of the plan including an overview of its investment options, the State Administrator of the plan as well as any principal private contractors with investment management or program management responsibilities, a description of the initial and ongoing fees and costs associated with the plan, performance information, and the principal risk factors associated with the plan. See e.g., the College Savings Plan Network Disclosure Principles (Statement No. 5, May 3, 2011), which are available at <http://www.collegesavings.org/includes/pdfs/CSPN%20Disclosure%20Principles%20Statement%20No%20%205.pdf> (the "CSPN Disclosure Principles"). 7 The MSRB has previously recognized that 529 plan offerings differ in material ways from other municipal securities offerings. When the MSRB proposed to revise its rules in 2000 to expressly address municipal fund securities, including defining the term, it noted that "[a]s a general matter, the proposed rule change has been drafted with the view that municipal fund securities should be treated differently from other municipal securities only under circumstances where current rules would not apply properly." The MSRB's current proposal appears to be one where the circumstances warrant treating 529 plan offerings differently from offerings of municipal securities. See Municipal Securities Rulemaking Board: Notice of Filing of Proposed Rule Change Relating to Municipal Fund Securities, SEC Release No. 34-43066 (July 21, 2000) at p. 19. 8 Notice at p. 2. Ms. Ronald W. Smith July 30, 2012 Page 4 of 6 As a preliminary matter, 529 plan offerings typically do not have "underwriters." Instead, they have a primary distributor that is registered with the MSRB as a municipal securities dealer. Much like a principal underwriter of a mutual fund, the primary distributor is involved in selling the plan to retail investors and/or executing selling agreements with other municipal securities dealers that sell the plan to retail investors. It is not involved in helping the state access capital markets. Moreover, unlike discrete offerings of traditional bonds that have "new issues" and that access the capital markets to obtain new or additional funds for a public works project, 529 plans do not have "new issues." Like mutual funds, these plans are continuously offered and there is no "financing" that is recommended to an issuer of 529 plan securities. Instead, the 529 trust is established and investors purchase an interest in the trust. A 529 plan accountholder is entitled to the value of the holdings in the shareholder's account, less any fees and expenses associated with the account, which are disclosed to the investor in the official statement. The 529 plan is not subject to issuer default, nor does it depend on external or third-party sources of revenue to pay investors. Also, while each new issue of municipal bonds may present a unique set of financial arrangements, challenges, and conflicts, the 529 plans offered by the states have the same basic fundamentals and structure from state-to-state, plan-to-plan, and year-to-year. Because of the maturity of this market and the consistency among the states' plans, the disclosures currently provided to investors in connection with these plans tend to have a uniform format that provides investors material information regarding the plan, including its operations, governance, management, investment options, performance, and fees and

expenses. Indeed, some of the information the MSRB appears to be contemplating for underwriters of municipal securities is already provided to 529 plan investors through voluntary compliance with the College Savings Plan Network (CSPN) Disclosure Principles.<sup>9</sup> To supplement this disclosure, there are also a variety of websites to educate investors about 529 plans, many of which include interactive features that enable investors to compare a variety of states' plans.<sup>10</sup> As noted above, the Notice did not describe any of these differences or explain whether – and, if so, how – the MSRB's contemplated disclosures would apply in the 529 plan context. In light of the significant differences between offerings of 529 plan securities and traditional bond offerings, the MSRB should determine whether any additional specific disclosures should be required of municipal securities dealers or municipal advisors in connection with an offering of 529 plan securities and, if so, identify and seek comment on them in a separate concept release. <sup>9</sup> The CSPN Disclosure Principles include information similar to that contemplated by the MSRB's Notice. In particular, Item 3.F. provides for detailed disclosure of fees and costs associated with an investment in the Savings Plan and whether any fees are received by the State Issuer, by any private program manager or investment manager or by other private parties. Also, Item 3.J. provides for a discussion of the material terms of the plan's governance and administrative structure. See, also, fn. 6, above. <sup>10</sup> See, e.g., <http://www.savingforcollege.com>. Ms. Ronald W. Smith July 30, 2012 Page 5 of 6

**CONCERNS WITH USING EMMA AS THE COMMUNICATION MEDIUM** Crucial to the effectiveness of any new disclosure initiative is ensuring that the disclosure reaches the intended audience. While EMMA's use as a repository for information on traditional bond offerings is wholly appropriate due to its role as a centralized depository that is widely used, we question whether the same holds true for information on 529 plans. This is because EMMA was originally developed to provide an Internet-based system for free, real-time public access to primary market, secondary market, and trade price data for municipal securities. As a centralized repository, it replaced the former system of multiple nationally recognized municipal securities information repositories, or NRMSIRs, and state information depositories. Over time, EMMA became the centralized source for municipal securities disclosure and it continues to be utilized as a valuable source of information for the public about traditional municipal securities. As we have previously pointed out however, in our view, EMMA does not appear to be as useful as a repository for information on municipal fund securities.<sup>11</sup> This is for three reasons. First, as noted above, 529 plan information is already available through a variety of readily-available sources, which makes EMMA a redundant repository of such information. Second, unlike investors in traditional municipal securities, 529 plan participants do not typically go to EMMA for information on 529 plan securities. Instead, they are more likely to utilize other public sources for meaningful information about these plans, such as the states' websites that are dedicated to 529 plan information, CSPN's website, websites of dealers offering 529 plans for sale, and other sites such as [Savingforcollege.com](http://www.savingforcollege.com). Not only are these websites tailored to provide 529 plan-specific information, they tend to be both user-friendly and interactive. Third, EMMA would only receive information on those 529 plans offered by municipal securities dealers that are subject to the MSRB's jurisdiction, not plans that are self-managed. As such, it could never provide complete information to the public.<sup>12</sup> Accordingly, prior to requiring additional 529 plan disclosure via EMMA, we strongly encourage the MSRB to consider the sources retail investors are most likely to consult to obtain information on these plans.

**MUNICIPAL ADVISORS' DISCLOSURE** The Notice includes an express discussion of potential disclosures that could be made by municipal advisors. As the MSRB is aware, the scope of the term "municipal advisor" remains uncertain. The SEC's proposed definition drew over one thousand comment letters, as state officials, industry participants, and members of Congress expressed concerns over its breadth, and the SEC is yet <sup>11</sup> See Letter from

Tamara K. Salmon, Senior Associate Counsel, ICI to Ronald W. Smith, Corporate Secretary, MSRB, dated August 31, 2011 (responding to MSRB Notice 2011-33 and the MSRB's plan to post information on 529 plans on EMMA).<sup>12</sup> As noted by CSPN in a comment letter to the MSRB, "CSPN's website, CollegeSavings.org, is the only source of complete, non-commercial information on 529 plans. Because CSPN's membership includes all MSRB regulated as well as all non-MSRB regulated State sponsored 529 Plans, it has access to reliable and up-to-date data for the entire market." See Letter from Joan Marshall, Chair, CSPN, to Ronald W. Smith, Corporate Secretary, MSRB, dated August 31, 2011, which was filed in response to MSRB Notice 2011-33. Ms. Ronald W. Smith July 30, 2012 Page 6 of 6 to adopt a permanent definition. Indeed, in its current form, the SEC's definition of municipal advisor could include entities, such as recordkeepers and investment providers, that provide services to governmental retirement plans regardless of whether the relationship involves municipal securities. Although we believe that providing services to a governmental retirement plan (not involving any actual municipal security) should not fall within the scope of the new municipal advisor regime, the possibility alone highlights an important consideration for the MSRB. Many of these service providers also serve the private-sector retirement plan market and are therefore subject to extensive disclosure standards under the Employee Retirement Income Security Act of 1974 (ERISA).<sup>13</sup> Subjecting these same entities to additional disclosure obligations imposed by the MSRB on topics currently covered by the DOL's disclosure rules could result in regulatory inconsistencies between the two disclosure regimes and lead to investor confusion, compliance inefficiencies, and additional costs. Accordingly, we strongly recommend that the MSRB defer proposing any disclosure or other regulatory requirements for municipal advisors until there is certainty for both the MSRB and market participants regarding what activities trigger being categorized as a municipal advisor. To proceed with rulemaking in this area without such certainty seems premature. ■ ■ ■ ■ The Institute appreciates the opportunity to share these comments with the MSRB. We commend the MSRB for its continued attention to protecting the interests of shareholders and market participants, and we look forward to working with the MSRB to better protect investors. If you have any questions concerning our comments or require additional information regarding our recommendations, please do not hesitate to contact the undersigned by phone (202-326-5825) or email (tamara@ici.org). Sincerely, /s/ Tamara K. Salmon Senior Associate Counsel

<sup>13</sup> For example, earlier this year, the DOL adopted a new regulation that requires retirement plan service providers to provide retirement plan fiduciaries detailed information in order for the contract or arrangement to be considered reasonable under ERISA. This detailed information includes, among other things, comprehensive fee information, all direct and indirect compensation, and compensation paid among related parties. See Reasonable Contract or Arrangement Under Section 408(b)(2) – Fee Disclosure; Final Rule, 77 Fed. Regis. 5632 (February 3, 2012). See, also, Revision to Annual Information Return/Reports, 72 Fed. Regis. 64731 (November 16, 2007), adopting revisions to DOL Form 5500 annual return that is filed by employee benefit plans. A sample of the DOL's revised form is available at <http://www.dol.gov/ebsa/pdf/2011-5500-Schedule-C.pdf>.