

**BY ELECTRONIC MAIL**

April 11, 2011

Ronald W. Smith  
Corporate Secretary  
Municipal Securities Rulemaking Board  
1900 Duke Street  
Alexandria, VA 22314

Re: MSRB Notice 2011-14 – Draft MSRB Rule G-36 (On Fiduciary Duty of Municipal Advisors) and Draft Interpretive Notice (February 14, 2011)

Dear Mr. Smith:

The American Bankers Association (ABA)<sup>1</sup> appreciates this opportunity to comment on draft Rule G-36 and the related draft Interpretive Notice of the Municipal Securities Rulemaking Board (MSRB) concerning the fiduciary duty of municipal advisors. Section 975 of the Dodd-Frank Wall Street and Consumer Protection Act (Dodd-Frank Act)<sup>2</sup> newly requires the registration of municipal advisors with both the Securities and Exchange Commission (Commission) and the MSRB and imposes on municipal advisors a fiduciary duty to their municipal entity clients. Our members provide a wide array of products and services to municipal entities, some of which may be determined to involve advice for purposes of Section 975.

ABA appreciates the efforts of the MSRB to provide guidance on the required fiduciary duty. However, as discussed more fully below, we strongly believe that the MSRB should await a final determination from the Commission on the scope of its rule establishing those activities that require registration as a municipal advisor. Absent that critical determination, our members cannot ascertain which, if any, of their services to municipal entities require registration and, therefore, provide a fully informed response with respect to the impact of the draft Interpretive Notice on those services.

**BACKGROUND**

Draft Rule G-36 provides simply:

In the conduct of its municipal activities on behalf of municipal entities, a municipal advisor shall be subject to a fiduciary duty, which shall include a duty of loyalty and duty of care.

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<sup>1</sup> The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$13 trillion banking industry and its 2 million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. Learn more at [www.aba.com](http://www.aba.com).

<sup>2</sup> Pub. L. No. 111-203.

## ***Duty of Loyalty***

The Interpretive Notice provides that the Rule G-36 duty of loyalty requires the municipal advisor to deal honestly and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor. It requires a municipal advisor to make clear, written disclosure of all material conflicts of interest, such as those that might impair its ability to satisfy the duty of loyalty, and to receive the written, informed consent of officials of the municipal entity with the authority to bind the municipal entity by contract with the municipal advisor. Such disclosure must be made before the municipal advisor may provide municipal advisory services to the municipal entity or, in the case of conflicts arising after the municipal advisory relationship has commenced, before the municipal advisor may continue to provide such services.

The Interpretive Notice further provides that under Rule G-36 a municipal advisor may not undertake an engagement if certain unmanageable conflicts exist, including (1) kickbacks and certain fee-splitting arrangements with the providers of investments or services to municipal entities, (2) payments by municipal advisors made for the purpose of obtaining or retaining municipal advisory business other than reasonable fees paid to a municipal advisor for solicitation activities regulated by the MSRB, and (3) generally acting as principal in matters concerning the municipal advisory engagement.

The Notice also provides that, in certain cases, the compensation received by a municipal advisor may be so disproportionate to the nature of the municipal advisory services performed that it is inconsistent with the Rule G-36 duty of loyalty and represents an unmanageable conflict.

Finally, the Interpretive Notice provides that the Rule G-36 duty of care requires that a municipal advisor act competently and provide advice to the municipal entity after inquiry into reasonably feasible alternatives to the financings or products proposed (unless the engagement is of a limited nature).

## ***Duty of Care***

A municipal advisor's fiduciary duty to its municipal entity client also requires that a municipal advisor exercise due care in performing its responsibilities. This duty requires a municipal advisor to consider alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time, if those alternatives would better serve the interests of the municipal entity. It also requires a municipal advisor to make a reasonable inquiry as to the facts that are relevant to a municipal entity's determination of whether to proceed with a course of action.

## **DISCUSSION**

### ***1. The MSRB should hold its rulemaking in abeyance until the SEC defines the activities that require registration as a municipal advisor.***

As the MSRB is aware, the Commission issued a proposal<sup>3</sup> seeking input on a proposed permanent registration system for municipal advisors. The proposal espoused a broad interpretation of Section 975 to cover a wide array of activities, including "advice" (an undefined term) with respect to funds "held" by a municipal entity, a proposition with which the MSRB itself is not in full agreement.<sup>4</sup> Indeed, the Chairman and staff of the Commission have acknowledged that the scope of its proposal has been cast broadly.<sup>5</sup>

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<sup>3</sup> See, Exchange Act Release No. 63576 (Dec. 20, 2010).

<sup>4</sup> See Comment Letter from Michael G. Bartolotta, MSRB, to Elizabeth M. Murphy, SEC, (Feb. 22, 2011) at 4–6, available at <http://sec.gov/comments/s7-45-10/s74510-586.pdf>.

<sup>5</sup> The Chairman and staff of the SEC have each indicated that they are looking closely at the scope of their proposal, including potential regulatory overlap, in light of significant comments received. See *Budget Hearing – Securities and Exchange Commission*:

As a result of this broad interpretation, the proposal included numerous questions about the scope of activities which would require registration. Key among those questions was whether certain traditional activities of banks should be exempted from the registration requirement. In our comment letter, ABA strongly asserted that such activities are outside the scope of Section 975 and, additionally, sought an exclusion from the registration requirement for banks that would be exempt under the statute but for the statutory bank exemption from the Investment Advisers Act of 1940.<sup>6</sup>

Given that the Commission's proposal could potentially require the registration of thousands of banks and their employees, we believe the MSRB should await final action by the Commission so that the banks that actually will be required to register may realistically assess the impact of a fiduciary duty on covered municipal advisory activities. For example, if custody accounts are, in a final rule, subject to the municipal advisor registration requirement, then the prohibition on principal transactions could prohibit foreign exchange transactions with respect to such accounts.

Virtually all of our members interact with municipal entities in numerous areas throughout their institutions, including with respect to deposit taking, lending and cash management services, to name but a few. We are aware that a number of our larger members have not yet completed an assessment of all the areas in which they interact with municipal entities. Accordingly, ABA believes the wiser course is to await action by the Commission. Indeed, the MSRB itself has indicated that the proposed Interpretive Guidance may require refinement once the Commission's proposal is finalized. Therefore, we strongly urge the MSRB to hold in abeyance its Interpretive Notice until that time.

## **2. The MSRB should coordinate its fiduciary duty standard with other regulators.**

In addition to the MSRB's proposed guidance, a number of other agencies are currently considering the imposition of a fiduciary standard on various participants in the capital markets that may serve municipal entity customers. For example, registered investment advisers have long been subject to a heightened standard of care established under the Investment Advisers Act, and the Commission is actively considering whether a similar standard should be applied to broker-dealers. In addition, both the Commission and the Commodity Futures Trading Commission are similarly considering a heightened standard of care that may be applicable to a securities-based swap dealer or a swap dealer respectively when advising municipal entities.<sup>7</sup> Moreover, the Department of Labor is considering a fiduciary duty for certain advisors to employee benefit plans under the Employee Retirement Income Security Act. In addition, to the extent products and services are provided through bank trust departments to municipal entities such as pension plans, those activities are subject to the most stringent fiduciary duties under common law and state trust law. Such activities are also comprehensively regulated and supervised by federal bank regulators.

Because our members may serve in all these capacities, it would be wholly unworkable for them to attempt to comply with differing – and possibly competing – fiduciary duties while providing the same services.<sup>8</sup>

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*Hearing Before the House Committee on Appropriations, Subcommittee on Financial Services and General Government*, 112th Cong. (Mar. 15, 2011) (testimony of Mary Schapiro, Chairman, SEC) (“[W]e’re looking very carefully at whether we may have cast the net too widely and taking the comments very, very seriously”); *see also Oversight of the Securities and Exchange Commission’s Operations, Activities, Challenges and FY 2012 Budget Request: Hearing Before the House Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government- Sponsored Enterprises*, 112th Cong. (Mar. 10, 2011) (testimony of Robert Cook, Director, SEC Division of Trading and Markets).

<sup>6</sup> A copy of ABA’s comment letter is attached.

<sup>7</sup> *See*, Exchange Act § 15F(h)(4)(B) (added by Section 764 of the Dodd-Frank Act); Commodity Exchange Act § 4s(h)(4)(B) (added by Section 731 of the Dodd-Frank Act).

<sup>8</sup> We note that the Commission’s municipal advisor proposal contemplates registration for a broker-dealer engaging in principal transactions with a municipal entity, while the MSRB’s Interpretive Notice would prohibit such activity as an unmanageable conflict of interest.

### **3. The proposed fiduciary duty should not apply to affiliates of the municipal advisor.**

Section 975 defines the term “person associated with a municipal advisor” to include “any person directly or indirectly controlling, controlled by, or *under common control* with such municipal advisor.”<sup>9</sup> [Emphasis added.] This definition would appear to impose the draft Rule G-36 fiduciary duty on an affiliate of a municipal advisor, despite the fact that the affiliate is not engaged in municipal advisory activities. It would further appear to encompass a registered investment adviser affiliate of a municipal advisor notwithstanding the fact that the former is expressly exempted under Section 975.

We note that under Rule D-11, the term “municipal advisor” also includes the advisor’s “associated persons,” including entities under common control. However, for purposes of its fair practice rules, the MSRB has interpreted “associated persons” under Rule D-11 to exclude persons who are associated “solely by reason of a control relationship.”<sup>10</sup> ABA believes such an interpretation would be appropriate in the context of draft Rule G-36. We believe that imposing a fiduciary duty on all entities under common control with a municipal advisor would be both unnecessary and burdensome, particularly for large financial institutions whose affiliates do not actually coordinate their activities.

Therefore, we urge the MSRB to clarify that the affiliates of a municipal advisor are not subject to draft Rule G-36 unless the affiliate is independently engaged in activities that would require registration as a municipal advisor.

### **4. Principal transactions should not be prohibited as unmanageable conflicts.**

Draft Rule G-36 would prohibit a municipal advisor from ever acting as principal in a transaction with its municipal entity client, notwithstanding disclosure by the advisor of potential conflicts and informed consent by the client. The MSRB bases this prohibition on its belief that a municipal entity could never give informed consent based on disclosure of the conflict in such transactions. ABA strongly disagrees with this position.

Indeed, common trust law, state fiduciary law and the Employee Retirement Income Security Act all which incorporate the highest, strictest form of true “fiduciary duty”, do not flatly prohibit such principal transactions. Rather, principal transactions may be permitted depending on whether the adviser has discretion as well as on the provisions of the governing documents. Under ERISA, an independent fiduciary may permit another fiduciary to engage in principal transactions. Similarly, registered investment advisers are permitted to act as principal in transactions with advisory clients so long as the adviser obtains the client’s consent after disclosure of (1) the adviser’s capacity, (2) any compensation to be received by the adviser and (3) any other relevant facts.<sup>11</sup>

Yet, despite this relevant common and statutory law, the MSRB has provided no support for its position that municipal entities, regardless of sophistication, are incontrovertibly unable to provide informed consent to principal transactions. Rather, its position would result in the wholly unacceptable position that a bank advising a municipal entity would not be able to provide deposit products or similar traditional banking services to that client because it would be a prohibited transaction. However, registered investment advisers who are exempt from Section 975 *would* be able to engage in appropriate principal transactions with municipal entities, while municipal advisers could not, resulting in a competitive disadvantage for the latter.

ABA urges the MSRB to reconsider this prohibition in light of common law and state fiduciary law and permit principal transactions with appropriate disclosure and client consent.

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<sup>9</sup> Exchange Act § 15B(e)(7).

<sup>10</sup> See Interpretive Notice, Approval of Fair Practice Rules (Oct. 24, 1978).

<sup>11</sup> See, Investment Advisers Act of 1940 § 206(3).

**5. Shareholder servicing fees and 12b-1 fees should not be deemed to be impermissible fee-splitting arrangements.**

The MSRB should clarify that payments to municipal advisers by means of shareholder servicing fees and 12b-1 fees do not constitute impermissible fee-splitting arrangements. Banks have long received payment for corporate trust services to municipal entities by means of shareholder servicing fees or 12b-1 fees through fully disclosed arrangements with clients.<sup>12</sup> In addition, banks that provide services to ERISA pension plans are typically compensated through 12b-1 fees. We are not aware that these traditional forms of compensation have been the subject of concerns with bank regulators; nor have they been deemed to be inappropriate.

To assure that such compensation programs remain available to municipal entities, ABA urges the MSRB to clarify affirmatively that this form of compensation is permissible.

**CONCLUSION**

For the reasons stated above, ABA strongly urges the MSRB to await Commission action finalizing the proposal on a permanent registration regime for municipal advisors. Until industry participants can determine with certainty whether or not their activities require registration as municipal advisors and therefore provide informed comments about the potential impact of a fiduciary duty on those activities, we believe the MSRB's efforts are premature. In addition, because other regulators are also considering the imposition of heightened standards of care on related activities, any efforts by the MSRB to devise an appropriate duty for municipal advisors should be undertaken only in consultation with those bodies. We further believe any such duty should not apply to affiliates of municipal advisors. Nor should principal transactions or traditional compensation programs be flatly prohibited.

If you have any questions about the foregoing, please do not hesitate to contact the undersigned.

Sincerely,



Cristeena G. Naser

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<sup>12</sup> We note that existing agreements with mutual funds may denominate trustee fees as 12b-1 fees, when, in fact, they are for the provision of shareholder servicing fees. This inclusion of this example does not mean that ABA believes that the provision of corporate trust services to municipal entities would trigger municipal advisor registration. To the contrary, we strongly believe that corporate trustees do *not* provide advice to such clients, but rather are directed by those clients.