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## SEC Investor Advocate: MSRB Public Investor Proposal 'Deeply Flawed'

by [Jack Casey](#)

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WASHINGTON -The Municipal Securities Rulemaking Board's proposal to ease the independence standard for its public investor slot is "deeply flawed" and "would undermine the very purpose" of Dodd-Frank Act provisions, according to the Securities and Exchange Commission's Investor Advocate.

The proposal "weakens the standard for material business relationships and allows the board to consider less independent applicants for the public investor representative seat," SEC Investor Advocate Rick Fleming said in an eight-page letter to the MSRB. "In our view, the proposal is based on an overly restrictive view of the existing pool of qualified candidates and focuses far too narrowly on what appears to be one preferred type of candidate," he said.

Several other industry groups echoed the investor advocate's concerns in their letters to the SEC, including the National Association of Municipal Advisors, Americans for Financial Reform, the American Federation of State, County and Municipal Employees, and the Consumer Federation of America.

Four former MSRB board members, along with the Investment Company Institute, the National Federation of Municipal Analysts, Wells Capital Management, Inc., and the Securities Industry and Financial Markets Association, supported the MSRB proposal.

The groups said comment letters to the MSRB in response to amendments to Rule A-3 on board membership it released in June that would allow it to select a public investor representative who has some affiliation with a regulated entity such as a broker-dealer.

The proposal is a narrower version of one the MSRB released in 2013 that would have eased the independence standard for all public board positions. But that proposal was abandoned after being criticized by many of the same groups that oppose the current proposal.

Under its current structure, which was created after Dodd-Frank mandated the board have a public majority, there are 21-members, 11 public and 10 regulated. The public members must be independent from muni brokers, muni advisors, and banks, meaning they have "no material business" with any of those entities.

The MSRB defined having no material business as meaning individuals are not, and have not been, associated with a regulated entity for two years and cannot have a compensatory or other

relationship with a regulated entity that would affect their independent decision-making.

At least one of the public members must represent institutional or retail investors, one must represent issuers and one must have knowledge of or experience in the muni industry.

Under the MSRB's proposed changes, an employee or officer of an MA- or dealer-affiliated investment advisory firm could qualify as independent public investor.

The MSRB said in its regulatory notice that it proposed the changes because the current rule is "unduly restrictive, resulting in the disqualification of qualified individuals, who have relevant knowledge and expertise that are key to the MSRB's ability to meet its statutory mandate."

The board is particularly concerned that many mutual fund companies are disqualified because they are affiliated with dealers who market their investments to 529 college savings plans, sources said.

Fleming challenged the idea that many qualified people are excluded from serving as the public investor representative on the board, citing a lack of proof in the MSRB's June proposal.

He said that while Dodd Frank requires board members to be 'knowledgeable of matters related to the municipal securities markets,' the MSRB proposal and economic analysis "does not describe who the MSRB believes would satisfy this requirement, nor does it attempt to quantify the pool of available candidates for the public investor representative position."

Fleming added that MSRB's proposal seems to imply it wants to "convert the public investor representative seat into a de facto buy-side fund adviser seat."

"Although we agree that the board could benefit by having representation from a buy-side portfolio manager, such a narrow view of public member qualification, particularly as applied to the public investor representative, is unnecessary," Fleming said. "It may also contradict the purpose of the Dodd-Frank Act amendments, which seem designed to inject greater independence into the board and avoid the inevitable bias that comes from an insular type of industry group-think." Fleming added that the MSRB should be looking to the "many thousands" of household investors who could qualify to serve as public investor representatives.

That advice clashed with four former MSRB board members who wrote letters in support of the amendments and backed the MSRB's claims that the current process is too restrictive. Mark Muller, a senior vice president of the Loews Corp., said finding candidates for the public investor position while he was on the board was a "significant challenge" because of the restrictions. Bob Lamb, president of Lamont Financial Services Corp., said any person with fiduciary duty to investors should qualify for the position.

Michael Decker, managing director and co-head of municipal securities for SIFMA, agreed the current rules make it "excessively difficult" to recruit members to the position. SIFMA urged the MSRB to clarify what portion of revenues would be enough to disqualify a candidate under the new amendments.

Lisa Good, the executive director of the National Federation of Municipal Analysts, said the proposal would "give voice to a significant segment of the municipal bond market, primarily analysts and portfolio managers employed by mutual funds, who are largely ineligible for membership consideration under existing rules." NFMA also proposed having at least three public investors on the board as an appropriate step for better representation.

But AFSCME, CFA and AFR, opponents of both the prior and current MSRB proposals,

challenged the need for mutual fund representatives to sit on the board while also recognizing this narrower version was an improvement from 2013. In a joint letter, the groups argued mutual funds, which make up about 20% of bondholders, are the most informed investors while households, which make up more than 40% of bondholders, would be more sensitive to the need for more transparency.

"[Mutual funds] are clearly not the investors currently most disadvantaged due to lack of transparency in the municipal market, nor do they represent the majority of investor holdings," the groups said. "As a result, we believe implementing this MSRB proposal is both unnecessary to ensure adequate investor representation and would essentially undermine the Dodd-Frank requirement that the board be majority independent."

Terri Heaton, president of the National Association of Municipal Advisors, also said there is a qualified pool of retail investors that would better suit the board position than institutional ones.

She said the proposal, "provides significant potential imbalance on the board to favor the interests of dealers and institutional investors, at the expense of issuers and retail investors" and that this could "affect ... a break with the public trust." Heaton also pushed for the MSRB to move to a majority-public 15-member board.

Concerns about retail investors serving on the board have centered on their potential lack of overall industry knowledge. Fleming said that, to ease those concerns, the MSRB could allow a public investor to serve two consecutive three-year terms to gain additional experience.

ICI, Lamb and former board member Benjamin Thompson, chief executive officer of Samson Capital Advisors, pushed for allowing all MSRB members to serve two consecutive three-year terms.

SIFMA called for four-term terms for new MSRB board members, with a lifetime cap of four years.

But NAMA and NFMA were concerned about a lack of turnover that could result from extended terms.

The MSRB's question of whether it should continue to publish the names of candidates applying for board positions, also got a mixed reception. The MSRB asked if publishing board candidates' names could discourage them from applying. ICI and Lamb said yes. But several market groups, including AFSCME, CFA, AFR, transparency would best be served by continuing to publish the names of candidates.

"Permitting anonymous applications is likely to give rise to an impression, or strengthen an impression that may already exist, that the MSRB is dominated by industry insiders and does not welcome a broad range of membership," the groups told the board.