

DRAFT

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: SEC File Number S7-45-10
Release No. 34-63576

The National Conference on Public Employee Retirement Systems (“NCPERS”) is pleased to submit its comments to the Securities and Exchange Commission (the “Commission”) in connection with Release No. 34-63576 (hereinafter the “Release”) which proposes the adoption of rules 15Ba1-1 to 15Ba1-7 [17 CFR 240.15Ba1-1 to 240.15Ba1-7](hereinafter the “Proposed Rules”).

NCPERS is the largest national, nonprofit public pension advocate, which for more than 65 years has been the principal trade association working to protect the pensions of public employees. NCPERS focuses on “Advocacy, Research and Education” for the benefit of public sector pension system trustees, administrators and government officials. NCPERS was founded in 1941 to protect public employees in connection with the debate about extending Social Security coverage to state and local government employees. Today, the membership of NCPERS includes more than 500 public pension funds representing millions of active and retired members, and over \$3 trillion in pension assets under management. Additional information about NCPERS can be found at www.NCPERS.org.

Overview:

The thrust of the comments set forth below is that municipal public pension trustees *receive* advice in connection with their fiduciary duties, and should not be confused with or required to register as “municipal advisors.” Moreover, public pension trustees serving on municipal boards of trustees are already covered by public records and open meeting laws, state conflict of interest laws, universally applied trust law principles that are almost always found in state laws throughout the 50 states, plan specific provisions and existing fiduciary duties explicitly enumerated under state laws. NCPERS is concerned that a federal registration regime which includes duplicative federal record-keeping requirements should not be imposed on state and local public pension trustees. Such regulation would also conflict with state laws and constitutional provisions governing the management of thousands of state and local retirement plans. NCPERS strives to protect the autonomy and independence of state and local government retirement systems in light of our constitutional system of federalism and local control.

The risk that public pension trustees would be deterred from service on their pension boards is particularly true for the many trustees who effectively participate as volunteers and are not compensated for their service on their respective pension board. NCPERS otherwise welcomes the Commission's efforts to improve financial stability, accountability and transparency in the financial system. NCPERS is hopeful that the Commission will effectuate these objectives mindful of any unintended consequences on the hard working trustees who oversee retirement systems that are already faced with financial constraints on the budgets of their plan sponsors.

Release No. 34-63576 begins by summarizing the background behind the Dodd-Frank Wall Street Reform and Consumer Protection Act (hereinafter "Dodd-Frank") amendments to Section 15B of the Exchange Act. The Proposed Rules recognize that Congress amended Section 15B to make it "unlawful for municipal advisors to provide certain advice to, or solicit, municipal entities or certain other persons without registering with the Commission." *See* Proposed Rules at pages 4-5. In providing an overview of municipal securities markets, the Commission notes that municipal advisors are largely unregulated with respect to municipal activities. *See* Proposed Rules at page 6.

While a lack of regulation may be true for the municipal activities of brokers, dealers and investment advisors, public pension trustees, however, are already subject to strict fiduciary duties and state ethics and financial reporting requirements. Most importantly, public pension trustees ordinarily operate in the "sunshine" since their activities are conducted at "open and public meetings", where agendas are published, minutes are kept, and public participation welcomed.¹ Because public pension trustees oversee funds which come from taxpayer and member contributions and are responsible for the retirement security of their participants, public pension trustees and plan participants have a vested interest in their activities as public pension trustees are often participants in the retirement system that they oversee.

Comments:

1) **Receiving v. providing advice:** In their fiduciary roles of administering their retirement systems, public pension trustees ordinarily only serve on a part time basis. As a general rule, public pension trustees have full time jobs which are often separate and distinct from the additional role that they perform as trustees. Frequently, retirees, no longer employed by the employing unit, serve as trustees as well. Depending on the size of the plan, pension board meetings are frequently conducted on a quarterly (or monthly) basis with special meetings scheduled as needed. For this reason, public pension trustees, by necessity, commonly delegate certain of their duties to investment and other professionals² who report back to the trustees at the scheduled pension board meeting. For example, the Uniform Prudent Investor Act, which has been adopted by numerous jurisdictions, expressly authorizes delegation of asset management to

¹ NCPERS would be able to provide examples of open meeting and public records laws around the country which already provide for transparent and open government.

² Depending on the size of the retirement system, day to day management is either delegated to independent contractors, staff, or some combination of the two.

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professional managers, who are already subject to SEC registration and regulation. *See* “The New Prudent Investor Rule and The Modern Portfolio Theory: A New Direction for Fiduciaries,” *34 Am. Bus. L. J.* 39 (Fall 1996.) *See also* Section 90, Restatement 3d of Trusts (2007) and comments.

It should be recognized that as a general rule, public pension trustees are not making discrete tactical decisions to invest in any particular security. Rather public pension trustees make macro level decisions to hire and fire professional money managers, along with asset allocation and related administrative decisions. Such decisions are made pursuant to pre-established investment policies/investment guidelines. Accordingly, public pension trustees are ordinarily not *providing* investment advice to their municipal entity or plan sponsor. To the contrary, public pension trustees are charged with *seeking, receiving and implementing* investment advice that they receive from registered investment advisors.³ The Proposed Rules exempt investment advisors from registration requirements under Dodd-Frank since the Investment Adviser’s Act of 1940 already covers their activities. *See* 240.15Ba1-1(d)(2)(ii) and the Release at page 20-21.

To the extent that the Proposed Regulations are directed at regulating the activities of municipal advisors who “provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products,”⁴ NCPERS believes that the Dodd-Frank Act is directed at *protecting* public pension trustees, their membership, and the financial system, rather than *burdening* public pension trustees with potentially conflicting and counterproductive requirements. Otherwise stated, public pension trustees should not be governed by the Proposed Rules since they are *advisees* not advisors.

2) **Kutak Rock comments:** NCPERS agrees with the September 28, 2010 comments by Kutak Rock regarding “Board Members,” which are referenced in footnote 140 of the Release. Kutak Rock observed that the Proposed Rules do not automatically exclude all trustees who serve on the governing body of a municipal entity from the definition of municipal advisor.

³ It is widely recognized under trust law concepts that public pension trustees should not invest or otherwise make decisions without first obtaining the assistance of investment experts. The overview in the Proposed Regulations appears to contemplate regulation of “advisory firms” that provide services with regard to “investment strategies”. *See* Proposed Rules at page 7. Likewise, the registration, record keeping, and consent to service of process requirements of the proposed rules also appear to be best directed at advisory firms, rather than individual public pension trustees.

⁴ *See* 15 U.S.C. 78o-4(a)(1)(B).
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The Commission responded to this comment on pages 40-41 as follows:

Exchange Act Section 15B(e)(4)(A) provides that the term “municipal advisor” excludes employees of a municipal entity.¹³⁹ One commenter suggested that the Commission clarify that this exclusion from the definition of “municipal advisor” would include any person serving as an appointed or elected member of the governing body of a municipal entity, such as a board member, county commissioner or city councilman. This commenter stated that because these persons are not technically “employees” of the municipal entity (but rather are “unpaid volunteers”), these persons would not fall within the exclusion from the definition of “municipal advisor” for “employees of a municipal entity” and, therefore, may have to register as municipal advisors.

The Commission believes that the exclusion from the definition of a “municipal advisor” for “employees of a municipal entity” should include any person serving as an elected member of the governing body of the municipal entity to the extent that person is acting within the scope of his or her role as an elected member of the governing body of the municipal entity. “Employees of a municipal entity” should also include appointed members of a governing body to the extent such appointed members are ex officio members of the governing body by virtue of holding an elective office. The Commission does not believe that appointed members of a governing body of a municipal entity that are not elected ex officio members should be excluded from the definition of a “municipal advisor.” The Commission believes that this interpretation is appropriate because employees and elected members are accountable to the municipal entity for their actions. In addition, the Commission is concerned that appointed members, unlike elected officials and elected ex officio members, are not directly accountable for their performance to the citizens of the municipal entity.

NCPERS respectfully disagrees with the Commission to the extent that appointed members of a governing body of a municipal entity that are not elected ex officio members should be excluded from the definition of a “municipal advisor” and treated the same as other trustees, elected or otherwise. A contrary result could potentially cause otherwise desirable persons, whose services as board members would be beneficial to the pension systems, to be unwilling to serve and might also create conflict within collegial boards and could undermine the cooperative equal footing and responsibilities shared by all public pension trustees sitting together on the same board.⁵ Note also that retired members, no longer municipal employees,

⁵ For a thoughtful and detailed discussion of the importance of affording equal treatment to all public pension trustees consistent with the purposeful organizational design of such plans, NCPERS commends the California Supreme Court decision in *Lexin v. Superior Court*, 47 Cal.4th 1050 at 1096-1098, 222 P.3d 214 at 244-247 (Ca. 2010)(noting that both appointed and elected member trustees have long been a standard feature of the composition of most public retirement system boards).

often are elected to serve on such boards and under the proposed rules would not be excluded from the definition of “municipal advisor.”

Additionally, it should be recognized that all public pension trustees share the identical responsibility as co-trustees/co-fiduciaries, regardless of the manner of their placement on the pension board. This consideration should not be overlooked, since all public pension trustees are properly insulated from pressure from plan sponsors. Public pension trustees owe a fiduciary duty to act exclusively in the interest of their members and beneficiaries and only owe a subordinate duty, if one at all, to the plan sponsor. Creating preferential treatment or exemptions for certain favored categories of trustees undermines these objectives.

3) **Statutory definition of “Municipal Advisor”**: The statutory definition of the term “municipal advisor,” as amended by the Dodd-Frank Act, should not be interpreted as applicable to municipal public pension trustees. *See* 15 USC 78o-4(e)(4)(A). The common thread running through the various provisions of the new definition of “municipal advisor” is that an advisor “provides advice” or otherwise solicits municipal entities, or solicits on behalf of municipal entities. *See* 15 USC 78o-4(e)(4)(A)(i) & (ii). As recognized by the Commission, the definition of advisor includes three distinct groups of “professionals” who “offer different services and compete in distinct markets.” *See* Release No. 34-63576 at page 21. According to the Commission, the three principal types of municipal advisors are: (i) financial advisors, including but not limited to, broker-dealers that provide advice to municipal entities; (ii) investment advisors that advise municipal pension funds and other municipal entities; and (iii) third-party marketers and solicitors. Public pension trustees do not perform any of these roles.

In Release No. 34-63576 the Commission provides a detailed overview of municipal securities markets and the activities of municipal advisors. The Commission identifies several examples of the important role played by municipal advisors and explains why regulation is appropriate.⁶ Yet, none of the examples provided by the Commission are applicable to public pension trustees. All of the examples support regulation of “market professionals” involved in “issuing municipal securities and advising municipal entities”. *See* Release No. 34-63576 at page 15. The Commission’s overview and discussion in Release No. 34-63576 does not support regulation of public pension trustees. To the contrary, public pension trustees are properly be treated as “municipal entities” or “employees of municipal entities”, rather than as regulated “municipal advisors.”

⁶ In the examples provided on pages 6-8 of Release No. 34-63576, the Commission explains that municipal advisors participate in the “issuance of municipal securities,” “provide advice to municipal entities concerning investment strategies,” “provide risk management, asset allocation, financial planning and cash management services,” or “help state and local governments find and evaluate other advisors.” These roles are functions performed by professional advisors and advisory firms, not by the public pension trustee who is receiving these services.

4) **Clarification regarding member “elected” trustees:** After studying the Proposed Rules, NCPERS is unclear whether public pension trustees who are elected *by the membership* are included in the exemption. Alternatively, does the election exemption only apply to elected officials who are elected by the electorate at large? NCPERS recommends that former interpretation. In so doing, NCPERS notes that trustees who are elected from the membership will frequently campaign among the membership and are ordinarily elected by secret ballot of the membership. Page 40 of the Release indicates that the Commission believes that the exclusion “should include any person serving as an elected member of the governing body of the municipal entity to the extent that person is acting within the scope of his or her role as an elected member of the governing body of the municipal entity.” Further clarification would be useful with regard to who is an “elected member of the governing body”? Does the pension board itself fit within the term “governing body”? This is a matter best left to state legislatures and municipal bodies who are ultimately responsible for funding the promised pension benefits.

5) **Clarification regarding “employee” members:** Public pension plans seemingly fall within Exchange Act Section 15B(e)(8)’s definition of “municipal entity”. Employees of a municipality are exempted by Exchange Act Section 15(e)(4)(A) from the definition of municipal advisor. Public pension trustees are commonly employees as well as retirees of the municipality, but ordinarily are not employees of the retirement system. Accordingly, are trustees who are municipal employees or retirees covered by the exemption even if they are not employed by the retirement system? In other words, the regulations should clarify that employees as well as retirees of the municipal entity/plan sponsor are exempted, even though the employee or retiree trustee is not employed by the retirement system (which is itself a municipal entity). Full time staff of a pension board should likewise be covered by the exemption for municipal employees, provided that the staff are employees of the retirement system or of the municipal entity.

6) **Accountability for appointees:** The Commission indicates that appointed members of a governing body that are not *ex officio* should not be excluded from the definition of municipal advisor. *See* Release at page 41. The Commission reasons that only employees and elected members are directly accountable for their actions. Yet, appointees are accountable in various other ways, notwithstanding their appointment.

Political accountability to the electorate is not the only form of accountability. Public pension trustees are subject to strict fiduciary duties under state law. Moreover, state law commonly requires all trustees to comply with state ethics and conflicts of interest laws, public records and open meeting laws, regardless of whether the trustee is an employee, retiree or elected officer *per se*. Similarly, municipal pension boards commonly file annual reports and are regulated by state agencies or legislative bodies that oversee retirement matters. More fundamentally, appointees are accountable to the municipal entity that appointed them or the employees or retirees who elected them in the first place.⁷ These identical considerations

⁷ Once appointed or elected, public pension trustees owe identical fiduciary duties to all of the membership and beneficiaries of the retirement system, regardless of how the trustees

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uniformly create accountability for all trustees on the same board, whether or not the public pension trustee is appointed or elected.

7) **Unintended consequences:** NCPERS is concerned that unpaid public pension trustees would potentially be deterred from service or would likely want the municipality to provide legal or other assistance with registration and related requirements. In many states, a municipality may have several separate pension boards for police officers, fire fighters and general employees. As a practical matter, finding and recruiting volunteers who are willing to assume obligations to the Commission, in addition to the already existing significant state mandated fiduciary obligations, may become problematic, particularly for small municipalities which may not be able to provide legal or other guidance for incoming public pension trustees. This concern is heightened if the Commission treats certain categories of elected trustees differently from other elected trustees (elected by the membership as opposed to the electorate at large), or treats appointed trustees differently than elected trustees.

8) **Who is the municipal entity in the context of a public pension board?:** The term “municipal entity” is defined by Dodd-Frank as “any State, political subdivision of a State, or municipal corporate instrumentality of a State” including “any agency, authority, or instrumentality of the State” or “any plan, program, or pool of assets” sponsored by the State or political subdivision.⁸ The term “municipal entity” has not been defined by the Commission in the proposed rules.⁹ At least one of NCPERS’ members has observed as follows:

There seems to be some confusion regarding the identity of the “municipal entity”. In our case, for example, is the “municipal entity” the County (the sponsor) or is it the County Employees’ Retirement Association (the system) or is it the Board of Retirement (the governing board)? As to the sponsor, the Board doesn’t advise on investments. As to the sponsor and as to the system, no individual Board member advises on anything; only the Board as a whole has any status in the law. If the Board itself is considered the “municipal entity”, then the critical misapprehension of the SEC apparently is that only elections can hold someone “directly accountable for their performance”. Individual Board members are directly accountable to all the “citizens of the municipal entity” (ie., retirement system members), by retirement system fiduciary law and state trust law made applicable, in part, by the Internal Revenue Code. Board members are well regulated and also potentially subject to personal liability for breach of fiduciary duty, the highest legal standard of conduct.

were placed on the board. Whether appointed by the municipal entity or elected by the membership, public pension trustees are required to exercise their independence as a fiduciaries.

⁸ See 15 U.S.C. 78o-4(e)(8).

⁹ Proposed rule §240.15Ba1-1’s definitional section refers to various defined terms in the Securities Exchange Act of 1934, including the definition of “municipal advisor”. Yet, proposed rule §240.15Ba1-1 is silent with regard to a definition of “municipality.”

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9) **Exemption for advisory boards?** In recent years, state legislatures and plan sponsors have begun creating advisory boards that work alongside the pension board. Similarly, pension boards might create subcommittees or advisory groups. NCPERS recommends that the Commission study and weigh the advantages of this tool versus the disadvantages of deterring citizens from serving in an advisory role. The same question could be asked about blue ribbon panels and similar entities that might be created in an ad hoc capacity. Under generally applicable state ethics laws, an advisory board member would not be permitted to participate in making recommendations where a conflict of interest exists. By definition, citizen advisory group members are therefore not selling a service or product. The Commission should be careful not to deter industry experts from serving in an unpaid advisory capacity. Clarification would be useful here as well.

NCPERS would be more than happy to work with Commission staff to answer any questions.

Sincerely,

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NCPERS Executive Director and Counsel

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