SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52496, File No. SR-MSRB-2005-12)

September 22, 2005

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Approving Proposed Rule Change Concerning Solicitation and Coordination of Payments to Political Parties and Question and Answer Guidance on Supervisory Procedures Related to Rule G-37(d) on Indirect Violations

On June 27, 2005, the Municipal Securities Rulemaking Board ("MSRB" or "Board"), filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] a proposed rule change consisting of an amendment to Rule G-37(c), concerning solicitation and coordination of payments to political parties, and Q&A guidance on supervisory procedures related to Rule G-37(d), on indirect violations. The proposed rule change was published for comment in the Federal Register on August 16, 2005.[3] The Commission received four comment letters

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 52235 (August 10, 2005), 70 FR 48214 (August 16, 2005) (the "Commission's Notice").

regarding the proposal.[4] On September 16, 2005, the MSRB filed a response to the comment letters from UBS, BMA and DSCC.[5] On September 21, 2005, the MSRB filed a response to the comment letter from Griffin, Kubik.[6] This order approves the proposed rule change.

The proposed rule change would prohibit a dealer and certain municipal finance professionals ("MFPs") from soliciting any person or PAC to make or coordinate a payment to a political party of a state or locality where the dealer is engaging or is seeking to engage in municipal securities business. In addition, the proposed Qs&As seek to provide dealers with more guidance as they develop procedures to ensure compliance with both the language and the spirit of Rule G-37. A full description of the proposal is contained in the Commission's Notice.

UBS, BMA and Griffin, Kubik stated in their comment letters that they fully support the elimination of pay-to-play practices in the municipal securities industry, but

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4 See letter to Jonathan G. Katz, Secretary, Commission, from Terry L. Atkinson, Managing Director, UBS Financial Services Inc. ("UBS"), dated September 1, 2005 ("UBS' Letter"); letter to Jonathan G. Katz, Secretary, Commission, from Leslie M. Norwood, Vice President and Assistant General Counsel, The Bond Market Association ("BMA"), dated September 2, 2005 ("BMA's Letter"); letter to Jonathan G. Katz, Secretary, Commission, from Marc E. Elias and Rebecca H. Gordon, Perkins Coie, Counsel to the Democratic Senatorial Campaign Committee ("DSCC"), dated September 6, 2005 ("DSCC's Letter"); and letter to Jonathan G. Katz, Secretary, Commission, from David M. Thompson, President, and Robert J. Stracks, Counsel, Griffin, Kubik, Stephens & Thompson, Inc. ("Griffin, Kubik"), dated August 29, 2005 ("Griffin, Kubik's Letter").

5 See letter from Carolyn Walsh, Senior Associate General Counsel, MSRB, to Martha M. Haines, Chief, Office of Municipal Securities, Commission, dated September 16, 2005 ("MSRB's First Response Letter").

6 See letter from Carolyn Walsh, Senior Associate General Counsel, MSRB, to Martha M. Haines, Chief, Office of Municipal Securities, Commission, dated September 21, 2005 ("MSRB's Second Response Letter"). Griffin, Kubik's Letter was provided to the MSRB after it had sent its First Response Letter.

raised concerns about implementation of the proposal. DSCC expressed concern that the guidance presented in the MSRB's proposed Questions and Answers may unnecessarily chill contributions to national party committees from MFPs and dealer-controlled PACs.

Vagueness and First Amendment Concerns

Both UBS and BMA stated that the proposed Qs&As are vague and do not provide clear, uniform standards as to when a contribution to a PAC or party committee results in an indirect violation. UBS and BMA also stated that the Qs&As represent an expansion of Rule G-37 because the Qs&As require that a broker-dealer have procedures in place to reasonably ensure that contributions to PACs and party committees do not result in indirect contributions to issuer officials, but provide no discernable standard as to when such indirect contribution would occur. BMA stated that the MSRB had previously established a safe harbor where a broker-dealer gets assurances from a party committee or PAC that the broker-dealer's contribution will not be used for issuer officials (e.g., for housekeeping or conference accounts), and that this safe harbor conflicted with the proposal. Both UBS and BMA stated that the vagueness of the proposal will allow different firms to develop different supervisory procedures depending on their tolerance for risk. UBS and BMA further stated that creating a vague standard for contributing to PACs and party committees is unconstitutional, and that the due diligence suggested by the proposed Qs&As is troublesome under the First Amendment. Griffin, Kubik stated that they believe that Rule G-37 is unconstitutional.

The MSRB noted in its Response Letters that the commentators raised these concerns to the MSRB during its comment period on the proposed guidance, that the MSRB responded to these comments in its filing and that the Commission's Notice

addresses these issues at some length. The MSRB stated that the proposed Qs&As do not extend the reach of Rule G-37 or create a vague standard of regulation. The MSRB stated that the proposed guidance does not change the standard regarding when a payment to a political party or PAC could result in either a rule violation or a ban on doing business with a municipal issuer. The MSRB further stated that a violation of Rule G-37(d) still will only occur when the payment is made to other entities "as a means to circumvent the rule," and that the standard enunciated in Rule G-37(d), which prohibits anyone from "directly or indirectly, through or by any other person or means" doing what sections (b) and (c) prohibit, is not unconstitutionally vague.

The MSRB further stated that contrary to statements made in the commentators' letters, this precise issue raised before the United States Court of Appeals in Blount v. SEC,[7] and that the Court of Appeals in Blount directly rejected the challenge that Rule G-37(d) was too broad and could not regulate payments to parties and PACs when they are intended as end-runs around the direct contribution limits. In Blount, the Court stated: "Although the language of section (d) itself is very broad, the SEC has interpreted it as requiring a showing of culpable intent, that is, a demonstration that the conduct was undertaken 'as a means to circumvent' the requirements of (b) and (c) . . .The SEC states its 'means to circumvent' qualification in general terms. The qualification appears, therefore, to apply not only to such items as contributions made by the broker's or dealer's family members or employees, but also gifts by a broker to a state or national party committee, made with the knowledge that some part of the gift is likely to be

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[7] Blount v. SEC, 61 F.3d 938 (D.C. Cir 1995), rehearing and suggestion for rehearing en banc denied (1995), certiorari denied by 517 U.S. 1119, 116 S.Ct. 1351, 134 L.Ed.2d 520 (1996).

transmitted to an official excluded by Rule G-37. In short, according to the SEC, the rule restricts such gifts and contributions only when they are intended as end-runs around the direct contribution limitations."[8]

The MSRB further stated that the cases cited by BMA related to different issues and did not discredit the Blount Court's ruling on this precise issue. In addition, the MSRB stated that the cases relied upon by BMA were decided prior to Blount as well as the Supreme Court's decision in McConnell.[9] Griffin, Kubik stated that the MSRB's citations to Blount and McConnell were weak arguments, but did not cite any authority for their belief that Rule G-37 is unconstitutional.

The MSRB stated in its filing that it was issuing the proposed guidance to remind dealers of the need to have adequate supervisory procedures. The MSRB guidance makes suggestions concerning such procedures but does not require particular procedures. The MSRB stated that it is up to individual dealers to create procedures that are appropriate to their particular circumstances, and that broker-dealers generally do not have uniform supervisory procedures.

The MSRB stated that it never intended for dealers to treat payments to administrative party accounts as a safe harbor and that payments to administrative-type accounts have always fallen within the rule's regulatory ambit. The MSRB further stated that the SEC's approval order of certain early amendments to Rule G-37 clearly demonstrates that the MSRB never intended for dealers to treat payments to

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8 Id., at 948.

9 McConnell v. Federal Election Commission, 540 U.S. 93, 124 S.Ct. 619 (Dec. 10, 2003).

administrative party accounts as a safe harbor.[10]

In 1995, the MSRB filed and the SEC approved amendments to Rule G-37's disclosure requirements to require dealers to record and report all payments to parties by dealers, PACs, MFPs and executive officers regardless of whether those payments constitute contributions. In the 1995 SEC Approval Order, the SEC reiterated that the party payment disclosure requirements are intended to help ensure that dealers do not circumvent the prohibition on business in the rule by indirect contributions to issuer officials through payments to political parties. The SEC explained that the need for the language amendment was motivated by attempts by dealer and/or political parties to assert that contributions to administrative-type accounts did not fall within the rule's regulatory ambit. In the 1995 SEC Approval Order, the SEC states: "Certain dealers and other industry participants have notified the MSRB that certain political parties currently are engaging in fundraising practices which, according to these political parties, do not invoke the application of rule G-37. For example, some of these entities currently are urging dealers to make payments to political parties earmarked for expenses other than political contributions (such as administrative expenses or voter registration drives). Since these payments would not constitute 'contributions' under the rule, the recordkeeping and reporting provisions would not apply. The MSRB is concerned, based upon this information, that the same pay-to-play pressures that motivated the MSRB to adopt rule G-37 may be emerging in connection with the fundraising practices

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[10] See Securities Exchange Act Release No. 35446 (SEC Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Rule G-37 on Political Contributions and Prohibitions on Municipal Securities Business, and Rule G-8, on Recordkeeping) (March 6, 1995), 60 FR 13496 ("1995 SEC Approval Order").

of certain political parties described above."[11]

In addition, in August 2003, when the MSRB published a notice on indirect rule violations of Rule G-37, the MSRB referenced the 1995 SEC Approval Order and specifically stated that, "The party payment disclosure requirements were intended to assist in severing any connection between payments to political parties (even if earmarked for expenses other than political contributions) and the awarding of municipal securities business."[12]

The MSRB further stated that the commentators continued incorrect assertions about a "housekeeping" safe harbor only serve to illustrate the potential for real (or imagined) safe harbors to become dangerous loopholes as parties or PACs tailor their solicitations for contributions to the safe harbor's parameters, and that, as noted in the MSRB's proposed guidance, the need for dealers to adopt adequate written supervisory procedures to prevent indirect violations via "housekeeping" type political party accounts is especially important in light of media and other reports that issuer agents have informed dealers and MFPs that, if they are prohibited from contributing directly to an issuer official's campaign, they should contribute to an affiliate party's "housekeeping" account.

National Party Committees and Federal Leadership PACs

UBS and BMA requested that the MSRB expressly state that contributions made to a national party committee or federal leadership PAC be permitted under the proposed Qs&As as long as (1) the contribution was not solicited by an issuer official, and (2) the

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[11] Id. at 13498.

[12] MSRB Notice 2003-32 (August 6, 2003) at pp. 1-2 (emphasis added).

party committee or leadership PAC is not controlled by an issuer official. The DSCC stated that it is concerned that the guidance presented in the MSRB's draft Questions and Answers may unnecessarily chill contributions to national party committees from MFPs and dealer-controlled PACs, and that contributions to national party committees do not present the "pay-to-play" concerns Rule G-37 was intended to address. These commentators are asking the MSRB to create a safe harbor for certain national party committees and federal leadership PACs.

The MSRB responded that there is no evidence that the lack of a safe harbor for national party committees and federal leadership PACs has inhibited MFPs or dealers from contributing to such parties or PACs. The MSRB does not believe it is useful to provide "safe harbors" concerning parties or PACs such that a dealer or MFP could make payments to certain parties or PACs without investigating whether the payment is actually being made as a means to circumvent the requirements of Rule G-37. The MSRB stated that the Court of Appeals in Blount[13] expressly recognized that Rule G-37(d) was originally intended to prevent payments to both national and state parties used as a "means to circumvent" Rule G-37. UBS and BMA stated that when a contribution is not solicited by an issuer official and the party leadership PAC is not controlled by an issuer official the national party committees and federal leadership PACs cannot be used as a means to circumvent Rule G-37; the MSRB stated that such a position is inconsistent with public perception. The MSRB also stated that the Supreme Court's recent decision in McConnell[14] emphasized the potential for payments to a political party to have undue

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13 See supra note 7.

14 See supra note 9.

influence on the actions of the elected officeholders belonging to the same party, and that McConnell upheld new federal statutory restrictions on soft money donations that were neither solicited by candidates nor used by the party to aid specific candidates. Given public perception and the Supreme Court's pronouncements, the MSRB believes it is reasonable to require dealers to be responsible for having adequate supervisory procedures that obligate the dealer to exercise its judgment concerning whether contributions to any party or PAC are being made as a means to circumvent the provisions of Rule G-37.

The Prohibition on Soliciting Contributions to State and Local Party Committees Should be Symmetrical to the Contributions Ban

UBS stated that the Rule G-37(c) amendment should be symmetrical to the contributions ban because it is illogical to impose a greater prohibition on soliciting contributions than on making contributions. The MSRB responded that the proposed rule amendment is more limited than as portrayed by UBS. UBS stated that the amendment would completely prohibit MFPs from soliciting contributions to any state and local party committees when, in fact, it only prohibits solicitations by the dealer or certain MFPs for contributions to a political party of a state of locality where the dealer is engaging or is seeking to engage in municipal securities business. Thus, the MSRB believes that the proposed amendment is narrowly tailored to regulate only a dealer's or certain MFP's solicitation of other persons' payments to political parties when there can be a perception that MFPs and dealers are soliciting others to make payments to parties or PACs as a means to circumvent the rule and the rule's disclosure requirements.

The MSRB determined that allowing dealers or certain MFPs to solicit other

persons to make political party or PAC payments in states and localities where they are engaging or seeking to engage in municipal securities business creates at least the appearance of attempting to influence the awarding of municipal securities business through such payments. Moreover, without the proposed prohibition, it would be very difficult for enforcement agencies to detect such potential indirect violations because the parties solicited do not have to disclose the payments. Additionally, the MSRB believes that the arguably stricter prohibition can be justified because a violation of Rule G-37(c) does not result in an automatic ban on business.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB[15] and, in particular, the requirements of Section 15B(b)(2)(C) of the Act and the rules and regulations thereunder.[16] Section 15B(b)(2)(C) of the Act requires, among other things, that the MSRB's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.[17] In particular, the Commission finds that the proposed rule change is consistent with the Act

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15 In approving this rule the Commission notes that it has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

16 15 U.S.C. 78o-4(b)(2)(C).

17 Id.

because it will help inhibit practices that attempt, or create the appearance of attempting, to influence the awarding of municipal securities business through an indirect violation of Rule G-37. The Commission also finds that the Q&A guidance will facilitate dealer compliance with Rule G-27, on supervision, and Rule G-37(d)'s prohibitions on indirect rule violations.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[18] that the proposed rule change (SR-MSRB-2005-12) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[19]

Jonathan G. Katz
Secretary

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[18] 15 U.S.C. 78s(b)(2).

[19] 17 CFR 200.30-3(a)(12).