SECURITIES AND EXCHANGE COMMISSION
(RELEASE NO. 34-65255; File No. SR-MSRB-2011-12)

September 2, 2011

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Proposed New Rule G-42, on Political Contributions and Prohibitions on Municipal Advisory Activities; Proposed Amendments to Rules G-8, on Books and Records, G-9, on Preservation of Records, and G-37, on Political Contributions and Prohibitions on Municipal Securities Business; Proposed Form G-37/G-42 and Form G-37x/G-42x; and a Proposed Restatement of a Rule G-37 Interpretive Notice

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("the Exchange Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on August 19, 2011, the Municipal Securities Rulemaking Board ("Board" or "MSRB") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The MSRB is filing with the SEC a proposed rule change consisting of (i) proposed MSRB Rule G-42 (on political contributions and prohibitions on municipal advisory activities); (ii) proposed amendments that would make conforming changes to MSRB Rules G-8 (on books and records), G-9 (on preservation of records), and G-37 (on political contributions and prohibitions on municipal securities business); (iii) proposed Form G-37/G-42 and Form G-

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

2 17 CFR 240.19b-4.

37x/G-42x; and (iv) a proposed restatement of a Rule G-37 interpretive notice issued by the MSRB in 1997 ("Rule G-37 Interpretive Notice").[3]

The MSRB requests that, if approved by the Commission, the proposed rule change be made effective six months after the date on which the Commission first approves rules defining the term "municipal advisor" under the Exchange Act or such later date as the Commission approves the proposed rule change; provided, however, that the MSRB requests that no contribution made prior to the effective date of proposed Rule G-42 would result in a ban pursuant to proposed Rule G-42(b)(i);[4] and, provided that any ban on municipal securities business under Rule G-37(b)(i) in existence prior to the effective date of proposed Rule G-42 would continue until it otherwise would have terminated under Rule G-37(b)(i), as in effect prior to the effective date of proposed Rule G-42.

The text of the proposed rule change is available on the MSRB's website at www.msrb.org/Rules-and-Interpretations/SEC-Filings/2011-Filings.aspx, at the MSRB's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

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3 Interpretation of Prohibition on Municipal Securities Business Pursuant to Rule G-37 (February 21, 1997), reprinted in MSRB Rule Book.

4 As described in more detail below, under proposed Rule G-42(b)(i) certain contributions could result in a ban on municipal advisory business for compensation, a ban on solicitations of third-party business for compensation, and a ban on the receipt of compensation for the solicitation of third-party business.

Item IV below. The Board has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[5] authorized the MSRB to establish a comprehensive body of regulation for municipal advisors and provided that municipal advisors to municipal entities have a federal fiduciary duty.[6] The Dodd-Frank Act required the MSRB to adopt rules for municipal advisors that, in addition to implementing the federal fiduciary duty, are designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade.[7] It also expanded the mission of the MSRB to include the protection of municipal entities[8] and obligated persons, in addition to the protection of investors and the public interest.

Municipal advisors that seek to influence the award of business by government officials by making or soliciting political contributions to those officials distort and undermine the fairness of the process by which government business is awarded. These practices can harm municipal entities and their citizens by resulting in inferior services and higher fees, as well as

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5 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

6 See 15B(c)(1) of the Exchange Act.

7 See Section 15B(b)(2)(C) of the Exchange Act.

8 "Municipal entity" is defined in Section 15B(e)(8) of the Exchange Act as any State, political subdivision of a State, or municipal corporate instrumentality of a State, including – (A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities.

contributing to the violation of the public trust of elected officials that might allow political contributions to influence their decisions regarding public contracting.

Similarly, Rule G-37 was adopted by the MSRB in 1994 due to concerns about the opportunity for abuses and the problems associated with political contributions by dealers in connection with the award of municipal securities business.[9] When it filed proposed Rule G-37 with the Commission,[10] the MSRB stated that it believed that there had been numerous instances in which dealers had been awarded municipal securities business because of their political contributions. Even when such improprieties had not occurred, the MSRB believed that political contributions created a potential conflict of interest for issuers, or at the very least the appearance of a conflict, when dealers made contributions to officials responsible for, or capable of influencing the outcome of, the award of municipal securities business and then were awarded business by issuers associated with such officials. The MSRB said:

> The problems associated with political contributions undermine investor confidence in the municipal securities market, which is crucial to the long-term health of the market, both in terms of liquidity and capital-raising ability . . . . The payment of such contributions to obtain business creates artificial barriers to those dealers not willing or able to make such payments, thereby harming investors and the public interest by stifling competition and increasing market costs associated with doing municipal securities business. Accordingly, . . . regulatory action is necessary to protect investors and maintain the integrity of the market.

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9 Municipal securities business generally consists of negotiated underwritings, private placements, and serving as remarketing agent or financial advisor on a new issue of municipal securities. See Rule G-37(g)(vii).

10 See File No. SR-MSRB-94-2 (January 12, 1994); "Political Contributions and Prohibitions on Municipal Securities Business: Proposed Rule G-37," MSRB Reports, Vol. 14, No. 1 (January 1994).

PROPOSED NEW MSRB RULE G-42

Proposed Rule G-42 concerns political contributions made by all municipal advisors, both those that are dealers and those that are not. Like Rule G-37, the proposed rule would not ban political contributions. Instead, proposed Rule G-42 would:

- prohibit a municipal advisor from engaging in "municipal advisory business" with a municipal entity for compensation for a period of time beginning on the date of a non-de minimis[11] political contribution to an "official of the municipal entity" by the municipal advisor, any of its municipal advisor professionals ("MAPs"), or a political action committee controlled by the municipal advisor or a MAP, and ending two years after all municipal advisory business with the municipal entity has been terminated;[12]
- prohibit a municipal advisor from soliciting third-party business[13] from a municipal entity for compensation, or receiving compensation for the solicitation of third-party business from a municipal entity, for two years after a non-de minimis political contribution to an "official of the municipal entity;"[14]

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11 Proposed Rule G-42(g)(ii) would provide in pertinent part: The term "de minimis," when used in connection with contributions made by a municipal advisor professional or a non-MAP executive officer, refers to contributions made . . . to officials of a municipal entity for whom the municipal advisor professional or non-MAP executive officer was entitled to vote at the time of the contribution and which contributions, in total, were not in excess of $250 to each official of such municipal entity, per election.

12 See proposed Rule G-42(b)(i).

13 Proposed Rule G-42(g)(xiv) would provide that: "third-party business" means an engagement by a municipal entity of a broker, dealer, municipal securities dealer, or municipal advisor (other than the municipal advisor that is soliciting the municipal entity) that does not control, is not controlled by, or is not under common control with, the person soliciting such third-party business for or in connection with municipal financial products or the issuance of municipal securities, or of an investment adviser (as defined in section 202(a)(11) of the Investment Advisers Act of 1940) to provide investment advisory services to or on behalf of a municipal entity.

14 See proposed Rule G-42(b)(i).

- prohibit municipal advisors and MAPs from soliciting contributions, or coordinating contributions, to officials of municipal entities with which the municipal advisor is engaging or seeking to engage in municipal advisory business or from which the municipal advisor is soliciting third-party business;[15]
- prohibit municipal advisors and MAPs from soliciting payments, or coordinating payments, to political parties of states or localities with which the municipal advisor is engaging in, or seeking to engage in, municipal advisory business or from which the municipal advisor is soliciting third-party business;[16]
- prohibit municipal advisors and MAPs from committing indirect violations of proposed Rule G-42;[17]
- require quarterly disclosures to the MSRB of certain contributions and related information;[18] and
- permit certain exemptions from the ban on business for compensation, either by the SEC, upon application,[19] or automatically.[20]

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15 See proposed Rule G-42(c)(i).

16 See proposed Rule G-42(c)(ii). An exception from this prohibition would be provided for certain supervisors and executives of municipal advisors that are only municipal advisors because they provide advice to municipal entities or obligated persons and do not solicit any third-party business from municipal entities.

17 See proposed Rule G-42(d).

18 See proposed Rule G-42(e).

19 See proposed Rule G-42(h).

20 See proposed Rule G-42(i).

PROPOSED AMENDMENTS TO EXISTING MSRB RULES

MSRB Rule G-37. The proposed amendments to Rule G-37 would remove any references to "financial advisory and consulting services," because those activities would be covered by proposed Rule G-42. The definitions of "solicit," "affiliated company," and "affiliated person of the broker, dealer, or municipal securities dealer" would be conformed to those in proposed Rule G-42. The reference in Rule G-37(b)(1)(B) to "any municipal finance professional associated with such broker, dealer or municipal securities dealer" has been changed to "any municipal finance professional of such broker, dealer, or municipal securities dealer," because, by definition, all municipal finance professionals are associated persons of brokers, dealers, or municipal securities dealers. Clarifications to Rule G-37 would provide that, in order for certain contributions not to result in a ban on municipal securities business or required reporting to the MSRB, they must be made to officials of issuers for whom the municipal finance professionals may vote at the time of the contribution. References to Forms G-37 and G-37x would be changed to Forms G-37/G-42 and G-37x/G-42x, which would be the combined "macroforms" used by both dealers and municipal advisors to make reports to the MSRB under Rule G-37(e) and proposed Rule G-42(e), respectively. Such forms would be required to be submitted electronically.

MSRB Rules G-8 and G-9. Proposed Rule G-42 would necessitate amendments to Rule G-8 (on books and records) and Rule G-9 (on preservation of records). The proposed amendments to Rule G-8 would require municipal advisors to create and maintain records necessary for the enforcement of the proposed rule, including, but not limited to, political contributions and payments; lists of MAPs and non-MAP executive officers; the states in which the municipal advisor is engaging or is seeking to engage in municipal advisory business with

municipal entities or soliciting third-party business; a list of municipal entities with which the municipal advisor has engaged in municipal advisory business and the type of municipal advisory business; a list of the third-party business awarded; and Forms G-37/G-42 and G-37x/G-42x. The proposed amendments to Rule G-9 generally would require municipal advisors to preserve records required to be made pursuant to the proposed amendments to Rule G-8 for six years. The proposed amendments to Rules G-8 and G-9 would subject municipal advisors to recordkeeping and record retention requirements related to proposed Rule G-42 that are substantially similar to those to which dealers are already subject under Rule G-37. The provisions of Rule G-8 and G-9 concerning Rule G-37 recordkeeping and preservation would change references to Forms G-37 and 37x to Forms G-37/G-42 and G-37x/G-42x. References to receipts of mailing the forms would also be removed, because the forms would only be submitted electronically.

RESTATED RULE G-37 INTERPRETIVE NOTICE

The Rule G-37 Interpretive Notice was drafted before municipal advisors to municipal entities were subject to a federal fiduciary duty and includes language providing guidance on the application of the ban on municipal securities business in circumstances where a non-de minimis contribution occurs during the course of an existing financial advisory relationship. Proposed Rule G-42 is inconsistent with the Rule G-37 Interpretive Notice, which would permit financial advisors to complete certain financial advisory engagements while continuing to receive compensation. Accordingly, the MSRB is proposing to restate the Rule G-37 Interpretive Notice to remove references to financial advisory services, which would instead be covered by proposed Rule G-42. A conforming change would also reference contributions made to officials of issuers to whom municipal finance professionals could vote at the time of the contribution.

2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with Section 15B(b)(2) of the Exchange Act, which provides that:

> The Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.

Section 15B(b)(2)(C) of the Exchange Act, provides that the rules of the MSRB shall:

> 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 and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.

The proposed rule change is consistent with Section 15(b)(2) of the Exchange Act because it would help to prevent municipal advisors from seeking to influence the award of business by government officials by making or soliciting political contributions to those officials, which contributions distort and undermine the fairness of the process by which government business is awarded. The proposed rule change would help protect municipal entities and help to perfect the mechanism of a free and open market in municipal securities. Just as pay to play activities by some dealers had the potential to undermine the integrity of the municipal securities market and were addressed by Rule G-37, pay to play activities by some municipal advisors could similarly damage the public's confidence in the municipal marketplace. The proposed amendments to Rules G-8 and G-9 would assist in the enforcement of Rule G-42. The proposed

amendments to Rule G-37 would make conforming changes. The new Forms G-37/G-42 and G-37x/G-42x would eliminate the need for duplicative filings for dealers that engage in both municipal securities business and municipal advisory activities. The proposed restatement of the Rule G-37 Interpretive Notice would remove provisions that would be otherwise inconsistent with proposed Rule G-42.

Section 15B(b)(2)(L)(iv) of the Exchange Act requires that rules adopted by the Board:

> not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, municipal entities, and obligated persons, provided that there is robust protection of investors against fraud.

While the proposed rule change would affect all municipal advisors, it would be a necessary regulatory burden because it would hamper practices that can harm municipal entities and their citizens by resulting in inferior services and higher fees to investors and the public, as well as contributing to the violation of the public trust of elected officials that might allow political contributions to influence their decisions regarding public contracting. While the proposed rule change might burden some small municipal advisors, any such burden would be outweighed by the need to protect their issuer clients.

B. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, since the proposed amendments to Rule G-37, the associated amendments to Rule G-8, and the proposed restatement of the Rule G-37 Interpretive Notice would apply equally to all dealers and proposed Rule G-42 and the associated amendments to Rules G-8 and G-9 would apply equally to all municipal advisors. Proposed Forms G-37/G-42 and G-37x/G-42x would apply equally to all dealers and municipal advisors.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

On January 14, 2011, the MSRB requested comment on a draft of the proposed rule change ("draft Rule G-42").[21] The MSRB received comment letters from (1) Acacia Financial Group, Inc.; (2) the American Bankers Association; (3) AGFS; (4) BMO Capital Markets GKST Inc. ("BMO"); (5) Mr. W. Hardy Callcott; (6) Mr. Robert Fisher; (7) G.L. Hicks Financial LLC; (8) H.J. Umbaugh & Associates; (9) the National Association of Independent Public Finance Advisors; (10) Repex & Co., Inc.; (11) the Securities Industry and Financial Markets Association; (12) the State of Texas (Texas Comptroller of Public Accounts); (13) the State of Texas (Office of Attorney General); (14) T. Rowe Price; (15) The PFM Group; and (16) WM Financial Strategies.[22] The comments are summarized by topic as follows:

Harmonization of Draft Rule G-42 and MSRB Rule G-37 with the Securities and Exchange Commission Investment Adviser Act Rule 206(4)-5 (the "SEC Pay to Play Rule").

Acacia Financial Group, Inc. ("Acacia Financial"), the American Bankers Association ("ABA"), Mr. W. Hardy Callcott ("Mr. Callcott"), the Securities Industry and Financial Markets Association ("SIFMA"), and T. Rowe Price called for draft Rule G-42 and, in some cases Rule G-37, to be consistent with the SEC pay to play rule and for conforming changes to Rule G-37, arguing that such consistency is necessary because many municipal advisors will be subject to both the SEC rules and the MSRB rules. Specifically, the ABA said that, "imposing two overlapping but inconsistent sets of rules on the same conduct would be inconsistent with the spirit of President Obama's January 18, 2011 Executive Order, "Improving Regulation and

21 See Exhibit 2.

22 See Exhibit 2.

Regulatory Review," which provides, in part: "Our regulatory system . . . must identify and use the best, most innovative and least burdensome tools for achieving regulatory ends."

Definition of "De Minimis" Political Contribution.

Comment: Each of these commenters said that the MSRB should harmonize draft Rule G-42 and Rule G-37 with the SEC pay to play rule by defining a "de minimis" political contribution as one not exceeding $350 per election for an issuer official for whom a municipal advisor professional ("MAP") may vote at the time of the contribution and $150 per election for other issuer officials. The ABA said that the Rule G-37 definition of de minimis political contribution has not been amended since the rule's adoption in 1994 and that the SEC, "which has most recently reviewed the current economic and political environment in the context of its deliberations on its adviser rule, determined that increased thresholds were warranted to account for inflation since 1994."

MSRB Response: The MSRB has determined to apply the current Rule G-37 "de minimis" political contribution limit to municipal advisors under proposed Rule G-42. Even though the Board is sensitive to differing regulations on the same topic, the Board is very concerned that allowing contributions of $150 per election to officials for whom municipal advisors cannot vote (as permitted by the SEC rule) is likely to result in the bundling of political contributions by large municipal advisor firms, despite the prohibition on such activity under proposed Rule G-42(c)(i). The Board has similar concerns about making a comparable amendment to Rule G-37. The MSRB has also clarified that, in order for a contribution or payment to be considered de minimis, it must be made to an official of a municipal entity or a bond ballot campaign the MAP or non-MAP executive officer could vote for at the time of the contribution, or to a political party of a state or political subdivision in which the MAP or a non-

MAP executive officer could vote at the time of the contribution. Comparable clarifying changes have been made to Rule G-37. This clarification is consistent with the way in which Rule G-37 has previously been interpreted.

Look-Back Provision.

Comment: The ABA also suggested that the MSRB conform the look-back provision of draft Rule G-42 to the SEC pay to play rule, which provides that, in the case of employees who do not solicit investment advisory business, a two-year "time out" from compensation for investment advisory services will be triggered by non-de minimis political contributions made by new "covered associates" within the six months prior to their employment. A two-year look-back provision covers employees who do solicit investment advisory business. The ABA said that the draft Rule G-42 look-back provisions generally[23] would trigger a ban on business for compensation if an employee had made a contribution within two years before becoming an MAP. The ABA also said that such a restriction, "would require municipal advisor employers to rely on the accurate disclosures of new hires and may preclude an employer from hiring an otherwise qualified candidate because of his or her legal and legitimate political contributions."

MSRB Response: The look-back period for individuals who solicit municipal advisory business or third-party business would be two years, which is the same as the look-back period for solicitors in the SEC pay to play rule. Under both rules, employers would need to adopt means designed to elicit information about contributions made by prospective employees during the two years preceding their employment. Unlike the SEC pay to play rule, proposed Rule G-42 would include within the definition of MAP those associated persons of a municipal advisor who are engaged in municipal advisory business with a municipal entity. The MSRB believes that

[23] A six-month look-back provision applies to individuals who are only MAPs because they supervise the municipal advisory activities of other MAPs.

these individuals have the greatest interest in obtaining municipal advisory business and, therefore, their political contributions present the most significant potential for abuse. The look-back period for those individuals would also be two years, which is the same as the look-back period under Rule G-37 for those individuals who are primarily engaged in municipal securities business. The two-year look-back provision of Rule G-37 for most new employees has worked well over the many years it has been in effect, and the MSRB has determined not to change it for either Rule G-37 or proposed Rule G-42.

Other.

Comment: Acacia Financial also requested that the provisions of draft Rule G-42 related to who is subject to the rule and the contribution recipients be made the same as those of the SEC pay to play rule.

MSRB Response: Unlike the SEC pay to play rule, proposed Rule G-42 would include within the definition of MAP all those associated persons of a municipal advisor who are engaged in municipal advisory business with a municipal entity. This provision is consistent with how the term "municipal finance professional" ("MFP") is defined under current Rule G-37. As said above, the MSRB believes that these individuals have the greatest interest in obtaining municipal advisory business and, therefore, their political contributions present the most significant potential for abuse. Therefore, the MSRB has determined not to change this aspect of proposed Rule G-42. As to the recipients of political contributions, proposed Rule G-42 pertains to contributions made to certain officials of municipal entities, while the SEC pay to play rule pertains to contributions made to certain officials of government entities. The definition of "official of a municipal entity" in proposed Rule G-42 is based both on the statutory definition of "municipal entity" and on the definition of "official of an issuer" in Rule G-37. The

definitions of the contribution recipients in proposed Rule G-42 and the SEC pay to play rule are effectively the same. The MSRB perceives no administrative burden associated with any slight differences and has determined not to make any changes.

Harmonization of Draft Rule G-42 with Rule G-37.

Comment: SIFMA said that the MSRB should also harmonize draft Rule G-42 with Rule G-37 by:

(1) allowing dealer municipal advisors to report their non-de minimis political contributions and municipal advisory activities either on Form G-42 or on a "macroform" Form G-37/G-42;[24]

(2) narrowing the definition of "supervisors" that are MAPs by limiting it to those individuals who supervise the municipal advisory activities of others and not including those individuals who supervise other activities of MAPs;

(3) requiring reporting of solicitations only if they are successful;[25]

(4) requiring reporting of municipal advisory business only in the quarter in which it is obtained; and

(5) using a "primarily engaged in municipal advisory business" standard, rather than an "engaged in municipal advisory business" standard in the definition of MAP.[26] Alternatively, SIFMA said that the MSRB should clarify that only "advice" within the meaning of the statute is covered. SIFMA also recommended that the MSRB adopt a de minimis exception to the definition of "municipal advisor professional."

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24 See also comments of BMO.

25 See also comments of BMO.

26 Proposed Rule G-42(g)(iv)(A) includes within the definition of MAP "any associated person engaged in municipal advisory business with a municipal entity."

MSRB Response: (1) The MSRB agrees with SIFMA's comment on the use of a "macroform" (Form G-37/G-42) and has revised proposed Rule G-42(e) accordingly.

(2) The MSRB agrees with SIFMA's comment on the types of supervisors that should be considered MAPs and has revised proposed Rule G-42(g)(iv)(D) accordingly.

(3) The MSRB agrees with SIFMA's comment on the reporting of solicitations and has amended proposed Rule G-42(e)(i)(C)(2) to require the reporting of a list of the third-party business awarded during the calendar quarter by state, rather than all solicitations.

(4) As to the required reporting of municipal advisory business engaged in during a calendar quarter, the wording of proposed Rule G-42(e)(i)(C)(1) would not differ from the wording of Rule G-37(e)(i)(C). The instructions for Form G-37 (pp. 14-15) clarify that reporting of financial advisory business must occur two times: first, when a financial advisory engagement is entered into and second, when a transaction that is the subject of the engagement closes. The instructions for Form G-37/G-42 would contain similar instructions.

(5) SIFMA's proposal that the MSRB use a "primarily engaged in municipal advisory business" standard in the definition of MAP would create a loophole by allowing individuals who are only occasionally financial advisors to escape the coverage of both Rule G-37 and proposed Rule G-42. The use of a "primarily engaged" standard in Rule G-37 was appropriate because Rule G-37(g)(iv)(A) defines as MFPs those associated persons who are "primarily engaged in municipal securities representative activities, as defined in Rule G-3(a)(i)." The term "municipal securities representative activities" includes a number of activities, such as sales and trading, that do not involve contact with officials of issuers. Had the MSRB not used a "primarily engaged" standard in Rule G-37, a broker's occasional sales activities could have subjected the broker to Rule G-37, even if the broker had no contact whatsoever with issuer

officials. Under proposed Rule G-42, a person could be a MAP when engaged in municipal advisory business, which is defined only with reference to activities that involve contact with issuer officials. In this respect, proposed Rule G-42 is distinguishable from Rule G-37 and this difference in the definition of MAP and MFP is appropriate. Therefore, the MSRB has not made this change. For the same reasons, the MSRB does not consider it appropriate to adopt a de minimis exception to the definition of MAP. The MSRB also notes that SIFMA's arguments on the definitions of "advice" are more appropriately directed to the SEC.

Ban on Receipt of Compensation.

Comment: The ABA said that the MSRB should prohibit only compensation for new municipal advisory services, consistent with Rule G-37. The ABA also said that the prohibitions of draft Rule G-42 should only apply to the municipal advisor and those employees of the municipal advisor that are actually engaged in the solicitation or provision of municipal advisory business and not to those individuals who are only MAPs as a result of their supervisory or management activities.

MSRB Response: Proposed Rule G-42's ban on business for compensation follows the structure of the SEC pay to play rule, as recommended previously by the ABA. The MSRB considers a mere ban on future municipal advisory business to be inadequate and believes that such ban also should apply to existing engagements. Supervisors of MAPs who are either engaged in municipal advisory business or solicit business also have a significant interest in whether such business is obtained. Particularly given that the MSRB has determined to narrow the types of supervisors who would be considered MAPs, the MSRB considers it appropriate for their contributions to have the potential to trigger a ban on business for compensation.

Comment: SIFMA said that the two-year ban on receipt of compensation for municipal advisory business should run from the date of the non-de minimis contribution and end two years later, rather than ending two years after all municipal advisory business with the municipal entity has been terminated. SIFMA also said that solicitors should be able to receive compensation for solicitations completed before the making of a non-de minimis contribution.

MSRB Response: The MSRB does not agree with SIFMA's comment regarding a flat two-year ban and has determined not to revise the proposed rule. Making SIFMA's suggested change would permit municipal advisors to remain in place with the understanding that they would receive their compensation at the end of two years. Many municipal advisory engagements concern transactions that might not close for at least two years, with payment contingent on the transaction closing, so SIFMA's suggested change would mean that the ban would have little practical effect in many cases. Furthermore, the MSRB does not agree with SIFMA's proposal concerning the receipt of compensation for solicitations already successfully completed at the time of a non-de minimis contribution. Under the SEC pay to play rule, an investment adviser may not compensate an intermediary that is an investment adviser if the intermediary has made a non-de minimis contribution within two years. The SEC rule does not distinguish between solicitations that have already been completed and new solicitations. SIFMA has presented no argument as to why broker-dealer intermediaries and investment adviser intermediaries should be treated differently.

Comment: H. J. Umbaugh & Associates ("Umbaugh") supported a longer ban, recommending that the term of the ban should be identical to the term of the related office to which the non-de minimis political contribution relates, which could be as long as four years.

MSRB Response: While the MSRB is sensitive to the concern expressed by Umbaugh about the continuing influence of political contributions, it has determined that certain boundaries on the consequences of a non-de minimis political contribution must be established in view of First Amendment concerns. The two-year ban in proposed Rule G-42 is based on Rule G-37, which has survived constitutional challenge.[27]

Comment: The National Association of Independent Public Finance Advisors ("NAIPFA") said that draft Rule G-42 and Rule G-37 should both provide that non-de minimis political contributions to an official of a municipal entity by non-MAP and non-MFP executive officers, respectively, should trigger a two-year ban on their respective business because the "allowance of such contributions provides large firms an opportunity to make significant 'indirect' contributions that directly benefit the municipal business of such firms."

MSRB Response: As is the case with Rule G-37, proposed Rule G-42 is narrowly tailored to address the potential for quid pro quo behavior in the selection of businesses performing key municipal services, while at the same time recognizing the First Amendment rights of citizens to support candidates for public office. While non-de minimis contributions by non-MFP executive officers (in the case of Rule G-37) and non-MAP executive officers (in the case of proposed Rule G-42) will not necessarily trigger a ban on business, they must be reported to the MSRB. If they represent an attempt to circumvent the prescriptions of either rule, they may trigger a ban on business under either Rule G-37(d) or proposed Rule G-42(d), respectively.

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[27] Blount v. SEC, 61 F.3d 938 (D.C. Cir. 1995), cert. denied, 517 U.S. 1119 (1996). In Blount, the court determined that Rule G-37 was constitutional under a strict scrutiny analysis by finding that the rule was narrowly tailored to serve a compelling government interest. The court found the SEC's interests in protecting investors from fraud and protecting underwriters from unfair, corrupt practices to be compelling.

Recordkeeping and Reporting Requirements.

Comment: NAIPFA supported the draft changes to Rules G-8 and G-9 related to the recordkeeping provisions of draft Rule G-42, as well as mandatory electronic reporting to the MSRB. However, some commenters said that certain of the reporting and recordkeeping provisions of the rule would be difficult and expensive to manage. The ABA said that the reporting and recordkeeping provisions of the draft rule were overly broad and would yield little benefit in return, particularly the provision that requires reporting of all solicitations, whether successful or not. The ABA also stated that the MSRB and the SEC would force market participants to adopt unnecessarily complex and burdensome compliance systems. BMO objected to the need to file separate Forms G-37 and G-42.

MSRB Response: As previously said, the MSRB has determined to require reporting of a list of the third-party business awarded during the calendar quarter by state, rather than all solicitations. The MSRB has also determined to allow reporting of required information under proposed Rule G-42 on a combined "macroform" (Form G-37/G-42). The MSRB does not believe that the recordkeeping and reporting requirements of the proposed rule change would be complex or burdensome. Dealers are already subject to the same requirements. The MSRB believes that the proposed rule change is a necessary regulatory burden that will assist in the enforcement of the proposed rule. Any potential burden would be outweighed by the need to protect municipal entities and their constituents.

Comment: Mr. Robert Fisher ("Mr. Fisher") said that draft Rule G-42 should provide an exemption from reporting for municipal advisors that do not make political contributions and whose MAPs and PACs do not make political contributions. However, Mr. Fisher suggested that such an exemption would have to incorporate an "aggressive" look-back provision in order to

capture any contribution that could disqualify the municipal advisor from engaging in a municipal advisory activity under the rule.

MSRB Response: While the MSRB is sensitive to the concerns expressed by Mr. Fisher, it has determined that, in order to ensure effective enforcement of the rule, all municipal advisors should be required to file Form G-37/G-42 as long as they are engaged in municipal advisory business or the solicitation of third-party business. Political contributions made in one quarter do not necessarily result in municipal advisory business in the same quarter. Sometimes municipal advisory business may be obtained based on an understanding that a non-de minimis political contribution will be made in a subsequent quarter. Requiring the reporting of municipal advisory business only after a non-de minimis political contribution has been made by a MAP would not provide enforcement officials with the information they need to enforce compliance with the rule. Reporting of municipal advisory business need only be made in the calendar quarter in which the engagement has commenced and in the calendar quarter in which a transaction closes.

Comment: Repex & Co., Inc. ("Repex") said that "[i]f any forms are to be filed they should be filed only by those firms that do business with those municipalities, state pensions etc." and that "[t]he little firms are suffocating."

MSRB Response: Only municipal advisors engaged in municipal advisory business with municipal entities or that solicit third-party business from municipal entities would be subject to the reporting requirements of proposed Rule G-42(e). A municipal advisor that is only engaged in municipal advisory activities with an obligated person need not file reports with the MSRB.

Scope of Draft Rule G-42.

Comment: Some commenters said that pending SEC rulemaking concerning the definition of "municipal advisor" should be completed before the MSRB filed proposed Rule G-

42 with the SEC and that an additional MSRB comment period might be warranted. For example, the Attorney General of the State of Texas said such [SEC] rulemaking, ". . . is likely to have a significant impact on the substance, interpretation and enforcement of MSRB rules" and requested the opportunity to provide comments as necessary pending the outcome of the SEC's rulemaking process.[28] SIFMA said that the MSRB should use a two-stage rulemaking process and move forward with rulemaking on those municipal advisors that are clearly covered by the statute and delay rulemaking on those who are only municipal advisors within the expansive definition of the term proposed by the SEC.

MSRB Response: The MSRB is sensitive to the concerns expressed by these commenters and has requested that the proposed rule change be made effective six months after the SEC has adopted a final rule defining the term "municipal advisor." Contributions made prior to the effective date would not result in a ban under proposed Rule G-42(b), provided that any ban under Rule G-37(b)(i) in existence prior to the effective date of proposed Rule G-42 would continue until it otherwise would have terminated under Rule G-37(b)(i) as in effect prior to the effective date of proposed Rule G-42.

Comment: SIFMA said that the definition of "municipal advisor" in the Exchange Act does not cover private placement agents that solicit municipal entities to make investments in private equity funds, because such solicitations are not the "solicitation of investment advisory services." Therefore, SIFMA said that the MSRB does not have jurisdiction to write rules for such private placement agents, including draft Rule G-42.

However, SIFMA said that the SEC pay to play rule for investment advisers prohibits investment advisers from paying intermediaries that solicit governmental entities on their behalf

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[28] See also State of Texas/Comptroller of Public Accounts.

after September 13, 2011, unless they are subject to a pay to play rule at least as stringent as the SEC rule. Therefore, SIFMA said that the MSRB should work with the SEC to help ensure that such private placement agents may continue to be compensated after September 13, 2011, by adopting an interim final rule for such private placement agents, which would apply pending resolution of whether such private placement agents are municipal advisors or pending the adoption by FINRA of a pay to play rule for such private placement agents. SIFMA also previously commented to the SEC that private placement agents should be given the option to comply with a FINRA pay to play rule.

MSRB Response: The September 13, 2011 date referred to by SIFMA has been revised to June 13, 2012. The MSRB has jurisdiction to write rules concerning municipal advisors. Proposed Rule G-42 contains provisions that would apply to such private placements if they are determined by the SEC to be municipal advisors. It is the goal of the MSRB to have proposed Rule G-42 effective before June 13, 2012.

Comment: T. Rowe Price said that draft Rule G-42's coverage of solicitations on behalf of affiliated investment advisers is premature, because the SEC has not yet resolved whether to treat such affiliates as "covered associates" of the investment adviser and, therefore, not subject to the ban on payments to intermediaries.

MSRB Response: The MSRB has revised the definition of "third-party business" so that it does not apply to solicitations of business on behalf of affiliated firms.

First Amendment Considerations.

Comments: Several commenters raised First Amendment concerns regarding draft Rule G-42. SIFMA argued that a number of the provisions of draft Rule G-42 to which it objected could violate the First Amendment: (1) the $250 de minimis political contribution definition; (2)

requiring reporting of all solicitations, whether or not successful; and (3) the definition of "supervisor." Its rationale differed depending upon the provision. Although the $250 limit in Rule G-37 was upheld by the D.C. Circuit in the Blount case, SIFMA argued that it is inconsistent with Supreme Court cases decided after Blount. SIFMA also stated that the MSRB could no longer rely on the Blount case to sustain the $250 limit, although SIFMA stopped short of arguing that Rule G-37 is unconstitutional.

SIFMA referred to statements by the SEC when it adopted its pay to play rule, noting that the SEC pointed to inflation as the reason for using $350, rather than the $250 it originally proposed. It noted that the SEC also said that the $150 limit for contributions to issuer officials for whom the investment adviser could not vote was justified because non-residents might have legitimate interests in those elections, such as a resident of a metropolitan area's interests in the city in which the person worked. The required reporting of all solicitations to the MSRB, regardless of whether they are successful, was characterized by SIFMA as impinging upon commercial speech. SIFMA also argued that the provisions of draft Rule G-42 that would prohibit MAPs from soliciting others to make political contributions and prohibit indirect violations of the rule are sufficient to prevent abuse of the proposed $150 limit.

Mr. Callcott said that, in order for draft Rule G-42 to survive a constitutional challenge, the MSRB would have to: (1) adopt the SEC pay to play rule definition of de minimis political contribution; (2) allow contributions to political parties as long as such contributions are not earmarked for certain issuer officials; and (3) clarify that independent expenditures in support of issuer officials are permitted under draft Rule G-42. He argued that, without such conforming changes, Rule G-37 would be at risk as well.

BMO expressed First Amendment concerns related to the reporting requirements of draft Rule G-42. BMO said, "Since we are dealing with first amendment considerations, we urge the MSRB to adopt the least intrusive program which will elicit relevant information."

MSRB Response: The MSRB considers SIFMA's and Mr. Callcott's references to recent Supreme Court decisions to be misplaced, because those cases addressed substantially different facts. First, unlike the Vermont statute considered by the Court in Randall v. Sorrell,[29] proposed Rule G-42 would not apply to a group of individuals that is large enough for their contributions to influence the results of elections in any state. Therefore, the Court's concern that limitations on political contributions would make it difficult for challengers to be elected is not applicable. Second, in Citizens United v. FEC,[30] the Supreme Court distinguished restrictions on "independent expenditures" from restrictions on "direct contributions" and left restrictions on direct contributions untouched while striking down a restriction on independent expenditures as unconstitutional.[31]

As stated above, the MSRB is concerned that defining the term "de minimis" as including contributions by municipal advisor professionals to issuer officials for whom they cannot vote will lead to the bundling of political contributions. Additionally, the change made by the MSRB to the types of supervisors who would be considered municipal advisor professionals has more narrowly tailored the proposed rule to those individuals who are most likely to benefit from business awarded as a result of political contributions.

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29 548 U.S. 230, 247 (2006).

30 130 S. Ct. 876 (2010).

31 The MSRB notes that proposed Rule G-42 would not restrict political campaign contributions. Rather, it would limit certain business activities as a result of such contributions.

The MSRB notes that, contrary to Mr. Callcott's reading, proposed Rule G-42(c)(ii) would not prohibit payments to political parties. Instead, it would prohibit the solicitation of such payments from others. The MSRB also does not agree with Mr. Callcott that the definition of "contribution" in Rule G-37 and proposed Rule G-42 precludes the making of independent expenditures in support of issuer officials in violation of Citizens United.

Comment: SIFMA also said that the MSRB should clarify that recordkeeping requirements of draft Rule G-42 are not retroactive. It said that only engagements obtained after the rule's operative date should be required to be reported.

MSRB Response: The recordkeeping provisions of proposed Rule G-42 would not become effective until the rest of the proposed rule change becomes effective and would not be retroactive.

Bond Ballot Campaign Contributions.

Comments: Some commenters said that draft Rule G-42 should prohibit certain contributions to bond ballot campaigns by underwriters and municipal advisors. AGFS expressed support for draft Rule G-42[32] but said that bond ballot contributions by underwriters and municipal advisors, "distort the democratic process" and that "[m]unicipal advisors violate their fiduciary duty when they encourage, and participate with, their public entity clients and officials of the clients in actions that are undemocratic at best and illegal at worst."

NAIPFA said, "All too often, we see funds and/or campaign services being contributed to bond campaigns by underwriters [and] financial advisors . . . who end up providing services for the bond transaction work once the election is successful." NAIPFA recommended that draft Rule G-42 should broaden the standards of ethical behavior to include a ban on municipal

[32] G.L. Hicks Financial LLC also expressed support for draft Rule G-42.

advisory business in the event of abusive bond ballot contributions. WM Financial Strategies also said that "bond ballot campaign contributions, when made outside of an individual's voting jurisdiction, are a form of [pay]-to-play that taint the integrity of the municipal market."

MSRB Response: The MSRB does not believe that a ban on business as a result of non-de minimis contributions to bond ballot campaigns is warranted at this time. As the MSRB said when it filed with the SEC a comparable amendment to Rule G-37 requiring the reporting of such contributions, "The MSRB believes, . . . that the proposed amendments would create a uniform disclosure regime to track and make available to public scrutiny bond ballot campaign contributions by dealers in the municipal securities market, thereby increasing available information to municipal securities market participants and the general public. The MSRB does not believe that a ban on municipal securities business as a result of a contribution to a bond ballot campaign is warranted at this time but notes that the disclosures provided for under the proposed rule change will assist in determining, in the future, whether it would be appropriate to consider further action in this area."[33] The MSRB notes that contributions made to bond ballot initiatives for which a municipal advisor professional cannot vote are not considered de minimis for purposes of the reporting requirements of Rule G-42(e).

Miscellaneous Comments.

Transition Expenses.

Comment: Umbaugh said that draft Rule G-42 is not clear as to the types of transition expenses that might be considered contributions in violation of the rule.

MSRB Response: When it requested comment on draft Rule G-42, the MSRB said that it expected to propose interpretations of draft Rule G-42 similar to those applicable to Rule G-37

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[33] See Securities Exchange Act Release No. 61381 (January 20, 2010); File No. SR-MSRB-2009-18 (December 4, 2010).

and that remains the MSRB's intent, subject to SEC approval. On November 29, 2001, the MSRB issued an interpretation of Rule G-37 concerning "Activities by Dealers and Municipal Finance Professionals During Transition Periods for Elected Issuer Officials." Municipal advisors may look to that interpretation for guidance under proposed Rule G-42.

Definition of "Seeking to Engage".

Comment: The PFM Group ("PFM") requested that the MSRB clarify when a municipal advisor will be considered to be "seeking to engage" in municipal advisory business. It suggested that draft Rule G-42(c)(i) and (ii) not apply to any activity occurring more than six months after the advisor's latest contact with the municipal entity looking toward an engagement or, in the case of an RFP response, between the time that the municipal entity has contracted with another party and the municipal advisor's next contact with the municipal entity.

MSRB Response: As under Rule G-37, whether a municipal advisor is seeking to engage in municipal advisory business is a facts and circumstances analysis, and the MSRB does not consider a bright line test appropriate.

Payments to Political Parties.

Comment: PFM requested clarification that the prohibitions on payments to political parties would only apply to the political party organization at the level of government with which the municipal advisor is engaged in business or is seeking to engage in business.

MSRB Response: Proposed Rule G-42(c)(ii) would not prohibit payments to political parties. It would prohibit the solicitation of such payments from others. As with Rule G-37, this prohibition under proposed Rule G-42 would apply to solicitations of payments to all political party organizations, state and local, operating within the jurisdiction in which the municipal

advisor is engaging or seeking to engage in municipal advisory business or in which the municipal advisor is soliciting third-party business.

Definition of "Payment."

Comment: PFM suggested that the definition of "payment" be modified to include the concept of an amount in excess of the fair value of goods or services provided by the political party to make it clear that commercial transactions with a political party are not prohibited.

MSRB Response: As explained above, proposed Rule G-42 does not prohibit payments to political parties.

Contributions by MAPs to Their Own Campaigns.

Comment: Umbaugh requested clarification that a non-de minimis contribution by a MAP of money, property, or services to his or her own election campaign would not trigger a ban on business for compensation with the government to which the MAP is elected for a two-year period.

MSRB Response: When it requested comment on draft Rule G-42, the MSRB said that it expected to propose interpretations of Rule G-42 similar to those applicable to Rule G-37 and that remains the MSRB's intent, subject to SEC approval. Q&A II. 10 issued under Rule G-37 provides that an MFP who is an incumbent or candidate for office is not limited to contributing the de minimis amount to his or her own campaign and that such contributions by the candidate or incumbent will not trigger a ban on business. Municipal advisors may look to that Q&A, and other Rule G-37 Qs&As, for guidance under proposed Rule G-42.

Rule G-38.

Comment: In its request for comment on draft Rule G-42, the MSRB asked whether Rule G-38 (on solicitation of municipal securities business) should be revised or eliminated now that

firms and individuals that solicit municipal securities business on behalf of dealers are regulated as municipal advisors. Both T. Rowe Price and PFM said that Rule G-38 should not be eliminated. PFM also noted other issues related to third-party business should Rule G-38 be eliminated.

MSRB Response: The MSRB has determined not to propose that Rule G-38 be revised or eliminated at this time.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act. An investment adviser subject to rule 206(4)-5 under the Investment Advisers Act of 1940 (the "Advisers Act") is prohibited from providing or agreeing to provide, directly or indirectly, payment to any third party to solicit a government entity for investment advisory services on behalf of such investment adviser unless that third party is a "regulated person" under the rule.[34] A regulated person may include a registered municipal advisor subject to pay to play rules that

[34] See 17 CFR 275.206(4)-5(a)(2)(i)(A).

the Commission, by order, finds "impose substantially equivalent or more stringent restrictions on municipal advisors than [the Advisers Act rule] imposes on investment advisers and . . . are consistent with the objectives of [the Advisers Act rule]."[35] We note that proposed rule G-42 differs from the Advisers Act pay to play rule in certain respects, and we request comment on the effect of those differences on the finding the Advisers Act rule requires.[36] Interested persons are also invited to submit views and arguments as to whether they can effectively comment on the proposed rule change prior to the date of final adoption of the Commission's permanent rules for the registration of municipal advisors. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2011-12 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-MSRB-2011-12. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule

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35 This provision will be codified at 17 CFR 275.206(4)-5(f)(9)(iii) (effective September 19, 2011). See Investment Advisers Act Release No. IA-3221 (June 22, 2011), 76 FR 42950 (July 19, 2011).

36 See, e.g., proposed rule G-42(b), G-42(c)(ii), G-42(g)(iv) and G-42(g)(v).

change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm.

Copies of such filing also will be available for inspection and copying at the MSRB's offices. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2011-12 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[37]

Elizabeth M. Murphy
Secretary

[37] 17 CFR 200.30-3(a)(12).