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September 2, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

RE: File Number SR-MSRB-2005-12; Comments to Proposed Amendment to and Interpretations of MSRB Rule G-37

Dear Mr. Katz:

The Bond Market Association ("Association")[1] appreciates this opportunity to comment on the proposed Questions and Answers ("Q&As"), which the Municipal Securities Rulemaking Board ("MSRB") submitted to the Securities and Exchange Commission ("SEC") on June 21, 2005.[2] In particular, the proposed Q&As, among other things, set forth new due diligence standards for making contributions to party committees and PACs. The MSRB submitted these proposed Q&As to the SEC after issuing and receiving comments from the industry (including the Association) on a prior draft.[3]

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1 The Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The Association's Member firms collectively represent in excess of 95% of the initial distribution and secondary market trading of municipal bonds, corporate bonds, mortgage and other asset-backed securities and other fixed income securities. More information about the Association is available on its website www.bondmarkets.com.

2 70 Fed. Reg. 48,214 (August 16, 2005).

3 MSRB Notice 2005-11 (February 15, 2005).

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The Association appreciates the difficult task before the MSRB of having to regulate such a highly sensitive and Constitutionally protected activity as the making of political contributions. Moreover, the Association fully supports the MSRB's efforts to eliminate any vestiges of pay-to-play in the municipal securities industry, whether they be in the form of direct or indirect contributions to issuer officials.

However, the proposed Q&As are vague, making it impossible for broker-dealers to develop clear uniform standards with which to comply. Indeed, the proposed Q&As require a broker-dealer to establish procedures that are "reasonably designed" to avoid indirect violations of Rule G-37 when contributing to PACs and party committees, but give no clear or objective guidelines as to what constitutes such an indirect violation. This latest draft of the proposed Q&As is even more vague than the prior draft to which the Association commented in that the MSRB eliminated certain language that pointed to specific, albeit impractical, standards while at the same time making the proposed Q&As more general in nature.[4]

Setting forth such a vague standard is bad policy in that it opens up the possibility of different broker-dealers coming up with different due diligence standards rather than establishing a uniform standard (an "even playing field") for the entire industry. Moreover, such vagueness has the effect of unduly chilling the making of legitimate political contributions, a form of political speech that is protected under the First Amendment of the Constitution. Thus, we request that the proposed Q&As be modified to create a clear and objective standard regarding contributions to party committees and PACs. We also request that the Q&A confirm that contributions to national party committees and federal leadership PACs are permitted under certain circumstances.

1. The Proposed Q&As Are Vague

In Q&As issued by the MSRB and approved by the SEC in 1996, the MSRB made clear that a broker-dealer's contribution to a party committee or PAC would not result in an indirect violation of Rule G-37 unless the broker-dealer knows that its contribution will go to issuer officials.[5] Moreover, the MSRB expressly

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[4] For our comments regarding the vagueness of the prior draft of the proposed Q&As, please refer to our comment letter to the MSRB, dated April 1, 2005.

[5] One Q&A states that a "dealer would violate Rule G-37 by doing business with an issuer after providing money to any person or entity when the dealer knows that such money will be given to an official of an issuer who could not receive such a contribution directly from

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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).[6] This safe-harbor was also recognized in the Voluntary Initiative (a pre-cursor to Rule G-37 that was approved by the SEC), which expressly permitted contributions to conference accounts of state and local party committees.

The MSRB appears to be replacing these existing, clear Q&As with a new standard. However, it is doing so without overruling or withdrawing the existing Q&As and thus creating confusion. For example, the proposed Q&As expressly state that making contributions to "housekeeping" or "conference" accounts is not a safe harbor and that money is fungible; while at the same time, citing to the above existing Q&As (which clearly recognize such safe harbors) as a way of avoiding an indirect violation.[7] This conflict within the very provisions of the proposed Q&As is irreconcilable and make it that much more difficult for a broker-dealer to arrive at a clear standard.

More importantly, the proposed Q&As provide no objective standard, or clear standard of any kind, as to when a contribution to a PAC or party committee results in an indirect violation. In fact, the proposed Q&As essentially say that a broker-dealer must have procedures 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. Is it enough that the party committee in question spends $1 out of a several $100 million budget on an issuer official or does the contribution to the party committee have to be earmarked for an official? The proposed Q&As provide no guidance as to where on this wide spectrum an indirect violation lies.

The few hints that the proposed Q&As do provide regarding this elusive standard are ones that cannot be applied as a practical matter. For example, the proposed Q&As state that a broker-dealer, as part of its due diligence, may want to inquire and document the underlying reasons for making a contribution to a PAC or party committee (the " Underlying Reasons Test"). The proposed Q&As go on to

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the dealer without triggering the rule's prohibition on business." MSRB Q&A III.4 (August 6, 1996)(emphasis added); see also Q&A III.5 (August 6, 1996).

6 Q&A III.5 states that "[d]ealers should inquire of the non-dealer associated PAC or political party how any funds received from the dealer would be used." (August 6, 1996).

7 Footnote 9 of the proposed Q&As refers to existing Q&As III.4 and III.5 (described above).

imply that broker-dealers must verify these underlying reasons based on the surrounding facts and circumstances.

However, the proposed Q&As do not state which underlying reasons are or are not permissible. In fact, it is not uncommon for a company to contribute unsolicited annual dues to a state party committee as part of an ongoing commitment, under which it has been giving the same amount to that party committee for decades. Would this be an impermissible reason for contributing? Moreover, having to verify the underlying reasons of a contribution based on the surrounding facts and circumstances begs the very question that the MSRB will not answer -- what objective standard applies when determining whether contributions to PACs and party committee indirectly violate Rule G-37?

2. The Proposed Q&As Should Be Modified to Set Forth Clear and Objective Standards

Creating a vague standard for contributing to PACs and party committees is bad policy and is also unconstitutional. A vague standard encourages different firms to come up with different due diligence standards depending on their tolerance for risk. Thus, firms that take a more conservative approach to contributions will be placed at a disadvantage to those that take a more liberal view. An objective and clear standard would eliminate such variations within the industry and even the paying field.

Regardless of which particular due diligence procedures a broker-dealer adopts, the vague standard will leave a broker-dealer and its individual employees with the difficult choice of taking an indefinable risk whenever they contribute to PACs and party committees (which is open to being second-guessed by a regulator based on a whole host of possible standards, if any at all) or shutting down all such contributions. Forcing broker-dealers to make this difficult choice is particularly troublesome given that for most broker-dealers, municipal securities business is only a small part of their total business and they have perfectly legitimate interests completely unrelated to municipal securities business in connection with which they make contributions. Indeed, as one of the most highly regulated industries, a wide variety of legislation, ranging from taxes to banking regulation, impact financial institutions. Broker-dealers have a legitimate and vested interest in supporting party committees and PACs to help elect legislators whose positions are good for the industry and the economy. Needless to say, MFPs as voting citizens have even further divergent political interests.

Moreover, unlike the other MSRB Rules, Rule G-37 regulates political contributions, which is a form of free speech protected under the First Amendment of

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the Constitution.[8] It is well established that as protected speech, political contributions may not be regulated in a vague or overbroad manner.[9] In particular, unless a restriction on political contributions is clear and precise, it will unduly chill the legitimate exercise of this most important right and violate the Constitution.[10] Such undue chilling of free speech is exactly what will result from the vague nature of the proposed Q&As in that broker-dealers and MFPs will be forced to make the difficult choice, described above, of having to take on an uncertain risk every time they give to PACs and party committee or shutting down such contributions altogether, regardless of how unrelated they are to municipal securities business. Please note the one cannot

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8 The Courts have equated political contributions with protected First Amendment speech. *See, e.g., Buckley v. Valeo, 424 U.S. 1, 14-15 (1976).*

9 In *Buckley*, the Supreme Court specifically notes that vagueness is intolerable in laws impacting core First Amendment rights such as political speech. In particular, the Court calls for "[c]lose examination of the specificity of the statutory limitation" in "an area permeated by First Amendment interests." *Buckley*, 424 U.S. at 40-41 (citing *Smith v. Goguen*, 415 U.S. 566, 573 (1974); *Cramp v. Board of Public Instruction*, 368 U.S. 278, 287-288 (1961); *Smith v. California*, 361 U.S. 147, 151 (1959)). *See also FEC v. Christian Action Network*, 110 F.3d 1049, 1051-1052 (4th Cir. 1997). Indeed, "standards of permissible statutory vagueness are strict in the area of free expression." *NAACP v. Button*, 371 U.S. 415, 432 (1963) (citing *Smith v. California*, 361 U.S. 147, 151; *Winters v. New York*, 333 U.S. 507, 509-510, 517-518; *Herndon v. Lowry*, 301 U.S. 242; *Stromberg v. California*, 283 U.S. 359; *United States v. C.I.O.*, 335 U.S. 106, 142 (Rutledge, J., concurring)). *Buckley* also maintains that the application of a statute must "afford the '[p]recision of regulation [that] must be the touchstone in an area so closely touching our most precious freedoms.'" *Buckley*, 424 U.S. at 41 (quoting *NAACP v. Button*, 371 U.S. at 438). The Supreme Court also stated that "[b]ecause First Amendment freedoms need breathing space to survive, government may regulate in the area only with narrow specificity." *NAACP v. Button*, 371 U.S. 415, 433 (1963).

10 Regarding vague applications of law, the Court in *Buckley* warned of:

> ...not only "trap[ping] the innocent by not providing fair warning" or foster[ing] "arbitrary and discriminatory application" but also operat[ing] to inhibit protected expression by inducing "citizens to 'steer far wider of the unlawful zone... than if the boundaries of the forbidden areas were clearly marked.'" *Grayned v. City of Rockford*, 408 U.S. 104, 108-109 (1972), quoting *Baggett v. Bullitt*, 377 U.S. 360, 372 (1964), quoting *Speiser v. Randall*, 357 U.S. 513, 526 (1958).

Buckley, 424 U.S. at 41 n.48. *See also NAACP v. Button*, 371 U.S. at 433 (noting that the perils of vagueness and overbreadth stem from "the danger of tolerating, in the area of First Amendment freedoms, the existence of a penal statute susceptible of sweeping and improper application"); *Kolender v. Lawson*, 461 U.S. 352, 357-358 (1983).

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dismiss this important constitutional concern by simply pointing to the Blount v. SEC[11] case (in which the court upheld the constitutionality of Rule G-37) given that the decision was based on a Rule that allowed contributions to party committees and PACs and did not impose a vague standard on such contributions.

As for the Underlying Reasons Test, which the proposed Q&As raise as one possible step of due diligence, the courts have repeatedly made clear that political activity may not be regulated based on intent. The Constitution does not permit a regulator to look at a person's intent on a case-by-case basis in determining whether his or her political activity violated a particular law -- an exercise in mind-reading that is inappropriate in light of the vagueness and overbreadth of the requirements impacting First Amendment freedoms.[12] Again, such regulation of political contributions leads to an unacceptable chilling of protected speech. In confirming the unconstitutionality of an intent-based regulation of political activity, the Eighth Circuit stated it best by saying:

> Questions of intent ... are to be excluded from the analysis, since a speaker, in such circumstances, could not safely assume how anything he might say would be understood by others...When a definition depends on the meaning others attribute to the speech, there is no security for free discussion.[13]

The Underlying Reasons Test by its very terms gets at such intent, and thus should not be adopted.

For the reasons described above, we request that the SEC modify the proposed Q&As so that they set forth an objective and clear standard as to when contributions to PACs and party committees result in an indirect violation of Rule G-37.

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11 Blount v. SEC, 61 F.3d 938 (D.C. Cir. 1995).

12 Indeed, a speaker cannot be left "'wholly at the mercy of the varied understanding of his hearers and consequently of whatever inference may be drawn as to his intent and meaning.'" *Buckley*, 424 U.S. at 43 (quoting *Thomas v. Collins*, 323 U.S. 516, 535 (1945)). *See also Perry v. Bartlett*, 231 F.3d 155, 161 (4th Cir. 2000) (striking down an intent-based statute as unconstitutionally overbroad: "[d]iscerning the 'intent' of an organization...can be problematic, even if some in the organization 'admit' their intent").

13 *Iowa Right to Life Committee v. Williams*, 187 F.3d 963, 969 (8th Cir. 1999) (citing *Buckley*, 424 U.S. at 43, and noting the notice problems that accompany an intent-based regulation).

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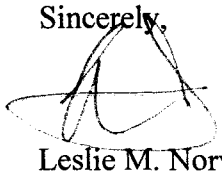
3. The Q&A Should Expressly State that Contributions to National Party Committees and Federal Leadership PACs Are Permitted

Even under the vague standard set forth in the proposed Q&As, contributions to national party committees and federal leadership PACs appear to be permitted. Indeed, national party committees raise hundreds of millions of dollars primarily for non-issuer official federal candidates, and thus are more than sufficiently diluted. Moreover, federal leadership PACs are controlled by an incumbent U.S. Senator or Representative (non-issuer officials) to contribute to his or her colleagues in Congress or to other federal candidates.

However, in light of the vague language in the proposed Q&As and for the sake of simplicity, the Q&A should expressly state that contributions made to a national party committee or federal leadership PAC are permitted under Rule G-37 as long as (1) the contribution was not solicited by, or earmarked for, an issuer official, and (2) the party committee or leadership PAC is not controlled by an issuer official. If they do not satisfy both of the above requirements, a broker-dealer would have to take whatever due diligence steps that ultimately become effective for such contributions.

If you have any questions or comments regarding this letter, please contact the undersigned at (646)637-9230 or via e-mail at lnorwood@bondmarkets.com.

Sincerely,



Leslie M. Norwood
Vice President and
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THE BOND MARKET ASSOCIATION

cc: ***Securities and Exchange Commission***

The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Annette L. Nazareth, Commissioner
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