inquiries regarding the effect of a ban on municipal securities business with an issuer arising from a contribution made after a dealer has entered into a long-term contract to serve as the primary distributor of the issuer's municipal fund securities.

In an interpretive notice published in 1997 (the "1997 Interpretation"), the MSRB stated that a dealer subject to a prohibition on municipal securities business with an issuer is allowed to continue to execute certain issue-specific contractual obligations in effect prior to the date of the contribution that caused the prohibition.[1] For example, dealers that had already executed a contract with the issuer to serve as underwriter or financial advisor for a new issue of debt securities prior to the contribution could continue in these capacities.

The 1997 Interpretation also addressed certain types of ongoing, non-issue-specific municipal securities business that a dealer may have contracted with an issuer to perform prior to the making of a contribution that causes a prohibition on municipal securities business with the issuer. For example, the MSRB noted that a dealer may act as remarketing agent for an outstanding issue of municipal securities or may continue to underwrite a specific commercial paper program so long as the contract for such services was in effect prior to the contribution. The MSRB stated that these activities are not considered new municipal securities business and may be performed by dealers that are banned from municipal securities business with an issuer. The MSRB further stated, however, that provisions in existing contracts that allow for changes in the services provided by the dealer or compensation paid by the issuer would be viewed by the MSRB as new municipal securities business and, therefore, rule G-37 would preclude a dealer subject to a ban on municipal securities business from performing such additional functions or receiving additional compensation. The MSRB cited two examples of these types of provisions. The first involved a contract to serve as remarketing agent for a variable rate issue that might permit a fixed rate conversion, with a concomitant increase in the per bond compensation. The second example involved an agreement to underwrite a commercial paper program that might include terms for increasing the size of the program, with no increase in per bond fees but an increase in overall compensation resulting from the larger outstanding balance of commercial paper. In both cases, the MSRB viewed the exercise of these provisions as new municipal securities business that would be banned under the rule.

In the 1997 Interpretation, the MSRB recognized that there is great variety in the terms of agreements regarding municipal securities business and that its guidance in the 1997 Interpretation may not adequately deal with all such agreements. The MSRB sought input on other situations where contracts obligate dealers to perform various types of activities after the date of a contribution that triggers a ban on municipal securities business and stated that additional interpretations might be issued based upon such input.

The MSRB understands that dealers typically are selected by issuers to serve as primary distributors of municipal fund securities on terms that differ significantly from those of a dealer selected to underwrite an issue of debt securities. Issuers generally enter into long-term agreements (in many cases with terms of ten years or longer) with the primary distributor of municipal fund securities for services that include the sale in a continuous primary offering of one or more categories or classes of the securities issued within the framework of a single program of investments.[2] In addition, an issuer may often engage a particular dealer to serve as the primary distributor of its municipal fund securities as part of a team of professionals that includes the dealer's affiliated investment management firm, which is charged with managing the investment of the underlying portfolios.

The MSRB believes that the guidance provided in the 1997 Interpretation, although appropriate for the circumstances discussed therein, may not be adequate to address the unique features of municipal fund securities programs. For example, so long as a program realizes net in-flows of investor cash, the size of an offering of municipal fund securities will necessarily increase over time. Under most compensation arrangements in the market, any net in-flow of cash generally would result in an increase in total compensation, causing any new sales of municipal fund securities that exceed redemptions to be considered new municipal securities business under the 1997 Interpretation. Also, the addition by the issuer of a new category of investments (*e.g.*, a new portfolio in an aged-based Section 529 college savings plan created for children born in the most recent year) could be considered a new offering from which such dealer might be banned, even where such new category may have been clearly contemplated at the outset of the dealer's engagement. Further, the MSRB understands that the repercussions to an issuer of municipal fund securities or investors in such securities of a sudden change in the primary distributor (and possible concurrent change in the investment manager) resulting from a ban on municipal securities business arising during the term of an existing arrangement often will be significantly greater than in the case of an underwriting or other primary market activity relating to the typical debt offering. Issuers could be faced with redesigning existing programs and investors may need to establish new relationships with different dealers in order to maintain their investments.

As a result, the MSRB believes that further interpretive guidance is necessary in this area. The MSRB is of the view that, where a dealer has become subject to a ban on municipal securities business with an issuer of municipal fund securities with which it is currently serving as primary distributor, any continued sales of existing categories of municipal fund securities for such issuer during the duration of the ban would not be considered new municipal securities business if the basis for determining compensation does not change during that period, even if total compensation increases as a result of net in-flows of cash. Further, the MSRB believes that any

changes in the services to be provided by the dealer to the issuer throughout the duration of the ban that are contemplated under the pre-existing contractual arrangement (*e.g.*, the addition of new categories of securities within the framework of the existing program) would not be considered new municipal securities business so long as such changes do not result in: (1) an increase in total compensation received by the dealer for services performed for the duration of the ban (whether paid during the ban or as a deferred payment after the ban); or (2) in an extension of the term of the dealer in its current role.

[1] *See* Rule G-37 Interpretation — Interpretation on Prohibition on Municipal Securities Business Pursuant to Rule G-37, February 21, 1997, *MSRB Rule Book* (January 2002) at 232.

[2] The various categories generally reflect interests in funds having different allocations of underlying investments. For example, a so-called Section 529 college savings plan may offer one category that represents investments primarily in equity securities and another in debt securities, or may have categories where the allocation shifts from primarily equity securities to primarily debt or money market securities as the number of years remaining until the beginning of college decreases. In the case of state and local government pools, the types of securities in the underlying portfolios may be allocated so as to create one category of short-term "money market" like investments (*i.e.*, with net asset value maintained at approximately $1 per share) and another with a longer timeframe and fluctuating net asset value.

Notice Concerning Indirect Rule Violations: Rules G-37 and G-38

August 6, 2003

The Municipal Securities Rulemaking Board's ("MSRB" or Board") statutory mandate is to protect investors and the public interest in connection with dealers' activities in the municipal securities market. The municipal securities market is one of the world's leading securities markets. Investors hold approximately $1.6 trillion worth of municipal securities — either through direct ownership or through investment in institutional portfolios. These investors provide much needed capital to more than 50,000 state and local governments. Maintaining municipal market integrity is an exceptionally high priority for the Board as it seeks to foster a fair and efficient municipal securities market through dealer regulation.

In 1994, the MSRB adopted Rule G-37 in an effort to remove the real or perceived conflict of interest of issuers who receive political contributions from dealers and award municipal securities business to such dealers. As noted by the Court reviewing Rule G-37, "[u]nderwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity."[1] Pay-to-play harms the integrity of the underwriter selection process.

In general, Rule G-37 prohibits brokers, dealers and municipal securities dealers ("dealers") from engaging in municipal securities business with issuers if certain political contributions have been made to officials of such issuers; prohibits dealers and municipal finance professionals ("MFP") from soliciting or bundling contributions to an official of an issuer with which the dealer is engaging or seeking to engage in municipal securities business; and requires dealers to record and disclose certain political contributions, as well as other information, to allow public scrutiny of political contributions and the municipal securities business of a dealer. The rule also seeks to ensure that payments made to political parties by dealers, MFPs, and political action committees ("PAC") not controlled by the dealer or MFP do not represent attempts to make indirect contributions to issuer officials in contravention of Rule G-37 by requiring dealers to record and disclose all payments made to state and local political parties.[2] 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.[3]

Although Rule G-37 initially included certain limited disclosure requirements for consultants used by dealers to obtain municipal securities business, in 1996, the MSRB adopted a separate Rule G 38, on consultants, to prevent persons from circumventing Rule G-37 through the use of consultants. Rule G-38 currently requires dealers who use consultants[4] to evidence the consulting arrangement in writing, to disclose, in writing, to an issuer with which it is engaging or seeking to engage in municipal securities business information on consulting arrangements relating to such issuer, and to submit to the Board, on a quarterly basis, reports of all consultants used by the dealer, amounts paid to such consultants, and certain political contribution and payment information from the consultant.

The impact of Rules G-37 and G-38 has been very positive. The rules have altered the political contribution practices of municipal securities dealers and opened discussion about the political contribution practices of the entire municipal industry.

While the Board is pleased with the success of these rules, it also is concerned with increasing signs that individuals and firms subject to the rules may be seeking ways around Rule G-37 through payments to political parties or non-dealer controlled PACs that find their way to issuer officials, significant political contributions by dealer affiliates (*e.g.*, bank holding companies and affiliated derivative counterparty subsidiaries) to both issuer officials and political parties, contributions by associated persons of the dealer who are not MFPs and by the spouses and family members of MFPs to issuer officials, and the use of consultants who make or bundle political contributions. In addition to dealer and dealer-related giving, the Board is also concerned about media and other reports regarding significant giving by other market participants, including independent financial advisors, swap advisors, swap counterparties, investment contract providers and public finance lawyers.

The MSRB is mindful that Rule G-37's prohibitions involve sensitive constitutional issues and is reluctant to significantly broaden the scope of the rule. The rule was constructed and will continue to be reviewed with full regard for and consideration of an individual's right to participate fully in our political processes. The Board, however, wishes to remind dealers that Rule G-37, as currently in effect, covers indirect as well as direct contributions to issuer officials, and to alert dealers that it has expressed its concern to the entities that enforce the Board's rules that some of the increased political giving may indicate a rise in indirect Rule G-37 violations. While Rule G-37 was adopted to deal specifically with contributions made to officials of issuers by dealers and MFPs, and PACs controlled by dealers or MFPs, the rule also prohibits MFPs and dealers from using conduits — be they parties, PACs, consultants, lawyers, spouses or affiliates — to contribute indirectly to an issuer official if such MFP or dealer can not give directly to the issuer without triggering the ban on business. The MSRB will continue to work with the enforcement agencies to identify and halt abusive practices. If, at a later date, the Board learns of specific problematic dealer practices that it believes must be addressed more directly, the Board may proceed with additional rulemaking relating to Rules G-37 and G-38.

The Board strongly believes that pay-to-play undermines the integrity of the municipal securities industry. Such practices are regulated not only by the specific parameters of Rule G-37, but also by the fair practice principles embodied in the MSRB's Rule G-17, on fair dealing. Similarly, the MSRB reminds issuers and dealers that the SEC has previously advised that, with respect to primary offering disclosure, increased attention needs to be directed at disclosure of potential conflicts of interest and material financial relationships among issuers, advisors and underwriters, including those arising from political contributions.[5] These issuer conflicts of interest can and do arise not only from contributions made by municipal securities dealers, but also from payments by unregulated municipal securities market participants.

The costs of political campaigns are skyrocketing across the country. The MSRB is aware of reports that elected officials, or persons acting on behalf of elected officials, are putting pressure on dealers and MFPs to find ways to contribute to the costs associated with political campaigns. The Board also recognizes that there is significant political giving that is not by, or directed by, municipal securities dealers. Thus, the MSRB wishes to encourage state and local governments to take a fresh look at these issues and see whether their policies and procedures should be revised to help maintain the integrity of the underwriting process. The Board believes that it is critical that the municipal market engender the highest degree of public confidence so that investors will continue to provide much needed capital to state and local governments.

[1] *Blount v. SEC*, 61 F. 3d 938 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 1351 (1996).

[2] If a dealer or MFP is considering contributing funds to a non-dealer associated PAC or political party, Rule G-37 requires that the dealer or MFP "should inquire of the non-dealer associated PAC or political party how any funds received from the dealer or MFP would be used." *See Questions and Answers Notice: Rule G-37, No. 2* (August 6, 1996), reprinted in *MSRB Rule Book*.

[3] *See* Securities and 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).

[4] Rule G-38 (a)(i) defines the term "consultant" as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on the dealer's behalf where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the dealer or any other person.

[5] *See* SEC Release No. 33-7049; 34-33741 (Statement of the Commission Regarding Disclosure Obligations of Municipal Issuers and Others) (March 17, 1994).

Reminder of Obligations Under Rule G-37 on Political Contributions and Rule G-27 on Supervision When Sponsoring Meetings and Conferences Involving Issuer Officials

March 26, 2007

The Municipal Securities Rulemaking Board ("Board" or "MSRB") is publishing this notice to remind brokers, dealers and municipal securities dealers ("dealers") of the possible application of Rule G-37, on political contributions and prohibitions on municipal securities business, when dealers sponsor meetings and conferences where issuer officials are invited to attend or are featured speakers. Dealers are responsible for ensuring that their supervisory policies and procedures established under Rule G-27, on supervision, are adequate to prevent and detect violations of MSRB rules. Thus, it is incumbent on dealers to have appropriate supervisory procedures in place to review the nature of, and activities surrounding, the types of events discussed in this notice to ensure that Rule G-37 is not violated, directly or indirectly.

Rule G-37, in general, prohibits dealers from engaging in municipal securities business with issuers for a two-year period if certain political contributions have been made to officials of such issuers by the dealer or a municipal finance professional ("MFP") (other than certain *de minimis* contributions), and requires dealers to record and disclose certain political party payments and municipal securities business to assist in severing the connection between contributions and the awarding of municipal securities business. The rule also includes, among other things, a prohibition on dealers and their MFPs from (1) soliciting any person (including, but not limited to, any affiliated entity of the dealer) or political action committee ("PAC") to make any contribution, or (2) coordinating any contributions to an official of an issuer with which the dealer is engaging or seeking to engage in business. Dealers and MFPs are prohibited from, directly or indirectly, through

or by any other person or means, doing any act which would result in violation of the rule's ban on business or prohibition on soliciting and coordinating (bundling) contributions.

A dealer sponsoring a meeting or conference where an issuer official is invited to attend or is a featured speaker should be mindful of the parameters of Rule G-37, including the prohibition on soliciting and coordinating contributions. For example, if the issuer official (or his/her staff) solicits contributions in connection with the event, or dealer personnel solicit or coordinate contributions, such activities may constitute fundraising activities.[1] If a determination is made, based on the particular facts and circumstances, that the event is a fundraising event for the issuer official, then expenses incurred by the dealer for hosting the event may be deemed a contribution, thereby triggering the two-year ban on municipal securities business with that issuer. Such expenses may include, but are not limited to, the cost of the facility; the cost of refreshments; any expenses paid for administrative staff; and the payment or reimbursement of any of the issuer official's expenses for the event.[2]

The dollar amount of an expense incurred by the dealer for hosting the event is not dispositive of whether that expense constitutes a contribution and therefore triggers the ban on municipal securities business under Rule G-37. If, depending on the particular facts and circumstances, the event is a fundraising event, then any expense incurred by the dealer may be deemed a contribution to the issuer official, thereby triggering the two-year ban on municipal securities business with that issuer.

By publishing this notice, the MSRB is not suggesting that dealers curtail their legitimate hosting or sponsoring of meetings or conferences where issuer officials are invited to attend or are featured speakers. However, dealers should consider carefully the true nature of such events and the possible application of Rule G-37 if the meeting or conference involves fundraising activities in support of an issuer official.

In addition to dealers' Rule G-37 obligations, Rule G-27, on supervision, requires that dealers supervise the conduct of their municipal securities activities, and that of their associated persons, to ensure compliance with MSRB rules, and that dealers adopt, maintain and enforce written supervisory procedures reasonably designed to ensure such compliance. It is therefore incumbent on dealers to have appropriate supervisory procedures in place to review the nature of, and activities surrounding, the types of events discussed in this notice to ensure that Rule G-37 is not violated, directly or indirectly. Dealers should therefore take appropriate steps to ensure that such events are not fundraising events by, among other things, ensuring that: (i) contributions are not solicited by the issuer official or his/her staff; (ii) any attendee contact information provided by the dealer is not used by the issuer official or his/her staff to solicit contributions; and (iii) contributions are not solicited, coordinated or made by dealer personnel in connection with the event.[3]

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[1] The MSRB has previously stated that "Dealers may not engage in municipal securities business with issuers if they or their municipal finance professionals en-gage in any kind of fundraising activities for officials of such issuers…." See Securities Exchange Act Release No. 33868 (April 7, 1994), 59 FR 17621 (April 13, 1994). *See also Questions and Answers Concerning Political Contributions and Prohibitions on Municipal Securities Business: Rule G-37* (May 24, 1994), reprinted in *MSRB Rule Book; MSRB Interpretation of November 7, 1994 (Solicitation of Contributions), reprinted in MSRB Rule Book; MSRB Interpretation of May 31, 1995 (Campaign for Federal Office)*, reprinted in *MSRB Rule Book*.

The MSRB has stated, however, that MFPs are "free to, among other things, solicit votes or other assistance for such an issuer official so long as the solicitation does not constitute a solicitation or coordination of contributions for the official." In upholding the constitutionality of Rule G-37, the United States Court of Appeals for the District of Columbia Circuit observed that "municipal finance professionals are not in any way restricted from engaging in the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events." *Blount v. SEC*, 61 F.3d 938, 948 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 1351 (1996). However, the MSRB has stated that hosting or paying to attend a fundraising event may constitute a contribution subject to section (b) of the rule. *See* Question and Answers II.11 and II.18 (May 24, 1994; *See also MSRB Interpretation of May 31, 1995 (Campaign for Federal Office)*, reprinted in *MSRB Rule Book*.

[2] Other amounts paid to issuer officials (such as honoraria) may be subject to Rule G-20 on gifts, gratuities and non-cash compensation, to the extent such payments are in relation to the issuer's municipal securities activities.

[3] Although Rule G-37(c) prohibits MFPs from soliciting or coordinating contributions, the MSRB has previously stated that "Whether a municipal finance professional is permitted by section (c) of the rule to indicate to third parties that someone is a 'great candidate' or to provide a list of third parties for the candidate to call would be dependent upon all the facts and circumstances surrounding such action. The facts and circumstances that may be relevant for this purpose may include, among any number of other factors, whether the municipal finance professional has made an explicit or implicit reference to campaign contributions in his or her conversations with third parties whom the candidate may contact and whether the candidate contacts such third parties seeking campaign contributions. However, the totality of the facts and circumstances surrounding any particular activity must be considered in determining whether such activity may constitute a solicitation of contributions for purposes of section (c) of the rule. Therefore, the Board cannot prescribe an exhaustive list of precautions that would assure that no violation of this section would occur as a result of such activity." *See MSRB Interpretive Notice on Solicitation of Contributions* (May 21, 1999), reprinted in *MSRB Rule Book*.

Reminder Regarding the Application of Rule G-37 to Federal Election Campaigns of Issuer Officials

September 11, 2008

In 1999, the Municipal Securities Rulemaking Board (MSRB) published a notice on the application of Rule G-37, on political contributions and prohibitions on municipal securities business, to Presidential campaigns of issuer officials.[1] In general, the notice described a 1995 interpretive letter[2] in which the Board noted that Rule G-37 is applicable to contributions given to an **official of an issuer**[3] who seeks election to federal office, such as the Presidency. The Board also explained that the only exception to Rule G-37's absolute prohibition on business is for certain contributions made to issuer officials by municipal finance professionals. Specifically, contributions by such persons to an official of an issuer would not invoke application of the prohibition if the municipal finance

professional is entitled to vote for such official, and provided that any contributions by such municipal finance professional do not exceed, in total, $250 to each official, per election. In the example of an issuer official running for President, any municipal finance professional in the country can contribute the *de minimis* amount to the official's Presidential campaign without causing a ban on municipal securities business with that issuer. Finally, the Board noted that a Presidential candidate who has accepted public funding for the general election is prohibited under federal law from accepting any contributions to further his or her general election campaign. In these circumstances, federal law allows individuals to contribute to the candidate's compliance fund, which uses the contributions solely for legal and accounting services to ensure compliance with federal law and not for campaign activities. Thus, any municipal finance professional in the country can contribute the *de minimis* amount to an issuer official's compliance fund without causing a ban on municipal securities business with that issuer. This would apply if the issuer official runs for President or Vice President.

The MSRB wishes to remind dealers that these concepts also apply to an issuer official who campaigns for **any** federal office. For example, any municipal finance professional residing in a state in which an issuer official is campaigning for a statewide federal office may contribute the *de minimis* amount to the official's campaign without causing a ban on municipal securities business with that issuer. The MSRB does not opine whether any particular individual is or is not an issuer official.

The MSRB also wishes to remind dealers to be aware of the Rule G-37 issues involving indirect rule violations and contributions to non-dealer associated political action committees and payments to political parties, which issues have been the subjects of previous notices and interpretive Questions and Answers.[4]

[1] *See* Application of Rule G-37 to Presidential Campaigns of Issuer Officials reprinted in *MSRB Rule Book* (January 1, 2008) at 246-247. The notice is also available from the *MSRB Rules/Interpretive Notices* section of the MSRB's website at www.msrb.org.

[2] *See* MSRB Interpretation of May 31, 1995, reprinted in *MSRB Rule Book* (January 1, 2008) at 251-253. The letter is also available from the *MSRB Rules/Interpretive Letters* section of the MSRB's website at www.msrb.org.

[3] The term "official of an issuer" is defined in Rule G-37(g)(vi) as any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate: (A) for elective office of the issuer which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by the issuer; or (B) for any elective office of a state or of any political subdivision, which office has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by an issuer.

[4] *See* Notice Concerning Indirect Rule Violations: Rules G-37 and G-38, reprinted in *MSRB Rule Book* (January 1, 2008) at 248-249; Rule G-37 Questions and Answers Nos. III.4 and III.5 regarding contributions to a non-dealer associated PAC and payments to a state or local political party, reprinted in *MSRB Rule Book* (January 1, 2008) at 240; and Rule G-37 Question and Answer No. III.7 regarding supervisory procedures relating to indirect contributions, reprinted in *MSRB Rule Book* (January 1, 2008) at 240-241. The notice and Questions and Answers are also available on the MSRB's website at www.msrb.org.

Build America Bonds and Other Tax Credit Bonds: Application of Rule G-37 to Solicitations of Issuers

June 9, 2009

On April 24, 2009, the Municipal Securities Rulemaking Board (the "MSRB") published Notice 2009-15 on Build America Bonds and Other Tax Credit Bonds (the "April 2009 Notice"). In the April 2009 Notice, the MSRB explained that Build America Bonds and the other tax credit bonds described in the April 2009 Notice are municipal securities and are, therefore, subject to MSRB rules, including Rule G-37 on political contributions.

The MSRB understands that, for the purpose of obtaining municipal securities business as defined in Rule G-37,[1] personnel from the taxable desk of brokers, dealers, or municipal securities dealers ("dealers"), or personnel from other departments or divisions of dealers that do not traditionally engage in municipal securities business, may participate in presentations to potential issuers of Build America Bonds or other tax credit bonds in response to requests for proposals or in other pre-selection meetings with such potential issuers to discuss the structuring, pricing, sales, and distribution of taxable bonds. Dealers are reminded that such participation generally will make those personnel "municipal finance professionals" under Rule G-37(g)(iv)(B), because the personnel are considered to have solicited municipal securities business.[2]

Pursuant to Rule G-37(b)(ii), political contributions made by such personnel to an official of the issuer solicited by such personnel within the two years prior to the solicitation would need to be examined by the dealer to determine whether the two-year ban on municipal securities business imposed by Rule G-37(b)(i) is triggered by the solicitation.[3] By engaging in solicitation activities, such personnel would become municipal finance professionals and subsequent political contributions to issuer officials by such personnel would also be subject to Rule G-37.

[1] Rule G-37(g)(vii) defines municipal securities business as "(A) the purchase of a primary offering (as defined in rule A-13(f)) of municipal securities from the issuer on other than a competitive bid basis (*e.g.*, negotiated underwritings); or (B) the offer or sale of a primary offering of municipal securities on behalf of any issuer (*e.g.*, private placement); or (C) the provision of financial advisory or consultant services to or on behalf of an issuer with respect to a primary offering of municipal securities in which the dealer was chosen to provide such services on other than a competitive bid basis; or (D) the provision of remarketing agent services to or on behalf of an issuer with respect to a primary offering of municipal securities in which the dealer was chosen to provide such services on other than a competitive bid basis."

[2] Any associated person of a dealer who solicits municipal securities business is a municipal finance professional pursuant to Rule G-37(g)(iv)(B), regardless of whether such associated person engages in any other municipal securities activities for the dealer. Pursuant to Rule G-37(g)(ix)

and Rule G-38(b)(i), solicitation of municipal securities business consists of any direct or indirect communication with an issuer for the purpose of obtaining or retaining municipal securities business.

Once a dealer has been selected to engage in the underwriting of the new issue, communications with the issuer necessary to undertake that engagement are not considered solicitations for purposes of Rule G-37. *See* Rule G-38 Interpretation — Interpretive Notice on the Definition of Solicitation Under Rules G-37 and G-38 (June 8, 2006).

[3] Thus, if a municipal finance professional has made a political contribution to an official of an issuer, other than a "*de minimis*" contribution under Rule G-37(b), during the preceding two years, the dealer would be banned from engaging in municipal securities business with such issuer if the municipal finance professional were to participate in the solicitation of such business. Political contributions made by a municipal finance professional to an issuer official for whom such municipal finance professional is entitled to vote are considered *de minimis* and would not result in a ban on municipal securities business if such contributions, in total, did not exceed $250 per election.

Guidance on Dealer-Affiliated Political Action Committees Under Rule G-37

December 12, 2010

Since 1994, the Municipal Securities Rulemaking Board ("MSRB") has sought to eliminate pay-to-play practices in the municipal securities market through its Rule G-37, on political contributions and prohibitions on municipal securities business.[1] Under the rule, certain contributions to elected officials of municipal securities issuers made by brokers, dealers and municipal securities dealers ("dealers"), municipal finance professionals ("MFPs") associated with dealers, and political action committees ("PACs") controlled by dealers and their MFPs ("dealer-controlled PACs")[2] may result in prohibitions on dealers from engaging in municipal securities business with such issuers for a period of two years from the date of any triggering contributions.

Rule G-37 requires dealers to record and disclose certain contributions to issuer officials, state or local political parties, and bond ballot campaigns, as well as other information, on Form G-37 to allow public scrutiny of such contributions and the municipal securities business of a dealer. In addition, dealers and MFPs generally are prohibited from soliciting others (including affiliates of the dealer or any PACs) to make contributions to officials of issuers with which the dealer is engaging or seeking to engage in municipal securities business, or to political parties of a state or locality where the dealer is engaging or seeking to engage in municipal securities business. Dealers and MFPs also are prohibited from circumventing Rule G-37 by direct or indirect actions through any other persons or means.[3]

Due to changes in the financial markets since the adoption of Rule G-37, many dealers and MFPs have become affiliated with a broad range of other entities in increasingly diverse organizational structures. Some of these affiliated entities (including but not limited to banks, bank holding companies, insurance companies and investment management companies) have formed or otherwise maintain relationships with PACs ("affiliated PACs") and other political organizations, many of which may make contributions to issuer officials. Such relationships raise questions regarding the extent to which affiliated PACs may effectively be controlled by dealers or their MFPs and thereby constitute dealer-controlled PACs whose contributions are subject to Rule G-37. Further, such relationships raise concerns regarding whether the contributions of such affiliated PACs, even if not viewed as dealer-controlled PACs, may be used by dealers or their MFPs to circumvent Rule G-37 as indirect contributions for the purpose of obtaining or retaining municipal securities business.

The MSRB remains concerned that individuals and firms subject to Rule G-37 may seek ways around the rule through payments to and contributions by affiliated PACs that benefit issuer officials. When evaluating whether contributions made by affiliated PACs may be subject to the provisions of Rule G-37, the MSRB emphasizes that dealers should first determine whether such affiliated PAC would be viewed as a dealer-controlled PAC. If an affiliated PAC is determined to be a dealer-controlled PAC, then its contributions to issuer officials would subject the dealer to the ban on municipal securities business and its contributions to issuer officials, state or local political parties, and bond ballot campaigns would be subject to disclosure under Rule G-37. Even if the affiliated PAC is determined not to be a dealer-controlled PAC, the dealer still must consider whether payments made by the dealer or its MFPs to such affiliated PAC could ultimately be viewed as an indirect contribution under Rule G-37(d) if, for example, the affiliated PAC is being used as a conduit for making a contribution to an issuer official.

The MSRB wishes to provide guidance regarding the factors that may result in an affiliated PAC being viewed as controlled by the dealer or an MFP of the dealer and thereby being treated as a dealer-controlled PAC for purposes of Rule G-37. The MSRB also wishes to ensure that the industry is cognizant of prior MSRB guidance regarding the potential for payments to and contributions by affiliated PACs to constitute indirect contributions under the rule.

Indicators of Control by Dealers and MFPs

Soon after adoption of Rule G-37, the MSRB stated that each dealer must determine whether a PAC is dealer controlled, with any PAC of a non-bank dealer assumed to be a dealer-controlled PAC.[4] The MSRB has also stated that the determination of whether a PAC of a bank dealer[5] is a dealer-controlled PAC would depend upon whether the bank dealer or anyone from the bank dealer department has the ability to direct or cause the direction of the management or the policies of the PAC.[6] Such ability to direct or cause the direction of the management or the policies of a PAC also would be indicative of control of such PAC by a non-bank dealer or any of its MFPs, although it would not be the exclusive indicator of such control. While this guidance establishes basic principles with regard to making a determination of control, it does not set out an exhaustive list of circumstances under which a PAC may or may not be viewed as dealer or MFP controlled.

The specific facts and circumstances regarding the creation, management, operation and control of a particular PAC must be considered in making a determination of control with respect to such PAC.

Creation of PAC. In general, a dealer or MFP involved in the creation of a PAC would continue to be viewed as controlling such PAC unless and until such dealer or MFP becomes wholly disassociated in any direct or indirect manner with the PAC. Thus, any PAC created by a dealer, acting either in a sole capacity or together with other entities or individuals, would be presumed to be a dealer-controlled PAC. This presumption continues at least as long as the dealer or any MFP of the dealer retains any formal or informal role in connection with such PAC, regardless of whether such dealer or MFP has the ability to direct or cause the direction of the management or policies of the PAC. This presumption also would continue for so long as any associated person of the dealer (either an individual, whether or not an MFP, or an affiliated company directly or indirectly controlling, controlled by or under common control with the dealer) has the ability to direct or cause the direction of the management or policies of the PAC. In effect, a dealer could not attempt to treat a PAC it created and then spun off to the control of an affiliated company as not being a dealer-controlled PAC. However, depending on the totality of the facts and circumstances, a PAC originally created by a dealer in which the dealer or its MFPs no longer retain any role, and with respect to which any other affiliates retain only very limited non-control roles, could be viewed as no longer controlled by the dealer.

Similarly, a PAC created by any person associated with the dealer at the time the PAC was created, acting either in a sole capacity or together with other entities or individuals, would be presumed to be controlled by such person. Such presumption continues at least for so long as such person retains any formal or informal role in connection with such PAC, regardless of whether any such person has the ability to direct or cause the direction of the management or policies of the PAC. This presumption also would continue for so long as any other person associated with the same dealer as the creator of the PAC has the ability to direct or cause the direction of the management or policies of the PAC. Although such PAC may not be viewed as being subject to Rule G-37 as an MFP-controlled PAC when originally created if such person was not then an MFP, if the person creating the PAC, or any other associated person with the ability to direct or cause the direction of the management or policies of such PAC, is or later becomes an MFP, such PAC would be deemed an MFP-controlled PAC.[7]

Management, Funding and Control of PAC. Beyond the role of the dealer, MFP or other person in creating a PAC and maintaining an ongoing association with such PAC, the ability to direct or cause the direction of the management or the policies of a PAC is also important. Strong indicators of management and control are not mitigated by the fact that such dealer, MFP or other person does not have exclusive, predominant or "majority" control of the PAC, its management, its policies, or its decisions with regard to making contributions. For example, the fact that a dealer or MFP may only have a single vote on a governing board or other decision-making or advisory board or committee of a PAC, and therefore does not have sole power to cause the PAC to take any action, would not obviate the status of such dealer or MFP as having control of the PAC, so long as the dealer or MFP has the ability, alone or in conjunction with other similarly empowered entities or individuals, to direct or cause the direction of the management or the policies of the PAC. In essence, it is possible for a single PAC to be viewed as controlled by multiple different dealers if the control of such PAC is shared among such dealers, although the presumption of control may be rebutted as described below.

The level of funding provided by dealers and their MFPs to a PAC may also be indicative of control. A PAC that receives a majority of its funding from a single dealer (including the collective contributions of its MFPs and employees) or a single MFP is conclusively presumed to be controlled by such dealer or MFP, regardless of the lack of any of the other indicia of control described in this notice. Another important factor is the size or frequency of contributions by a dealer or MFP,[8] viewed in light of the size and frequency of contributions made by other contributors not affiliated in any way with such dealer or MFP. For example, a limited number of small contributions freely made by employees of a dealer to an affiliated PAC (*i.e.*, not directed by the dealer and not part of an automated or otherwise dealer-organized program of contributions) would not, by itself, automatically raise a presumption of dealer control so long as the collective contributions by the dealer or its employees is not significant as compared to the total funding of the affiliated PAC, subject to consideration of the other relevant facts and circumstances. In addition, contributions made by a dealer or MFP to an affiliated PAC could raise a stronger inference of *de facto* dealer or MFP control than when such contributions were made to non-affiliated PACs.

However, even where a dealer or MFP is not viewed as controlling a PAC under the principles described above, dealers should remain mindful of the potential for leveraging the contribution activities of affiliated PACs in soliciting municipal securities business in a way that could raise a presumption of dealer or MFP control. For example, an MFP's references to the contributions made by an affiliated PAC during solicitations of municipal securities business could, depending on the facts and circumstances, serve as evidence of coordination of such PAC's activities with the dealer or MFP that could, together with other facts, be indicative of direct or indirect control of the PAC by such dealer or MFP. Such control could be found even in circumstances where the dealer or its MFPs have not made contributions to the affiliated PAC.[9]

Of course, the presumptions described above may be rebutted, depending upon the totality of facts and circumstances. Considerations that may serve to rebut such presumptions may include whether the dealer or person creating the PAC:

(i) participates with a broad-based group of other entities and/or individuals in creating the PAC, (ii) at no time undertakes any direct or indirect role (and, in the case of a dealer, no person associated with the dealer undertakes any direct or indirect role) in leading the creation of the PAC or in directing or causing the direction of the management or the policies of the PAC, and/or (iii) provides funding for such PAC (and, in the case of a dealer, its associated persons collectively provide funding for such PAC) that is not substantially greater than the typical funding levels of other participants in the PAC who do not undertake a direct or indirect role in leading the creation of the PAC or in directing or causing the direction of the management or the policies of the PAC.

Indirect Contributions Through Bank PACs or Other Affiliated PACs

As noted above, if an affiliated PAC is determined not to be a dealer-controlled PAC, a dealer must still consider whether payments made by the dealer or its MFPs to such affiliated PAC could be viewed as an indirect contribution that would become subject to Rule G-37 pursuant to section (d) thereof. The MSRB has provided extensive guidance on such indirect contributions, noting in 1996 that, depending on the facts and circumstances, contributions to a non-dealer associated PAC that is soliciting funds for the purpose of supporting a limited number of issuer officials might result in the same prohibition on municipal securities business as would contributions made directly to the issuer official.[10] The MSRB also noted that dealers should make inquiries of a non-dealer associated PAC that is soliciting contributions in order to ensure that contributions to such a PAC would not be treated as an indirect contribution.[11]

The MSRB also has previously provided guidance in 2005 with regard to supervisory procedures[12] that dealers should have in place in connection with payments to a non-dealer associated PAC or a political party to avoid indirect rule violations of Rule G-37(d). In such guidance, the MSRB stated that, in order to ensure compliance with Rule G-27(c) as it relates to payments to political parties or PACs and Rule G-37(d), each dealer must adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that neither the dealer nor its MFPs are using payments to political parties or non-dealer controlled PACs to contribute indirectly to an official of an issuer.[13] Among other things, dealers might seek to establish procedures requiring that, prior to the making of any contribution to a PAC, the dealer undertake certain due diligence inquiries regarding the intended use of such contributions, the motive for making the contribution and whether the contribution was solicited. Further, in order to ensure compliance with Rule G-37(d), dealers could consider establishing certain information barriers between any affiliated PACs and the dealer and its MFPs.[14] Dealers that have established such information barriers should review their adequacy to ensure that the affiliated entities' contributions, payments or PAC disbursement decisions are neither influenced by the dealer or its MFPs, nor communicated to the dealers and the MFPs.

The MSRB subsequently noted that the 2005 guidance did not establish an obligation to put in place the specific procedures and information barriers described in the guidance so long as the dealer in fact has and enforces other written supervisory procedures reasonably designed to ensure that the conduct of the dealer and its MFPs are in compliance with Rule G-37(d).[15] Thus, for example, when information regarding past or planned contributions of an affiliated PAC is or may be available to or known by the dealer or its MFPs, the dealer might establish and enforce written supervisory procedures that prohibit the dealer or MFP from providing information to issuer personnel regarding past or anticipated affiliated PAC contributions.

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1 Rule G-37 defines municipal securities business as: (i) the purchase of a primary offering of municipal securities from an issuer on other than a competitive bid basis; (ii) the offer or sale of a primary offering of municipal securities on behalf of an issuer; (iii) the provision of financial advisory or consultant services to or on behalf of an issuer with respect to a primary offering of municipal securities in which the dealer was chosen to provide such services on other than a competitive bid basis; or (iv) the provision of remarketing agent services to or on behalf of an issuer with respect to a primary offering of municipal securities in which the dealer was chosen to provide such services on other than a competitive bid basis.

2 The MSRB has previously stated that the matter of control depends upon whether or not the dealer or the MFP has the ability to direct or cause the direction of the management or policies of the PAC (MSRB Question & Answer No. IV. 24 — Dealer Controlled PAC).

3 Rule G-37(d) provides that no broker, dealer or municipal securities dealer or any municipal finance professional shall, directly or indirectly, through or by any other person or means, do any act which would result in a violation of sections (b) or (c) of the rule. Section (b) relates to the ban on business and Section (c) relates to the prohibition on soliciting and coordinating contributions.

4 *See* Rule G-37 Question & Answer No. IV.24 (May 24, 1994).

5 MSRB Rule D-8 defines a bank dealer as a municipal securities dealer which is a bank or a separately identifiable department or division of a bank.

6 *See* Rule G-37 Question & Answer No. IV.24 (May 24, 1994).

7 However, a PAC created by an individual acting in his or her formal capacity as an officer, employee, director or other representative of a dealer, regardless of whether such individual is an MFP, would be deemed a dealer-controlled PAC rather than a PAC controlled by the individual.

8 A dealer or an MFP may make sufficiently large or frequent contributions to a PAC so as to obtain effective control over the PAC, depending on the totality of facts and circumstances.

9 *See* Rule G-37 Question & Answer No. III.7 (September 22, 2005) for a discussion of potential indirect contributions through affiliated PACs.

10 *See* Rule G-37 Question & Answer No. III.4 (August 6, 1996).

11 *See* Rule G-37 Question & Answer No. III.5 (August 6, 1996).

12 Rule G-27, on supervision, provides in section (c) that each dealer shall adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance with MSRB rules.

13 *See* Rule G-37 Question & Answer No. III.7 (September 22, 2005).