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Invested in America

February 25, 2011

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1900 Duke Street
Alexandria, VA 22134

Re: MSRB Notice 2011-04

Dear Mr. Smith:

The Securities Industry and Financial Markets Association (**"SIFMA"** or **"we"**)[1] welcomes this opportunity to comment on Proposed Rule G-42 (**"Proposed Rule G-42"** or the **"Proposed Rule"**), the proposed pay-to-play rule for municipal advisors, which the Municipal Securities Rulemaking Board (**"MSRB"**) issued for comment on January 14, 2011.[2] SIFMA strongly supports the MSRB's goal of eliminating "pay-to-play" practices from the business of municipal advisors with state and local government entities. We write, however, to address certain concerns regarding the scope, timing, and operation of the Proposed Rule.

EXECUTIVE SUMMARY

Proposed Rule G-42 bans "municipal advisors," a category created by Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] MSRB Notice 2011-04, Request for Comment on Pay to Play Rule for Municipal Advisors (Jan. 14, 2011) (**"MSRB Notice 2011-04"**).

(**"Dodd-Frank"** or **"the Dodd-Frank Act"**),[3] from advising or soliciting a municipal entity within two years of a non-*de minimis* contribution by the municipal advisor to an official of that entity (**"covered political contribution"**).[4] But there are conflicts between the definition of "municipal advisor" in the Dodd-Frank Act and the SEC's notice of proposed rulemaking on the "Registration of Municipal Advisors" (**"Municipal Advisors NPRM"**).[5] In our letter submitted on February 22, 2011 commenting on the SEC's Municipal Advisors NPRM, we provided extensive comments to the SEC addressing these inconsistencies.[6] We therefore incorporate these comments by reference, and only repeat them as necessary in this letter for context and clarity.

Given the inconsistencies between the text of Dodd-Frank and the proposed definitions in the Municipal Advisors NPRM, SIFMA encourages the MSRB to split this rulemaking into two stages—as it has effectively done with other recent rulemakings[7]—moving forward with respect to those parties who are clearly covered under the statutory definition of "municipal advisor," while delaying action for those entities who may not qualify until the SEC's definition of "municipal advisor" is finalized. Relatedly, because Proposed Rule G-42's definition of "solicitation" is in part inconsistent with the statutory definition of "municipal advisor" in Dodd-Frank, we recommend that the MSRB revise the "solicitation" definition accordingly, delaying any consideration of an expanded definition until the scope of the term "municipal advisor" is settled. The two-stage approach we propose would necessitate coordination with the SEC to ensure that broker-dealer placement agents who currently solicit government entities on behalf of investment advisers are not effectively barred from continuing to provide such services by the "**SEC's Pay-to-Play Rule**,"[8] which prohibits investment advisers from paying registered broker-dealers to solicit government

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[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). Section 975 has been codified in relevant part at 15 U.S.C. § 78o-4.

[4] Proposed Rule G-42(b).

[5] Registration of Municipal Advisors, 76 Fed. Reg. 824, 831-32 (Jan. 6, 2011).

[6] Ltr. from SIFMA to Elizabeth M. Murphy, Sec'y, SEC (Feb. 22, 2011) (**"SIFMA Municipal Advisors NPRM Letter"**).

[7] *See* MSRB Notice 2011-16: Request for Comment on Gifts and Gratuities Rule for Municipal Advisors (Feb. 22, 2011) (**"MSRB Notice 2011-16"**), *available at* http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-16.aspx; MSRB Notice 2011-14: Request for Comment on Draft MSRB Rule G-36 (On Fiduciary Duty of Municipal Advisors) and Draft Interpretive Notice (Feb. 14, 2011) (**"MSRB Notice 2011-14"**), *available at* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-14.aspx?n=1; & MSRB Notice 2011-13: Request for Comment on Draft Interpretive Notice Concerning the Application of MSRB Rule G-17 to Municipal Advisors (Feb. 14, 2011) (**"MSRB Notice 2011-13"**), *available at* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-13.aspx?n=1.

[8] *See* Political Contributions by Certain Investment Advisers; Final Rule, 75 Fed. Reg. 41,018 (July 14, 2010) (**"SEC's Pay-to-Play Rule"**) (codified at 17 C.F.R § 275.206(4)-5).

entities after September 13, 2011, unless such broker-dealers are subject to a pay-to-play regime (**"the September problem"**).[9]

For those persons who are clearly covered municipal advisors, and regardless of the outcome of the SEC's Municipal Advisors NPRM, we recommend that the MSRB revise its proposal to harmonize Proposed Rule G-42 with MSRB Rules G-37 and G-38 and the SEC's Pay-to-Play Rule. As proposed, Rule G-42 and the amended Rule G-37 would create duplicative and potentially costly recordkeeping and reporting requirements with respect to associated persons who would qualify as both municipal advisor professionals (**"MAPs"**) and municipal finance professionals (**"MFPs"**). We provide the MSRB with suggested targeted revisions to Proposed Rule G-42 and Rule G-37 to reconcile the two schemes while allowing the MSRB to monitor all activities covered by Rule G-37 and the municipal advisor category in Section 975 of Dodd-Frank. We also recommend an amendment to Rule G-38 that would, in conjunction with Rule G-42, permit municipal dealers to use any regulated solicitor subject to a pay-to-play regime regardless of affiliate or non-affiliate status. Moreover, although we believe that the MSRB has rightly concluded that the *de minimis* contribution limits in Proposed Rule G-42 should parallel those in Rule G-37, we believe the limits for both Rule G-37 and G-42 should be the same as the limits contained in the SEC's Pay-to-Play Rule.

In addition, we propose that the MSRB adopt a more narrowly tailored ban on compensation in Proposed Rule G-42 to allow solicitors to receive compensation for solicitations completed prior to a covered political contribution. This more narrowly tailored rule should also be harmonized with the SEC's Pay-to-Play Rule so that the two-year ban on compensation runs from the date of the covered political contribution, rather than from the date of the end of the advisory relationship, in cases where the municipal advisor owes a fiduciary duty to a municipal entity and therefore must wind down its advisory business before terminating it.

Finally, SIFMA recommends that the MSRB identify an operative date that gives covered municipal advisors an adequate opportunity to alter their compliance structures to conform to the new requirements of Proposed Rule G-42. At the same time, if necessary, we recommend the MSRB permit voluntary compliance prior to the operative date in order to allow municipal advisors with sufficient compliance structures to subject themselves to a pay-to-play regime in order to meet the September 13, 2011 deadline in the SEC's Pay-to-Play Rule.

[9] *See* discussion of this "September problem" *infra* Section I.B.

I. PROPOSED RULE G-42 IS PREMATURE, NECESSITATING A TWO-STAGE APPROACH

Proposed Rule G-42 rests on the assumption that the definition of "municipal advisor" is relatively clear. But that is not the case—to the contrary, substantial differences between the statutory definition of "municipal advisor" in the Dodd-Frank Act and the SEC's definition of "municipal advisor" in its Municipal Advisors NPRM are causing significant confusion over the scope of the proposed rule.[10] The uncertainty of the definition of "municipal advisor" is important because Proposed Rule G-42 is unlikely to be an effective pay-to-play regime if it is designed and tailored to regulate numerous entities ultimately not subject to the Rule's provisions. Therefore, we respectfully submit the following two-stage approach for consideration.

A. Proposed Two-Stage Approach

There are three general categories of individuals and entities potentially affected by Proposed Rule G-42. For ease of reference, we have categorized the parties in Appendix A. One category encompasses those parties clearly covered by the definition of "municipal advisor" in both the Dodd-Frank Act and the SEC's Municipal Advisors NPRM (**"Category A"**). A second, "disputed" category is made up of those parties not covered by Dodd-Frank's definition of "municipal advisor," but who are included in the SEC's definition of "municipal advisor" in its Municipal Advisors NPRM (**"Category B"**). A third category consists of those parties clearly outside the scope of both Dodd-Frank and the SEC's Municipal Advisors NPRM (**"Category C"**), but who the SEC and MSRB suggest may "voluntarily" register as municipal advisors so as to remain eligible to be retained by investment advisers to solicit government entities under the SEC's Pay-to-Play Rule.

SIFMA proposes the MSRB split the proposed rulemaking into two stages by proceeding with the Proposed Rule G-42 for previously unregulated persons (Category A) while delaying promulgation of a rule for entities that may—or may not—ultimately be covered by the SEC's final definition of "municipal advisor" (Category B).[11] While the parties in Category C do not qualify as municipal

[10] We have discussed these differences and problems they raise at length in our Companion Letter to the SEC, attached hereto as Exhibit 1 and filed on February 25, 2011, as well as in our January 24, 2011 letter to the SEC on the proposed amendments to the Pay-to-Play Rule, Ltr. from SIFMA to Elizabeth M. Murphy, Sec'y, SEC, *available at* http://www.sec.gov/comments/s7-36-10/s73610-34.pdf.

[11] For example, it is unclear whether and to what extent banks are subject to regulation as municipal advisors. As SIFMA has commented in its letter to the SEC on the Municipal Advisors NPRM, the SEC's proposed definition of "investment strategies" is broad enough to potentially capture banks holding funds of a municipal entity that may be used for investment. SIFMA Municipal Advisors NPRM Letter at 14-15.

advisors, both the SEC and the MSRB have suggested that some of Category C's parties may "voluntarily" register as municipal advisors. As discussed below, *see infra* page 8, and in our **"Companion Letter"** filed today with the SEC, (attached here as Exhibit 1), "voluntary" registration raises significant legal and practical issues.

We commend the MSRB for adopting a two-stage approach in other recent rulemakings involving municipal advisors and believe it should use the same approach here. For example, recognizing the dispute over whether certain brokers are covered "municipal advisors" under the Dodd-Frank Act, the MSRB adopted a two-stage approach in its *Request for Comment on Draft MSRB Rule G-36*, which addresses the fiduciary duties of municipal advisors.[12] The MSRB explained that "should certain brokerage activities be construed [by the SEC in its final rule on municipal advisors] to be the provision of advice on investment strategies, and, therefore, make the brokers municipal advisors, the Board would reconsider" the interpretive notice accompanying Rule G-36 as necessary.[13] Similarly, the MSRB decided to issue a draft interpretive notice on the application of Rule G-17 to municipal advisors "without regard to any interpretation of that term proposed by" the SEC in its Municipal Advisors NPRM, thus reserving for further MSRB rulemaking any issues arising from the SEC's final municipal advisors rule.[14] Given the substantial uncertainty regarding the Municipal Advisors NPRM, we believe that the MSRB should adopt an analogous two-stage approach in the present rulemaking.

B. Proposed Rule G-42's Interplay With The SEC's Pay-To-Play Rule—The "September Problem"

As discussed in our Companion Letter to the SEC, broker-dealer placement agents registered with the SEC who are engaged in the solicitation of municipal entities for investments in funds ("**BD placement agents**") must be subject to a pay-to-play rule at least as stringent as the SEC's Pay-to-Play Rule by September 13, 2011. Third-party BD placement agents are among the disputed group of Category B solicitors, and affiliated BD placement agents are clearly not municipal advisors (Category C). Both third-party and affiliated BD placement agents, however, are currently permitted solicitors under the SEC's Pay-to-Play Rule.[15] Assuming third-party BD placement agents are ultimately determined not to be municipal advisors (and therefore not subject to G-42), investment advisers may not continue engaging and compensating them (or affiliated BD placement agents) to solicit government entities after September 13, 2011 unless (i) BD

[12] MSRB Notice 2011-14, *supra* note 7.

[13] *Id.*

[14] MSRB Notice 2011-13, *supra* note 7. Rule G-17 prohibits municipal dealers from engaging in deceptive, dishonest, or unfair practices.

[15] *See* SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,018.

placement agents voluntarily subject themselves to municipal advisor registration (where they would then fall under G-42), or (ii) the SEC alone (or together with an appropriate self-regulatory organization) adopts a separate pay-to-play regime for BD placement agents. We explain in our Companion Letter to the SEC that requiring BD placement agents to "voluntarily" register as municipal advisors is not an appropriate solution to this problem and ask that the SEC work with the MSRB and FINRA to create a single, non-duplicative and jurisdictionally sound pay-to-play regime for BD placement agents. *See also infra* page 7.

Based on the foregoing, we request that the MSRB coordinate with the SEC to ensure that, whatever the outcome of the SEC's Municipal Advisors NPRM, BD placement agents are not inadvertently dropped from the pool of solicitors currently available to advisers. The SEC received many comments on its pay-to-play rule underscoring the benefits that placement agents provide to government entities, particularly their access to and the benefits they provide to small and mid-size advisers.[16] As part of the coordination process with the SEC, we also request that the MSRB clarify whether, assuming BD placement agents are not ultimately determined to be "municipal advisors," the MSRB has jurisdiction to simply add them to G-42 or whether the SEC (or FINRA) would have to create an analogous rule. SIFMA has always taken the position, and indeed, has been asking for, BD placement agents to be covered by a pay-to-play regime.[17] *See* Companion Letter, Ex. 1.

We have requested in our Companion Letter that the SEC work with the MSRB and FINRA to ensure that all BD placement agents are covered by a single, non-duplicative, and jurisdictionally sound pay-to-play regime by the September 13, 2011 deadline. We recognize the MSRB's jurisdiction is limited to municipal advisors, including those BD placement agents who have voluntarily registered as municipal advisors and therefore are presumably subject to Proposed Rule G-42. While we expect that a solution to the September problem will be forthcoming, in the event that BD placement agents are not determined to be municipal advisors, we request that the MSRB monitor the situation and take any actions within its authority to ensure that at least those BD placement agents who have voluntarily registered are covered by the deadline. Such stop-gap measures potentially could include the promulgation of a interim final rule to bridge any

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[16] *See* SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,021, 41,038. *See, e.g.*, Ltr. from SIFMA to Elizabeth W. Murphy, Sec'y, SEC 13 (Oct. 5, 2009), *available at* http://www.sec.gov/comments/s7-18-09/s71809-166.pdf (commenting on the SEC's pay-to-play proposal) ("As the Chief Investment Officer of the Missouri State Employees Retirement System stated, 'limiting the role of placement agents would reduce our ability to access some of the best managers throughout the world and ultimately result in lower investment returns for our members'") & Ltr. from Lazard Freres & Co., LLC to Elizabeth M. Murphy, Sec'y, SEC (Oct. 5, 2009), *available at* http://www.sec.gov/comments/s7-18-09/s71809-168.pdf.

[17] Ltr. from SIFMA to Elizabeth Murphy, Sec'y, SEC (Oct. 5, 2009), *available at* http://sec.gov/comments/s7-18-09/s71809-166.pdf.

gap in coverage, allowing covered BD placement agents to continue their solicitation business pending an ultimate decision by the SEC on a final pay-to-play regime for BD placement agents.

C. The Definition Of "Solicitation"

SIFMA also urges the MSRB to follow the two-stage process with respect to Proposed Rule G-42's definition of "solicitation," as the scope of the definition also is linked to the municipal advisor rulemaking. Proposed Rule G-42 defines solicitation in relevant part as "a direct or indirect communication by any person with a municipal entity for the purpose of obtaining or retaining (A) municipal advisory business with a municipal entity or (B) third-party business."[18] The proposed rule further provides that "an investment adviser to a covered investment pool in which a municipal entity is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the municipal entity" ("**covered investment pool clause**"), and defines "covered investment pool"[19] to encompass private funds and other types of pooled investment vehicles, including those that are investment options in government-sponsored plans such as 529 plans.[20] Thus, the proposed rule defines "solicitation" to include solicitations of municipal entities by BD placement agents to invest in private funds and pooled investment vehicles.

It is unclear, however, whether the MSRB has the authority to regulate such solicitations. On its face, Section 975 of the Dodd-Frank Act does not delegate to the MSRB the authority to regulate BD placement agents engaged by an investment adviser to solicit investments in funds managed by the adviser.[21] And beyond Section 975, we do not know of any other statute which provides the MSRB with the authority to regulate such activity. Thus, the only potential basis for the MSRB's jurisdiction over this of solicitation activity would be pursuant to

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[18] Proposed Rule G-42(g)(ix).

[19] Both the SEC Pay-to-Play Rule and Proposed Rule G-42 define "covered investment pool" as:

> (A) An investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a) that is an investment option of a plan or program of a government entity [the Proposed Rule defines "government entity" by reference to the SEC's Pay-to-Play Rule]; or
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> (B) Any company that would be an investment company under section 3(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(a)), but for the exclusion provided from that definition by either section 3(c)(1), section 3(c)(7) or section 3(c)(11) of that Act (15 U.S.C. 80a–3(c)(1), (c)(7) or (c)(11)). Proposed Rule G-42(g)(xiii).

[20] SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,044.

[21] SIFMA Municipal Advisors NPRM Letter at 19 (citing *Goldstein v. SEC*, 451 F.3d 873, 879-80 (D.C. Cir. 2006) ("An investor in a private fund may benefit from the adviser's advice (or he may suffer from it) but he does not receive the advice directly.")).

the SEC's proposed definition of "municipal advisor," which extends beyond the text of Section 975. And, as discussed above, whether the SEC ultimately adopts a definition of "municipal advisor" broader than what is provided in the text of Section 975 will not be known until the conclusion of the Municipal Advisors NPRM.

Accordingly, we recommend that the MSRB eliminate the covered investment pool clause in the definition of "solicitation" pending completion of the SEC's promulgation of a final definition of "municipal advisor."[22] Until such time, the MSRB should not attempt to regulate solicitation activities that do not clearly fall within Section 975's coverage.[23]

D. The "Voluntary" Option

While it is unclear which parties and activities will eventually be covered by the definition of "municipal advisor," effectively requiring parties in an ambiguous status, such as third-party BD placement agents, or even those clearly not covered by the definition, such as affiliated solicitors, to "voluntarily" register as municipal advisors only leads to further confusion.[24] SIFMA supports pay-to-play regulation to protect against corruption in public investment, and in particular has requested and supported developing a pay-to-play regime for BD placement agents. Although at present the SEC has indicated that "voluntary" registration is a potential solution to the September problem, we do not believe that an approach which requires parties to subject themselves to municipal advisor status—and to incur potentially onerous regulatory, registration, and reporting requirements—merely to ensure that they are subject to pay-to-play regulation represents an appropriate long-term solution.[25] We recognize that some entities may continue in their present temporary registration status or register as a municipal advisor for the first time in order to avoid the September problem.

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[22] There is therefore no statutory authority for the MSRB to treat solicitation of a municipal entity for investments in a covered investment pool as an attempt to sell advisory services to the municipal entity. If the SEC determines that BD placement agents are not municipal advisors, then the MSRB would need to amend the definition of "solicitation" in Proposed Rule G-42.

[23] Several states have already enacted significant and varying regulation of placement agent activity. As discussed *supra* page 5, SIFMA has consistently supported a pay-to-play rule for regulated BD placement agents, and believes a consistent federal regulatory scheme is preferable to piecemeal regulation by the states.

[24] MSRB Notice 2011-04, at n. 13.

[25] Indeed, it is not clear that the MSRB has the authority to regulate those parties that do not statutorily qualify as municipal advisors, even if they voluntarily register. For example, Congress expressly concluded that affiliated solicitors are not municipal advisors and thus not within in the MSRB's jurisdiction. Given Congress's choice, neither the SEC nor the MSRB has the authority to effectively require affiliated solicitors to register as municipal advisors in order to continue their business activities. *See, e.g.*, *Mich. v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001) ("if there is no statute conferring authority, a federal agency has none"). *See also* Companion Letter, Ex. 1.

Such a solution, however, means subjecting already-regulated solicitors to another large body of regulation that is not, and never was, intended to cover sales of limited fund interests (*i.e.*, not municipal securities), and is less preferable than a tailored pay-to-play regime designed by FINRA or the SEC.[26]

* * *

In our view, the MSRB should instead tailor Proposed Rule G-42 to cover persons clearly within the definition of "municipal advisor" under Dodd-Frank and the SEC's Municipal Advisors NPRM (*i.e.*, Category A). We ask that it do so while keeping in mind the September problem for BD placement agents. In light of the present dispute over the scope of the "municipal advisor" definition—and, accordingly, the MSRB's jurisdiction—it is particularly difficult for us to comment meaningfully on the scope and operation of Proposed Rule G-42 as it applies to the disputed categories.[27] Proceeding with Proposed Rule G-42 with respect to the disputed categories would thus deprive potentially affected parties of an opportunity to comment on the proposal.

II. FOR ALL COVERED MUNICIPAL ADVISORS, THE MSRB SHOULD RECONCILE PROPOSED RULE G-42 WITH MSRB RULES G-37 AND G-38 AND THE SEC'S PAY-TO-PLAY RULE

Below we discuss issues that arise from the interplay between Proposed Rule G-42, MSRB Rules G-37 and G-38, and the SEC's Pay-to-Play Rule, for municipal advisors covered by Rule G-42.

First, we are concerned that, as proposed, Rule G-42 would impose unnecessary, duplicative, and potentially costly requirements on municipal dealers already subject to Rule G-37's recordkeeping and reporting requirements. We believe that the MSRB should minimize these burdens by standardizing recordkeeping and reporting requirements across both rules and by clarifying key definitional terms in Proposed Rule G-42.

Second, we believe that Proposed Rule G-42 and Rule G-38 should be coordinated to provide a comprehensive regime that allows municipal dealers to use either affiliated or non-affiliated persons to solicit municipal securities business, as long such persons are subject to comprehensive pay-to-play regulation. This can be accomplished by preserving Rule G-38 while amending it to permit the use of non-affiliated, regulated solicitors, much as the SEC decided

[26] SIFMA Municipal Advisors NPRM Letter at 25-26.

[27] *See, e.g.*, *Am. Water Works Ass'n v. EPA*, 40 F.3d 1266, 1274-75 (D.C. Cir. 1994) (agencies must "provide[] sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully") (internal quotation and citation omitted); *Shell Oil Co. v. EPA*, 950 F.2d 741, 751 (D.C. Cir. 1991) (affected parties cannot be "expected to divine the [agency's] unspoken thoughts").

to permit the use of non-affiliated, regulated solicitors by investment advisers under the SEC's Pay-to-Play Rule. Similarly, municipal advisors should not be prohibited from using non-affiliated municipal advisors to solicit on their behalf. Elimination of Rule G-38 is premature and should not be considered until the municipal advisor definition is settled.

Third, while we agree with the MSRB that the *de minimis* contribution limit should be uniform across Rule G-37 and Proposed Rule G-42, we recommend that the MSRB set the limit for both rules to match the approach taken in the SEC's Pay-to-Play Rule, which permits covered individuals to contribute up to $350 per election for candidates for whom they can vote and up to $150 per election for candidates for whom they cannot vote. We believe the SEC's approach reflects the reality of inflation since the MSRB adopted the $250 *de minimis* limit for Rule G-37 in 1994 as well as the Supreme Court's recent campaign finance decisions, which have significantly increased the First Amendment protection for political contributions.

A. The MSRB Should Adopt A Clear And Standardized Set Of Recordkeeping And Reporting Requirements Across Proposed Rule G-42 And Rule G-37

The MSRB has proposed to remove the category of "financial advisory services" from the definition of covered "municipal securities business" in Rule G-37,[28] and to cover such activity solely in Proposed Rule G-42,[29] presumably in light of the coverage of such services within the definition of "municipal advisor" in Section 975 of Dodd-Frank. Although SIFMA does not dispute that "financial advisory services" as encompassed by Rule G-37 fall within the ambit of covered municipal advisory services under Dodd-Frank, we believe that the proposed change does not adequately address the unnecessary burdens and duplication that result from the interplay between Rule G-37 and Proposed Rule G-42. Therefore, the MSRB should take additional steps to standardize the recordkeeping and reporting requirements across Proposed Rule G-42 and Rule G-37 and clarify the scope of key terms in Proposed Rule G-42. Our proposed revisions should reduce the burden of complying with the recordkeeping and reporting requirements in the two rules.

[28] *See* Rule G-37(g)(iv).

[29] MSRB Notice 2011-04, at "Draft New MSRB Rule G-42: Draft Rule G-42 Distinguished from Rule G-37."

1. Taken Together, Proposed Rule G-42 And Rule G-37 Would Create Unnecessary, Costly, And Potentially Inconsistent Recordkeeping And Reporting Requirements

Because Proposed Rule G-42 covers "financial advisory and consulting services," the MSRB proposes to eliminate a similar category of activities currently conducted by MFPs from Rule G-37.[30] The proposed shift fails to address fully, however, the potential cause for duplicative and burdensome recordkeeping and reporting requirements under the two rules: many MFPs engage in a sufficiently broad range of activities—including financial advisory services to municipal issuers—such that, notwithstanding the proposed shift, they will be subject to both Rule G-37 and Proposed Rule G-42. Specifically, many MFPs engage in various business activities and thus are covered under multiple prongs of the definition of "municipal finance professional" and "municipal securities business" in Rule G-37.[31] Accordingly, such professionals will continue to be subject to Rule G-37's recordkeeping and reporting requirements notwithstanding the proposed deletion of the "financial advisory and consulting services" category from the rule. If Rule G-42 is promulgated as proposed, the contributions of these same professionals will trigger recordkeeping and reporting requirements under that rule. Therefore, many individuals engaged in multiple forms of municipal securities representative activities will now need to comply with two pay-to-play regimes that, although similar in many ways, differ in several important respects.

For example, Proposed Rule G-42 would require far more burdensome recordkeeping and reporting requirements than Rule G-37 with respect to solicitation activities. Proposed Rule G-42(e)(i)(C)(2), unlike Rule G-37, requires the reporting of all solicitation activities, which significantly increases the reporting burden on affected entities. (See discussion *infra* page 14.) As a practical matter, this and other differences will result in confusing and potentially conflicting reporting requirements with respect to the activities of a single associated person.[32]

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[30] MSRB Notice 2011-04, at "Draft Amendments to Existing MSRB Rules: MSRB Rule G-37." More specifically, Rule G-37 requires recordkeeping and reporting of the political contributions of any MFP, which is defined in part by reference to "municipal securities business," a term that currently includes "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." Rule G-37(g)(iv) & (vii).

[31] *See* Rule G-37(g)(vii).

[32] There are other examples as well. Rule G-37(e)(i)(A) requires reports of "contributions to officials of issuers," which must include, among other things, disclosure of contributions to any elected official 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," Rule G-37(e)(vi). Proposed Rule G-42(g)(vi) requires reports of contributions to a different set of

The dual reporting and enforcement regimes create an extraordinary compliance burden on municipal dealers because the activities of an associated person engaged in municipal securities business will need to be carefully evaluated to determine whether the individual must comply with G-37, Proposed Rule G-42, or both. For these reasons, simply moving coverage of "financial advisory and consulting services" to Proposed Rule G-42 will not adequately eliminate the confusing and costly overlap between the two recordkeeping and reporting regimes.

2. The MSRB Should Adopt Standardized, Clear Recordkeeping And Reporting Requirements Across Proposed Rule G-42 And Rule G-37

We therefore propose five modifications to Rule G-37 and Proposed Rule G-42 that would reduce the unnecessary confusion and overlap between the recordkeeping and reporting requirements of Proposed Rule G-42 and Rule G-37. These modifications would allow the MSRB to continue to require recordkeeping and reporting for all activities currently covered by Rule G-37 as well as those contemplated by the municipal advisor category in Section 975 of Dodd-Frank. These reforms therefore would represent a more narrowly tailored, less costly, and thus more reasonable regulatory regime than one in which the proposed regulatory shift occurs without further changes.[33]

a. The MSRB Should Permit Entities To Fulfill Their Rule G-37 And Rule G-42 Reporting Requirements On A Single Form

Under the current proposal, entities that employ persons who are both MFPs and MAPs would need to file on a quarterly basis both a Form G-37 (with respect to MFP activity) and a Form G-42 (with respect to MAP activity).[34] We believe that the MSRB could achieve significant regulatory benefits by providing a standardized macroform that would permit entities to file a single report covering the disclosure requirements for both Rules G-37 and G-42. A standardized form would provide regulated entities with clearer guidance regarding the scope and relationship of their Rule G-37 and G-42 recordkeeping and reporting requirements, and also likely would assist the MSRB in reviewing required disclosures. In our view, entities should be permitted to elect whether to report their covered Rule G-37 and G-42 activities on the standardized macroform

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public officials, namely, those who, among other things, are "directly or indirectly responsible for, or can influence the outcome of, the hiring of a municipal advisor."

[33] *Nat'l Tel. Coop. Ass'n v. FCC*, 563 F.3d 536, 540 (D.C. Cir. 2009) (agency rules must be both "reasonable and reasonably explained").

[34] MSRB Notice 2011-04, at "Request for Comment: Electronic Filings" (discussing Forms G-37 and G-42).

or on separate forms. This would provide entities with dual MFPs/MAPs the flexibility to adapt their compliance systems to both Rules G-37 and G-42.

b. The MSRB Should Adopt A Consistent Definition Of Covered Supervisors Across Proposed Rule G-42 And Rule G-37

Proposed Rule G-42 would require reporting of contributions of persons who supervise a MAP for non-municipal business or solicitation activities. As the MSRB has explained, "[i]f an individual who is a [MAP] engages in municipal advisory business or solicits third-party business, as well as other activities (*e.g.*, municipal securities activities), the individual's supervisors for both types of activities would be considered municipal advisor professionals."[35] Rule G-37 does not sweep so broadly as to encompass supervisors who supervise municipal finance professionals for activities that do not involve "municipal securities business."[36] This reflects the MSRB's recognition that supervisors that have no nexus with covered municipal securities business do not present a significant pay-to-play risk. We see no policy or other reason for the different treatment in the two rules, which is not necessary to make Proposed Rule G-42 as stringent as the SEC's Pay-to-Play Rule. This proposed definition creates regulatory uncertainty and expands the reporting and recordkeeping requirements under Proposed Rule G-42 beyond what are required to address the risk of pay-to-play corruption. Indeed, to the extent there is no justification for burdening the political contributions of supervisors with little or no nexus to municipal advisory business, the First Amendment may prohibit the MSRB from regulating that activity.[37]

We therefore request that the MSRB follow the model of Rule G-37 and employ a standardized approach to supervisory personnel in both Rule G-42 and Rule G-37. The term "municipal advisory professional" should be defined to include only those supervisors who supervise municipal advisory or related solicitation activities, just as the definition of "municipal finance professional" in Rule G-37 reaches only supervisors who supervise municipal securities business.

[35] MSRB Notice 2011-04, at "Draft New MSRB Rule G-42: Draft Rule G-42 Distinguished from Rule G-37"; *see* Proposed Rule G-42(g)(iv)(C).

[36] MSRB Notice 2011-04, at *id.* ("the types of supervisors that are included within the definition of 'municipal advisor professional' would be different from the types of supervisors that are included in the definition of 'municipal finance professional' found in Rule G-37(g)(iv)"). "Municipal securities business" is defined at Rule G-37(g)(vii).

[37] *See Citizens United v. FEC*, 130 S. Ct. 876, 897 (2010); *see also infra* notes 46-49 and accompanying text.

c. The MSRB Should Preserve Uniform *De Minimis* Contribution Limits Across Rule G-37 And Proposed Rule G-42

As proposed, Rule G-42's definition of permissible *de minimis* political contributions will parallel the definition in Rule G-37: $250 per election for candidates for whom the contributor is entitled to vote. Like the MSRB, we believe that a uniform definition of permissible *de minimis* contributions will greatly facilitate the ability of regulated entities to design comprehensive compliance systems to track and report covered contributions. Although we recommend that the MSRB consider whether to modify the *de minimis* limit in both Rule G-37 and Rule G-42, *see infra* page 18-22, we support retaining the same limit for both rules.

d. The MSRB Should Adopt Consistent Recordkeeping Requirements Across Rule G-37 And Proposed Rule G-42

The creation of a standardized macroform, a consistent definition of covered supervisors, and uniform *de minimis* contribution limits would go far towards reconciling the recordkeeping and reporting requirements of Proposed Rule G-42 and Rule G-37. But there remains a substantial difference between the two rules: unlike Rule G-37 (not to mention the SEC's Pay-to-Play Rule), Proposed Rule G-42 requires entities to keep records of every single solicitation of third-party business. We believe the MSRB should reconcile Rule G-37 and Proposed Rule G-42 by requiring recordkeeping and reporting only with respect to solicitation activities that actually secure municipal advisory business. Requiring reports of unsuccessful solicitations adds a layer of unwarranted complexity on existing compliance requirements.

Proposed Rule G-42 requires municipal advisors to make quarterly filings to the Board.[38] As a part of these filings, municipal advisors must report not only (i) municipal advisory business with or on behalf of municipal entities, but also (ii) "in the case of third-party business solicited, a list of each municipal entity solicited during the calendar quarter by state, along with the names of persons on behalf of which third-party business was solicited and the nature of the third-party business solicited."[39] As a result, under the Proposed Rule, municipal advisors would be required to report business that they have not actually obtained and may

[38] Proposed Rule G-42(e)(i).

[39] Proposed Rule G-42(e)(i)(C)(2).

never bring in. Under the corresponding proposed changes to Rule G-8, municipal advisors would also be required to keep records of such solicitations for two years.[40]

Requiring municipal advisors to comply with Rule G-42 as proposed would force them to design systems capable of tracking every single communication that could be construed as an attempt to solicit municipal business. Such a system is not only impracticable but also unnecessary to satisfy the goal of preventing pay-to-play activity. This is clear from a comparison of Proposed Rule G-42 with Rule G-37, which requires each broker, dealer and municipal securities dealer to file "a list of issuers with which the broker, dealer or municipal securities dealer has engaged in municipal securities business during such calendar quarter, listed by state, along with the type of municipal securities business."[41] Put simply, for nearly two decades the MSRB successfully addressed pay-to-play concerns with respect to municipal securities business through a policy requiring only the reporting and recording of business actually obtained.

Moreover, the SEC *rejected* a recordkeeping and disclosure requirement similar to Proposed Rule G-42's requirement in its recent pay-to-play rulemaking. As initially proposed, SEC Rule 204-2(a)(18)(i)(B) would have required a list of all government entities that the adviser solicited for advisory business.[42] In response to comments from SIFMA and others, the SEC abandoned that proposal. Among the reasons[43] cited by the SEC in rejecting a requirement to track and report unsuccessful solicitations were that the potential scope of the requirement[44] was vague and that "requiring advisers . . . to make and keep these records could be unnecessarily intrusive to employees and burdensome on advisers."[45]

Proposed Rule G-42's approach is not needed to satisfy the goal of preventing pay-to-play activity, as shown by the effectiveness of G-37. The putative state interest justifying Rule G-42 is preventing pay-to-play corruption. But such a concern is inapplicable to unsuccessful solicitation activity, which

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[40] Proposed Rule G-8(h)(i)(D)(2).

[41] G-37(e)(i)(C).

[42] *See* Proposed Rule 204-2(a)(18)(i)(B). *See also* SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,050.

[43] *See* SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,050 ("We are not requiring, as proposed, a list of government entities the adviser solicited for advisory business. Some commenters expressed concerns about the potential scope of this requirement and noted that solicitation does not trigger rule 206(4)-5's two-year time out, rather it is providing advice for compensation that does so. In light of these concerns, and the record before us today, we are not requiring advisers to maintain lists of government entities solicited that do not become clients." (internal citations omitted)).

[44] *See id.*

[45] *Id.*

involves neither a *quid-pro-quo* exchange nor the risk of actual corruption.[46] And that distinction matters: *Citizens United v. FEC* indicates that political contributions can be burdened only to prevent actual corruption or a substantial risk of such corruption.[47] Moreover, the proposed recordkeeping and reporting requirements burden the solicitation activity, which involves protected petitioning of government[48] and commercial speech in its own right.[49] Only actual transactions involve actual or potential corruption and are thus capable of justifying the substantial burdens on speech involved in Proposed Rule G-42's recordkeeping and reporting requirements.

In addition, we recommend that the MSRB clarify the quarterly reporting requirement regarding ongoing advisory relationships. Under Rule G-37, advisory assignments are only reported in the quarter during which the municipal dealer and municipal entity enter into the engagement letter for the advisory assignment. Specifically, Rule G-37 requires reporting of "a list of issuers with which the broker, dealer or municipal securities dealer *has engaged in* municipal securities business during [each] calendar quarter."[50] Municipal dealers thus do not report each quarter the existence of an ongoing advisory assignment. We suggest that Rule G-42 be similarly limited to reporting only those engagements that are obtained during a particular quarter.[51]

In sum, we believe that the MSRB should adopt a uniform recordkeeping and reporting rule for Rule G-37 and Rule G-42, under which only actual transactions engaged in during a quarter will be subject to recordkeeping and

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[46] *Citizens United*, 130 S. Ct. at 897. Although the case involved limits on expenditures, the Court's reasoning regarding the state interests that will justify burdening political speech is applicable to limits on contributions as well. *See Randall v. Sorrell*, 548 U.S. 230, 247 (2006) (plurality opinion) ("contribution limits might sometimes work more harm to protected First Amendment interests than their anticorruption objectives could justify") (citation omitted).

[47] *Citizens United*, 130 S. Ct. at 897.

[48] *See, e.g.*, *Mills v. Ala.*, 384 U.S. 214, 218-19 (1966) ("a major purpose of [the First] Amendment was to protect the free discussion of governmental affairs"). *See also E. R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 138 (1961) ("The right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress an intent to invade these freedoms.").

[49] *See, e.g.*, *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 776 (1976) (speech that "does no more than propose a commercial transaction" is protected by the First Amendment).

[50] Rule G-37(e)(i)(C) (emphases added).

[51] We also request that the MSRB clarify that recordkeeping is not retroactive. Municipal advisors should not be required by Rule G-42 to report relationships that were entered into prior to promulgation of the rule, but should only be required to report engagements obtained after the rule's operative date.

reporting requirements.[52] By aligning the recordkeeping and reporting requirements between Rule G-37 and Rule G-42, the MSRB will reduce unnecessary compliance costs on regulated entities, many of whom will be able to build upon existing Rule G-37 compliance protocols. Just as the SEC abandoned a proposal to require reporting of all solicitation communications in response to the comments from SIFMA and others, so too should the Board narrow the scope of its proposed rule to exclude unsuccessful solicitations while requiring the tracking and disclosure of actual transactions.

e. The MSRB Should Modify The Definition Of "Municipal Advisor Professional" To Cover Only Those Associated Persons Primarily Engaged In Municipal Advisory Business

We believe one additional change is necessary to standardize and clarify the reach of Proposed Rule G-42 as compared to Rule G-37. Proposed Rule G-42 defines a covered "municipal advisor professional" to include "any person engaged in municipal advisory business with a municipal entity."[53] Recognizing that Rule G-37, by contrast, defines "municipal finance professional" to include only associated persons who are "*primarily* engaged" in municipal securities representative activities,[54] the MSRB explains that the difference is necessary to make Proposed Rule G-42 "at least as stringent as" the SEC's Pay-to-Play Rule.[55] SIFMA respectfully submits that this change is not necessary to accomplish that goal, and that Rule G-37 provides an appropriate model for Proposed Rule G-42's definition of "municipal advisor professional."

Rule G-37 and Proposed Rule G-42 both define covered associated persons in relevant part by reference to their activities as municipal advisors or solicitors of municipal business. Rule G-37 defines "municipal finance professional" to include "any associated person primarily engaged in municipal securities representative activities,"[56] which is defined in Rule G-3(a)(i) to include persons in advisory relationships with municipal entities.[57] Proposed Rule G-42

[52] We note that if the SEC adopts a broad definition of "municipal advisor," complying with even this reporting requirement will require entities to develop sophisticated tracking systems. If, for example, the SEC extends "municipal advisory" to cover broker and banking accounts, we request that the MSRB give affected parties the opportunity to comment on reporting and recordkeeping requirements applicable to brokers and banks.

[53] Proposed Rule G-42(g)(iv)(A).

[54] Rule G-37(g)(iv) (emphasis added).

[55] MSRB Notice 2011-04, at "Draft New MSRB Rule G-42: Draft Rule G-42 Distinguished from Rule G-37" n.28.

[56] Rule G-37(g)(iv)(A).

[57] Specifically, Rule G-3(a)(i) defines "municipal securities representative" to include any "natural person associated with a broker, dealer or municipal securities dealer, other than a person whose

defines "municipal advisor professional" to include associated persons in advisory relationships with municipal entities, but reaches more broadly than Rule G-37 to cover any such person "engaged in municipal advisory business."[58] By contrast, Rule G-37's "municipal finance professional" definition includes any associated person "who solicits municipal securities business," without a limitation that such person be primarily engaged in soliciting such business.[59] In this respect, Proposed Rule G-42 follows the model of Rule G-37, defining "municipal advisor professional" to include any associated person "who solicits municipal advisory business . . . or solicits third-party business."[60] In other words, Rule G-37 and Proposed Rule G-42 are *consistent* with respect to coverage of associated persons who solicit municipal entities, but *inconsistent* with respect to associated persons who advise municipal entities.

As noted above, the MSRB states that this divergence is necessary for Proposed Rule G-42 to be as "at least as stringent" as the SEC's Pay-to-Play Rule. Following the model of Rule G-37, however, will also result in a rule that is consistent with Dodd-Frank[61] and "substantially equivalent" to the SEC's Pay-to-Play Rule with respect to the requirements imposed upon municipal advisors.[62] As the SEC made clear in its pay-to-play rulemaking for investment advisers, it believes that Rule G-37 is an appropriately stringent model for pay-to-play regulation, which indicates that it is not necessary to drop the "primarily engaged" threshold from Rule G-37 to make Proposed Rule G-42 consistent with the SEC's Pay-to-Play Rule.[63]

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functions are solely clerical or ministerial, whose activities include one or more of the following: (A) underwriting, trading or sales of municipal securities; (B) *financial advisory or consultant services for issuers in connection with the issuance of municipal securities*; (C) *research or investment advice with respect to municipal securities*; or (D) any other activities which involve communication, directly or indirectly, with public investors in municipal securities." (Emphases added.)

[58] Proposed Rule G-42(g)(iv)(A).

[59] Proposed Rule G-37(g)(iv)(B); Rule G-37 FAQs, question IV.8, *available at* http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G37-Frequently-Asked-Questions.aspx.

[60] Proposed Rule G-42(g)(iv)(B).

[61] Nothing in Dodd-Frank requires the proposed departure from the appropriately stringent definitions in Rule G-37. Although Section 975 defines which entities will be covered municipal advisors, it does not prescribe a definition of covered MAPs associated with those entities. 15 U.S.C. § 78o-4(e)(4)(A).

[62] Rule 206-4(5) requires that investment advisers use solicitors subject to the SEC's Pay-to-Play Rule or one that is "substantially equivalent" to that rule.

[63] SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,010 ("We modeled our proposed rule on those adopted by the . . . MSRB, which since 1994 has prohibited municipal securities dealers from participating in pay to play practices. We believe these rules have significantly curbed pay to play practices in the municipal securities market").

Moreover, Proposed Rule G-42 will be substantially equivalent to the SEC's Pay-to-Play Rule's requirements for investment adviser entities as long as it imposes substantially similar restrictions on municipal advisor entities. The SEC's Pay-to-Play Rule has a category of covered associates who *solicit* municipal business, and in this respect, Proposed Rule G-42 and the Pay-to-Play Rule (as well as Rule G-37) are consistent.[64] But the definition of a "covered associate" in the SEC's Pay-to-Play Rule is based solely on solicitation, not advice.[65] Rule G-37, by contrast, does provide a model on point. In our view, the MSRB should follow the example of Rule G-37 by limiting the coverage of associated persons who advise municipal entities to those primarily engaged in such advisory business.

Without this change, Proposed Rule G-42 will impose unnecessary and onerous recordkeeping and reporting burdens on municipal advisors, who will be forced to alter their compliance structures constantly to track the communications of their associated persons to determine if any could be construed as offering even minimal financial advice to a municipal entity. Such an onerous and unnecessary burden on commercial speech could present significant constitutional issues.[66] Therefore, we recommend revising Proposed Rule G-42 to define "municipal advisor professional" to include only those associated persons primarily engaged in municipal advisory business, while retaining the current definition with respect to associated persons that "solicit" municipal entities.[67]

Although we believe the appropriate approach is to harmonize Proposed Rule G-42 and Rule G-37 with respect to the coverage of associated advisory professionals, in the alternative we propose that the MSRB clarify that the term "engaged in municipal advisory business" reaches no further than Section 975(e)(4)(A)(i) of Dodd-Frank. Moreover, SIFMA has proposed that the SEC adopt a *de minimis* exception to the definition of "municipal advisor,"[68] and we believe that at a minimum a similar approach is warranted with respect to the definition of "municipal advisor professional" in Proposed Rule G-42.

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[64] *Compare* Rule 206(4)-5(f)(2)(ii), 17 C.F.R. § 275.206(4)-5(f)(2)(ii), *with* Proposed Rule G-42(g)(iv)(B).

[65] Rule 206(4)-5(f)(2).

[66] *See supra* note 49.

[67] Of course, if the SEC and MSRB coordinate their rulemakings to reflect the statutory definition of "municipal advisor"—which, among other things, excludes BD placement agents and affiliated entities—it may be necessary for the MSRB to revise its proposed approach to solicitation activity. For example, the current definition of "third-party business" was devised to permit "voluntary" registration, *see* MSRB Notice 2011-04, at 4 n.13, and it may be necessary to change that definition if the SEC alters its proposed amendments to the Pay-to-Play Rule for investment advisers.

[68] SIFMA Municipal Advisors NPRM Letter at 12.

B. The MSRB Should Preserve Rule G-38 While Amending It To Permit The Use Of Affiliated Solicitors

Currently, MSRB Rule G-38 prohibits broker-dealers or municipal securities dealers from paying non-affiliated persons to solicit municipal securities business on the dealer's behalf.[69] Broker-dealers or municipal securities dealers can, however, pay any employee or "registered person"—any associated person of the dealer qualified under MSRB Rule G-3 or under the rules of a registered securities association[70]—of the dealer or an affiliated company of the dealer to solicit on the dealer's behalf. Thus, Rule G-38 contains an absolute prohibition on dealers paying third parties to solicit on its behalf, even if the third-party solicitor is also registered and subject to Rule G-37.

The MSRB has requested comment on whether MSRB Rule G-38 should be eliminated, because Proposed Rule G-42 would create a pay-to-play regime for third-party municipal advisors. In the alternative, the MSRB is considering whether G-38 should be expanded, so as to ban payments by non-dealer municipal advisors to other municipal advisors for the solicitation of municipal advisory business.[71] SIFMA recommends that Rule G-38 not be eliminated, because doing so would create a potential coverage gap in the MSRB's regulatory regime, particularly given that, at present, the scope of covered municipal advisors is not certain. At the same time, there is no reason to expand Rule G-38's prohibition against paying non-affiliates to solicit to ensure adequate deterrence of pay-to-play corruption. Instead, we recommend that Rule G-38 be amended to remove the distinction between affiliated and non-affiliated solicitors, replacing it with a distinction between regulated and non-regulated solicitors, as the SEC did in its recent Pay-to-Play Rule. Such an approach would allow municipal dealers maximum flexibility in structuring their solicitation arrangements, while still ensuring parties who solicit municipal securities business are subject to robust pay-to-play regulation.

1. Rule G-38 Should Be Amended, Not Eliminated

In Proposed Rule G-42, the MSRB explains that it banned payments to third-party solicitors in Proposed Rule G-38 "because it was concerned that dealers were using solicitors not subject to MSRB rules as a way to avoid the limitations of Rule G-37."[72] In other words, the purpose of Rule G-38 was to

[69] Rule G-38(a).

[70] Rule G-38(b)(iv).

[71] MSRB Notice 2011-04, at "Request for Comment: MSRB Rule G-38 (on solicitation of municipal securities business)."

[72] *Id*. The original Rule G-38 required only disclosure of the use of third-party consultants and their campaign contributions, but the MSRB replaced it with the current Rule G-38, because of concerns about "questionable practices by some consultants" and the MSRB's judgment that the whole process of soliciting municipal securities business should be subject to the MSRB's rules.

ensure that parties who solicit municipal securities business were subject to a comprehensive pay-to-play regime. SIFMA supports this objective, but eliminating Rule G-38 could frustrate rather than further that goal, particularly in light of the substantial uncertainty that exists over the outcome of the SEC's Municipal Advisors NPRM.

At the same time, however, we believe that Rule G-38's complete ban on paying non-affiliated persons to solicit for municipal securities business is broader than necessary to accomplish the MSRB's goal of avoiding of the circumvention of Rule G-37. Current Rule G-38 prohibits non-affiliated parties from sharing fees when they co-market or solicit on behalf of each other for municipal securities business. This is the case even with non-affiliates who are registered and subject to Rule G-37. This prohibition has, in practice, resulted in unnecessary restructuring of transactions, resulting in higher fees for municipal entities without any discernable regulatory benefits.

The SEC's recent Pay-to-Play Rule demonstrates how a more tightly-focused regime can reduce the risk of pay-to-play corruption while allowing firms flexibility in choosing who solicits government entities on their behalf. The SEC's Pay-to-Play Rule allows affiliated and non-affiliated persons, as long as they are employees, covered associates, or "regulated persons," to solicit a government entity on behalf of an investment adviser for investment advisory services.[73] In promulgating the Pay-to-Play Rule, the SEC reversed course from its notice of proposed rulemaking on the subject, which had included a complete ban on third-party solicitors resembling MSRB Rule G-38.[74] The SEC's Pay-to-Play Rule now allows investment advisers to compensate third-party "regulated persons" to solicit government entities, provided the "regulated persons" are themselves (i) registered with the SEC as an investment adviser or broker-dealer and (ii) subject either to the SEC's Pay-to-Play Rule, or to an equivalent pay-to-play regime.[75]

We encourage the MSRB to consider eliminating the distinction between affiliated and non-affiliated parties, in favor of a distinction between regulated and unregulated parties. We recommend Rule G-38 be amended to allow municipal securities dealers to use non-affiliated entities who are subject to Rule G-37, Rule G-42, or another comparable pay-to-play regime to solicit municipal securities business on the dealer's behalf.

Ltr. of Peter T. Clarke, Chair, MSRB, to Elizabeth M. Murphy, Secretary, SEC 2 (Oct. 23, 2009), *available at* http://sec.gov/comments/s7-18-09/s71809-247.pdf.

[73] *See* Rule 206(4)-5, 17 C.F.R. § 275.206(4)-5.

[74] SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,036-41,041.

[75] Rule 206(4)-5, 17 C.F.R. § 275.206(4)-5.

2. Rule G-38 Should Not Be Expanded To Cover Payments By Municipal Advisors To Other Municipal Advisors

The MSRB has also asked whether it should expand Rule G-38 so as to ban payments by non-dealer municipal advisors to other municipal advisors that assist them in soliciting municipal advisory business. For the reasons set forth above, SIFMA believes that payments should be permitted to any solicitor that is both regulated and subject to an adequate pay-to-play regime.

C. The MSRB Should Modify The *De Minimis* Contribution Limits In Proposed Rule G-42 And Rule G-37

After careful consideration, the SEC decided in promulgating its Pay-to-Play Rule to define a permissible *de minimis* contribution as (i) any contribution up to $350 per election for candidates for whom the contributor is entitled to vote and (ii) any contribution up to $150 per election for candidates for whom the contributor is not entitled to vote.[76] The SEC explicitly rejected the $250 *de minimis* exception in MSRB Rule G-37, concluding that it did not account for present inflation, and that an exception for contributions to candidates for whom the contributor is not entitled to vote was necessary to protect a person's "legitimate interest in contributing to campaigns."[77]

We believe the same regime should apply uniformly to both Proposed Rule G-42 and Rule G-37, particularly in light of the constitutional concerns involved. The *de minimis* exception in both rules permits a contribution up to only $250 per election, and only for candidates for whom the contributor is entitled to vote.[78] Although this approach may be driven by concerns about circumvention of the pay-to-play regime, it is unnecessary to accomplish that result and unconstitutional under present First Amendment doctrine, which has shifted since the constitutionality of Rule G-37 was considered in *Blount v. SEC*.[79] Put simply, *Blount* is no longer a reliable guide to First Amendment doctrine, and inflation has reduced the significance of a $250 contribution.

As the SEC has recognized, a $250 *de minimis* limit does not "reflect the effects of inflation since the MSRB first established its $250 *de minimis* amount in 1994."[80] In the present day, contributions of $250 do not reflect a significant pay-to-play concern. Indeed, federal contribution limits—for example, $2,500

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[76] SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,035.

[77] *Id.*

[78] Proposed Rule G-42(g)(ii).

[79] *Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995).

[80] SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,035.

per election per candidate for individuals—are much greater and reflect a reasonable distinction between small contributions and those that could have a meaningful effect on a candidate's estimation of the contributor. The present federal contribution limits represent a significant increase from those in place when Rule G-37 was promulgated, and are indexed to inflation.[81] The MSRB has presented no evidence that a $250 *de minimis* limit, set in 1994, is appropriate to address concerns about undue influence or circumvention in 2011. And, as the SEC noted, it may be necessary to "considering increasing" the set amount "in the future if, for example, the value of it decreases materially as a result of further inflation."[82]

Moreover, flatly prohibiting contributions by MAPs to candidates for whom they cannot vote is unduly burdensome. As the SEC has recognized, "persons can have a legitimate interest in contributing to campaigns of people for whom they are unable to vote."[83] Persons who live in metropolitan areas that straddle multiple jurisdictions have perfectly legitimate interests in contributing to campaigns of candidates who, if elected, will be able to alter metropolitan policy. For example, many persons work in Washington, D.C., but live in jurisdictions outside the District. They have legitimate civic interests in contributing to candidates in D.C. elections. It is not clear to us a flat ban on such contributions is necessary. Indeed, the SEC expressly rejected such a flat ban in its Pay-to-Play Rule. Furthermore, the provisions of Proposed Rule G-42, which ban the solicitation or coordination of contributions, and the anti-circumvention provision eliminate any risk of contributions to candidates for whom municipal advisory professionals cannot vote being bundled in such a way to create corruption.[84]

Contributions are a form of protected political speech, and laws restricting contributions must be "closely drawn" to match a "sufficiently important interest."[85] Contribution limits are not closely drawn when they limit more speech than is necessary to advance the state's interest.[86] Therefore, as explained by a plurality of the Supreme Court in *Randall v. Sorrell*, contribution limits can "work more harm to protected First Amendment interests than their anti-corruption objectives [would] justify" and must be struck down when they do so.[87] Preventing corruption is an important state interest, but it will rarely justify

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[81] *See, e.g.*, Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, § 307(a), 116 Stat. 81, 103 (2002); 2 U.S.C. § 441a(c).

[82] SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,035.

[83] SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,035.

[84] *See* Proposed Rule G-42(c) & (d).

[85] *Randall*, 548 U.S. at 247 (plurality opinion) (internal quotation and citation omitted).

[86] *Id.*

[87] *Id.* at 247-48.

a flat ban on political speech, as made clear by the Court in *Citizens United*.[88] Taken together, *Randall*, which involved unduly restrictive contribution limits, and *Citizens United*, which involved expenditure limits but which discussed the First Amendment limits on contribution restrictions, make clear that the MSRB can no longer rely upon the D.C. Circuit's decision in *Blount* to sustain either a $250 *de minimis* limit on contributions to candidates for whom covered persons can vote or flat ban on contributions to candidates for whom covered persons cannot vote. Moreover, Congress has not directed the MSRB to adopt such restrictions.

The strict limits in Proposed Rule G-42 cannot be justified based upon the risk of circumvention. The MSRB need not be concerned about the possibility of the rule being circumvented through multiple *de minimis* contributions being donated to a candidate. The solicitation prohibition in the rule will prevent a dealer or its MAPs from soliciting contributions to covered officials. And the anti-circumvention provision of Proposed Rule G-42 will also be available to address this concern. The SEC's Pay-to-Play Rule addresses the risk of circumvention through similar mechanisms, and the MSRB could adopt the same approach.

Based on the foregoing, we believe the MSRB's approach should be modified in favor of a limit that reflects present inflation and permits persons to exercise their constitutionally protected right to political speech. We recommend that the MSRB adopt the *de minimis* limits contained in the SEC's Pay-to-Play Rule for both Proposed Rule G-42 and Rule G-37. In all events, however, we strongly recommend that the MSRB keep a uniform definition of a *de minimis* contribution under both rules. *See supra* page 11.

III. THE PROPOSED BAN ON COMPENSATION SHOULD BE MORE NARROWLY TAILORED

Proposed Rule G-42 prohibits municipal advisors from "engag[ing] in municipal advisory business with a municipal entity for compensation, solicit[ing] third-party business from a municipal entity for compensation, or receiv[ing] compensation for the solicitation of third-party business from a municipal entity, within two years" of a covered political contribution.[89] With respect to municipal advisors that provide advisory services, the ban on compensation begins when the covered political contribution is made, but ends two years after the advisor has wound down and terminated its business with the municipal entity.[90] Thus, the proposed rule (i) prohibits a solicitor from receiving compensation for work completed prior to the covered political contribution and (ii) potentially bans

[88] 130 S. Ct. at 897.

[89] Proposed Rule G-42(b)(i).

[90] *See* Proposed Rule G-42(b)(i), (iv).

compensation for advisory services for a period greater than two years from the covered political contribution.

We believe that this approach (i) unnecessarily deprives solicitors of compensation with respect to work that is completed prior to a covered political contribution and (ii) unjustifiably extends the compensation ban for advisory services. With respect to the former, we recommend an alternative approach that imposes a ban on future business (similar to the ban in Rule G-37) for municipal advisors engaged in solicitation activities at the time of the covered contribution. This approach would be tailored to the nature of solicitation activities, which like Rule G-37, are transactional in nature and do not require any winding down following a covered contribution. With respect to the latter issue, we recommend the MSRB follow the example of the SEC's Pay-to-Play Rule and measure the two-year time period from the date of the covered political contribution, not from the termination of the advisory relationship.

A. The Proposed Ban On Compensation Should Be Modified To Permit A Solicitor To Receive Compensation For Already-Completed Solicitation Activities

We believe that a ban on compensation that draws on the model of Rule G-37 and permits solicitors to receive compensation for already-completed solicitation activities is appropriately tailored to reflect the transactional nature of solicitation activities.

1. Advisory Relationships And Solicitation Activities Should Be Addressed Differently

Advisors have a fundamentally different relationship with their municipal clients than solicitors, who generally have episodic contacts with potential investors. Advisors have long-term ongoing client relationships, create tailored investment advice to help their clients meet long-term goals, and owe them traditional fiduciary duties. If a municipal advisor is forced to resign, for whatever reason, it may still be required "to fulfill its fiduciary duty to the municipal entity and create an orderly transition period during which the municipal entity [can] obtain successor advisory services."[91] Given these fiduciary duties, we agree that the regulation of advisory services must be sufficiently flexible to allow the continuation of long-term relationships during a winding down period. By contrast, solicitation activity is transactional in nature; in essence, it consists of nothing more than the sale of a security or a service. The risk of pay-to-play corruption with respect to discrete transactions can be addressed differently than the risk of pay-to-play corruption associated with ongoing advisory services.

[91] MSRB Notice 2011-04, at "Draft New MSRB Rule G-42: Reasonable Transition Period."

These differences are reflected in the contrasting approaches of the SEC's Pay-to-Play Rule and MSRB Rule G-37. The SEC's Pay-to-Play Rule imposes a two-year ban on compensation for investment advisers who make a covered political contribution to a municipal official, and directs advisors to discharge their fiduciary duties by winding down their municipal advisory business within a reasonable time.[92] Rule G-37, by contrast, provides a ban on new municipal securities business for two years following a covered political contribution by a municipal dealer (including new business from existing clients).[93] But Rule G-37 does not prohibit compensation for already completed municipal securities transactions and in fact permits a municipal dealer to maintain pre-existing business after a triggering contribution, provided the business was obtained prior to the contribution. There is no evidence that this approach has failed to address pay-to-play practices adequately. Instead, the MSRB has repeatedly reaffirmed the effectiveness of Rule G-37, including in explaining the need for Proposed Rule G-42.[94]

2. Solicitors Should Be Permitted To Receive Compensation For Already-Completed Solicitation Activity

By contrast, Proposed Rule G-42 is not so narrowly tailored. With respect to ongoing advisory business, Proposed Rule G-42 imposes a two-year ban on compensation following "the date on which [the municipal advisor's] . . . municipal advisory business with the municipal entity has been terminated."[95] Municipal advisors providing municipal advisory services, however, would *not* be prohibited for receiving compensation due for work completed *prior to* the covered political contribution; instead, the prohibition on "*engaging* in municipal advisory business for compensation" would "begin on the date of the contribution."[96]

With respect to transactional solicitation activities, however, Proposed Rule G-42 bans the solicitor from "receiv[ing] compensation for the solicitation of third-party business[] within two years after any" covered contribution.[97] As a consequence of the proposed approach, it appears that solicitors would be unable to receive compensation for a completed solicitation in any case in which the solicitation activity was done before both (i) the receipt of compensation and (ii) the covered political contribution. This approach appears designed to reduce the

[92] Rule 206(4)-5, 17 C.F.R. § 206(4)-5.

[93] Rule G-37(b)(i); Rule G-37 Interpretive Notice.

[94] MSRB Notice 2011-04, at "Background: Existing MSRB Rule G-37."

[95] Proposed Rule G-42(b)(iv).

[96] Proposed Rule G-42(b)(iv) (emphasis added).

[97] Proposed Rule G-42(b)(i).

risk of circumvention. As the MSRB has explained, the "draft rule would . . . ban the receipt of compensation for the solicitation of third-party business from a municipal entity within two years after a non-*de minimis* contribution to address those situations in which the solicitation might have been made at the time of the contribution."[98] But the effect of the proposed rule will be not only to prevent contemporaneous *quid pro quo* transactions, but also to prohibit a solicitor from receiving compensation for work that was already completed before the covered political contribution took place.

We therefore request that Proposed Rule G-42 be modified to permit solicitors to receive compensation for work completed prior to a covered political contribution. In our view, the most straightforward solution would be to create two separate bans that mirror the bans in the SEC's Pay-to-Play Rule and MSRB Rule G-37, respectively. Following a covered political contribution, municipal advisors would be prohibited from engaging in municipal advisory business with a municipal entity for compensation within two years after they have ended the advisory relationship—just as investment advisers are subject to a similar ban in the SEC's Pay-to-Play Rule. Solicitors, however, would be subject to a flat ban on soliciting any new business for two years after a covered political contribution, including new business from an existing relationship, but would be permitted to receive compensation for work completed prior to the contribution—just as municipal dealers are subject to a two-year ban on new business under Rule G-37, but are permitted to receive compensation for pre-existing business. Enforcement under Rule G-37 demonstrates that our proposed approach is feasible, manageable, and appropriately tailored to transactional settings.

In sum, we recommend the MSRB tailor its pay-to-play rule to fit the differences between advisory and solicitation relationships while deterring pay-to-play corruption.[99]

B. The Proposed Ban On Compensation Should Not Be Greater Than Two Years From The Date Of The Contribution For Municipal Advisors

Under Rule G-42 as proposed, "in the case of a municipal advisor engaged in municipal advisory business with a municipal entity, the [two-year] prohibition on engaging in municipal advisory business for compensation . . . shall begin on the date of the [covered political] contribution . . . and end two years after the date on which all of its municipal advisory business with the municipal entity has been

[98] MSRB Notice 2011-04, at "Draft New MSRB Rule G-42: Draft Rule G-42 Distinguished from Rule G-37," n.27.

[99] The MSRB can address its concern for cases "in which the solicitation might have been made at the time of the contribution" by either (i) revising the compensation ban to focus squarely upon that issue or (ii) making clear in an interpretive guidance that such simultaneous solicitations and contributions cannot be used to circumvent Proposed Rule G-42's pay-to-play regime. *Id*.

terminated."[100] Because an municipal advisor engaged in municipal advisory business owes its clients a fiduciary duty and must take time to wind down any business before terminating it, the MSRB's proposed approach makes the ban on compensation effectively longer than two years from the date of a covered contribution. We see no reason why a greater-than-two-year ban is necessary to deter pay-to-pay corruption.[101]

The SEC's Pay-to-Play Rule—which also addresses advisory relationships—does not impose such a ban, but instead provides that an investment adviser may not "provide investment advisory services for compensation to a government entity within two years after" a covered political contribution.[102] Like the MSRB, the SEC has recognized that an advisor has a fiduciary duty and must unwind advisory relationships before terminating them. And like the MSRB, the SEC has recognized that an advisor should not be forced to conduct advisory services for an extended period of time, but rather should be allowed to terminate business after a "reasonable" time period.[103] But unlike the MSRB, the SEC has recognized that there is no reason to impose a ban on compensation that is in effect longer than two years from the date of a political contribution simply because an advisor (who is already not being compensated) is properly dismissing its fiduciary duty.

We recommend that the MSRB follow the SEC's model in the Pay-to-Play Rule and measure the end of the two-year compensation ban from the date of the covered political contribution in all cases. A more stringent approach is unnecessary and unduly burdensome.

IV. THE MSRB SHOULD SET AN OPERATIVE DATE THAT ALLOWS COVERED MUNICIPAL ADVISORS AN ADEQUATE OPPORTUNITY TO DEVELOP COMPLIANCE REGIMES

Finally, we respectfully request that the MSRB give covered municipal advisors an adequate opportunity to adapt their compliance structures to the new requirements of Proposed Rule G-42. Developing a comprehensive Rule G-42 compliance framework will be a time-consuming and burdensome task for many covered parties, and in particular, a significant amount of time will be necessary if the SEC adopts a broad definition of "municipal advisor" and thus sweeps many

[100] Proposed Rule G-42(b)(iv).

[101] Instead, the MSRB has simply noted that advisors have a fiduciary duty and must wind down their advisory relationships, *see* MSRB Notice 2011-04, at "Draft New MSRB Rule G-42: Ban on Business for Compensation," but that fact alone does not mandate a greater-than-two-year ban on compensation.

[102] Rule 206(4)-5(a)(1), 17 C.F.R. § 275.206(4)-5(a)(1).

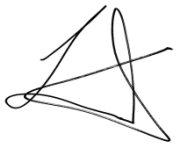
[103] *See* SEC's Pay-to-Play Rule, 75 Fed. Reg. at 41,057; MSRB Notice 2011-04, at "Draft New MSRB Rule G-42: Reasonable Transition Period."

already-regulated entities—such as banks providing traditional banking services—into Proposed Rule G-42. Accordingly, the MSRB should follow the approach taken in the SEC's Pay-to-Play Rule and provide that covered municipal advisors are not subject to the prohibitions of Proposed Rule G-42 for a period of time after the Rule takes effect, although—in light of the September problem—we recommend that the MSRB permit covered municipal advisors to voluntarily subject themselves to the Rule's restrictions at an earlier date.[104]

* * *

SIFMA appreciates this opportunity to comment upon Proposed Rule G-42. Please do not hesitate to contact me with any questions at (212) 313-1130; or Barbara Stettner and Charles Borden, of O'Melveny & Myers LLP, at (202) 383-5283 and (202) 383-5269, respectively.

Sincerely,



Leslie M. Norwood
Managing Director and
Associate General Counsel

Enclosure

[104] As we discuss *supra* page 5-6, SIFMA recommends that if it is necessary to solve the September problem the MSRB should promulgate an interim final pay-to-play rule for persons who have voluntarily registered as municipal advisors.

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Robert Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
Martha Haines, Assistant Director and Chief, Office of Municipal Securities
Victoria Crane, Assistant Director, Office of Market Supervision
Robert Plaze, Associate Director, Division of Investment Management

Lynnette Hotchkiss, Executive Director, Municipal Securities Rulemaking Board

APPENDIX A: COVERED PERSONS UNDER SECTION 975 OF THE DODD-FRANK ACT

The following chart reflects the categories of parties who are clearly covered and clearly outside the scope of the definition of "municipal advisor" in the Dodd-Frank Act. The disputed category column reflects conflicts between the statute and the SEC's proposed definition of "municipal advisor."

Category A	Category B[105]	Category C
Unaffiliated solicitors seeking investment advisory services contracts	Regulated, unaffiliated solicitors placing fund interests (*e.g.*, third-party BD placement agents) selling fund, LGIP, other pooled investment vehicle interests	Affiliated solicitors seeking investment advisory services contracts[106] (*e.g.*, BDs or investment advisers soliciting for separate accounts or other direct advising arrangements)
Unregulated solicitors/advisors to muni entities (*e.g.*, municipal consultants, finders) [107]	Any person providing advice (or soliciting advisory services) with respect to assets that are not the initial proceeds of municipal securities (*e.g.*, banks providing traditional banking activities)	Advisers to pooled investment vehicles[108]

[105] In addition to the examples offered herein, this category includes the disputed entities discussed in SIFMA's comment letter to the SEC on the Municipal Advisors NPRM. *See* SIFMA Municipal Advisors NPRM Letter.

[106] The SEC has proposed that affiliates should "voluntarily" register as municipal advisors. *See* Municipal Advisors NPRM, 76 Fed. Reg. at 831-32.

[107] This category is a subset of the three categories below it.

[108] SIFMA is requesting confirmation of this point in its comments to the SEC on the Municipal Advisors NPRM. SIFMA Municipal Advisors NPRM Letter at 18-20.

Category A (con't)	**Category B (con't)**	**Category C (con't)**
Any person who is providing advice (or soliciting advisory services) on (i) the initial investment of the proceeds of municipal securities and (ii) the recommendation of and brokerage of municipal escrow investments (except for BD/muni dealer underwriters, investment advisers providing advice on the issuance of municipal securities under the Advisers Act, commodity traders providing advice on municipal swaps, or attorneys and engineers)[109]		Regulated, affiliated solicitors placing fund interests[110] (BDs, investment advisers)
Any person who is providing advice (or soliciting advisory services) with respect to the issuance of muni securities (except for BD/muni dealer underwriters, investment advisers providing advice on the issuance of municipal securities under the Advisers Act, commodity traders providing advice on municipal swaps, or attorneys or engineers acting in their professional capacities)[111]		
Any person who is providing advice (or soliciting advisory services) on municipal derivatives or GICs (except for BD/muni dealer underwriters, investment advisers providing advice on the issuance of muni securities under the Advisers Act, commodity traders providing advice on muni swaps, or attorneys or engineers acting in their professional capacities)[112]		

[109] The scope of the exception noted here is still unclear and was the subject of comments from SIFMA on the Municipal Advisors NPRM. SIFMA Municipal Advisors NPRM Letter at 28-35.

[110] The SEC has proposed that affiliates should "voluntarily" register as municipal advisors. *See* Municipal Advisors NPRM, 76 Fed. Reg. at 831-32.

[111] The scope of the exception noted here is still unclear and was the subject of comments from SIFMA on the Municipal Advisors NPRM. SIFMA Municipal Advisors NPRM Letter at 28-35.

[112] The scope of the exception noted here is still unclear and was the subject of comments from SIFMA on the Municipal Advisors NPRM. *Id*.