

INFORMATIONAL

MSRB Rule G-37 Exemptive Relief

NASD Issues Various MSRB Rule G-37 Decisions On Exemptive Relief

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- Internal Audit
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KEY TOPICS

- MSRB Rule G-37
- Political Contributions

Executive Summary

Since May 1999, NASD Regulation, Inc. (NASD RegulationSM) has considered three requests for exemptive relief under Municipal Securities Rulemaking Board (MSRB) Rule G-37 (Rule G-37 or Rule), relating to political contributions and prohibitions on municipal securities business. NASD Regulation granted exemptive relief to one member firm and denied exemptive relief to two other firms. In one of the cases where NASD Regulation staff denied exemptive relief, the member firm appealed the decision to the National Adjudicatory Council (NAC), which upheld the initial decision. The decisions are included in redacted form as Attachments to this Notice.

Questions/Further Information

Questions regarding this Notice may be directed to Malcolm Northam, Director, Fixed Income Securities, Department of Member Regulation, NASD Regulation, at (202) 728-8085; or Sharon Zackula, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8985.

Discussion

In recent years, NASD Regulation has published its responses to requests from member firms for exemptive relief to assist firms in evaluating the adequacy of their Rule G-37 compliance procedures and assessing the circumstances that may warrant exemptive relief under Rule G-37(i).

Attachment A provides guidance with respect to political contribution payments made by municipal finance professionals (MFPs) that are drawn from joint checking

accounts. The exemption request arose as a result of a \$400 political contribution made by an MFP from an account in which the MFP and his spouse were signatories. The member firm argued in the request for exemptive relief that the political contribution should be viewed as having been made on behalf of both the MFP and the spouse, *i.e.*, a contribution of \$200 each. NASD Regulation staff denied the exemption based on an MSRB interpretive release that states that if an MFP signs a check, whether the check was drawn on a joint account or not, and submits it as a contribution to an issuer official, the MFP is deemed to have made the full contribution.

The second exemption letter, **Attachment B**, grants relief from the prohibitions of engaging in municipal securities business contained in MSRB Rule G-37(b) in response to the merger of two parent corporations, each of which owned a broker/dealer subsidiary. Political contributions were made by MFPs of one of the parent corporations to candidates in states in which that corporation did not engage in municipal finance activities.

In the absence of an exemption, the merger of the two parent corporations and their respective broker/dealer subsidiaries would subject the surviving broker/dealer subsidiary to the prohibitions of Rule G-37. Exemptive relief was granted in this instance based on NASD Regulation staff's consideration of a recent MSRB rule interpretation that clarifies that Rule G-37 was not intended to prevent mergers in the municipal securities industry, or seriously hinder the surviving broker/dealer's business, if the merger was not intended to circumvent the Rule.¹

In **Attachment C**, the NAC responded to the most recent request for relief under MSRB Rule G-37(i) filed with NASD Regulation. The NAC was asked to consider the appeal of a firm that was barred from participating in municipal securities business with certain issuers in a state because P, the chairman and president of the firm, made duplicate campaign contributions, each totaling \$250, to a candidate for state office for whom P was entitled to vote. P made the second contribution, by check, based upon the representation from a campaign staff member that the campaign had lost the first check. Because the campaign then cashed both checks, absent an exemption, the firm was barred because P

exceeded the *de minimis* campaign contribution of \$250 per official per election allowed under MSRB Rule G-37(b). The firm had formal procedures in place to ensure compliance with the Rule, but the firm was not able to detect the second \$250 contribution because P did not follow the firm's procedures when he made the second contribution. Given P's position and his understanding of the potential adverse consequences to the entire entity, the NAC concluded that exemptive relief should not be granted in that P's second contribution was made without taking clear, simple, inexpensive, and effective steps to ensure that the second contribution would not have an adverse impact on the firm's business operations.

Summary

Although exemptive relief under Rule G-37 is granted based on the unique facts and circumstances presented by each request, publication of the exemption letters attached to this *Notice* are intended to provide member firms further guidance as to the conditions under which exemptions may be granted. NASD Regulation's publication of the factual circumstances presented in the exemption requests is also intended to help member firms avoid inadvertently triggering the two-year prohibition of Rule G-37.

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ATTACHMENT A

Exemptive Relief Denied

This is in response to your letters dated May 17 and June 10, 1999 requesting an exemption for **Firm X** from the prohibition of engaging in municipal securities business contained in Municipal Securities Rulemaking Board (MSRB) Rule G-37 (Rule).

The exemption request results from a \$400.00 contribution made on October 5, 1997 by a registered representative (Representative) to a member of the **City A** City Council for whom the Representative was eligible to vote. Subsequent to the contribution, the Firm participated in three transactions involving the **City A**. You seek an exemption from the Rule because although the \$400.00 contribution check was signed by and reflects only the Representative's name, both the Representative and his spouse were authorized signatories on the joint account. You have provided affidavits dated May 17, 1999 from both the Representative and his spouse which indicate that the political contribution was discussed and agreed to by both individuals prior to the time the contribution was made, and that it was the intention that the contribution be made on behalf of both individuals. Thus, you believe that the contribution should be viewed as having been made on behalf of both the Representative and spouse, *i.e.* a contribution of \$200.00 each.

Rule G-37 allows municipal finance professionals to make political contributions in an amount up to and including \$250.00 to a person for whom the municipal finance professional is entitled to vote. In a February 16, 1996 interpretive release the MSRB stated that "[I]f a municipal finance professional signs a check, whether the check was drawn on a joint account or not, and submits it as a contribution to an issuer official, then the municipal finance professional is deemed to have made the full contribution"

Based upon the facts you have presented, and the MSRB's interpretive release, we conclude that the entire \$400.00 contribution should be attributed to the **Firm X's** Representative. Accordingly, the Firm is not entitled to an exemption from Rule G-37.

Additionally, your letters state that the **Firm X** does not believe that the Representative is a "municipal finance professional" because the Representative's municipal securities conduct was limited to isolated introductions of **Firm X** municipal finance bankers to representatives of the government of the **City A**. For purposes of this response, we have assumed that the Representative would be considered a municipal finance professional under the Rule. Any questions concerning the Representative's status as a municipal finance professional under the Rule should be addressed to the MSRB.

Finally, as outlined in your letters and the attachments, **Firm X** had procedures which required that political contributions by officers or employees of **Firm X** be subject to a pre-clearance/reporting process. The Representative apparently did not either pre-clear or report his political contribution. The failure of the Representative to follow **Firm X's** procedures is not a consideration whether to consider an exemption to the Rule.

ATTACHMENT B

Exemptive Relief Granted

This is in response to your letter dated August 30, 1999, which requests an exemption from the prohibition of engaging in municipal securities business contained in the Municipal Securities Rulemaking Board (MSRB) Rule G-37 (Rule).

The request for an exemption is a result of a merger of **Corporation A** with **Corporation B**. **Corporation A** is the parent company of **Firm X**. Pursuant to the merger of **Corporation A** and **Corporation B**, **Firm X** will be merged with **Firm Y**, a registered broker-dealer subsidiary of **Corporation B**. An exemption from the Rule is requested because of political contributions to issuer officials made by two senior officials of **Corporation B**.

In support of your request for an exemption, you make a number of representations in your letter including the following:

Two senior officials at **Corporation B** made contributions that were properly reported by **Corporation B** in its G-37/38 Reports. One of the senior officials made a \$1,000 contribution to a private citizen running for Governor of **State A** on August 10, 1998. You state that the recipient of the **State A** Contribution lost the election and is not currently an issuer official. You represent that the **Corporation B** senior official who made the **State A** Contribution was not connected with municipal finance efforts; rather, he was a chief operating officer of **Corporation B's** holding company. You further represent that the senior official is resigning from **Corporation B** prior to the merger date with **Firm X**, and the official will not be associated with **Firm X**.

A second contribution of \$1,000 was made by an official of **Corporation B** to the current Lt. Governor of **State B** in connection with the 1998 campaign for Governor and Lt. Governor of **State B**. The **State B** Contribution was made on October 22, 1998. You argue that the **State B** Contribution does not raise any of the concerns that the Rule is designed to address. You state that an individual at **Corporation B** (rather than its broker-dealer subsidiary, **Firm Y**), made the contribution while working for **Corporation B**. **Corporation B**, as you represent, does not have any operations in the **State B** and has no **State B** public finance clients. You also state that the senior official who made the **State B** Contribution will not be involved in the public finance effort at **Firm X**; he possibly will be a director. You represent that the **State B** Contribution was never intended to, nor could be perceived to be intended to, influence the awarding of public finance business in **State B**, since **Corporation B** had no plans to seek business in **State B** at the time of the contribution. Further, you state that the **Corporation B** officer who made the **State B** Contribution will not be involved in the solicitation of municipal finance business, and there is no connection between the contribution and **Firm X's** public finance efforts.

We consent to an exemption of the two year prohibition from municipal securities business with an issuer as defined by Rule G-37. Our consent is based on consideration of the MSRB's recent interpretation of G-37;² and in consideration of the fact that instead of combining the activities of its affiliated securities firms, the parent holding company could have exercised its ability to simply avoid the prohibition contained in the Rule by maintaining separate securities affiliates. Our consent is also based on your representation that the senior official who made the **State B** Contribution will not be involved in the solicitation of municipal finance business or otherwise involved in the public finance effort at **Firm X**. Please be advised that this exemption is based strictly on our understanding of the material facts as you have represented them and that our decision in this matter could be different if the facts are not represented or if other material facts have not been disclosed to us.

ATTACHMENT C

Exemptive Relief Denied

The National Adjudicatory Council ("NAC") of NASD Regulation, Inc. ("NASD Regulation") reviewed the appeal of **Firm X** requesting exemptive relief on December 16, 1999, and denied the request.

P, the chairman of the Board and president of **Firm X**, made two \$250 contributions to the campaign of a candidate for a **G** state office. Before making the first contribution, **P** did not follow the **Firm X** procedures expressly by submitting a request in writing to **DQ**, the firm's Designated Qualified Municipal Securities Principal, to obtain clearance to make the contribution, but represented that he took steps above and beyond those required by the procedures by obtaining pre-clearance orally from both **DQ** and **R**, Associate General Counsel of **Firm X**. Several months later, upon receiving a telephone call from the campaign stating that the campaign had misplaced **P**'s initial \$250 contribution, **P** wrote a second check for \$250 to the campaign. **P** did not follow the **Firm X** procedures when he wrote the second contribution check. He indicated that he did not do so because the second check was merely a replacement for the first contribution, which had been pre-cleared by the appropriate **Firm X** person, the firm's Designated Qualified Municipal Securities Principal. Both checks were cashed by the campaign with the result that **P** exceeded the allowable contribution to the candidate for whom **P** was entitled to vote by \$250.

Although it appears that the formal procedures in effect at **Firm X** are sufficient to assure compliance with MSRB Rule G-37, **P** did not use these procedures in determining whether to make a second contribution to the campaign. Further, the MFP, as president of **Firm X**, is keenly aware of the adverse impact to a firm for failing to comply with MSRB Rule G-37. Notwithstanding **P**'s position and the potential adverse consequences to the entire entity, **P** made a second contribution to the campaign without taking clear, simple, inexpensive, and effective steps to assure that a contribution would not have an adverse impact on the firm's business operations. **P** did not determine before writing the second check if the first check had been cashed; if the check had not been cashed, **P** did not issue instructions to stop payment on the first check to avoid a duplicative contribution. Although the motive or intent of the senior officer here does not appear to be in issue, a person could use similar facts and circumstances to intentionally avoid the limits that MSRB Rule G-37 imposes on campaign contributions. In conclusion, granting relief does not appear to be appropriate because of **P**'s failure to take simple, remedial steps to avoid the possibility of violating the rule, and for this reason the NAC denied the exemptive relief requested.

The NAC granted the request for confidential treatment regarding the record generally, except that the decision of the NAC will be published in redacted form in the NASD's Notices to Members, and otherwise provided in redacted form as requested. Key identifying information that may identify the actual parties or the issuer will be redacted (e.g., the name of the MFP; the name of the member firm; the name of the recipient of the contribution; the name of the city, state or governmental entity that is the issuer; and other legal names that may allow a reader to identify the parties involved).

Endnotes

¹See MSRB Notice of Interpretation, Q&A No. 1, Securities Exchange Act Release No. 34-40167 (July 2, 1998), 63 FR 37434.

²In recent interpretive guidance concerning the applicability of Rule G-37 in connection with mergers in the municipal securities business, the MSRB stated that the rule, “was not intended to prevent mergers in the municipal securities industry or, once a merger is consummated, to seriously hinder

the surviving dealer’s municipal securities business if the merger was not an attempt to circumvent the [Rule’s] letter or spirit.” See MSRB Notice of Interpretation, Q&A No. 1, Securities Exchange Act Release No. 34-40167 (July 2, 1998), 63 FR 37434.