

NASD Notice to Members 99-14

NASD Grants Exemptive Relief Under MSRB Rule G-37(i)

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) recently considered and granted three requests for exemptive relief under Municipal Securities Rulemaking Board (MSRB) Rule G-37(i). The staff decisions are published on the following pages in redacted form.

Questions regarding this *Notice* should be directed to Malcolm Northam, NASD Regulation, at (202) 728-8085; or Sharon Zackula,

Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8985.

Two of the exemption requests resulted from circumstances involving political contributions made prior to a merger of member firms. One exemption request resulted from unique circumstances surrounding the application of MSRB Rule G-37 to member firms that distribute Internal Revenue Code Section 529 tuition savings plans.

Suggested Routing

- ☒ Senior Management
- ☐ Advertising
- ☐ Continuing Education
- ☐ Corporate Finance
- ☐ Executive Representatives
- ☐ Government Securities
- ☐ Institutional
- ☐ Insurance
- ☐ Internal Audit
- ☒ Legal & Compliance
- ☒ Municipal
- ☐ Mutual Fund
- ☒ Operations
- ☐ Options
- ☒ Registered Representatives
- ☒ Registration
- ☐ Research
- ☐ Syndicate
- ☐ Systems
- ☐ Trading
- ☐ Training
- ☐ Variable Contracts

Recent Decisions Regarding MSRB Rule G-37(i) Exemptive Relief

Letter 1: Exemptive Relief Granted

Firm A
Address

Re: **Firm A** MSRB Rule G-37 Exemption Request

Dear **Mr.**

This is in response to your letters dated **Date**, and **Date** and our telephone communication of **Date** requesting an exemption for **Firm A** from the prohibition of engaging in municipal securities business contained in Municipal Securities Rulemaking Board (MSRB) Rule G-37 (Rule).

Based on your letters, as well as our telephone conversation on **Date**, we understand that this request arises out of **Firm A's Date** purchase of certain assets of **Firm B**, a municipal securities dealer located in **City**. You represent that although **Firm B** was a municipal bond dealer, its retail municipal bond business accounted for less than 2% of its annual revenue, and any such business merely accommodated clients who wished to purchase or sell municipal bonds. **Firm B** was not involved in municipal negotiated underwriting activities, private placement activities, remarketing services, or financial advisory or consultant services. You also represent that **Firm B's** municipal business did not play a role in **Firm A's** decision to purchase certain of its assets.

Name was the President and Chief Executive Officer of **Firm B** and on its executive committee. By virtue of his position on the executive committee, **Name** falls within the Rule's definition of a municipal finance professional (MFP). However, you represent that he was the only individual in **Firm B** that was an MFP as defined in G-37(g)(iv). Accordingly, pursuant to G-37 (g)(iv)(E), any political contributions made by **Name** while employed at **Firm B** were neither recordable nor reportable and would not have triggered a two-year business ban for **Firm B**.

In connection with the **Date** asset purchase, both **Firm A** and **Name** envisioned that **Name** would play an integral role at **Firm A**. Prior to the closing of the purchase, **Name** disclosed that within the past two years while employed at **Firm B**, **Name** had made a political contribution to an issuer official for whom he was not eligible to vote. Specifically, **Name** made a \$1,000 personal contribution to City Mayor **Name** on **Date**. You represent that **Name** contribution was not intended to influence, obtain or retain municipal securities business for **Firm B** or any other firm. Because **Name** was not deemed an MFP under Rule G-37, his contribution did not trigger any business ban for **Firm B**.

Firm A, as a registered municipal securities dealer, is subject to Rule G-37. You represent that, to date, **Name** is not deemed an MFP at **Firm A**. **Name** has been appointed an Executive Vice President - Capital Markets. He does not operate in any municipal securities representative capacity at **Firm A** and does not obtain or retain any municipal securities business for **Firm A**. You represent that **Name's** current position as an associated person in charge of a principal business unit classifies him as a "non-municipal finance professional executive officer" under the Rule, and does not subject **Firm A** to a two-year prohibition due to his 1997 contribution to Mayor **Name**.

If the request for an exemption from the prohibition of engaging in municipal securities is granted, **Firm A** will appoint **Name** to its Executive and Management Committee, making him a MFP within the definition of the Rule. You indicate that **Name's** extensive and considerable experience in corporate finance and management will provide essential advice and guidance to the direction of **Firm A's** overall business as it cultivates clients and develops new products and markets.

You indicate that **Firm A's** purchase of **Firm B's** assets was not an attempt to circumvent the letter or spirit of MSRB Rule G-37. You assert that if **Firm A's** request for an exemption is not granted, **Firm A** would be penalized based

solely for a political contribution made by **Name** prior to **Firm A's** acquisition that was not subject to the Rule when it was made. You believe this is inconsistent with the intent of Rule G-37 and interpretive guidance.

As you know, the Rule makes provision for a *de minimis* political contribution in instances when the political contribution is made to a person for whom the contributor is entitled to vote. However, there is no *de minimis* exemption when a political contribution is made to a person for whom the contributor is not entitled to vote. The MSRB has published several interpretations to Rule G-37. In a published interpretation dated May 24, 1994 (Q&A number 15), the MSRB indicates, in part, that in the event political contributions were made prior to becoming a MFP, the dealer's prohibition on business would begin when the MFP becomes associated with the dealer. However, in June, 1998, the MSRB provided interpretive guidance that Rule G-37 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 letter or spirit of Rule G-37.

Based on the representations contained in your letters, including that **Firm B** was deemed not to have any MFPs, that **Name** does not currently meet the Rule's definition of an MFP, and that **Name** will become an MFP solely by his appointment (if the exemption request is granted) to **Firm A's** Executive and Management Committees, we consent to exemption relief to **Firm A** by removing the ban on the MSRB's Rule G-37(b) business activities effective as of the date of this letter. Please be aware that our consent 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 as represented or if other material facts have not been disclosed to us.

Letter 2: Exemptive Relief Granted

Firm A
Address

Dear **Mr.**

This is in response to your letters dated **Date**, and **Date** and subsequent telephone conversations requesting an exemption for **Firm A** from the prohibition of engaging in municipal securities business contained in Municipal Securities Rulemaking Board (MSRB) Rule G-37 (Rule).

The request for an exemption is the result of the merger of **Firm B** into **Firm A**, and arises because of political contributions to issuer officials made by three employees who were designated as municipal finance professionals at **Firm A**.¹

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

- the applicable contributions were made by three associated persons of **Firm C** [a firm which previously merged into **Firm A**] and two of these individuals are no longer associated with **Firm A**;
- the designation by **Firm C** of these three individuals as municipal finance professionals was a conservative measure taken by virtue of their membership on the **Firm C** Executive Committee and had no bearing on the business of **Firm C** because the firm did not engage in negotiated underwritings, financial advisory services, or placement or remarketing agent services with issuers of municipal securities;
- the contributions were not intended to influence the award of municipal securities business within the meaning of the Rule because **Firm C** did not engage in municipal securities business, as defined in the Rule, prior to its acquisition, and **Firm A** has not been involved in such business in **State** since such date;
- both **Firm C** and **Firm A** had developed and instituted procedures reasonably designed to ensure compliance with MSRB Rule G-37 when the contributions were made and the contributions were duly reported on MSRB Form G-37/G-38 in accordance with Rule G-37; and
- the merger of the two member firms was incidental to, and effected subsequent to, the merger of the bank holding companies **Name** and **Name**.

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 all of the representations made in your letters; in consideration of the MSRB's recent published interpretation of Rule G-37²; and in consideration of the fact that instead of combining the activities of their 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, and **Firm B** could have continued to engage in municipal securities business throughout **State** free from any Rule G-37 prohibition.

Please be aware that our consent 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 as represented or if other material facts have not been disclosed to us.

¹ Recipient Office: issuer Name Office: issuer Name Name	Amount \$1,000 \$1,000 \$ 500	Date Date Date Date	Contributor Name Name Name
---	--	---	--

²In recent interpretive guidance concerning the applicability of Rule G-37 in connection with mergers in the municipal securities business, the MSRB stated:

[Rule G-37] 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.....(emphasis added). See MSRB Notice of Interpretation, Q&A No. 1, Securities Exchange Act Release No. 34-40167 (July 2, 1998), 63 FR 37434.

Letter 3: Exemptive Relief Granted

Firm A
Address

Dear **Mr.**

This is in response to your letter dated **Date** requesting a one-time exemption for **Firm A** from the prohibition of engaging in municipal securities business contained in Municipal Securities Rulemaking Board (MSRB) Rule G-37 (Rule).

Based on your letter, we understand that this request arises because of **Firm A's** desire to act as distribution agent in a tuition savings plan³ being developed by the **Issuer**. As indicated by your letter, you believe that certain Section 529 tuition savings plans might be deemed to be municipal securities. Accordingly, by virtue of being the distribution agent for such securities, **Firm A** might be responsible for complying with MSRB rules pertaining to the municipal securities underwriting business.² If so, **Firm A** would be precluded from performing the functions described in your letter with respect to **issuer's** proposed Section 529 tuition savings plan program.

According to your letter, **Firm A** is not in the municipal securities underwriting or finance business, and has not engaged in, and does not intend to engage in, municipal securities business as defined in Rule G-37 other than in connection with Section 529 tuition savings plans. **Name** is the President of **Firm A** and is eligible to vote in the **State** gubernatorial election. On **Date**, he made two \$500 contributions to each of two candidates for Governor of **State**. Two months after the contributions were made, **Firm A** was advised by outside counsel that its participation in Section 529 tuition savings plans might be deemed to involve the underwriting of municipal securities. **Name** subsequently sought and received the return of \$250 of each of his contributions, thus bringing the contributions within the "*de minimis*" exception to Rule G-37(b). In order both to assist **Issuer** in implementing its Section 529 tuition savings plan and to participate in the distribution of interests in the Section 529 tuition savings plan, **Firm A** has undertaken to comply with all of the applicable MSRB rules, including Rule G-37.

The following additional representations and arguments are made in support of your request:

- In its letter to Alden Adkins dated **Date**, **Issuer** has represented that unless the exemption request is granted, the citizens of **State** will be deprived of access to an important state-sponsored college savings program until **Date**, and that this will have a significant negative effect on the ability of the **State** to offer an effective and secure savings program.
- The Section 529 tuition savings plan seemingly has little in common with investments that are classified as municipal securities, and **Firm A** reasonably did not assume that its role in distributing interests in the tuition savings plan on an agency basis would constitute municipal securities business.
- In **Date**, when **Firm A** discovered that **Name** might become a municipal finance professional because of the proposed Section 529 tuition savings plan business, his contributions already had been identified and reported to the MSRB because of his association with, and designation as a non-MFP executive officer of, a different **Firm A** broker-dealer, **Firm B**.

We hereby grant an exemption to **Firm A** from the prohibition of MSRB Rule G-37(b) effective **Date**. This position is based on all the representations contained in your letter, supporting attachments, and telephone communications. In granting this exemption we note in particular: that the contributions by **Name** are the only contributions by a person who may be deemed a **Firm A** municipal finance professional that, absent an exemption, would prohibit **Firm A** from engaging in municipal securities business with **State**; that all contributions by **Name** previously have been properly recorded and reported; that **Firm A** has not engaged in municipal securities business as defined in Rule G-37 other than in connection with Section 529 tuition savings plans; that **Firm A** does not intend to engage in municipal securities business as defined in Rule G-37 during the remainder of the two-year period since **Name** contributions; and the unique characteristics of the tuition savings plans. Please be aware that our consent 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 as represented or if other material facts have not been disclosed to us.

³In 1996, the Internal Revenue Code was amended through the addition of Section 529 to encourage "qualified state tuition programs" pursuant to which states can establish and maintain tax-deferred savings programs under which participants may make contributions to accounts established for the purpose of meeting the qualified higher education expenses of designated beneficiaries. To qualify, the program must be "established and maintained" by a state, a state agency, or a state municipality (Section 529 tuition savings plan).

²For purpose of this request we assume that participant interests in **Issuer's** Section 529 tuition savings plan constitute "municipal securities," and that **Firm A's** activities in connection with the plan constitute municipal securities business within the meaning of Rule G-37. Any questions concerning the legal interpretation of terms used in the letter should be addressed to the MSRB.

© 1999, National Association of Securities Dealers, Inc. (NASD). All rights reserved.