



MSRB Notice 2007-29 (SEPTEMBER 25, 2007)

MSRB Publishes Interpretive Letter Relating to Payments to Non-Political Accounts of Political Organizations Under Rule G-37

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The Municipal Securities Rulemaking Board has published an interpretive letter relating to Rule G-37, on political contributions and prohibitions on municipal securities business, with respect to payments to non-political accounts of political organizations. The text of the interpretive letter is included below. Questions regarding the interpretive letter may be directed to Ernesto A. Lanza, Senior Associate General Counsel, Jill C. Finder, Associate General Counsel, or Ronald W. Smith, Senior Legal Associate.

September 25, 2007

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TEXT OF INTERPRETIVE LETTER

Rule G-37 Interpretive Letter – Payments to Non-Political Accounts of Political Organizations. This is in response to your request for clarification that language relating to the “fungibility” of money included in Question and Answer No. III.8 dated September 22, 2005 (the “2005 Q&A”)[1] under Rule G-37, on political contributions and prohibitions on municipal securities business, was not intended to be construed to prohibit all contributions to political committees, political parties, political action committees (“PACs”) and other political entities or committees within the meaning of Section 527 of the Internal Revenue Code (collectively, “political organizations”) that might themselves make contributions to officials of issuers.

Rule G-37 does not prohibit contributions to political organizations or issuer officials. Rather, contributions to officials of an issuer by a broker, dealer or municipal securities dealer (“dealer”), a municipal finance professional (“MFP”) of the dealer, or a PAC controlled by the dealer or any of its MFPs can result in the dealer being banned from engaging in municipal securities business with such issuer for a period of two years under section (b) of the rule.[2] Further, if a dealer is currently engaged in, or seeking to become engaged in, municipal securities business with an issuer, then such dealer and its MFPs are prohibited from soliciting or coordinating contributions to officials of such issuer under section (c) of the rule. Section (d) of Rule G-37 provides, in part, that no dealer or MFP shall, directly or indirectly, through or by any other person or means, do any act which would result in a violation of section (b) or (c) of the rule.

The MSRB has previously provided guidance regarding the potential for payments made to political organizations or other third parties to constitute indirect contributions to issuer officials for purposes of Rule G-37(d). In guidance published in 1996, the MSRB stated that a dealer would violate Rule G-37 by doing municipal securities business with an issuer after providing money to any person or entity when the dealer knows that such money will be given to an official of an issuer who could not receive such a contribution directly from the dealer without triggering the rule’s prohibition on municipal securities business. Further, depending on the specific facts and circumstances, a payment to a political organization that is soliciting funds for the purpose of supporting a limited number of issuer officials might result in the same prohibition on municipal securities business as would a contribution made directly to an issuer official.[3] In such circumstances, dealers should inquire of the political organization how any funds received from the dealer would be used.[4]

In 2005, the MSRB published guidance, as a companion to the 2005 Q&A (the “2005 Companion Guidance”), to the effect that each dealer must adopt, maintain and enforce written supervisory procedures under Rule G-27, on supervision, reasonably designed to ensure that neither the dealer nor its MFPs are using payments to political organizations to contribute indirectly to an official of an issuer.[5] This guidance also included examples of certain provisions that dealers might include in their written supervisory procedures to ensure compliance with Rule

G-37(d). In a subsequent interpretive letter (the "2006 Interpretation"),^[6] the MSRB stated that such examples are not exclusive and are only suggestions, and that each dealer is required to evaluate its own circumstances and develop written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance with Rule G-37(d). Thus, a dealer need not include the specific supervisory procedures described in the guidance in order to meet its obligation under Rule G-27 so long as the dealer in fact has, and enforces, other written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance with Rule G-37(d).

In the 2005 Q&A, the MSRB stated that payments to housekeeping, conference or overhead accounts of political organizations (referred to herein, together with any other similar accounts, as "non-political accounts") are not safe harbors under Rule G-37 and that a dealer must have adequate supervisory procedures reasonably designed to prevent a violation of Rule G-37(d) even when payments are being made to non-political accounts of political organizations. The MSRB noted that "preemptive" instructions accompanying payments to non-political accounts of political organizations stating that the payments are not to be used for the benefit of one or a limited number of issuer officials are not considered sufficient to meet the dealer's obligations with regard to ensuring that such payments are not being made to circumvent the requirements of Rule G-37. Among other things, the MSRB stated that "because money is fungible, a payment made to a fund earmarked for non-issuer official elections might 'free up' other money to support the candidacy of specific issuer officials." Thus, merely limiting contributions to such non-political accounts, or merely providing preemptive instructions regarding the use of funds, does not automatically avoid the possibility of an indirect contribution under Rule G-37(d). However, as the MSRB noted in the 2006 Interpretation, procedures permitting payments to political organizations only if made to non-political accounts and/or requiring preemptive instructions regarding the use of such payments may be elements in a supervisory program that, together with other appropriate procedures, could adequately ensure compliance with Rule G-37(d), depending on the specific facts and circumstances.

The fungibility language used in the 2005 Q&A makes clear, and the 2006 Interpretation confirms, that a dealer may not satisfy its obligation to adopt and enforce written supervisory procedures to prevent violations of Rule G-37(d) merely by limiting payments to non-political accounts of political organizations since such payments may "free up" other money that would otherwise have been used to fund such political accounts to now be used to support the candidacy of specific issuer officials. Thus, the guidance provided in the 2005 Q&A, the 2005 Companion Guidance, and the 2006 Interpretation, as well as the MSRB's prior guidance with respect to Rule G-37(d), is relevant for any payment to a political organization, whether such payment is provided without restriction as to its use (referred to herein as an "unrestricted payment") or is made to a non-political account. The fungibility language in the 2005 Q&A serves to illustrate that, in many cases, it may be reasonably foreseeable that moneys provided to non-political accounts could result in indirect contributions to issuer officials under Rule G-37(d) much in the same way as unrestricted payments. As a result, the types of procedures (including but not limited to any due diligence procedures) that would apply to unrestricted payments generally also should apply when payments are made to non-political accounts of political organizations.^[7]

The fungibility language does not, however, cause all payments to political organizations that make contributions to issuer officials to trigger the ban on municipal securities business under Rule G-37. Rather, as described above, it places payments to non-political accounts on relatively equal footing with unrestricted payments to political organizations regarding the need for dealers to adopt and enforce written supervisory procedures reasonably designed to ensure that neither the dealer nor its MFPs are using payments to political organizations to contribute indirectly to an official of an issuer in circumvention of the rule's ban on municipal securities business.^[8] The procedures adopted by dealers with respect to Rule G-37(d) must be designed to address such possible circumvention, regardless of whether it is through unrestricted payments or through payments to non-political accounts. ***MSRB Interpretation of September 25, 2007.***

[1] See [Rule G-37 Question and Answer No. III.8 \(September 22, 2005\)](#), reprinted in MSRB Rule Book.

[2] Certain *de minimis* contributions made by MFPs to issuer officials do not trigger this ban on engaging in municipal securities business.

[3] See [Rule G-37 Question and Answer No. III.4 \(August 6, 1996\)](#), reprinted in MSRB Rule Book.

[4] See [Rule G-37 Question and Answer No. III.5 \(August 6, 1996\)](#), reprinted in MSRB Rule Book.

[5] See [Rule G-37 Question and Answer No. III.7 \(September 22, 2005\)](#), reprinted in MSRB Rule Book.

[6] See [Rule G-37 Interpretive Letter – Supervisory procedures relating to indirect contributions: conference accounts and 527 organizations](#), reprinted in MSRB Rule Book.

[7] As noted above, the 2006 Interpretation observed that limiting payments solely to non-political accounts of political organizations may itself serve as one of the elements in a supervisory program that, together with other appropriate procedures, could adequately ensure compliance with Rule G-37(d), depending on the specific facts and circumstances.

[8] As you note in your letter, section (d) of Rule G-37 was adopted by the MSRB to prohibit dealers and their MFPs from using other persons or entities as conduits to circumvent Rule G-37's prohibitions. See Exchange Act Release No. 33482 (January 14, 1994), 59 FR 3389 (January 21, 1994). See also Exchange Act Release No. 33868 (April 7, 1994), 59 FR 17621 (April 13, 1994).

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