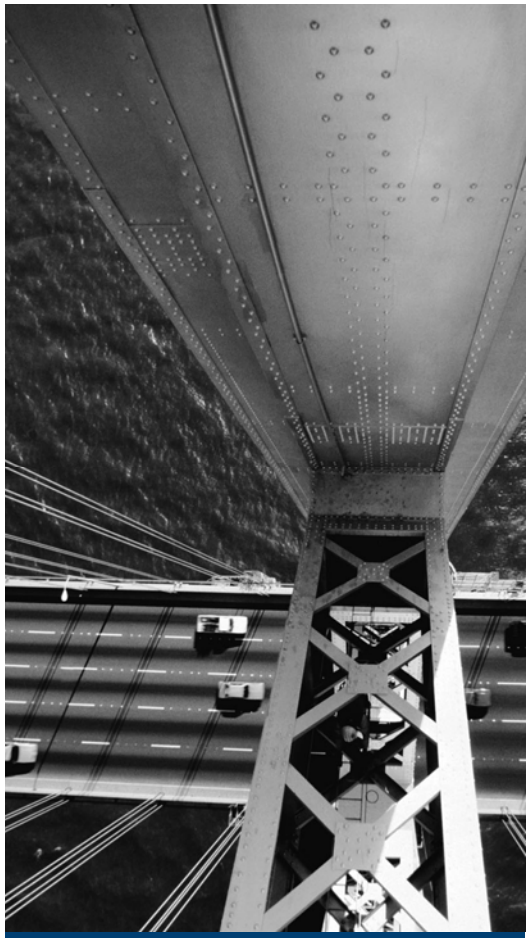
MSRB Draft Municipal Advisor Pay to Play Rule

February 3, 2011



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Dodd-Frank Wall Street Reform and Consumer Protection Act

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- The Dodd-Frank Act authorized the MSRB to establish a comprehensive body of regulation for all municipal advisors and provides that municipal advisors have a federal fiduciary duty to their municipal entity clients
- The Dodd-Frank Act requires the MSRB to adopt rules for municipal advisors that are designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade
- It also expands the mission of the MSRB to include the protection of municipal entities and obligated persons in addition to the protection of investors and the public interest

Pay to Play Practices

- Pursuant to the authority granted to it by the Dodd-Frank Act, the MSRB is requesting comment on draft Rule G-42
- Municipal advisors that seek to influence the award of business by government officials by making or soliciting political contributions to those officials distort and undermine the fairness of the process by which government business is awarded
- These practices can harm municipal entities and their citizens by resulting in inferior services and higher fees, as well as contributing to the violation of the public trust of elected officials

Draft Municipal Advisor Pay to Play Rule – Scope

- There are two types of municipal advisors:
  - Firms and individuals who provide advice to or on behalf of municipal entities or obligated persons on municipal financial products or the issuance of municipal securities (referred to in the draft rule as “municipal advisory business”); and
  - Firms and individuals that solicit municipal securities business, municipal advisory business, or investment advisory business from municipal entities on behalf of third parties (referred to in the draft rule as “third-party business”)

SEC Pay to Play Rule for Investment Advisers

- Rule 206(4)-5 under the Investment Advisers Act of 1940 imposes pay to play restrictions upon investment advisers
- Under an SEC proposal to amend that rule, the rule would provide that it is unlawful for investment advisers subject to the rule to provide or agree to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of such investment adviser unless such person is:
  - A regulated municipal advisor; or
  - An executive officer, general partner, managing member (or, in each case, a person with similar status or function), or employee of the investment adviser

Draft Municipal Advisor Pay to Play Rule – Key Provisions

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- Engaging in municipal advisory business
  - Draft Rule G-42 would prohibit a municipal advisor from engaging in "municipal advisory business" with a municipal entity for compensation for a period of time beginning on the date of a *non-de minimis* political contribution to an "official of the municipal entity" and ending two years after all municipal advisory business with the municipal entity has been terminated
- Soliciting third-party business
  - Draft Rule G-42 would prohibit a municipal advisor from soliciting third-party business from a municipal entity for compensation, or receiving compensation for the solicitation of third-party business from a municipal entity, for two years after a non-*de minimis* political contribution to an "official of the municipal entity"

Draft Municipal Advisor Pay to Play Rule – Key Provisions (cont'd.)

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- Soliciting or coordinating contributions
  - Draft Rule G-42 would prohibit municipal advisors and municipal advisor professionals from soliciting contributions, or coordinating contributions, to officials of municipal entities with which the municipal advisor is engaging or seeking to engage in municipal advisory business or from which the municipal advisor is soliciting third-party business
- Soliciting or coordinating payments
  - Draft Rule G-42 would prohibit municipal advisors and MAPs from soliciting payments, or coordinating payments, to political parties of states or localities where the municipal advisor is engaging in, or seeking to engage in, municipal advisory business or where the municipal advisor is soliciting third-party business

Draft Municipal Advisor Pay to Play Rule – Key Provisions (cont'd.)

- Indirect violations
  - Draft Rule G-42 would prohibit municipal advisors and MAPs from committing indirect violations of the rule
- Disclosure
  - Draft Rule G-42 would require quarterly disclosures to the MSRB of certain contributions and related information

Draft Municipal Advisor Pay to Play Rule – Key Terms

- "De minimis" when used in connection with contributions made by a MAP or a non-MAP executive officer refers to:
  - Contributions made to an official of a municipal entity for whom the municipal advisor professional or non-MAP executive officer was entitled to vote;
  - Contributions made to bond ballot campaigns for a ballot initiative for which the MAP or non-MAP executive officer was entitled to vote; and
  - Do not exceed $250 per official per election

Draft Municipal Advisor Pay to Play Rule – Key Terms (cont'd.)

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- For purposed of Rule G-42, a "municipal advisor professional (MAP)" is any associated person of a municipal advisor that:
  - Engages in municipal advisory business with a municipal entity;
  - Solicits municipal advisory business from a municipal entity on its own behalf or solicits third-party business;
  - Is a supervisor of any person who is a municipal advisor professional in one of the first two categories;
  - Is, in turn, part of the supervisory chain up through and including the Chief Executive Officer or similarly situated official; or
  - Is a member of the municipal advisor's executive or management committee or similarly situated officials

Draft Municipal Advisor Pay to Play Rule – Key Terms (cont'd.)

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- "Official of a municipal entity" is any person, including any election committee for such person, who:
  - At the time of contribution was an incumbent, candidate or successful candidate
  - For elective office of the municipal entity, which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a municipal advisor by the municipal entity or the hiring of a person on behalf of which the municipal advisor is soliciting third-party business; or
  - For any elective office of a municipal entity, which office has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of a municipal advisor by a municipal entity or the hiring of a person on behalf of which the municipal advisor is soliciting third-party business

Draft Municipal Advisor Pay to Play Rule – Look-Back Provision

- Contributions made within two years before an individual's employment as a municipal advisor could trigger
  - A ban on municipal advisory business for compensation,
  - A ban on the solicitation of third-party business from a municipal entity for compensation, and
  - A ban on receipt of compensation for the solicitation of third-party business from a municipal entity
- No contributions made before the effective date of draft Rule G-42 would trigger such a ban, with the exception of contributions made prior to the effective date of the rule by dealer financial advisors already subject to Rule G-37

Draft Municipal Advisor Pay to Play Rule – Look-Back Provision Limitations

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- Limitations on the look-back provision would apply to persons who are MAPs only due to:
  - Their solicitation of municipal advisory business (only contributions to officials of municipal entities solicited would count), or
  - Their supervisory activities (only a six-month look back)
- The limitation on the look-back provision for persons who are only MAPs as a result of solicitation activities would only apply to persons who solicit municipal advisory business on their own behalf, not to persons who solicit third-party business (which would be subject to the regular two-year look-back provision)
- This distinction was drawn to ensure draft Rule G-42 concerning persons who solicit third-party business from municipal entities is at least as stringent with respect to such solicitors as SEC Rule 206(4)-5

MSRB Rule G-37 on Dealer Political Contributions – Comparison

- For Compensation
  - Rather than create a ban on new municipal advisory business with municipal entities as per Rule G-37, Rule G-42(b) would ban municipal advisory business with municipal entities for compensation and solicitations of third-party business from municipal entities for compensation
- "Municipal advisor professional"
  - Would include associated persons who are engaged in municipal advisory business, rather than associated persons who are primarily engaged (as per Rule G-37) in municipal advisory business
  - Would include any associated person who is a member of the municipal advisor's executive or management committee or similarly situated officials, regardless of whether there are any other municipal advisor professionals in the municipal advisory firm
  - Types of supervisors that are included within the definition of "municipal advisor professional" would be different from Rule G-37(g)(iv)

Draft Municipal Advisor Pay to Play Rule – Exemptions

- Rule G-42(i) provides a process under which the SEC can grant exemptions from the ban on business for compensation, and Rule G-42(j) provides a process for automatic exemptions
- In general, for a municipal advisor to qualify for an exemption, the contribution must have been small, discovered quickly, and returned
- The SEC will also consider whether the municipal advisor had policies and procedures in place designed to prevent non-*de minimis* contributions

Other MSRB Rules Affected by Draft Pay to Play Rule

- MSRB Rule G-37 on dealer pay to play activities
  - The proposed draft amendments to Rule G-37 would remove any references to “financial advisory and consulting services,” because those activities would be covered by draft Rule G-42
  - The definitions of “solicit,” “affiliated company,” and “affiliated person of the broker, dealer, or municipal securities dealer” would be conformed to those in draft Rule G-42
  - The Rule G-37 Interpretive Notice would be restated to remove references to financial advisory services, which would instead be covered by Rule G-42
- MSRB Rule G-8 and G-9 on books, records and preservation
  - Proposed draft amendments would require municipal advisors to create, maintain and preserve records of political contributions and payments

Other MSRB Rules Affected by Draft Pay to Play Rule (cont'd.)

- MSRB Rule G-38 on solicitation of municipal securities business
  - Covers dealer payments to unaffiliated persons for the purpose of soliciting municipal securities business on behalf of the dealer
  - Requesting comment on whether Rule G-38 should be eliminated, in part, because Dodd-Frank provides for the regulation by the MSRB of municipal advisors that solicit certain types of business from municipal entities on behalf of a third party, such as a dealer
  - Alternatively, should the MSRB expand Rule G-38 to include a prohibition on payments by non-dealer municipal advisors to other municipal advisors for the solicitation of municipal advisory business, just as Rule G-38 currently prohibits dealers from paying others to solicit dealer financial advisory business?

Draft Municipal Advisor Pay to Play Rule – Electronic Filings

- Rule G-37 and draft Rule G-42 provide that certain forms may be submitted either in paper or electronically
- The MSRB is requesting comment on whether it should require that Forms G-42, G-42x, G-37, and G-37x be submitted in electronic format only

Draft Municipal Advisor Pay to Play Rule

Questions?

Draft Municipal Advisor Pay to Play Rule – Questions/Comments

- Questions about the webinar should be sent to:
  - G42@msrb.org
- Comments about draft MSRB Rule G-42 should be sent to:
  - CommentLetters@msrb.org
  - Include MSRB Notice 2011-04 in the subject line
- Sign up to receive email notifications regarding MSRB rulemaking initiatives at the top of the MSRB's homepage at www.msrb.org

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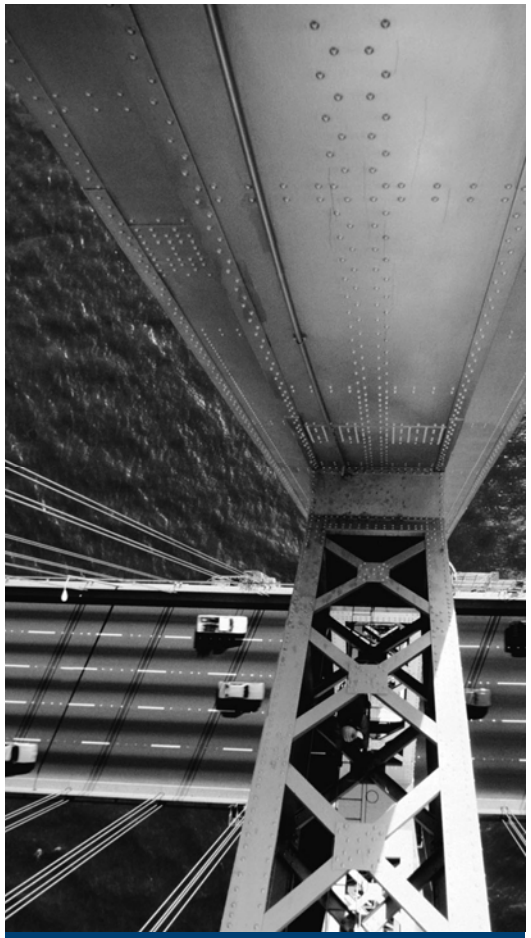

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