



Political Law Alert

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MSRB Submits Pay-to-Play Rule G-37 Amendments to SEC for Approval

On December 16, 2015, the Municipal Securities Rulemaking Board (MSRB) filed its draft amendments to Rule G-37 on political contributions (the Draft Rule) with the Securities and Exchange Commission (SEC). The Draft Rule closely resembles the MSRB's proposal from 2014. It would extend the rule to cover municipal advisors and change the existing requirements for broker-dealers that underwrite municipal securities. The Draft Rule makes conforming changes to MSRB Rules G-8 and G-9 (required records and preservation period, respectively) and Forms G-37 and G-37x (required reporting to the MSRB).

The Draft Rule is slated to take effect between six and 14 months after it is approved by the SEC. Within two months of SEC approval, the MSRB will issue a release establishing the effective date for the amended Rule. The MSRB will set the effective date for the Rule between six months and one year after the date of such release.

The following summarizes the Draft Rule with respect to (1) municipal advisors and (2) the changes to the existing Rule G-37 requirements for dealers that underwrite municipal securities.

Municipal Advisors

What Type of Business Is Covered?

The Draft Rule extends current Rule G-37 to cover municipal advisors and their municipal advisory activity as defined in Section 15B(e)(4) of the Securities and Exchange Act of 1934, as amended (the Exchange Act). In general, municipal advisory activity includes:

- Providing advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products (as defined under municipal advisor rules) or the issuance of municipal securities, *or*
- Soliciting a municipal entity or obligated person on behalf of a third-party dealer, municipal advisor or investment adviser (as defined in the Investment Advisers Act of 1940) for the purpose of obtaining or retaining business in connection with municipal financial products, the issuance of municipal securities, or investment advisory services for an investment adviser to or on behalf of a municipal entity.

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Prohibitions on Political Activity

Ban on Making Political Contributions

The Draft Rule prohibits a municipal advisor from engaging in municipal advisory business with a municipal entity for two years beginning on the date a Covered Contribution is made by a Covered Donor to a Covered Official (as both terms are defined below). However, the Draft Rule does permit a municipal advisor subject to this prohibition to continue to engage in municipal advisory business solely in order to permit an orderly transition to another service provider and, where applicable, to comply with its fiduciary duty. In such an instance, the two-year ban still begins on the date of the Covered Contribution, but terminates two years after all the advisor's municipal advisory business with the municipal entity has ceased.

Ban on Soliciting/Coordinating Political Contributions

The Draft Rule prohibits a municipal advisor and its Municipal Advisor Professionals (MAPs) from soliciting or coordinating political contributions on behalf of (1) Covered Officials of a municipal entity with which the advisor is engaging, or is seeking to engage, in municipal advisory business or (2) a political party of the state or locality of such municipal entity. The political party solicitation ban does not apply to MAPs who are merely municipal advisor supervisory chain persons or executive officers.

The following definitions apply:

- **Covered Contributions.** This term includes anything of value made by a Covered Donor to a Covered Official for the purpose of influencing an election, debt retirement for an election, or transition or inaugural expenses.

Please note that while contributions to bond ballot campaigns do not trigger a ban, they are potentially reportable as described below.

- **Covered Officials.** A Covered Official is a candidate for, successful candidate for, or incumbent of (1) an office of the municipal entity that is directly or indirectly responsible for, or can influence the outcome of, the hiring by the municipal entity of a municipal advisor for municipal advisory business or (2) any state or local elective office that has authority to appoint any person with such influence.

Covered Donors

In addition to the municipal advisor itself, the following are Covered Donors with respect to municipal advisory activities.

- **Municipal Advisor Professionals.** A MAP includes the following persons, each of which is its own defined term within the

Draft Rule:

- **Municipal Advisor Representative.** Any associated person engaged in municipal advisory activities on the firm's behalf (there is no *de minimis* exemption).
- **Municipal Advisor Solicitor.** Any associated person who solicits a municipal entity for municipal advisory business on behalf of the municipal advisor or, in the case of a Municipal Advisor Third-Party Solicitor, on behalf of a third-party dealer, municipal advisor or investment adviser.
- **Municipal Advisor Principal.** Any associated person who is a municipal advisor principal as defined in MSRB Rule G-3(f) (i) and supervises individuals described above.
- **Municipal Advisor Supervisory Chain Person.** Any associated person who is a supervisor of any municipal advisor principal up through and including, in the case of a municipal advisor other than a bank municipal advisor, the chief executive officer, and, in the case of a bank municipal advisor, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal advisory activities.
- **Municipal Advisor Executive Officer.** Any associated person who is a member of the executive or management committee (or similarly situated official) of a municipal advisor.

Please note that under the Exchange Act, "associated person of a municipal advisor" includes, among others, any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor (*i.e.*, the advisor's affiliates).

It is important to note that any person designated as a MAP on the list required to be maintained by a municipal advisor under the Draft Rule's related recordkeeping requirements (as discussed below) is deemed to be a MAP, regardless of whether such person was placed on the list in error. All MAPs retain such status for one year after the last activity or position which gave rise to such designation.

- **Municipal Advisor Third-Party Solicitors.** A municipal advisor that solicits a municipal entity, for direct or indirect compensation, on behalf of a dealer, municipal advisor or investment adviser that does not control, is not controlled by or is not under common control with the municipal advisor undertaking such solicitation. MAPs of a Third-Party Solicitor also are covered.
- **Political Action Committee (PACs).** Any PAC controlled by any of the above.
- In addition, the Draft Rule provides that with respect to an entity that is both a dealer and a municipal advisor, contributions by covered individuals in one line of business to an official with influence over the award of business to the other line

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of business can trigger a ban (a Cross Ban). For example, if an MFP of a dealer-advisor firm made a contribution to an official of a municipal entity who could influence the award of municipal advisory business, the dealer-advisor could be subject to a ban on municipal advisory business. Similarly, contributions by covered employees in the municipal advisory line of business could trigger a ban on municipal bond underwriting business. This also extends to contributions made by Municipal Advisor Third-Party Solicitors engaged by a dealer-advisor, their MAPs and any of their controlled PACs, regardless of the type of business such entity is engaged to solicit.

Look-Back for New MAPs

Different look-back periods apply for different types of MAPs:

- Municipal advisor representatives are subject to a full two-year look-back.
- For persons who trigger MAP status solely by soliciting a municipal entity for municipal advisory business, there is a two-year look-back only for a contribution made to an official of a municipal entity that the MAP solicited.
- For all other MAPs, there is a six-month look-back.

Prior to an employee being hired or transferred to a MAP position, one must “scrub” that employee to make sure he or she has not made a Covered Contribution during the relevant look-back period.

Exemptions

- **De Minimis Contribution.** A MAP may contribute up to \$250 per election, per candidate, to a candidate for whom the MAP is entitled to vote.
- **Automatic Exemption.** If a MAP contributes within the \$250 per election limit but is not entitled to vote for the candidate, there is an automatic exemption if (1) the municipal advisor discovers the contribution within four months, and (2) a refund is obtained within 60 days of the discovery. A municipal advisor may use this automatic exemption only twice during a 12-month period and only once in a lifetime for any MAP.
- **Discretionary Exemption.** A municipal advisor may seek from the appropriate regulatory agency (e.g., the SEC or FINRA) a discretionary exemption under which the agency will consider a variety of factors, including but not limited to, the sufficiency of the municipal advisor’s compliance procedures, whether the advisor had knowledge of the contribution before it was made, and the remedial steps, if any, the advisor took after discovering the contribution.

Indirect Violations

A municipal advisor or MAP is prohibited from doing indirectly

what it is prohibited from doing directly (e.g., using an affiliate, an affiliate’s PAC, or a spouse or third-party to make or solicit prohibited contributions).

Broker-Dealers Engaging in Municipal Securities Business (e.g., Municipal Bond Underwriting)

While the major impact of the Draft Rule’s amendments to Rule G-37 is to extend the restrictions on political activity to municipal advisors and certain of their associated persons, there are changes that impact dealers as well. Some are changes in terminology. However, there are some substantive changes, the more notable of which include:

- **Cross Bans.** As noted above, for dealer-advisors, the group of individuals whose contributions may trigger a two-year ban on engaging in municipal securities business is expanded by the Draft Rule to include MAPs and their controlled PACs.
- **Municipal Advisor Third-Party Solicitors.** Contributions by a Municipal Advisor Third-Party Solicitor, its MAPs or its controlled PACs can trigger a ban on municipal bond underwriting business for its third-party client. Rule G-38 prohibits a dealer from making payments to a third party to solicit municipal bond underwriting business. The Draft Rule’s plain language, however, does not appear limited to the activity prohibited by Rule G-38, and indeed the MSRB notes in its filing that the provision is intended to cover the limited cases where payments to a third-party solicitor are permitted under Rule G-38 as well as cases where a dealer engaged a Municipal Advisor Third-Party Solicitor in violation of Rule G-38.
- **Orderly Transition Period.** Just as advisors are permitted to engage in municipal advisory business to permit an orderly transition following a ban, as described above, dealers also would be granted an orderly transition period. Although the plain language appears to be a substantial change with respect to remarketing agreements, in that such existing agreements must be terminated as well, the MSRB comments state that the Draft Rule is merely codifying an existing interpretation for dealers, which remains undisturbed.

Required Disclosure to MSRB

In addition to current reporting for dealers doing municipal bond underwriting, the Draft Rule provides that municipal advisors must file quarterly reports with the MSRB via Forms G-37 and/or G-37x. The report will include, for the quarter, the following:

- Contributions made by the municipal advisor and each MAP, Non-MAP Executive Officer (as defined below), and PAC controlled by the municipal advisor or any MAP to Covered Officials, state and local political parties, and ballot measures that authorize the issuance of municipal securities, and whether any are subject to the automatic exemption.

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- The municipal entities to which the municipal advisor provided municipal advisory services and the type of municipal advisory business provided; and
 - The municipal entities solicited as a Municipal Advisor Third-Party Solicitor, the name of the third party and the nature of the business solicited.

Non-MAP Executive Officer means an associated person who is in charge of a principal business unit, division or function of the municipal advisor, or any other person who performs a similar policy-making function of the municipal advisor but is not a MAP.

Disclosure Exemptions

De minimis contributions of up to \$250 per year made by MAPs and non-MAP Executive Officers to candidates, political parties and bond ballot measure campaigns will not need to be disclosed.

Record-Keeping Requirement

In addition to the existing record-keeping requirements for dealers, the MSRB also is proposing amending Rule G-8 to include pay-to-play record-keeping requirements for municipal advisors.

The municipal advisor must keep records of the information reported to the MSRB as described above. In addition, the municipal advisor must keep records of:

- The names, titles, city/county and state of residence of MAPs and Non-MAP Executive Officers;
- The states in which the municipal advisor is engaging or is seeking to engage in municipal advisory business or solicit a municipal entity for a third party;
- The municipal entities with which the advisor has engaged in municipal advisory business during the current year and the prior two calendar years, and the type of business engaged in;
- The municipal entities that the advisor solicited on behalf of a third party during the current year and the prior two calendar years, and the nature of the business solicited; and
- Contributions by new MAPs made during the applicable look-back period.

Under Rule G-9, these records would need to be maintained for at least six years.

Please contact us with questions.

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