

disproportionate impact on issuer officials who are candidates for federal office.

Other Issues

Eliminate the Two-Year Ban on Business

Morgan Stanley is concerned that NASD, in administering exemptive requests, does not take into account "the proportionality of the penalty to the perceived violation. * * *" They note that "the two-year ban applies regardless of the nature of, or intent in making, the contribution. Thus, a \$1 million contribution triggers the same ban as a \$5 contribution * * * [and the] so-called 'death penalty' applies equally to minor infractions and blatant attempts to engage in 'pay-to-play'." Morgan Stanley also states that the protracted nature of the current exemption process "is particularly problematic when a broker-dealer has committed significant resources in connection with a municipal securities deal and is suddenly subject to a ban because it discovers an inadvertent contribution by an MFP with no relationship to that particular deal." While they agree with the Board's proposal to amend the exemption process, Morgan Stanley believes that "simply changing the exemption standards does not go far enough to remedy the problem. * * * It is imperative that the Rule incorporate a mechanism designed to avoid disproportionate and clearly inequitable results." Therefore, Morgan Stanley urges the Board to consider eliminating the two-year ban on business and replacing it "with a fair and equitable enforcement process in which the NASD has the mandate to consider issues of proportionality and impose sanctions that are consistent with the facts and circumstances of each case." They state that, under this approach, offending contributions would not automatically trigger the two-year ban but instead would require the NASD "to craft a penalty that is proportional to the egregiousness of the violation."

MSRB Response. The MSRB determined not to eliminate the two-year ban on business that results when a dealer or MFP (or their controlled PACs) makes a contribution to an issuer official. In formulating rule G-37, the MSRB initially proposed a rule that would focus on the intent of the giver and be enforced like other MSRB rules through the normal inspection and review process of the enforcement agencies. Many commentators noted that such a rule would not halt pay-to-play practices because determining the

intent of the giver would be impossible. Thus, the MSRB determined to make the ban on business an automatic result of certain contributions to issuer officials. In this way, the MSRB believed that pay-to-play practices would be halted, but MFPs still could contribute to those they were entitled to vote for, and could continue to volunteer their services to those elections. The ban is a way to ensure fair competition by avoiding conflicts of interest or the appearance of such a conflict.

Morgan Stanley complains that the two-year ban should be eliminated because it does not take into account the proportionality of the contribution to the business lost. Morgan Stanley also gives examples of MFPs making small contributions that resulted in bans on business but were not granted exemptions by NASD. As noted in rule G-37(i), the regulatory agencies have the ability to review a number of factors in making its decision on exemption requests and has the ability to make conditional or unconditional exemptions. Certain of the conditions noted include what procedures the firm had in place at the time of the contribution and the actions of the MFP. After reviewing these and other facts, in a number of cases exemptions were not given. In other cases, the ban was lifted, either in whole or in part. A review of the totality of the factors apparently led NASD to these results. If one of the factors had been the proportionality of the contribution to the business lost, one could argue that a contribution of any size should not result in a ban on business in a large issuing state. The MSRB believes that the addition of such a factor would push the process to be too lenient in contravention of the purposes of rule G-37.

Contributions by Bank PACs and Bank Holding Company PACs

The MSRB's Web site contains links to information provided to the Federal Election Commission ("FEC"), the Internal Revenue Service ("IRS") and state election offices.

Wilmer supports the Board's decision to continue excluding from rule G-37 contributions by bank PACs and BHC PACs. On the other hand, Morgan Stanley states that "bank affiliated dealers have the ability to circumvent the spirit of the Rule through contributions made by their bank affiliate or its PAC * * *. [T]his unintended loophole undermines the effectiveness of the Rule and places traditional broker-dealer firms at a competitive disadvantage." Morgan Stanley therefore recommends that the Board require disclosure on Form G-37

of contributions to issuer officials by dealer affiliated banks, bank PACs and BHC PACs. They believe that this "would bring much needed transparency to this area * * * [which] would serve to discourage attempts to circumvent the spirit of the Rule through the use of bank affiliates.

Seasongood believes that sufficient disclosure of bank PAC contributions does not currently exist under federal law. They state that certain Web sites (e.g., http://www.fec.gov/finance_reports) "are not user-friendly * * * which prevents someone from gleaning the information necessary to determine what PAC gave money to who." Moreover, the "information available is old and difficult to analyze." Seasongood believes that the MSRB should be the single repository for information relating to political contributions and municipal securities business.

MSRB Response. The MSRB determined not to require disclosure on Form G-37/G-38 of contributions to issuer officials from dealer-affiliated banks, bank PACs and BHC PACs. As noted above, the MSRB has published links on its website to information provided by the FEC, IRS and state election offices. Banks and their PACs contribute to state and local officials for many reasons that have nothing to do with acquiring municipal securities business. Requiring affiliated dealers to report these contributions to the MSRB would raise a potentially unfair implication that the contribution was intended to influence the official to exercise his or her discretion in favor of granting an affiliate municipal securities business, when in fact the contribution may have been made to further the bank's legitimate political activity and there may be no connection between the contribution and the affiliated dealer's business.

Moreover, to the extent that dealer-affiliated bank PACs are controlled by the dealer, or by an MFP of the dealer (even if the MFP is an employee of the bank), rule G-37 already obligates the dealer to report contributions made by the bank PAC. In a recent administrative proceeding, the SEC, in only its second rule G-37 enforcement action, held that contributions by a bank PAC, controlled by bank-employed MFPs, resulted in bans on business by the affiliated dealer.⁶ When the dealer engaged in banned business, it violated rule G-37.

Finally, there already is substantial public reporting of PAC contributions. The FEC requires all corporate affiliated

⁶ See *In the Matter of Fifth Third Securities, Inc.*, Exchange Act Release No. 46087, June 18, 2002.