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Appeals Court Judges Uphold SEC Rule Similar to G-37.

WASHINGTON — A panel of three federal appeals court judges on Tuesday dismissed a challenge to the Securities and Exchange Commission's pay-to-play rule for investment advisors, which is similar to the Municipal Securities Rulemaking Board's Rule G-37 for broker-dealers.

The U.S. Court of Appeals for the District of Columbia Circuit dismissed the challenge by the New York Republican State Committee and the Tennessee Republican Party, saying the two groups missed the 60-day deadline to challenge the rule after it went into effect, as the Investment Advisors Act of 1940 requires. A lawyer for the groups would not comment on whether there are plans to appeal the decision.

The two Republican groups first challenged the SEC's rule in a 2014 federal district court case that was ultimately dismissed for a lack of subject matter jurisdiction. The rule, which was adopted in 2010, is designed to prevent investment advisors and their firms from making significant political contributions to state and local officials or candidates who can influence the award of investment business. If an IA contributes to such an official beyond a specified de minimis amount, the rule requires the IA to wait two years before he or she can provide services for compensation to that government client.

The Republican groups argued the rule violated their constitutional rights and was an example of the SEC overstepping its authority.

While the appeals court panel decision was based on a failure to follow appeals procedures and thus does not have much bearing on the rule's substance, Hardy Callcott, a partner at Sidley Austin, said the constitutionality issue is likely to resurface when the MSRB modifies G-37 to include municipal advisors as well as dealers.

G-37 currently prevents a dealer from engaging in negotiated municipal business with an issuer for two years if that dealer or one of its municipal finance professionals makes a significant contribution to an issuer official who could influence bond business. Muni finance professionals can give $250 to a candidate whom they can vote for without triggering the ban.

FINRA has said it hopes to classify broker-dealers acting as placement agents as investment advisors under the SEC rule and that could also raise the constitutionality issue, Callcott said.

Neither of the proposed rule changes have been drafted, but Callcott said both will be "ripe for a challenge" if they are and the SEC approves them. He added that if they are challenged, the DC Circuit court will have to reconsider a 20-year-old case brought by Alabama bond dealer William Blount, who argued Rule G-37 violated his constitutional right to free speech.

The DC appellate court rejected the argument in 1995, ruling G-37 was "narrowly tailored to serve a compelling government interest." The Supreme Court declined to take up an appeal of the appellate ruling. But one could question whether the current Supreme Court would refuse to hear a similar case given that it has issued rulings overturning restrictions on political contributions, such as in

Citizens United vs. Federal Election Commission in 2010.

THE BOND BUYER

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