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Republican Groups, FSI Urge Federal Court to Vacate Rule G-37 Changes.

WASHINGTON – The Financial Services Institute has joined three state Republican groups in urging federal appeals court judges to vacate the Securities and Exchange Commission's approval of Municipal Securities Rulemaking Board rule changes that they say restrict political contributions for municipal advisors.

The Republican groups, which are requesting an oral argument before the Sixth Circuit Court of Appeals in Cincinnati, are also asking the judges to then order the SEC to disapprove the rule. The Tennessee Republican Party, Georgia Republican Party, and New York Republican State Committee made their requests in a brief filed earlier this month. FSI recently filed a friend-of-the-court brief in support of the Republican groups' arguments. The group represents independent financial advisors and financial services firms.

The Sixth Circuit Court had halted proceedings in the case pending an order on a motion to dismiss from the SEC. A panel of three judges from that court referred the case to a merits panel, which received the groups' most recent motion and will handle upcoming filings expected from the SEC. The SEC will have until Dec. 19 to submit its response.

The state parties' suit against the SEC and MSRB claims the revised MSRB Rule G-37 unconstitutionally forces municipal advisor and dealer employees to choose between doing their jobs and exercising their right to support political candidates. The rule took effect on Aug. 17.

Under the changes to Rule G-37, municipal advisors, similarly to dealers, are barred from engaging in municipal advisory business with an issuer for two years if the firm, one of its professionals, or a political action committee controlled by either the firm or an associated professional, makes significant contributions to an issuer official who can influence the award of municipal advisory business.

The revised rule contains a de minimis provision like the original rule. It would allow a municipal finance professional or a municipal advisor professional to give a contribution of up to $250 per election to any candidate for whom he or she can vote without triggering the two-year ban.

The Republican groups' lawyers, led by Christopher Bartolomucci, a partner with Kirkland & Ellis here, said that the process of getting the rule changes approved showed that the MSRB and SEC believe "the SEC may supplant Congress' limits with a broad, prophylactic rule of its own in an effort to deter so-called 'pay-to-play' activities in the provision of advisory services for public assets."

Bartolomucci added that, as the groups told the MSRB and SEC in comment letters during the rulemaking process, "that contention is flatly foreclosed by federal campaign finance law, the statute under which the SEC purports to be acting, the Administrative Procedures Act, and, ultimately, the First Amendment."

FSI's friend-of-the-court brief similarly argues that the rule, both in its original and amended forms,

“has curtailed the constitutional rights of independent broker-dealers (IBDs) and registered representatives while failing to take into consideration IBD firms’ unique structure, and in particular their remoteness from any articulated ‘pay-to-play’ threat.”

The group said that, unlike non-IBD firms, IBD firms generally operate through a wide network of independent contractors that are not employees and are given almost complete freedom to act as solo practitioners. The rule, however, treats the independent contractors as employees, allowing for “the action of a single independent financial advisor or registered representative to pollute the whole IBD network.” That limits “the First Amendment rights of individuals who neither control nor profit from the governmental business obtained by a financial advisor they may never have met, operating in another jurisdiction,” FSI argued.

FSI also noted that some of the rule’s phrasing is vague and runs the risk of further limiting political speech. It said the rule regulates financial support that may indirectly influence hiring while not giving useful guidance as to what indirect influence might be. It also refers to indirect communication with a municipal entity as a part of its solicitation definition without explaining what that could entail, according to the group. Both examples of vague language are likely to cause firms to be overly careful and restrict individuals’ activities more than might be necessary, FSI argued.

The financial group said the MSRB and SEC could have considered alternatives like levying tougher penalties for pay-to-play corruption or providing additional whistleblower protections. Instead of doing that, the “MSRB leapt without looking, and the SEC unfortunately ratified that decision,” FSI said.

The three Republican groups added their own complaints in their brief on top of the First Amendment concerns, arguing that Congress “never intended to grant an agency like the SEC – much less the MSRB – the authority to tinker with contributions to political parties and candidates for federal office.” Congress determined the contribution limit should be $2,700 per federal candidate per election and $10,000 per year for political party federal accounts and left no room for the SEC to second-guess its judgment, Bartolomucci and the other lawyers wrote.

The lawyers also argued that the SEC violated congressional appropriations language for 2016 that prohibited the commission from finalizing, issuing, or implementing any rule, regulation, or order regarding the disclosure of political contributions. The SEC has said it did not violate the rule because it never acted. Instead, the rule was deemed approved at the end of a 45-day period as happens under federal law when the SEC does not act. The groups and SEC have been arguing whether the course of events meet the qualifications for a final order or agency action, either of which would help the Republican groups’ case.

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