Nos. 16-3360, 16-3732

In the

United States Court of Appeals for the Sixth Circuit

Tennessee Republican Party, Georgia Republican Party, and
New York Republican State Committee

Petitioners,

v.

United States Securities and Exchange Commission, and
Municipal Securities Rulemaking Board,

Respondents.

On Petition for Review of Final Rule of the
Municipal Securities Rulemaking Board Approved
by the United States Securities and Exchange Commission

Brief of *Amicus Curiae* Financial Services Institute in Support of Petitioners

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Corporate Disclosure Statement

Pursuant to Federal Rule of Appellate Procedure 26.1, counsel for *amicus curiae* certify that the Financial Services Institute, Inc. has no parent company and that no publicly held company owns more than 10 percent of its stock. The Financial Services Institute, Inc. is a Georgia non-profit corporation.

Interest of *Amicus Curiae*

The Financial Services Institute ("FSI") was founded in 2004 with a clear mission: to ensure that all individuals have access to competent and affordable financial advice, products, and services via a growing network of independent financial advisors and independent financial services firms. FSI's membership includes both independent broker-dealers ("IBDs") and their registered representatives, who operate as independent contractors. FSI's 100 broker-dealer member firms and their more than 138,000 registered representatives serve more than 14 million American households. Additionally, FSI has over 40,000 independent "financial advisor" members—a term of art used generically to refer to a broker-dealer's independent contractors all of whom register with regulators as registered representatives, investment advisory representatives, or both.

FSI's members do not operate like traditional brokerage firms, as IBDs often operate through broad networks of independent contractors. Rule G-37, in both its original and amended forms, has curtailed the constitutional rights of independent broker-dealers 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. As a result, FSI member firms will be required to establish overly broad policies—prohibitions that will strike at the heart of FSI members' constitutional liberties—in order to ensure compliance with the Amended Rule.

Amicus confirms that no party's counsel authored this brief in whole or in part, and that no person contributed funds intended for the preparation or submission of this brief. All parties have consented to the filing of this brief.

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ARGUMENT

Amended Rule G-37 ("Rule" or "Amended Rule") exists to "protect[]…municipal entities and obligated persons by subjecting municipal advisors to a ban on municipal advisory business upon the making of certain contributions…" Municipal Securities Rulemaking Board Regulatory Notice 2016-06 (Feb. 17, 2016) ("MSRB Notice") at 4. The Rule expands upon existing regulations limiting campaign contributions from municipal securities dealers, and extends those restrictions to municipal advisors and their affiliated persons.

With minor exceptions, this greatly limits the ability of those municipal financial advisors whom the Rule classifies as "municipal advisor professionals (MAPs)" to make political contributions to any candidate that might be tangentially involved in hiring dealers for municipal securities business. Specifically, a MAP is only permitted to make $250 contributions to candidates for whom she is eligible to vote. Apart from that narrow exception, the Rule bars municipal advisors or broker-dealers from doing any compensated business—for two years—with any municipal entity whose covered officials have received a political contribution.

The Rule is overinclusive as applied to Independent Broker-Dealer firms, an enormous swath of the regulated community whose concerns are not reflected in the MSRB's final rule. This is troubling enough as a matter of administrative law, but it is especially pernicious here because political contributions, a substantial number of

which have been constructively banned by the Rule, "lie[] at the foundation of a free society." *Buckley v. Valeo*, 424 U.S. 1, 25 (1976) (*per curiam*).

I. Amended Rule G-37 Imposes Significant Restrictions Upon Independent Broker-Dealer Firms.

Although both IBD firms and more traditional "wirehouse," or otherwise non-independent broker-dealer firms, are covered by the Rule, the two types of firms differ greatly.

Non-IBD firms have dedicated firm employees, offer their services to high net-worth clients, and typically offer proprietary "in-house" products and services sold directly by the firm's staff. They typically employ their own registered representatives and investment advisers, who operate under the corporate brand and provide services centrally controlled by the firm itself.

In contrast, IBD firms offer access to a wide network of independent contractors—not salaried employees—who offer investment services as "solo practitioners," or as part of small producer groups. An IBD's registered representatives are typically "entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition" among their client base and community. Comments of Financial Services Institute, MSRB Notice 2013-16 (Oct. 7, 2013) at 2.[1] Their connection to the IBD is a contractual one, with the IBD

[1] *Available at:* http://www.msrb.org/RFC/2013-16/FinancialServicesInstitute.pdf

providing transactional services the independent representative cannot provide herself given considerations of scale and securities regulation. Financial Services Institute, "Overview of the Independent Broker-Dealer Industry" at 1 ("IBD firms…generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products…and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their financial advisor").[2]

Over 167,000 registered representatives work for IBDs in the United States, constituting 64.5 percent of all independent financial advisors. In the context of an IBD firm, the independence of one representative from another means that those representatives offer investment management activities that are unconnected to those offered by others. IBD advisors are truly *independent* contractors.

IBD financial advisors are registered as investment advisor representatives that provide advisory services through their IBD firm, but many also operate independent investment advisory practices that provide services to individuals and government retirement plans. But the Rule treats independent contractors as employees—and therefore "MAPs"—to the extent they solicit a government entity.

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[2] *Available at*: http://www.financialservices.org/uploadedFiles/FSI_Content/Docs/Advocacy/Backgrounder_Independent-Broker-Dealer.pdf

This allows the action of a single independent financial advisor or registered representative to pollute the whole IBD network, limiting 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.[3]

Thus, in its zeal to circumscribe unethical pay-to-play activity, the MSRB's Amended Rule fails to address—or even fully cognize—the fact that municipal advisory services offered by different financial advisors working under the IBD model are distinct. Nevertheless, as IBD firms will be forced to apply it, a firm must treat all of these separate, independent, solo practices as interchangeable cogs within a larger whole, even though that is not how such firms operate.

To the extent that the Rule prevents a particular financial advisor from using political contributions to induce a public officer to retain the services of *that particular* financial advisor, its strictures may well be appropriate. But the Rule is not so discriminating. As a result, an unknown number of Americans will find that their right to contribute to a candidate of their choosing will be either eliminated or

[3] If a financial adviser in Minnesota donates to her trade association's PAC, which in turn donates to a leadership PAC run by a junior senator from New Jersey, which in turn contributes a similar amount to a candidate seeking the lieutenant governorship of Florida, does that original advisor's contribution now impact the Florida business opportunities of every other adviser in her IBD network? Such complexities are not addressed by the Rule, but pose serious compliance issues for IBD firms.

reduced to a *de minimis* level, even where they have no connection to the "municipal entities and obligated persons" the Rule seeks to protect. MSRB Notice at 4.

Amicus's members have already labored for five years under SEC Rule 206(4)-5, which imposed similarly onerous restrictions on contribution rights in the interest of protecting government pension funds from corrupting "pay-to-play" activities. As a practical matter, in order to comply with Rule 206(4)-5, IBD firms have been forced to impose broad prohibitions on financial contributions in excess of even the *de minimis* limits imposed by the SEC rule.[4] Given that the Amended Rule at issue here actually imposes, without explanation, *lower* contribution limits than Rule 206(4)-5, IBD firms will have to double down on enforcement. The risk of massively disproportionate financial penalties in the form of foregone or uncompensated business due to a stray contribution will require such vigilance. Rule G-37(g)(iii)(x).

This unintentional *in terrorem* application to IBD firms is compounded by the Rule's wording, which couples overbreadth with vagueness. The Amended Rule fails to delineate covered officials with any precision, instead prohibiting contributions to *all* candidates—including challengers running in competitive primaries—seeking an office that is "directly or *indirectly responsible* for, or can

[4] $350. 17 C.F.R § 275.206(4)-5(b)(1).

influence the outcome of" the decision to hire a dealer or advisor for municipal securities business. Rule G-37(g)(xvi)(A)-(C) (emphasis supplied).

In the precise context of campaign regulation, the Supreme Court has struck down language seeking to regulate activity with merely "the purpose of influencing" an election. *Buckley*, 424 U.S. at 23, 79-81. Vague language compels actors to "hedge and trim" their activities, and inevitably will cause a number of individuals to simply refuse to make contributions—even to candidates with only a tangential connection to a government's municipal securities business. *Buckley*, 424 U.S. at 43 (internal citation and quotation marks omitted), *also McCutcheon v. Fed. Election Comm'n*, 134 S. Ct. 1434, 1440-1441 (2014) ("There is no right more basic in our democracy than the right to participate in electing our political leaders…[including through] contribut[ing] to a candidate's campaign").

But the Rule goes even further, regulating the giving of financial support to candidates that may "indirectly…influence" hiring—and neither the MSRB nor the SEC have provided useful guidance as to the meaning of that phrase. *Cf. Blount v. Sec. and Exch. Comm'n*, 61 F.3d 938, 948 (D.C. Cir. 1995) (permitting use of the phrase "indirectly" as part of anti-circumvention portion of then-existing Rule 37(d), under a Fifth Amendment analysis, only after SEC provided sound and concrete definition). If firms cannot know what is or what is not a covered office, the inevitable result will be the immediate institution, whether formally or informally,

of corporate policies banning contributions to candidates seeking offices with even amorphous connection to the awarding of municipal contracts.[5]

Nor is this the only example of the Rule's fatal vagueness. In covering MAPs that "solicit" a government entity for business, the Amended Rule defines solicitation as any "direct or indirect communication with a municipal entity for the purposes of obtaining or retaining an engagement" for a dealer, advisor, or representative. Rule G-37(g)(xix). The phrase "indirect communication" is incapable of having an obvious meaning. As the hallmark of a communication is the conveyance of information from one person to another, it is not clear what an "indirect communication" entails: either information is conveyed, or it is not. The functional effect of this language is to require firms to prohibit any potentially-covered independent contractor from doing *anything* in connection with any potentially-covered local official. The scope of such a policy could reach social interactions, meeting with a public official's staff, attendance at public political

[5] In MSRB Regulatory Notice 2016-06, it was claimed that "Amended Rule G-37" would "[r]equir[e] a nexus that links the influence that may be exercised by an official of a municipal entity…and the contributions received by an official." MSRB Notice at 2. But the plain language of the Rule belies this certainty. What, for instance, constitutes "indirect[] responsib[ility]" for the awarding of a contract? Scheduling a meeting? Merely talking to another official? Organizing an event? *But cf. McDonnell v. United States*, 136 S. Ct. 2355, 2372 (2016) (in defining "official act" under 18 U.S.C. § 201, "[s]etting up a meeting, talking to another official, or organizing an event (or agreeing to do so) – without more – does not fit that definition").

events, posting on a candidate's Facebook page, or sending a public message to an official's Twitter account. Each of these activities lies at the core of the First Amendment's protections. *Mills v. Ala.*, 384 U.S. 214, 218 (1966) ("Whatever differences may exist about interpretations of the First Amendment, there is practically universal agreement that a major purpose of that Amendment was to protect the free discussion of governmental affairs").

The Amended Rule also fails to advise firms as to exactly what sort of activity constitutes solicitation, and which officeholders are covered. Without that information, IBD firms will be unable to fashion appropriate guidelines for their advisors to follow. Such vagueness is a classic example of a trap for the unwary, and will inevitably lead to draconian internal policies chilling protected political speech and association. This counsels in favor of vacating the Rule. *See Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972) ("…where a vague statute abuts upon sensitive areas of basic First Amendment freedoms, it operates to inhibit the exercise of those freedoms…") (punctuation altered, citation omitted).

II. The Harms Imposed By The Rule Are Compounded By The Sanctity Of The Right At Stake.

The effects of the Rule's vagueness and overbreadth are magnified by the Rule's context: the limiting, by regulatory fiat, of the right to make political contributions. Unlike most activity regulated by the MSRB or the SEC, the right to make political contributions is a fundamental First Amendment right. "Broad

prophylactic rules in the" First Amendment area "are suspect. Precision of regulation must be the touchstone in an area so closely touching our most precious freedoms." *NAACP v. Button*, 371 U.S. 415, 438 (1963) (internal citations omitted). The Rule's failure to adequately recognize that it reaches an area of great First Amendment sensitivity, and its concomitant failure to carefully and narrowly craft its prohibitions, suggest that a return to the drafting board is in order.

As "a basic constitutional freedom," political contributions cannot be limited—let alone eliminated—unless "the State demonstrates a sufficiently important interest and employs means closely drawn to avoid unnecessary abridgement of associational freedoms." *Buckley*, 424 U.S. at 25 (citation and quotation marks omitted). The sweep of the Rule, particularly in its application to IBD firms, indicates that it cannot survive this "exacting scrutiny." *Id*. at 44.

Under an exacting scrutiny analysis, "preventing corruption or the appearance of corruption [is] the only legitimate and compelling government interests thus far identified for restricting campaign finances." *Fed. Election Comm'n v. Nat'l Conservative Political Action Comm.*, 470 U.S. 480, 496-497 (1982) ("*NCPAC*"). Accordingly, "[a]ny regulation must...target…'[t]he hallmark of corruption…the financial *quid pro quo*: dollars for political favors.'" *McCutcheon*, 134 S. Ct. at 1441 (quoting *NCPAC*, 470 U.S. at 497). But the Amended Rule does not narrowly aim its prohibitions at such corrupt bargains, and thus fails exacting scrutiny. And the

Rule's open-ended language, which is "susceptible" to a "potentially expansive" reading, only magnifies the Rule's lack of tailoring. *Buckley v. Valeo*, 519 F.2d 821, 870 (D.C. Cir. 1975) (*en banc*).

The Rule's "substantial mismatch" between its means and the proper end of fighting corruption is further magnified because, unlike SEC Rule 206(4)-5, the Rule actually *prohibits* campaign contributions to candidates for whom a given representative is not eligible to vote. *McCutcheon*, 134 S. Ct. at 1446. Twenty years ago, in the *Blount* decision, the D.C. Circuit—without any significant discussion—approved a similar rule. But subsequent Supreme Court decisions have undercut *Blount* by strengthening the First Amendment's protections for political activity and underscoring the judiciary's duty to demand narrow tailoring from bans on such activity. *Reed v. Town of Gilbert*, 135 S. Ct. 2218 (2015), *McCutcheon*, 134 S. Ct. at 1462, *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010), *Randall v. Sorrell*, 548 U.S. 230 (2006), *Nixon v. Shrink Mo. Gov't PAC*, 528 U.S. 377 (2000).

Indeed, intervening Supreme Court precedent makes clear that even the Rule's somewhat less draconian $250 limit for candidates whom an advisor may vote for fails a proper scrutiny analysis as being "too low" and "harm[ful to] the electoral process." *Randall*, 548 U.S. at 249. In 2006, the Supreme Court invalidated a Vermont statute that limited state campaign contributions to $200. *Id*. at 249-253. The Amended Rule's contribution limit is indistinguishable from the Vermont limit,

except that it is, in fact, far lower than the range of limits the Court suggested might be constitutionally impermissible. *Id*. (noting that the Supreme Court has never approved a limit less than $1,000).

Moreover, the contribution limits at issue here have other features the *Randall* Court found constitutionally objectionable. First, the Rule applies its low limits to *all* states, including states such as California, New York, Florida, Texas, Pennsylvania, and Illinois, where campaigns are substantially more expensive than those in smaller states like Vermont. *Id*. at 251-252 (comparing Vermont limit to the higher Missouri limit upheld in *Nixon v. Shrink Mo. Gov't PAC*). Second, the Rule bars not only cash contributions, but the giving of "anything of value." Rule G-37(g)(vi). If interpreted plainly, this could include yard signs, buttons, coffee, pizza, or other materials that may be donated, as well as services that may be volunteered to a political campaign.[6] Such a blanket approach, taken by the Vermont statute

[6] In a query regarding volunteer work from the 1994 version of Rule G-37, the MSRB stated that "Rule G-37 is not intended to prohibit or restrict municipal finance professionals from engaging in personal volunteer work. However, soliciting and bundling of contributions would invoke application of the rule. In addition, if the municipal finance professional uses the dealer's resources (*e.g.*, a political position paper prepared by dealer personnel) or incurs expenses in the conduct of such volunteer work (*e.g.*, hosting a reception), then the value of such resources or expenses would constitute a contribution. Personal expenses incurred by the municipal finance professional in the conduct of such volunteer work, which expenses are purely incidental to such work and unreimbursed by the dealer (*e.g.*, cab fares and personal meals), would not constitute a contribution."

struck in *Randall*, "may well impede[s] a campaign's ability [to] effectively…use volunteers, thereby making it more difficult for individuals to associate in this way." *Id*. at 260. Finally, the contribution limits are not indexed to inflation, with the result that the "limits decline in real value each year." *Id*. at 261. Accordingly, even if the Rule's sweep in terms of covered individuals and candidates was in fact tailored, which it is not, the monetary limits themselves fail the *Randall* Court's analysis.

This does not mean that the MSRB and SEC have no available options at hand to fight pay-to-play corruption. One possible approach would provide for tougher penalties for those who use pay-to-play arrangements to obtain contracts with municipal entities, and the dedication of stronger investigative tools and additional examination resources to those tasked with uncovering corrupt bargains. Additional whistleblower protections could also protect those who report wrongdoing, and whistleblowers could be given rewards based on the size of the ill-gotten contracts or the penalties imposed for violations. The existence of such a wide range of less-

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Additionally, the Board stated that "[a]n employee of a dealer generally can donate his or her time to an issuer official's campaign without this being viewed as a contribution by the dealer to the official, as long as the employee is volunteering his or her time during non-work hours, or is using previously accrued vacation time or the dealer is not otherwise paying the employee's salary (*e.g.*, an unpaid leave of absence)."
Questions and Answers Concerning Political Contributions and Prohibitions on Municipal Securities Business: Rule G-37, MSRB, *available at*: http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G37-Frequently-Asked-Questions.aspx.

restrictive measures suggests that the Rule is not "narrowly tailored." *McCutcheon*, 134 S. Ct. at 1445 ("…we must assess the fit between the stated governmental objective and the means selected to achieve that objective").

The Rule's sweep could also be limited. The MSRB and SEC should have insisted on exemptions from the Rule where contracts are put up for transparent, competitive bidding sufficient to foreclose pay-to-play manipulation. Similarly, issuer officials should be permitted to recuse themselves from decisions regarding potential contractors from whom they have accepted contributions. *Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 887 (2009) (requiring recusal by elected judge when "extreme facts", such as overwhelming campaign contributions and expenditures on his behalf, "create[] an unconstitutional probability of bias").

Rather than considering these available "alternatives" that could serve the government's interests "while avoiding unnecessary abridgment of First Amendment rights," the MSRB leapt without looking, and the SEC unfortunately ratified that decision. *McCutcheon*, 134 S. Ct at 1458 (internal citation and quotation marks omitted). This failure counsels vacation of the Rule. *McCutcheon*, 134 S. Ct. at 1457 ("In the First Amendment context, fit matters…we…require a fit that is not necessarily perfect, but reasonable; that represents not necessarily the single best disposition but one whose scope is in proportion to the interest served, that employs not necessarily the least restrictive means, but a means *narrowly tailored* to achieve

the desired objective") (punctuation altered, emphasis supplied, internal citation and quotation marks omitted).

III. Regulating Campaign Finances Is Beyond Respondents' Mandate.

At the end of the day, regulating the funding of local political campaigns is not the duty of either the SEC or the MSRB. The SEC enjoys a general grant of regulatory power, but that grant is limited to protecting the "just and equitable principles of trade" on "a free and open market." 15 U.S.C. § 78o-4(b)(2)(C).

Rather, the people, through their elected representatives, have delegated the regulation of municipal campaign finance to local and state campaign finance boards. There is no need to interrupt those efforts. "[P]roper deference" ought to be granted to those with "particular expertise" within the campaign finance system. *McConnell v. Fed. Election Comm'n*, 540 U.S. 93, 137 (2003). As the recent scandal involving the targeting of § 501(c)(3) applicants by politically motivated individuals at the Internal Revenue Service demonstrates, agencies lacking expertise in regulating campaign finance should not be trusted with the constitutionally sensitive job of regulating political activity. Bradley A. Smith and Allen Dickerson, *The Non-Expert Agency: Using the SEC to Regulate Partisan Politics*, 3 Harv. Business L. Rev. 420, 438 n.102 (2012) (Congress's decision to allow the Internal Revenue Service to supervise the disclosure of financial contributors to corporations organized under 26 U.S.C. § 527 likely led the agency to put pressure on § 501(c)(3)

groups for reasons of donor disclosure unconnected to any revenue interest). In this instance, those institutions and agencies already entrusted with regulating speech and association ought to be free to do their job, and the SEC and MSRB ought to do theirs.

CONCLUSION

The First Amendment protects Americans' ability to, through the making of political contributions, voice their political beliefs without fear of sanction. One way of doing so is through the making of political contributions. The Rule, as promulgated, simply goes too far—it regulates IBDs without regard to their unique role and structure, and extinguishes the First Amendment rights of a range of individuals posing no threat of pay-to-play practices. Judgment ought to be granted to Petitioner.

Respectfully Submitted,

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Certificate of Compliance

I hereby certify that this brief complies with the type-volume limitation set forth in Federal Rule of Appellate Procedure 32(a)(7)(B)(i) because it contains 3,489 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in a proportionally-spaced typeface using Microsoft Word 2016 in Times New Roman 14-point font.

Dated: November 23, 2016

/s/ Allen Dickerson
Allen Dickerson

Certificate of Service

I hereby certify that on November 23, 2016, I electronically filed the foregoing using the court's CM/ECF system which will automatically generate and send by email a Notice of Docket Activity to all registered attorneys currently participating in this case, constituting service on those attorneys.

/s/ Allen Dickerson
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