

Webcast Transcript
SEC Historical Society
April 28, 2011
Fireside Chat on Pay to Play

LISA FAIRFAX: Good afternoon and welcome to the Fireside Chat on Pay to Play broadcast by the Securities and Exchange Commission Historical Society on www.sechistorical.org. My name is Lisa Fairfax, and I am a Professor of Law at the George Washington University Law School and moderator for today's program.

In 1994, the Municipal Securities Rulemaking Board adopted MSRB Rule G-37. The rule was designed to ensure that bond business is awarded on the basis of merit by seeking to sever any connection between political contributions to issuers and the awarding of underwriting contracts to municipal securities dealers. The rule was the first of its kind to address pay to play in the financial industry. As MSRB Executive Director Lynnette Kelly Hotchkiss has stated, "The MSRB was the first regulator to prohibit pay to play activities in the financial services industry and our rules have served as a model for similar federal and state prohibitions."

Joining me today to discuss MSRB's role in the creation of the pay to play rule and its role in curbing conflicts of interest in the municipal market, are David Clapp, a retired partner with Goldman Sachs & Company and the 1994 chairman of the Municipal Securities Rulemaking Board. Also joining me is Ronald Stack, Managing Director, Wells Fargo and the 2009 Chairman of the Municipal Securities Rulemaking Board. So welcome to both of you.

Before we begin our program, I would just like to say a couple of words. Today's program is one activity in a partnership between the Municipal Securities Rulemaking Board and the SEC Historical Society to preserve the significant history of municipal securities regulation. The MSRB was established by Congress to develop rules regulating securities firms and banks involved in underwriting, trading and selling municipal securities. The MSRB is a self regulatory organization subject to oversight by the U.S. Securities and Exchange Commission or the SEC. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the MSRB's rule-making authority has been extended to regulate municipal advisors. Its investor protection rules now protect municipal entities.

The SEC Historical Society, through its virtual museum and archive, shares, preserves and advances knowledge of the history of financial regulation from the 20th century to the present. The museum and archive is free and accessible worldwide at all times. Both the museum and the Society are independent of and separate from the SEC and receive no funding from the public sector. The virtual museum and archive already includes material on municipal securities regulation, including the April 2005 Fireside Chat on municipal securities available in Programs, over 20 developments on municipal securities regulations since the 1970s in the Timeline, as well as a recent interview with Frank Chin, a former chairman of Municipal Securities Rulemaking Board available in Oral Histories. Today's Fireside Chat will add to the information on municipal securities regulation in the museum collection.

The Society thanks the MSRB for its generous sponsorship of today's program. I would like to note however that the Society selected me to moderate today's program. I am

solely responsible for the topics and questions that will be discussed and I have developed these questions independent of the MSRB. And with that let us begin.

First, I will start with the very basic question and that, David, exactly what does MSRB Rule G-37 do and to whom does it apply?

DAVID CLAPP: Well, the rule itself was put together to prohibit broker-dealers and banks from undertaking and negotiating underwriting bond business, in the municipal bond business and some other markets as well with local government within two years after certain contributions to officials on such an issue were made by the dealer or any municipal finance professional in the firm whereby any political action committee controlled by the dealer. It was actually put together to stop people from bribing people to give them business. It also, the rule goes much longer than that, there are some devils in the detail, but it prohibits a solicitation or coordination by a dealer and a professional of contributions to officials of issuers, as contributions made by professionals who have a direct interest in being awarded new business from an issuer and who seeks that kind of business. And it runs not just to the municipal professionals themselves but to people to whom they report to at their firms including and right up to the CEO and there have been some instances involving CEOs. That's it. Anyone is allowed to make it to minimus, so quote to minimus contribution of \$250 to any candidate really basically because it was done at the time by the board that eliminating all of the contributions you might make, you could be... you could have a First Amendment problem and some other complications.

LISA FAIRFAX: Sure. We will talk just a second... I am glad you raised the First Amendment issue. We will talk just a second about that. But first, just at its basic level what kinds of concerns motivated the adoption of G-37?

DAVID CLAPP: G-37 relates to the fact that... for quite a period of time in the municipal bond business, and it is true of other businesses of course as well. The wining and dining habit that people got into with potential clients had grown into not just wining and dining but people asking for contributions for their candidates or asking people to buy tables at events being held for candidates and et cetera. One of the main things that happened was that while this just got with wining and dining and a few other requests for money here and there, it grew into a very big deal with people asking for firms or individual municipal finance professionals or their bosses to buy tables at these events costing from \$25 to \$50,000 and on occasion more. I have myself experienced someone sitting across the table from me saying that she would need a \$50,000 from me for a candidate who was running for office and I said I wasn't able to do that and she said, "Well, then I have to be very frank with you. You are not going to do any business with this particular client." And that got me going.

LISA FAIRFAX: Yes.

DAVID CLAPP: It was at the first instance but I felt this is blatant and it is horrible, it is bribery. I won't mention names of anybody because Ron knows them.

RONALD STACK: I think I was in a meeting there with...

DAVID CLAPP: Not in that meeting.

RONALD STACK: Okay.

DAVID CLAPP: Really what was going on and I was giving everybody a terrible, terrible feeling that our business was kind of crooked. I mean, let me just give you one little example. Let's say you have a municipal entity and it is in the South somewhere, I am not picking on the South, it could be anywhere actually. And let's say it is a \$10 million issue and let's say somebody asks you for a \$10,000 contribution. If you agree to make that and they give you the deal, you have started making, let's say, you were going to make a point. Instead of making \$100,000 on a \$10 million deal, you will make only 90. But you see that is not so bad, 90 is not zero.

LISA FAIRFAX: One of the things I get from your example is we use the term pay to play and I think some people might think of that as a quid pro quo but it sounds like it actually can extend quite much more broadly than that. So, Ron, let me ask you, when people talk about pay to play what exactly are they referring to?

DAVID CLAPP: Lisa, let me take one more.

LISA FAIRFAX: Sure.

DAVID CLAPP: Pay to play was borrowed. That was a term that lasted for a long time basically in the construction business, where construction companies of one kind or another who were going to be awarded business or got business on an awarded basis from some kind of municipal entity or other, would pay some down and get the business. So it would generally initiate with us but it seemed like a good name and we adopted it. Go ahead, please go to Ron.

LISA FAIRFAX: I am sorry. I was just asking Ron to elaborate it a little more on the term pay to play and the fact that it seems to speak more broadly than I think what people may traditionally understand it as. So maybe if Ron could just chime in.

RONALD STACK: I would like to begin by saying that David is too modest to say this himself, so I will say it. It is that David was the driving force behind G-37. David Clapp as Chairman of the MSRB forced this, pushed this with Chairman Levitt, with others, with Frank Zarb, other people who were interested but he was the industry leader in doing it. And for that he will go down in history and the legacy of municipal bonds of having gotten this done. Because what David was able to do was to have the foresight and insight and ability to understand that although this, what we call pay to play which in its most gross terms, as David alluded to is actually extortion that in the public sector arena where we were in the municipal industry; we had a higher level responsibility in not submitting to it. We were dealing with a market that where the issuers were public sector clients, there were governments, there were hospitals, they were universities, these were 501(c)3s in these and a lot of governments in terms of the election campaigns obviously were the main focus. The bonds were being bought a lot more and more and a great deal today in this \$3 trillion market by retail customers, by mom and pop retail customers. The protection of those customers and the protection of the issuers themselves in the market of municipal securities required a leader like David to say, "Do you know what? Although there is nothing, there is no proverbial, provable, indictable extortion or pay to play going on here, quid pro quo, there is still something wrong. If you actually had for example a true quid pro quo, you would have an indictable event but no one had that. It was sort of like, we, I am the treasurer of the State of XYZ, I want you to

give \$50,000 to my campaign, it was sort of... there was no like... and if you don't necessary or if you do, maybe it wasn't explicitly said but it was clear to us as industry recipients what was being said. Although there was no direct, written or verbal necessarily quid pro quo, it was implied and David had the foresight to say, "We have to stop this." And he led the MSRB of the early '90s into adoption of this rule which as you know is going all the way up into... yesterday's New York Times, we had the President of the United States considering an Executive order to have just disclosure of corporate contributions, this has not ended, it never will end as long as there are political contributions.

LISA FAIRFAX: I think that is exactly right. Your words just capture this notion of the importance of to make sure there is nothing, kind of no direct quid pro quo but nothing that undermines investor confidence, undermines also the public, you get these retail customers in kind of making sure that they feel secure about the industry that seems to be one of the concerns that our rule was trying to address. You spoke a little bit when you were mentioning David's very important role in getting this rule passed in... you spoke a little bit about our Chairman Levitt. And so I just wanted to get your insights, Ron, on kind of what was his role in pushing or helping to support this rule, or did he have a role?

RONALD STACK: I think I will defer to David but it really I think began with the MSRB, it was already working there when Chairman Levitt was sworn in as SEC Chairman in 1993. But he became a key proponent. His father had been Comptroller at the State of New York for, I think, 12 or 16 years, I am not sure which, and was well known and then his son, Arthur Levitt, Jr. had been at the American Stock Exchange in business securities role. But David, I think that is more for you.

DAVID CLAPP: Arthur came into this not very late because he hadn't been appointed yet. I have known Arthur for many, many years and what happened to him was he liked it, he latched onto it. He said this is something I can do something about, we ought to do something about. So then he went in sort of a different way, instead of just getting behind the MSRB, what he wound up doing was putting together a group of major dealers, investment banking dealers who became known as the 'Group of 17' and they had a meeting down in Washington to discuss this. I have to tell you, these were guys that ran Wall Street firms and they had no idea what they were doing there. Dick Fuld, you remember him, came up to me and said, "What am I doing here?" And I said, "Well, you know, just listen, Dick, don't worry about it." None of them, nobody had any trouble with it. They said, "Okay, we will do whatever you want to do." And I said, "Well, I just want to sell this, because in case for some reason or the other, A, the MSRB doesn't really pass this thing, B, if they pass it and then it is found not to be constitutional, I want these 17 firms to stick to it anyway. Make a moral or whatever you want to call it commitments that they were going to stick with it anyway." And my own boss from Goldman Sachs, Steve Friedman, who said to me afterwards, "Can't they hold on to these people together on something like that?" I said, "You know, I don't know. Time will tell." So but I don't want to play him down either because he allows statements to be made in the press and tell the people to support him in this kind of thing in what we were doing. And how his name got involved with it was very important.

LISA FAIRFAX: It is interesting you talk about bunch of people obviously behind the rule and wanting it implemented, so that raises a kind of question on the other side which is

where there is anyone you pushed back? And if so what was the push back on adopting a rule like this? Maybe I will just ask Ron that.

RONALD STACK: I think that the vast majority of the original commentators to the original draft did recognize that a problem existed which needed to be dealt with. There was some, what you might call, David mentioned devils in the detail, nuts and bolts types of concern and the MSRB went through its lengthy rulemaking process getting comments and trying to deal with them and as well as the broader issues of the constitutional requirements whether it met those. The MSRB worked very hard to try to address the First Amendment concerns that some people had. There are always some firms that I think were opposed to it because they felt that it would in fact inhibit them from getting business that they thought they would put them as an unfair disadvantage, in terms of maybe a larger firm that the fact that their contributions in their mind was sort of a leveling thing as opposed to something giving an advantage. So there were firms who were against it, I think but in the end I think that basically the industry as a whole supported it as a good idea for the industry.

DAVID CLAPP: There were some push backs too from the elected officials themselves. They had always gotten political contributions. I was invited to address a meeting of the state treasurers from all over the country and the meetings being held in Utah and the then Treasurer of the State of Utah who was a friend of mine said, "You know, this is not going to go so great." And I found out what he meant, after I was introduced half of them got up and left the room.

LISA FAIRFAX: Wow.

RONALD STACK: There are also the concerns that the other groups in the municipal industry, for example attorneys, who as much as we tried to pressure the bar associations to take a position into a voluntary ban themselves since the state regulates their attorneys, there is no federal regulation of attorneys. The lawyers all the way up to this day are not subject to any ban on contributions. On one hand, the underwriter could not give a contribution but a law firm whose partner might be giving the tax opinion could actually give money. And there was something like, this doesn't make sense but there was nothing the MSRB could do about it.

DAVID CLAPP: A good thing there was and I believe those are some of my best friends but they are generally too cheap to make very big contributions.

LISA FAIRFAX: I am making no comment.

DAVID CLAPP: It is all too sad, but it is true.

RONALD STACK: One of the things, I think is important, I think to note here too is that and I think David you would agree, which G-37 also demonstrated was the unique importance of a self regulatory organization, an SRO which MSRB was then and is today. Because as an SRO the industry, and I will again say, under David was able to look at itself and say, "We need to fix this." And it was able to come up with a rule to fix it. It is under the aegis of the SEC, its rules are ultimately approved by the SEC, the regulatory branch of the federal government. But it was the SRO that said, "We need to clean this up ourselves." It was not going to be cleaned up by, as David said, by elected politicians who were depending upon our money to stop us from giving them money,

there was nobody doing that. It required a self regulatory organization to look at itself and just clean up the industry ourselves. I think that this was one example when people say, "You are an SRO, you can't regulate yourself, you are all in it for yourselves." Well, this showed that an SRO actually could do something that was for the benefit of the industry and the public that would not have necessarily benefited the elected officials.

LISA FAIRFAX: That is a very good point. I think you are exactly right. A lot of people look at SROs and think that they don't have the ability to regulate themselves. You raise a very important point about this ability to come and look at themselves, look at the industry practices and based on their experience in the industry really come up with the rule. Really first understand the problem and they come up with a rule that seeks to address it. I wonder though, I mean some might say and this is for either one of you guys. Some might say, "Look there are a lot of potential ways that you can deal with this sort of problem, codes of ethics, compliance procedures, a lot of stuff kind of short of a firm rule. Do you think those things are less effective than a rule, you know why not rely on something else other than a particular rule like the G-37?" David?

DAVID CLAPP: There are a couple of reasons why. One thing about all that is and this is the first thing that pops out at me. Will you have a regulation not an SRO type of regulation, but the kind of thing that I think that you are talking about. You are not going to stop the bad guys, the guys who want to give them and incidentally to this day you would probably have a hard time stopping the real bad guys. But I think that what I thought anyway, was that you could all these kind of things you wanted in terms of putting together various kinds of codes of conduct and et cetera, et cetera and never really pay lip service to it and that in the end it just wouldn't work, if it works it probably becomes sort of a joke. Ron, why don't you go ahead?

RONALD STACK: I agree with you 100%, David, but I think one of the great things about having a regulation like this is that it becomes so critical and the penalty is so onerous. That is if... and this happened to a major firm a head of fixed income division gives money to the Governor of Massachusetts who at the time was running for the Senate, the firm itself caught the contribution, reported itself, that firm was banned from doing business in the State of Massachusetts for two years. That is a very very onerous penalty. And so what you have now is on Wall Street, you have a situation where this rule is taken so seriously, in a municipal department, anywhere you have what we call municipal finance professionals. It is drilled into people's heads from day one before they are hired, they are asked whether they have given any political contributions. We have, because SEC requirements with MSRB, we have annual compliance reviews. I ran a department, David ran a department, the fear keeps saying, you have got to understand G-37 because the biggest fear in Wall Street municipal department is you are running a department and you are in the State of New York, for example, and you have a young guy or woman, lives in New Jersey who just thinks it is okay to give Governor Cuomo a \$250 contribution, and think, knowing that anyone who lives in New Jersey can't vote for a governor and gives \$250 to Governor Cuomo running for election. That \$250 could ban Goldman Sachs from doing business in the State of New York for two years. That one little innocent act could do that. So the rule is strictly enforced internally by the firms because it is a regulation that is a rule of the MSRB and therefore the SEC.

DAVID CLAPP: He had no idea there was such a rule. Had he known, knowing what I knew about him, I am not saying he probably wouldn't have done it but he had no idea there was such a rule.

LISA FAIRFAX: One other thing that you guys are suggesting is important about the rule is that it actually it has a huge deterrent impact but also it sounds like one of the key pieces of the rule is that it becomes a part of best practices, it creates the norm. So if you want a system of kind of voluntary compliance the question is to what are you complying? And the answer is if you have a rule then people kind of start realizing that that is one of the things that they have to do in the ordinary course and it seeps into the culture.

RONALD STACK: Yes, absolutely.

DAVID CLAPP: I think that it has. I think that is exactly what has happened. I think that actually people don't worry about it or complain or moan about it very much anymore. So people just sort of understand that is the way it is.

LISA FAIRFAX: It is just something you do. I briefly want you to talk a little bit because we have been kind of circling around this First Amendment question and obviously very early on in its history the rule was challenged on First Amendment grounds, and I won't go too much in detail but was challenged based on the notion that it infringed on the First Amendment rights of those who want to give political contributions and essentially the Appeals Court upheld the rule against that challenge. Really upheld it which is important under the strict scrutiny basis basically saying that the rule was narrowly tailored to achieve a compelling state interest and that interest is obviously to protect the municipal securities industry. So I think the good thing about the rule and I am sure you guys will probably agree but I will ask is that it has been tested. That is, Appeals Court upheld the rule and the Supreme Court didn't disturb that decision, so I think that is a good position to be in from a kind of First Amendment perspective and one of the more obvious federal challenges to a rule such as this. I don't know if you guys have anything further to say.

DAVID CLAPP: I will tell you that when we were passing the rule, one of the longest discussions, I will say, we had was how much money could we put into the minimus part of this?

LISA FAIRFAX: Yes.

DAVID CLAPP: \$250? \$500? \$1,000? \$100? People have different ideas. There were some other examples of \$250. So that is the rule that when we picked with wasn't any great philosophical thing about it, we didn't think \$250 was so little that it didn't matter and we never think that it would matter so much that it would have a great effect on what we were trying to do. So that is where the 250 bucks came from and it is just the way that this thing really moved along in a way that we just felt alright to each one of the things that happened. I know we are getting to think that subsequent MSRB actions that picked up on some of the things that this rule did not pick up ... pick up on but wasn't easy do this. I think there was no clear example of exactly this.

LISA FAIRFAX: Yes.

DAVID CLAPP: One of the things I want to say about SROs. The NASD had come up under tons and tons of criticism over the years for basically finding in favor of a securities

dealers guys against the customer, that is to say, the client and that was in the back of everybody's mind.

LISA FAIRFAX: The notion that we need to do more to make sure that we are protecting the client, you mean?

DAVID CLAPP: No, the fact that SROs cannot really self-regulate. Now I think as a guy who worked in the securities industry for 30 years, I felt the NASD did not a bad job but the press thought it was a lousy job, the financial press in particular.

LISA FAIRFAX: We were just talking about this notion of people attacking SROs or at least questioning their legitimacy in the face of the kind of more obvious criticism that you can expect people to kind of regulate themselves. But I think a rule like this exactly as Ron pinpointed really does underscore the fact that in fact there are things that SROs can do to regulate themselves. And because they have greater experience that they may have greater understanding of the types of rules that will work and the type of things that are warranted. Ron, you had some...?

RONALD STACK: I am going to turn the tables here, okay, Lisa?

LISA FAIRFAX: Sure.

RONALD STACK: Okay, since you teach law. Given the Citizens United case which where the Court, this current Court, a 5-4 decision struck down provisions in the McCain-Feingold Act that prohibited corporations both profit and non-for-profit and unions from broadcasting electioneering communications. This Court is very strong on the First Amendment, and is not hesitant to overturn precedents as we know. I would not think that our rule would come up before the Court but how would this current Court view something like a G-37 in maybe another area or whatever?

LISA FAIRFAX: I think it is a very important question and I think a case like Citizens United raises again the specter that maybe there is a constitutional challenge that can be brought against the rule such as this and that is always a question right whenever you get to issues about restrictions on political contributions. And certainly you are exactly right this Court seems to be incredibly sensitive to that and the Court also seems to be incredibly mild for not just on individual rights but of course organizational rights this rule bumps up against. Having said that, I don't think this rule, and of course, I should caveat all those things, you never can predict what the Supreme Court would do but I think this rule is fairly safe. In terms of precedent, you at least have the Appeals Court decision upholding the rule when there is strict scrutiny now, since which is what I just said is very important because ultimately what they are saying is, "We think this rule is actually quite narrowly tailored to do what it is supposed to do which is to protect against bribery, to protect the retail investors and to protect the consumer. I do think that what people should not take out of Citizens United is that there can be no prohibitions on political contributions." That is not the Court was saying, instead what they were saying was you need to have a rule that is quite narrowly tailored. And I think number one, that the minimus exception is very important and number two, the fact that it is not all out bad, it is designed to impact particular people, particular professionals. So I think David likely deserves a credit for that, that it is a rule that kind of nicely balances the two competing interests that the Court would be concerned about. So I mean it is my sense,

you always have to be concerned about the possibility of that type of challenge but I really, I think that G-37 is kind of well crafted in that way to kind of dodge that challenge.

DAVID CLAPP: We actually retained for the MSRB an individual who later became the Chairman of SEC. His prescription of why he thought we were okay sounded a lot like what you were saying. He was saying, if this is an out and out ban, you have trouble, you have a problem.

LISA FAIRFAX: Yes.

DAVID CLAPP: But it is not an out and out ban. Now the question is, can you craft it in such a way that truly it is not an out and out ban. That it is just not an out and out ban by some other name and you know, we didn't know whether it didn't. But I will tell you, I was just worried until Kit Taylor told me that the Court probably would refuse to hear this.

LISA FAIRFAX: Yes.

RONALD STACK: At the time of the G-37 discussions I was at Goldman Sachs working with David and we had many spirited discussions about this and at one point I said to David, "I am not sure you are right, David, I think that I still have a constitutional right to make contributions." David said, "Well, Stack, you have many constitutional rights but one of them isn't working at Goldman Sachs."

DAVID CLAPP: I have some really grave doubts about whether when you start messing around with what people can do constitutionally, can you craft such a thing that gets around that?

LISA FAIRFAX: My scholarship is in the corporate and securities area, so a law scholar might have better been able to talk about Citizens United. While you can never say never, I think you have a pretty good rule on your hands. Of course a lot of things have changed since the adoption of the rule and the rule itself has kind of evolved over time. One of the things that changed is in 1998 you got rule G-38. David, can you explain a little bit what that rule is and kind of what it was aimed at responding to?

DAVID CLAPP: Let us put it this way. G-38 came about because by this time we found out that people were circumventing G-37 basically through the use of outside consultants, paid consultants. And we always thought that we weren't the smartest men and women in the world and somebody would figure ways around this. But that is where G-38 came from. It basically was to prevent everybody from using these consultants, to deter that and to detect attempts by dealers to avoid restrictions placed on them by G-37 and also G-20 which we haven't talked about.

LISA FAIRFAX: You just mentioned...

DAVID CLAPP: What happened was in 2005, firms had to disclose that they had hired outside consultants to contact issuers for them as well as contributions made by such outside consultants.

LISA FAIRFAX: Yes.

DAVID CLAPP: Can I say it was not perfect but I thought it was pretty good.

LISA FAIRFAX: And then another change came in 2005, right, where there was a ban on municipal securities dealers use of consultants put in place. Ron, can you talk a little bit about that?

RONALD STACK: I can say this because that firm is no longer in business. One firm hired a consultant in the State of Illinois as perfectly allowable in MSRB G-38, fully disclosed to the issuer, et cetera and the State of Illinois did an \$8 billion pension deal and the consultant's fee was like 10% of the firm's profit really like \$8 million. So the consultant got an \$800,000 fee and there was sort of an outcry like, "What in the world is going on here? Is somebody who is just a consultant made \$800,000, did nothing on the deal, didn't run a number, doesn't know anything, is not a municipal expert or anything but somehow was hired by a particular firm and was perfectly allowable?" So the MSRB went around the country looking at different ways to disclosing and limiting, et cetera, et cetera, how can we do this? How can we make this political consultancy work in terms of disclosure, contributions? You know we already had in the books, a consultant couldn't do what you couldn't do by your own self, et cetera. But the MSRB ultimately decided that the best way to deal with political consultants was to ban them, okay, not that the original architecture from the G-38 which was quite reasonable, was that it just became impossible to police and the cleanest way for the industry to deal with it is nobody could hire a consultant to do... to be a political consultant on financing. You can hire an engineering firm to do an engineering study. You can hire some lawyer to do some legal work for you but you couldn't hire somebody to solicit municipal business for you and that put the end of political consultants in the municipal business.

LISA FAIRFAX: Has there been any push back with regard to that?

RONALD STACK: I think that there have been cases where people wondered whether or not... David correctly said crooks will be crooks but I think that we have always suspected that Harry or Sally was hired as a consultant to work on the furniture design and in fact, they were hired because of political connections and ends up with the firm getting a deal. But basically again what you have goes back to the notion when SRO is self regulatory, you have the firms, the best firms, the good firms, the firms that want to do it right saying we don't do this anymore. Okay? We just don't do it. And so if you come in and say... somebody came into my office when I was head of public finance at Lehman Brothers and said, "We could hire this guy and...?" And I said, "No, no, we don't do that. We do not do that. We do not jeopardize the franchise. We do not jeopardize the department. We do not jeopardize... and you do not jeopardize your career and my career for one deal. No deal is worth it. No deal is ever worth it."

DAVID CLAPP: It doesn't take a huge amount of grey matter to figure out that if you hired somebody to help you work on a deal and you didn't pay... I said hired, excuse me, you brought someone in to help you and you didn't pay him anything, what does that mean? Well, it may mean that he has gone out and done something else for you somewhere else. And what I am saying is, if you were really clever you can get around these things but I say think what I am suggesting too is, that's true but any major thing that is going on is going to be discerned and figured out.

LISA FAIRFAX: I mean it is always the case, or at least it goes without saying that someone who is determined enough will try to find a way, you know but that sounds like what these rules are designed to do is to really make sure that the bulk of this industry is

doing the right thing. And in some ways to kind of give industry professionals who want to do the right thing some support so that they can in fact say, "Look, not only are we doing this but this is the reason why." And exactly as Ron as alluded to, we don't want to jeopardize the entire firm over some one deal I have and I think that is very important and I think another reason why a rule like this is important is because it gives people in some sense some additional ammunition for ensuring that best practices are followed.

DAVID CLAPP: I'm having dinner with someone many years ago. He said, "Let me ask you a question. If we put this rule and then years go by, what percentage of rules you consider to be success in terms of how much we eliminate this?" And I said, "If we eliminate 80/85% of everything we will have done very well because that had been where the big money was. And I think we have done better than that considerably. But that is what my thinking was at that time just because I would never have trusted the fact that we have done such a good job that somebody couldn't figure out some way around it.

LISA FAIRFAX: I want to talk about success in a moment but let me ask a different question since you raised it which is, what about those getting around it? Do we have other than the out and out crux, you know, obviously something like this can't go away entirely. Who is that 15%? Why is it still going on and there is something, some commonality amongst that 15%? I guess I would suggest it is likely less than that but you know to the extent that these practices continue, why do you think that? So is there some kind of common theme about how they continue to arise?

DAVID CLAPP: I actually do believe that is less than 15%. But what I would say first of all, this is going to sound really funny but believe it or not there are people who don't know the rule exists, they really don't. Now that is probably a small group but they are there and they are doing that. And then there are just people who say, "To heck with it." Ron touched on this much earlier, "I can't get any business any other way than this. So I am going to do it. And I am not going to go the direct route, make a direct contribution to the guy's campaign. I am going to use some sort of gimmick involving lawyers or consultants or somebody."

RONALD STACK: I have heard, and David, I am sure you have too, a particular individual whose mother and father in Massachusetts decided they were going to give money to somebody running in the State of Wisconsin. And you could say that undoubtedly the particular banker in Wisconsin gave money to his mother and father to send the money to the guy. But you can't prove any of that, so, are there ways of doing that kind of things? The rule does not prohibit giving via spouses and I think some of that probably goes on. But I think for the large part it is just not something people want to do. Nobody wants to get anywhere near that line.

LISA FAIRFAX: It sounds what is happening to the extent there, something is happening, it is happening indirectly. One might ask if the rule can capture that and one response could be, you go too far out thinking it would really have a First Amendment problem, but it sounds like for the most part the rule has been able to kind of root out the kind of more straight forward instances that it was aimed at.

DAVID CLAPP: Honestly the mother and father in Massachusetts in all probability are not going to be giving vast sums of money to the candidate in Wisconsin.

LISA FAIRFAX: Yes.

DAVID CLAPP: I am not forgiving it or excusing it but there is where it comes from. But what about somebody running for President? He is currently a Governor and he wants to run for President. Well, they are subject to the rule.

LISA FAIRFAX: How are they subject to the rule?

DAVID CLAPP: Well, because while they are running, they are still the CEO of the state who appoints all the people who administer the state's business.

LISA FAIRFAX: That is good to know because I think people waiting obviously think about someone who is running for President is just kind of capturing them.

DAVID CLAPP: That is a lobby.

LISA FAIRFAX: Yes.

DAVID CLAPP: What do you think, Ron? It is an odd one, if he gets elected President. I think we had one like that. It did come up at the time your rule was being drafted.

RONALD STACK: It did. Actually David, it came up on in the last election because Sarah Palin was the Governor of the State of Alaska.

DAVID CLAPP: See that?

RONALD STACK: She no longer is the Governor.

DAVID CLAPP: My reaction to it was, alright, I mean if that strange oddball, off beat situation happens, it happens.

LISA FAIRFAX: Yes.

DAVID CLAPP: I mean you just can't stop everything, everywhere, every time.

LISA FAIRFAX: Let us change gears a little bit but you know still talking about, I think the other thing that it is important to know is that since the rule's implementation, of course there has been lot of changes in the financial markets. One of those changes is that dealers have become affiliated with a broad range of other entities. I will ask you, Ron, are there any concerns that these kind of affiliated relationships raise in connection with the Rule?

RONALD STACK: Affiliated in terms of what?

LISA FAIRFAX: That is the notion that dealers have kind of relationships with a bunch of other entities in the industry. To what extent does that raise a concern or a problem or banks?

DAVID CLAPP: I don't know what will happen here. I mean, remember we are trying to stop people from doing negotiable bond business and when you get too far a field in

terms of the way you are suggesting, I am just not sure how it would work. Let me be honest you, I don't know how it would work.

RONALD STACK: I mean as you said what is it, when the change is obviously that after the 2008 basically all the major firms became banks. Jefferies is the largest independent broker-dealer in the country right now. That is not something that was the case on September 14th, 2008; it is now the case. So you do have a change in kind of the organizational structure but I think basically the rule is still working as it did before.

LISA FAIRFAX: And it doesn't make a difference, banks, broker-dealer...

RONALD STACK: There have been issues with banks, PACs and how does this all work and that is something the board will always have to continue to deal with.

LISA FAIRFAX: Just recently, in 2010, the SEC approved a pay to play rule aimed at curtailing practices by investment advisors and I think the rule required that investment advisors become compliant by early March 2011. The interesting thing about that rule is, of course the SEC not only modeled the rule after G-37 but they specifically justified adoption of the rule by pinpointing the success of G-37. so I know that makes you feel good but what is your reaction? I know obviously that MSRB's investment advisors don't fall within the scope of MSRB's functions but what is your reaction to the new rule?

RONALD STACK: Just as a quick vignette and I won't say the individual's name, David, but you know him. When we were doing G-37 I got a call from a manager of a state worker of a major pension fund who said, "How do we do this?" and I said, "What do you mean?" and he said, "Well, this happens all the time to me. I got these people who are advisors. And what do I do?" I said, "You can't do much. I don't think there is nothing you can do. Because the pension advisors are not regulated. There is nothing you can do." And what this individual did was in order to protect himself and also his boss would require these intermediaries, these advisors to when the pension system made an investment that they had to write a letter to him saying, if they use the consultant and if they did how much they paid them, him or her and they did that not because he could stop it but just because he wanted to put it on record and also if it just happened to be like the cousin of his boss or something, he could go to his boss and say, "We shouldn't do this one. I mean this won't look good if it ever comes out." So he put it on record but this is early '90s. He was looking for something like this which did not really occur until this recent scandals in the State of New York and the resultant changes in the advisory rules. I guess I can't speak to the MSRB whatever but the MSRB still has to work out with FINRA and the SEC exactly how all this is regulated and that is something that still has to be done.

LISA FAIRFAX: You mentioned the scandals in New York. Does that you think suggest something about a potential concern in increase pay to play schemes or I mean, I know that is not, I think the scandals in New York related to kind of public pension funds, et cetera. I think you are exactly right, that is the reason why kind of the SEC stepped in. Do you think there is any kind of broader concern, broader kind of re-emergence of pay to play schemes?

RONALD STACK: I think I would be remiss if I didn't state that in general the difficulty we always have in this and we were very special, the difficulty you have is that people give political contributions for a reason. And in our particular case, for example,

pensions, whatever the treasurer, whatever the control is, it isn't because they like their views on social issues or they like their views on healthcare. I mean these people are managing money, so they are giving for a reason and this tends to be why people give money. That is why yesterday the executive vice president of the U.S. Chamber of Commerce was very vehement against the possibility of President Obama would issue an executive order that would require just the disclosure of \$5,000 more contributions by businesses to campaigns. It is because they are giving money for a reason. And in some ways, by some people's views that is free speech and there is nothing wrong with it. I would say in general this is an issue that will always be there. Because of the nexus of our public sector, of our municipal bonds, of the retail buyers and being an SRO, we were able under David's work to kind of separate ourselves out from this broader debate. But this broader debate is never going to end about political contributions, should they be limited, how and why.

DAVID CLAPP: I was approached by more than one person who said, "What are you going to do here? I mean all this pension money is being given away to funds and other people by these state officials and they are giving these state officials huge, huge contributions." And my answer was, "I don't like it but I don't regulate it."

LISA FAIRFAX: It is now someone else's.

DAVID CLAPP: That is someone else's. It is still very relevant today. The thing I like the best about it and Ron was banging away at it still is that it now distinguishes this particular business which has a very particular place in the American economy and in the way people think about things. It distinguishes them in a way that this proved to be very effective and it is just the simple fact, if you do it you cannot do business there and nobody wants to do that, no one wants to do that.

LISA FAIRFAX: We are getting towards the end of the program. Let me see if either one of you guys has any closing thoughts either about the success. Ron, I think you made some very powerful points about the relevancy of the rule both to, I think the particular industry but also I think important to note about the broader debate about these types of contributions. So let me just give you guys both a chance to make some closing remarks on kind of the rule's relevancy or any other thing you want to say about the rule.

RONALD STACK: I would say the rule has been an unqualified success. Since its inception I think it has been enforced well, I think it has been a success. I think it set out to do the objectives that David in the board at the time laid out before the industry and I think it has a 110% support of the major players throughout the industry. It has been a great success and is now as you said is being used as a model of the SEC for other areas. David?

DAVID CLAPP: Ron has said such nice things about me today that it occurred to me that he was going to ask me for a job, I guess he is not. I don't have one to give him anyway. I agree with what Ron said. I mean I think it sort of did what we thought it would do, failures have been more or less the ones and the kind of things that happened that we more or less predicted. I feel very good about it. Ron said some very nice things about me but it wasn't just me, it was the MSRB and the staff of the SEC then who by the way did all the drafting, who come in for a lot of credit. It is one of those times when the time is right and we were able to get it done.

LISA FAIRFAX: Well, thank you so much for those comments and for your insights into pay to play and the role of the Municipal Securities Rulemaking Board in curbing the kinds of conflicts of interests that we have been talking about. I know that today's audience as well as museum visitors as well as me access the program in the future will benefit from the remarks you made and the insights that you provided to us.

Today's Fireside Chat will be permanently preserved in audio, mp3 and edited transcript formats under Programs in the virtual museum and archive at www.sechistorical.com. On behalf of the SEC Historical Society let me thank the Municipal Securities Rulemaking Board again for their very generous support in making today's broadcast possible.

Looking ahead, the virtual museum and archive will next broadcast The Supreme Court and the SEC with former SEC General Counsel David Becker and Professor Adam Pritchard of the University of Michigan Law School as presenters, with Professor Kurt Hohenstein of Winona State University as moderator. Like today's broadcast the Supreme Court and SEC online broadcast will be free and accessible worldwide without prior registration. Unlike today, it will be a live video broadcast. Please plan to join us on www.sechistorical.org on June 2nd at 12 noon Eastern Time. Thank you again for being with us today.