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Impact of Pay-to-Play Rules in the 2016 Election Cycle

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The federal Pay-to-Play Rules may impact campaign contributions in the 2016 election and, in particular, campaign contributions to a major party's presidential campaign. Financial institutions that do business with, or seek to do business with, state or local pension plans should be aware of the business consequences that a political contribution in the 2016 election cycle may trigger.

In particular, vice presidential candidate Mike Pence's authority over the Indiana Public Retirement System ("INPRS") and the Indiana Education Savings Authority ("IESA") as Governor of Indiana may limit political contributions from a wide spectrum of financial institutions and their associates to the Donald Trump presidential campaign. Investment advisers, brokers, dealers, municipal securities dealers, municipal advisors, swap dealers and security-based-swap ("SBS") dealers (collectively, the "Covered Institutions"), and their associates are all potentially impacted.

Governor Pence is an "official" of INPRS and IESA under the Pay-to-Play Rules because he appoints members of their boards of trustees. As a result, direct or indirect contributions to the Trump campaign could trigger a two-year "time-out" that would prevent Covered Institutions from collecting fees from, or engaging in certain activities with, INPRS and the Indiana CollegeChoice 529 Savings Plans or the Indiana CollegeChoice CD 529 Savings Plan, of which IESA serves as the governing board.

This article summarizes the four principal federal Pay-to-Play Rules currently in effect: Securities and Exchange Commission Rule 206(4)-5 (the "SEC Rule"); Municipal Securities Rule Making Board Rule G-37 (the "MSRB Rule"); Commodity Futures Trading Commission Regulation 23.451 (the "CFTC Rule"); and SEC Rule 15Fh-6 applicable to SBS dealers and major securities-based swap participants.

In addition, the Pay-to-Play Rules broadly prohibit a person from doing indirectly what the person would have been prohibited from doing directly. Accordingly, a payment to a political action committee ("PAC") or political party that is soliciting funds for the purpose of supporting an official of an issuer could be treated as a contribution made directly to such official.

SEC Pay-to-Play Rule

The SEC Rule was adopted in 2010 and modeled on the MSRB Rule.[1] It prohibits "Covered Advisers"[2] from receiving compensation for providing advisory services to a government entity client (such as INPRS) for two years after the adviser or a Covered Associate (as defined below) has made a contribution to an "official" of the government entity, or has solicited from others or coordinated contributions to an "official" of the government entity. The SEC Rule defines "Covered Associate" as: (i) any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) any employee who solicits a government entity for

[1] "Political Contributions by Certain Investment Advisers," SEC Release No. IA-3043, www.sec.gov/rules/final/2010/ia-3043.pdf.

[2] The SEC Rule applies to investment advisers registered or required to be registered with the SEC, "foreign private advisers" not registered in reliance on Section 203(b)(3) of the Investment Advisers Act, and "exempt reporting advisers."

the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) any PAC controlled by the investment adviser or by any person described in parts (i) or (ii).

In addition, a contribution to a political party, PAC, or other committee or organization may trigger the two-year "time-out" if the contribution is, for example, earmarked for or known to be provided for the benefit of a particular political "official."[3] An "official" means any individual (including any election committee of the individual) who was, at the time of a contribution, a candidate (whether or not successful) for elective office or holds the office of a government entity, if the office (i) is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity or (ii) has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity.

Accordingly, a candidate for federal office may be an "official" as a result of holding a state or local office. For example, the SEC Rule covers contributions to Trump's presidential campaign because his running mate, Governor Pence, is an "official" under the SEC Rule given his current office of Governor of Indiana.

Under the SEC Rule, Covered Associates (but not Covered Advisers) may make a contribution up to the *de minimis* amount per election without triggering the two-year "time-out" on advisory fees. This *de minimis* amount is $150 in an election where a Covered Associate may not vote for the candidate and $350 in an election where a Covered Associate may vote for the candidate.

MSRB Pay-to-Play Rule

The MSRB Rule prohibits brokers, dealers and municipal securities dealers (each, a "Covered Municipal Dealer") from engaging in municipal securities business and municipal advisors from engaging in municipal advisory business with municipal entities if certain political contributions have been made to officials of such municipal entities.

Under the MSRB Rule, a Covered Municipal Dealer is prohibited from engaging in municipal securities business with a municipal entity for two years after the Covered Municipal Dealer, a municipal finance professional of the Covered Municipal Dealer or any of their controlled PACs makes a contribution to any official of the municipal entity who can influence the selection of the Covered Municipal Dealer.

In addition, effective August 17, 2016, municipal advisors are prohibited from engaging in municipal advisory business with a municipal entity for two years after the municipal advisor, a professional of the municipal advisor or any of their controlled PACs makes a contribution to an official of the municipal entity who can influence the selection of the municipal advisor.

The MSRB Rule also prohibits Covered Municipal Dealers and municipal advisors, and their professionals, from soliciting or coordinating contributions from any person (including an affiliated entity) or PAC to an official of a municipal entity with the ability to select a Covered Municipal Dealer or municipal advisor with whom the Covered Municipal Dealer or municipal advisor does or is seeking to do business.

The MSRB Rule permits a municipal finance professional or a municipal advisor professional (but not Covered Municipal Dealers or municipal advisors) to make a contribution up to $250 in an election where the individual may vote for the candidate without triggering the "time-out." There is

[3] "Staff Responses to Questions About the Pay to Play Rule," www.sec.gov/divisions/investment/pay-to-play-faq.htm.

no de minimis exception if the municipal finance professional or municipal advisor professional is not eligible to vote for the candidate.

Other Pay-to-Play Rules

The CFTC Rule restricts swap dealers from offering to enter into or from entering into a swap or a trading strategy involving a swap with a governmental special entity, if the swap dealer (or a covered associate of the swap dealer) made or solicited contributions to an official of that governmental special entity during the preceding two years, with limited exceptions. When proposing the rule, the Commodity Futures Trading Commission stated an objective of harmonizing the CFTC Rule with the MSRB Rule and the SEC Rule that already covered many swap dealers. Accordingly, the application and terms of the CFTC Rule to swap dealers are very similar to the MSRB Rule and the SEC Rule described above.

SEC Rule 15Fh-6 restricts SBS dealers from engaging in certain activities with a municipal entity, if the SBS dealer (or a covered associate of the SBS dealer) made or solicited contributions to an official of that municipal entity during the preceding two years, with limited exceptions.[4] The SEC stated that Rule 15Fh-6 was designed to subject the SBS dealers to the same types of restrictions as the CFTC Rule.

FINRA has proposed a similar rule that would apply to executives of broker-dealers.

In addition, many states and localities have also adopted pay-to-play rules that are applicable to persons who contract with their governmental agencies.

Contributions to the Trump/Pence Campaign

The Governor of Indiana appoints members of the boards of INPRS and IESA. This power to appoint board members, who make the decisions whether to hire or terminate service providers, makes Governor Pence an “official” of INPRS and IESA for purposes of the Pay-to-Play Rules.

Because the presidential and vice presidential candidates of a political party run on a single ticket, a contribution to the Trump presidential campaign would be subject to the Pay-to-Play Rules. In addition, contributions to the Republican Party or to a PAC supporting the Trump presidential campaign may trigger a “time-out” as well because the Pay-to-Play Rules apply to contributions that the donor knows will benefit a particular official.

Other Campaigns

In addition to the Trump/Pence campaign, Covered Institutions should be mindful of the ramifications of the Pay-to-Play Rules with respect to other donations this election cycle. As both Hillary Clinton and Tim Kaine are not “officials” for purposes of the Pay-to-Play Rules, a contribution to the Clinton/Kaine campaign would not be subject to the Pay-to-Play Rules. There are, however, other candidates for whom a campaign contribution may trigger the Pay-to-Play Rules.

Financial institutions should assess whether the Pay-to-Play Rules present a business risk in the 2016 election campaign, not just with respect to firm contributions but also those of their associates and related PACs, given their current or potential investors or clients. If so, they should review their compliance policies and procedures accordingly.

[4] SEC Rule 15Fh-6 was adopted in April 2016 and became effective on July 12, 2016.

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