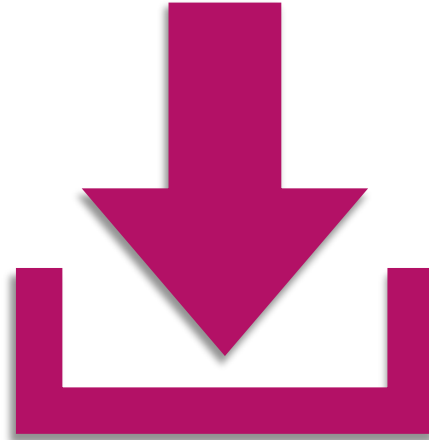




# Investment Advisers and Campaign Donations

# Download Our Slides

<https://www.ria-compliance-consultants.com/campaign-donations>



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## **Effective On 1/1/25:**

U.S. Virgin Islands





# Investment Adviser Rep Continuing Education

This Course Has Been  
Approved by NASAA For 1  
Hour of IAR CE Under Ethics  
Category

# NASAA Disclosure

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# Course Requirements

- ▶ **Login** - You must be logged in during the presentation under your email address.
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# Content Questions & Technical Help

If you have questions about the content of this course or need technical help, please contact us via the email address below:

[ContEd@ria-compliance-consultants.com](mailto:ContEd@ria-compliance-consultants.com)

# Your Instructor



Bryan Hill, President  
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Bryan has over 29 years of experience working with investment advisers, broker-dealers and investors as a compliance consultant, attorney and executive.

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877-345-4034 x 101



# Course Overview

- ▶ Background
- ▶ Details of Rule 206(4)-5
- ▶ Recent Enforcement Action
- ▶ Best Practices

# Limitations & Exclusions

Limited to Investment Adviser Firms Registered with SEC & Exempt Reporting Advisers



Does Not Address Requirements of State Registered Investment Advisers



Does Not Cover Additional Laws or Rules of States or Cities

Investment  
Advisers  
Only  
Registered  
with State  
Securities  
Regulators

Rule 206(4)-5 Only Applies to  
Investment Advisers Registered with SEC &  
Exempt Reporting Advisers



States May Have Additional Requirements



Even for State Has No Specific  
Requirements, There Is Still Risk of  
Enforcement Action for Fraud



# Regulatory Resources

SEC Rule 206(4)-5 (Political Contributions By Certain Investment Advisers):

[https://www.law.cornell.edu/cfr/text/17/275.206\(4\)-5](https://www.law.cornell.edu/cfr/text/17/275.206(4)-5)

SEC Final Release for Rule 206(4)-5:

<https://www.sec.gov/files/rules/final/2010/ia-3043.pdf>

SEC Enforcement Action, SEC Charges Four Investment Advisers for Pay-To-Play Violations Involving Campaign Contributions, (09/15/2022):

<https://www.sec.gov/enforce/ia-6126-s>

SEC Enforcement Action, SEC Charges Investment Adviser for Pay-To-Play Violation Involving a Campaign Contribution, (08/19/2024):

<https://www.sec.gov/enforcement-litigation/administrative-proceedings/ia-6662-s>

## What Is Pay-To-Play

A Government Official  
Selects An Investment  
Adviser to Manage Public  
Funds Based Upon  
Whether Investment  
Adviser Is Making A  
Campaign Contribution  
Or Other Payment To  
Government Official

# Examples of Pay-To-Play



**Political Contributions to Elected Officials**



**Contributions Through Covered Associates**



**Using Intermediaries or "Straw Donors"**



**Payments to Political Action Committees (PACs)**



**Offering Excessive Hospitality or Gifts**



**Hiring "Placement Agents" With Political Ties**



**Promise of Future Employment or Consulting Fees**



# Pay-To-Play Enforcement Actions Prior To Adoption of Rule 206(4)-5 in 2010

**New York:** Charging Former NY Official with Allegedly Engaging in Fraudulent Scheme to Extract Kickbacks from IA Seeking to Manage NY Retirement Fund

**New Mexico:** IA Allegedly Paid Kickbacks in Return for IA Business Awarded by NM Treasurer's Office

**Connecticut:** Allegedly Former CT Treasurer Awarded State Pension Fund Investments to Private Equity Fund Managers for Fees Paid to Treasurer's Friends & Associates

# Impact of Pay-to-Play

*“Elected officials who allow political contributions to play a role in the management of these assets and who use these assets to reward contributors **violate the public trust**. Moreover, they **undermine the fairness of the process** by which public contracts are awarded. Similarly, investment advisers that seek to influence government officials’ awards of advisory contracts by making or soliciting political contributions to those officials **compromise their fiduciary duties** to the pension plans they advise and **defraud prospective clients**. These practices, known as “pay to play,” distort the process by which advisers are selected. They can harm pension plans that may subsequently **receive inferior advisory services and pay higher fees**. Ultimately, these violations of trust can harm the millions of retirees that rely on the plan or the taxpayers of the state and municipal governments that must honor those obligations.”*

See <https://www.sec.gov/files/rules/final/2010/ia-3043.pdf> at page 6 (emphasis added).

# Overview of SEC Rule 206(4)-5

- **What Is Rule 206(4)-5?**
  - Intended To Prevent Fraudulent, Deceptive Or Manipulative Acts
  - Designed To Prevent "Pay-To-Play" Practices
  - Applies To Investment Advisers (**Registered With U.S. Securities And Exchange Commission, Exempt Reporting Advisers and Unregistered Relying Upon Foreign Adviser Exemption**) Providing Advisory Services To Governmental Entities



**Two-Year Time-Out:** Prohibits Compensation For Advisory Services After Certain Political Contributions.

**Look-Back Period:** Applies To Contributions Made Up To Two Years Before Engaging A Governmental Client.

**Covered Associates:** Includes Firm's Executive Officers & Employees Who Solicit Governmental Business.

## Key Provisions Of Rule 206(4)-5

# What Contributions Are Covered

- ▶ Contribution To An Official Of The Government Entity Is Made By The Investment Adviser Or Any Covered Associate Of The Investment Adviser
- ▶ Including A Person Who Becomes A Covered Associate Within Two Years After Contribution Is Made

# Contribution

**Any Gift, Subscription, Loan, Advance, Or Deposit Of Money Or Anything Of Value Made For:**

- ▶ Purpose Of Influencing Any Election For Federal, State Or Local Office;
- ▶ Payment Of Debt Incurred In Connection With Any Such Election; Or
- ▶ Transition Or Inaugural Expenses Of The Successful Candidate For State Or Local Office



# Official

**Any Person (Including Any Election Committee For The Person) Who Was, At The Time Of The Contribution, An Incumbent, Candidate Or Successful Candidate For Elective Office Of A Government Entity, If The Office:**

- *Is Directly Or Indirectly Responsible For, Or Can Influence The Outcome Of, The Hiring Of An Investment Adviser By A Government Entity Or*
- *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*





# Government Entity

## **Any State Or Political Subdivision Of A State, Including:**

- Any Agency, Authority, Or Instrumentality Of The State Or Political Subdivision;
- A Pool Of Assets Sponsored Or Established By The State Or Political Subdivision Or Any Agency, Authority Or Instrumentality Thereof, Including A Defined Benefit Plan, Or A State General Fund;
- A Plan Or Program Of A Government Entity; And
- Officers, Agents, Or Employees Of The State Or Political Subdivision Or Any Agency, Authority Or Instrumentality Thereof, Acting In Their Official Capacity

# Investment Pool

An Investment Adviser To A Covered Investment Pool In Which A Government Entity Invests Or Is Solicited To Invest Shall Be Treated As Though That Investment Adviser Were Providing Or Seeking To Provide Investment Advisory Services Directly To The Government Entity

# Covered Associate

Any General Partner, Managing Member Or Executive Officer, Or Other Individual With A Similar Status Or Function;



Any Employee Who Solicits A Government Entity For Investment Adviser And Any Person Who Supervises, Directly Or Indirectly, Such Employee; And



Any Political Action Committee Controlled By Investment Adviser Or By Any Person Described Above

# Executive Officer

President;

Any Vice President In Charge Of A Principal Business Unit, Division Or Function (Such As Sales, Administration Or Finance);

Any Other Officer Of The Investment Adviser Who Performs A Policy-making Function; Or

Any Other Person Who Performs Similar Policy-making Functions For The Investment Adviser



## De Minimis Exception:

Prohibition Does  
Not Apply To  
Contributions By  
Covered Associate  
If A Natural Person:

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If Entitled To Vote For Official  
At Time Of Contributions,  
Cannot Exceed **\$350** In  
Aggregate To Any One  
Official Per Election

---

If **Not** Entitled To Vote For  
Official At Time Of  
Contributions, Cannot Exceed  
**\$150** In Aggregate To Any  
One Official Per Election

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# Exception for New Covered Associates

Contribution Prohibition Does Not Apply If A Contribution Was Made More Than Six Months Prior To Becoming A Covered Associate

Exception Not Available If Covered Associate Solicit Clients On Behalf of Investment Adviser

# Exception for Return of Contribution

- ▶ **Discovery Timeline:** Adviser Must Discover Prohibited Contribution Within **4** Months Of Contribution Date
- ▶ **Contribution Limit:** Contribution Must Not Exceed **\$350**
- ▶ **Return Of Contribution:** Contributor Must Obtain A Return Of The Contribution Within **60** Calendar Days Of The Discovery
- ▶ **Annual Limit:**
  - Firms With **> 50** Employees: Maximum Of **3** Exceptions Per Year
  - Firms With **50 ≥** Employees: Maximum Of **2** Exceptions Per Year
- ▶ **Single Use Per Associate:** Adviser Cannot Rely On This Exception More Than **Once** For Contributions By The Same Covered Associate



# Solicitors Must Be Registered

Prohibited To Provide Or Agree To Provide, Directly Or Indirectly, Payment To Any Person To Solicit A Government Entity For Investment Advisory Services On Behalf Of Such Investment Adviser Unless Such Person Is:

- ▶ A Regulated Person; Or
- ▶ An Executive Officer, General Partner, Managing Member (Or, In Each Case, A Person With A Similar Status Or Function), Or Employee Of The Investment Adviser



# Political Action Committee

Investment Adviser And Covered Associates Are Prohibited From Coordinating Or Soliciting Any Person Or Political Action Committee To:

- ▶ **Make Contributions:** To An Official Of A Government Entity Where The Adviser Is Providing Or Seeking To Provide Advisory Services
- ▶ **Make Payments:** To A Political Party In The State Or Locality Where The Adviser Is Providing Or Seeking To Provide Advisory Services To A Government Entity

# SEC Pay-To-Play Enforcement Action

## August 2024

### Key Events:

- ▶ A New Employee Of An Investment Adviser Made A Political Contribution Of \$7,150 To A Candidate For Michigan State Office In 2022, Before Joining Investment Adviser
- ▶ In 2017, Prior to Hiring New Employee, Michigan Invested \$100 Million in Private Fund Advised By Investment Adviser. Private Fund Was A Closed-end Fund And Investors Were Generally Prohibited From Withdrawing Their Money For The Life Of Fund
- ▶ After Joining In 2020, New Employee Solicited Business For Investment Adviser (But Not State of Michigan)
- ▶ Investment Adviser Continued To Provide Investment Advisory Services For Compensation To Private Fund After New Employee Became A Covered Associate

## SEC Pay-to-Play Enforcement Action in August 2024 Violation, Cease & Desist and Penalty

- ▶ Although Returned by Official, Contribution Exceeded \$350 and Wasn't Returned Within 60 Days of Discovery
- ▶ SEC Alleged Violation Of Rule's 2 Year "Time-Out" Period, Which Prohibits Compensation For Advisory Services From Govt Entity If Political Contribution Was Made Within Prior 2 Years
- ▶ SEC Censured Investment Adviser, Issued Cease & Desist Order Against Investment Adviser From Violating Rule & Ordered to Pay Civil Money Penalty of \$95,000

# Best Practices

- ▶ **Pre-Hire Employee Screening:** If Open to Governmental Entity Clients, Review Contributions Made By Prospective Employee Within The Past Two Years To Identify Potential Conflicts
- ▶ **New Client/Investor Screening:** If Not Open To Governmental Entity Clients, Review (Before Accepting New Client or Investor) Whether Such Client/Investor Is Governmental Entity



# Best Practices Continued

- ▶ **Establish Comprehensive Compliance Policies:** Ensure Policies Address Political Contributions, Solicitations, And Interactions With Governmental Entities.
- ▶ **Regular Training:** Conduct mandatory training sessions for all employees on the Pay-to-Play Rule
- ▶ **Monitor Contributions Continuously**
  - **Ongoing Surveillance:** Regularly Review Contributions By Covered Associates To Ensure Ongoing Compliance
  - **Timely Response:** Act Quickly If A Problematic Contribution Is Identified, Including Seeking Return Of Contributions When Applicable

# Best Practices Continued

## ▶ **Maintain Detailed Records**

- ▶ **Document All Contributions:** Keep Accurate And Up-to-date Records Of All Political Contributions By Covered Associates.
- ▶ **Recordkeeping Of Compliance Efforts:** Ensure All Compliance Reviews, Training Sessions, And Exceptions Are Well-documented.

## ▶ **Monitor Third-party Solicitors:** Ensure Third-party Solicitors Are Registered

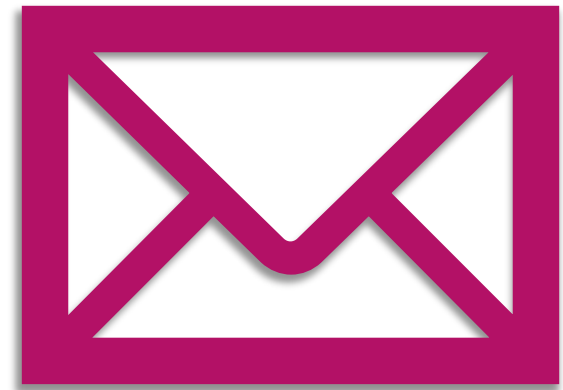
## ▶ **Review Annually:**

- ▶ Check Whether There Is An Additional Law/Regulation In Your State Prohibiting Pay-To-Play
- ▶ Survey Employees & Officers At Least Annually
- ▶ Review Whether Your P&P Are Effective

# Questions

Please submit any question online or email with any questions about the content of this course.

[ContEd@ria-compliance-consultants.com](mailto:ContEd@ria-compliance-consultants.com)



Thank You

