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Pay-to-Play, Chris Christie and the 2016 Election

From the Experts

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Recently a spokesman for New Jersey Governor Chris Christie announced that he will not resign from office if he decides to run for president. For many in the political donor community, this decision may create considerable unease, because Christie—as Governor of New Jersey—is considered an "official" covered under the U.S. Securities and Exchange Commission Rule 206(4)-5, the pay-to-play rule for investment advisors. In addition to the 2016 presidential election, which may involve a Christie campaign, there are other elections throughout the country that will be impacted by the SEC rule and other applicable pay-to-play rules, including elections on the state or local level.

Those in the financial services industry—specifically those who are, or work for, registered investment advisors—who are interested in contributing to candidates should recognize that there may be a significant level of risk created by the federal rule and state pay-to-play rules. This risk also would include contributions to any potential Christie campaign, including any Super PAC that may be created to support his campaign.

PHOTO BY BOB JAGENDORF, VIA WIKIMEDIA COMMONS

Gov. Chris Christie

The Pay-to-Play Rule for Investment Advisers

The rule prohibits investment advisors from providing compensated advisory services for two years to a jurisdiction if it, or a covered associate, makes a contribution (above the *de minimis* limit discussed below) to certain covered officials, including the governor of New Jersey. A violation of the rule occurs when the two-year ban is violated, or when the solicitation or anticircumvention provisions are violated. While some firms may decide not to accept compensation for advisory services for that particular jurisdiction in order to contribute to a covered official's campaign, others regard that risk as too great. Additionally, in this instance, there may be many potential donors who already do business with the state of New Jersey, thus creating an issue with a contribution.

As a general matter, an "official" covered under the rule is defined by the office the person seeks *or* holds. If the office is responsible for or can influence the selection of an investment advisor, or has the authority to appoint an individual with such power, then the holder of that office—or any candidate for that office—is considered an "official" covered under the rule. It is clear, given the powers of the governor's office, that Christie meets this classification. (Note that if Christie were to resign, he would no longer qualify as an "official," thus alleviating pay-to-play concerns under the Rule.)

Those in the donor community may be restricted under the rule if they are

considered "covered associates" of investment advisors. A covered associate includes general partners, managing members and executive officers (or others with similar functions or status); employees who solicit government entities for the advisor, and their supervisors (direct or indirect); and any PAC controlled by the advisor or any of the previously mentioned individuals.

Covered associates are limited to contributions of $350 per covered official per election (primary and general), provided that the covered associate is eligible to vote for the official. Note that this *de minimis* limit drops to $150 per covered official per election if the covered associate is *not* eligible to vote for the covered official (i.e., if that individual lives in State A, and therefore is ineligible to vote in State B, but wants to contribute to a gubernatorial candidate for State B). These limits are significantly less than the Federal Election Commission individual limits of $2,600 per candidate per election.

Under the rule, additional violations can occur when the advisor or covered associate solicits contributions for certain covered officials or state or local parties, or attempts to circumvent the rule (i.e., donations in the name of another; donations to a PAC knowing that the money may go to the covered official's campaign).

It is without question that the rule has created compliance challenges for those in the financial services industry. There currently is a legal challenge to the rule pending in the U.S. Court of Appeals for the D.C. Circuit, yet its prospects remain uncertain.

Super PACs and Pay-to-Play

Some have suggested that the creation of a pro-Christie Super PAC would be a way to solicit large contributions from those restricted by pay-to-play rules, including Rule 206(4)-5. While the rule covers direct contributions to candidate committees and certain political committees, and not independent expenditures, contributions to certain Super PACs, which are supposed to be independent expenditure-only committees that are then free to raise and spend unlimited amounts, may nevertheless create risk. Care should still be taken before deciding to contribute to such a Super PAC supporting a covered official.

First, a certain Super PAC could be considered an "election committee" of the covered official, thereby placing it within the contours of the rule. The definition of "official" in the rule includes "any election committee for the person." It is not without risk that the SEC could consider a particular Super PAC, whose sole purpose is to support a covered official, not truly independent and therefore an election committee for that official. This term is not defined, and is open to interpretation by the SEC (*not* the FEC) under the Investment Advisers Act of 1940, under which the rule was promulgated. Therefore, a contribution to such an election committee would then run the risk of triggering the rule.

Second, even if the SEC were to determine that such a Super PAC is not considered to be an election committee of the official, there still is some risk with contributing to Super PACs. For instance, a Super PAC may make (even incidentally) an in-kind contribution to a covered official if it coordinates with that official when determining when and how to make its expenditures. While the FEC has deadlocked in its determinations on what constitutes "coordination" between a Super PAC and candidate, the SEC, is not bound by those deadlocks and could reach a different conclusion on coordination and what constitutes a contribution in this instance.

If independence between a Super PAC and candidate truly exists, then such contributions should not trigger the prohibitions of the rule. But there is some risk involved, especially if the Super PAC's sole purpose is to support a covered official like Christie.

Compliance With the Pay-to-Play Rule

Those responsible for implementing and overseeing compliance programs at financial services firms should take care in staying in front of any pay-to-play issues. In fact, the SEC appears to be ramping up its enforcement of the relatively new rule, having settled its first case this past summer, which involved contributions to a gubernatorial campaign. The Director of the Division Enforcement for the SEC recently highlighted the settlement as part of the discussion of the SEC's 2014 accomplishments. Additionally, violations of this rule create severe headline risk, which could impact business.

While Rule 206(4)-5's application to Christie is clear, there are numerous other elections that run the risk of being overlooked if the appropriate policies and procedures are not put into place and followed effectively. At the outset, determining the covered associates in your organization and constructing a preclearance system for contributions are essential for compliance. Further, firms should note the recordkeeping obligations and keep track of contributions as required by the rule.

Many in the financial services sector should seek representation letters from candidates and committees that describe and demonstrate compliance with the various aspects of the rule. Even though these letters are helpful, a thorough analysis of all contributions is required. This due diligence is especially vital when considering contributions to—or fundraising for—Joint Fundraising Committees, which are pass-through vehicles that are constituted of various types of political committees.

In conclusion, the 2014 election was only a few months ago, but the 2016 campaign season is already upon us—companies and financial services firms need to be prepared to deal with the pay-to-play restrictions and reassess their compliance and record-keeping systems. Additionally, before contributing to Super PACs, a proper determination of risk should occur to make sure you or your firm stays in compliance with the various laws and regulations.

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