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How Companies Can Avoid Campaign Finance and Pay-to-Play Pitfalls

From the Experts

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The presidential primaries are in full swing. As individuals and corporations seek to influence the elections, now is a good time to remember that our campaign finance system is not the Wild West – at least not yet. There are various restrictions and prohibitions that apply to corporate involvement in federal elections, and depending on your status in the financial services industry, pay-to-play restrictions could severely hamper your ability to do business with government entities. Before the election calendar progresses, corporations should review their political compliance policies and procedures, and keep eyes out for several important pitfalls.

Corporate Contributions

Corporate contributions to federal elections are strictly prohibited. *Citizens United v. FEC,* the 2010 U.S. Supreme Court case, did nothing to change this prohibition. That opinion allowed corporations and unions to spend general treasury money on *independent expenditures*, as opposed to *contributions* to candidates or committees. "Independent expenditures" include spending that supports or opposes a candidate but is not coordinated in any way with a candidate. While the most popular vehicle for this activity are Super PACs, it can also be done by a company alone or through coalitions of companies (such as trade associations). Many corporations have formal board processes for approving such political activity.

While many people understand contributions to mean direct contributions – *i.e.* from a general treasury to a federal candidate – this prohibition also extends to "in-kind" contributions. An example of this type of contribution includes room space and food for an event. There is a dollar value associated with all of these activities and resources, and if provided to a candidate without sufficient reimbursement, it will be considered a prohibited corporate contribution. Further, employee time and corporate resources such as phones and computers also could be considered in-kind contributions. There is a safe-harbor for minimal activity, yet such activity should be monitored very closely.

Additionally, reimbursement of individual contributions is also prohibited. Not only would reimbursements violate the federal prohibition on corporate contributions, they would also implicate federal rules against making a contribution in the name of another. Compensation and bonus structures should also avoid taking contributions, since this would also be considered a prohibited activity.

Corporate PAC activity

Since corporations are prohibited from making contributions to candidates from their general treasuries, many decide to form PACs – or "separate segregated funds" – to assist in election-year efforts. The Federal Election Commission (FEC) has an explicit set of rules that spell out which employees can be solicited, how they can be solicited and what counts as a solicitation. All of these rules are based on the fundamental tenet in campaign finance law that all contributions must be voluntary and free of any threats of coercion. In a workplace environment, safeguards

must be put in place to make sure that no employees feel pressured to contribute to a company PAC or to make a contribution directly to a candidate or other election-year vehicle.

Pay-to-Play

Those in the financial services industry must pay attention to federal pay-to-play rules that could have a direct and significant impact on business, even if the rules are not violated. In the past few months, we have seen regulators ramping up their activities in this area. The Securities and Exchange Commission brought an enforcement action against pay-to-play practices under its antifraud rules, and also suggested that the pay-to-play rule for investment advisers (Rule 206(4)-5) is an enforcement priority for 2016. The Municipal Securities Rulemaking Board (MSRB) is seeking final approval over a pay-to-play rule for municipal advisors (Rule G-37). And the Financial Industry Regulatory Authority (FINRA) is seeking final approval over its pay-to-play rule for third party placement agents (Rule 2030). These are all in addition to federal pay-to-play rules on the books for municipal securities dealers and swap dealers along with a multitude of state and local pay-to-play rules for government contractors.

When the SEC announced recently that the pay-to-play rule for investment advisers would be an enforcement priority this year, there was a common perception that Rule 206(4)-5 is not a concern for federal elections. But that misunderstanding could lead to severe consequences. The rule specifically states that if a registered investment adviser or a covered associate makes a contribution to an "official" of a government entity, above a de minimis amount, then that investment adviser is subject to a two-year ban on compensated investment advisory services to that government entity. A violation of the rule occurs when that two-year ban is defied (regardless of intent); if there are solicitation activities for certain "officials" or state or local political party; or if there is an attempt to circumvent the rule--for example by making a contribution in the name of another or directing a contribution to an "official" through a third-party.

An "official" is defined by the office the person holds or seeks. If the office is responsible for or can influence the selection of an investment adviser, or has the authority to appoint an individual with such power, then the office-holder, or any candidate for that office, is considered an "official" under Rule 206(4)-5. In practice, that means that contributions to an individual who is running for a federal office, but is a current "official" under the rule, are subject to the rule's restrictions. Sitting governors, such as Ohio's John Kasich, are covered officials for the purpose of the rule, and therefore contributions to these candidates from those covered by Rule 206(4)-5 may trigger the timeout, and solicitation activities for these candidates will violate the rule. Accordingly, those subject to Rule 206(4)-5 must conduct diligence into a candidate's current office to determine whether a contribution may subject the investment adviser to a two-year timeout.

As evidence of its commitment to enforcement, the SEC last month brought an enforcement action against State Street Bank and Trust Company, and an associated attorney/lobbyist, arguing that they conducted a "scheme" using cash payments and campaign contributions to win pension fund contracts in Ohio. State Street agreed to pay $12 million (disgorgement of $4 million and a civil penalty of $8 million) and a senior vice president at State Street agreed to pay $274,202.81 (disgorgement plus interest of $174,202.82 and a civil penalty of $100,000). The SEC filed a complaint against the associated attorney/lobbyist for serving as a "conduit for corrupt payments." Given that the activities occurred before Rule 206(4)-5 went into effect, the SEC brought the sanctions and complaint pursuant to 10(b) of the Exchange Act and Rule 10b-5. The fact that the SEC used its general antifraud provisions is a telling sign of how it views this type of behavior.

Additionally, both MSRB and FINRA submitted long-awaited final pay-to-play rules to the SEC for approval. First, the MSRB amended its pay-to-play rule for municipal securities dealers (MSRB Rule G-37) to include coverage of municipal advisors. This rule differs slightly from the pay-to-play rule for investment advisers (Rule 206(4)-5)), so specific attention should be paid to its contours (e.g. the de minimis limit for contributions differs between G-37 and Rule 206(4)-5)). Second, FINRA completed its pay-to-play rule for member firms that engage in distribution or solicitation activities for investment advisers (FINRA Rule 2030). In other words, broker-dealers that are placement agents for investment advisers are governed by similar pay-to-play restrictions as the investment advisers themselves. Both of these new proposed final rules have accompanying record-keeping requirements as well.

Compliance

While certain rules have been on the books for years, taking stock of your entity's plan for compliance is always prudent. Especially if your entity may be covered by one of the new pay-to-play rules, now is an appropriate time to conduct an analysis of your prospective exposure under the new rules. As a general matter, in order to manage risk surrounding corporate or employee election activities, company policies and procedures should contain the following election-related sections:

- political contributions and activities
- corporate use restrictions
- pay-to-play, generally
- pay-to-play for specific federal rules should you be covered by a particular rule

These policies will help guide the company and also protect against a situation where a violation may have occurred. One of the first questions a regulator may ask is whether (and where) such questionable activity is prohibited under company policy. The ability to point to such policies and established procedures is important, and in the case of 206(4)-5, a necessity.

Additionally, the first quarter of 2016 is an opportune time to remind employees of the rules surrounding political activities. Formal trainings may be useful to cover the various risks that may impact the company.

As we head to Super Tuesday and beyond, taking appropriate compliance should ensure that your risk is not "super" but rather manageable and under control.

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