Overview of Restrictions on Political Activities by Investment Advisers, Broker-Dealers and Their Employees

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The following is a discussion of the application of various federal and state securities laws and Financial Industry Regulatory Authority ("FINRA") and Municipal Securities Rulemaking Board ("MSRB") rules, as well as various federal, state and local election laws, on political contributions and other related activities by investment advisers, broker-dealers and their respective employees, officers and directors.

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I. SEC Rule 206(4)-5

The Securities and Exchange Commission ("SEC") has promulgated Rule 206(4)-5 under the Investment Advisers Act of 1940, as amended, restricting pay-to-play practices for both registered and unregistered investment advisers. The principal components of the rule are as follows:

Restriction on political contributions: Under Rule 206(4)-5(a)(1), if an investment adviser or "covered associates," makes a political contribution (other than a *de minimis* contribution described below) to an elected official of a state, local or municipal government entity[1] (or a to candidate for the office) who is in a position to influence the selection the investment adviser as an adviser to the government entity,[2] then the investment adviser may be prohibited from providing advisory services to such entity for compensation for two years.

A "contribution" includes any "gift" or "anything of value" given for the purpose of influencing any federal, state or local election.[3]

A contribution could conceivably include the value of gifts or entertainment provided to a political candidate or official. It would also include the value of invitations, facilities, food and refreshments associated with a social function or event hosted for a political candidate or official.

Not all political events are affected by the rule.

[1] Rule 206(4)-5(f)(5) defines "government entity" to include a state or political subdivision of a state; any agency, authority or instrumentality thereof; any offices, agents and employees thereof acting in their official capacity; a pool of assets of the state or political subdivision thereof; and a plan or program of a government entity.

[2] An adviser may include an adviser in connection with the management of state or local pension monies, directly or through a pooled investment vehicle such as a hedge fund.

[3] Rule 206(4)-5(f).

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Ban on solicitation of certain contributions: Under Rule 206(4)-5(a)(2)(ii), an investment adviser and its covered associates are prohibited from soliciting or coordinating campaign contributions from others (*i.e.*, "bundling") for an elected official (or candidate for the office) who is in a position to influence the selection of the investment adviser to perform advisory services on behalf of a government plan or agency. The rule also prohibits the solicitation and coordination of payments to a political party in the state or locality (but not at the national level) where the investment adviser may be seeking business.[4]

If no contributions are made or solicited at the event, and no attendees are office holders or candidates, the restrictions on contributions and solicitations under federal pay-to-play rules should not be implicated.[5]

II. MSRB Rule G-37

MSRB pay-to-play rules contain restrictions and prohibitions on political contributions to government officials and political organizations similar to those contained in SEC Rule 206(4)-5. Violation of MSRB Rules in connection with an event occurring in advance of any resumption of municipal securities activities by the investment adviser could operate to restrict the Firm's business in this regard for an extended period (*i.e.*, for two years).

Under MSRB Rule G-37(b), if a broker-dealer or certain of its officers, directors, employees or control persons makes a contribution to a government official or other representative a state or municipal issuer – other than a *de minimis* contribution by its employees not exceeding $250 to each official for whom such individual is entitled to vote or $250 to a state or local political party in the locality where such individual is entitled to vote – then the broker-dealer may be prohibited from engaging in business with such issuer for two years. Rule G-37(c) prohibits a broker-dealer or its employees from soliciting any person or political action committee to make any contribution, or from bundling any contributions, to an official of an issuer with which the broker-dealer is or seeks to be engaged in municipal securities business, as well as the solicitation or bundling of payments to state or local political parties in the locality where the broker-dealer is or seeks to be engaged in municipal securities business. Rule G-37(e) requires disclosure to the MSRB of contributions by the broker-dealer and its employees to (i) officials of state and local issuers, except for contributions by the investment adviser's employees not exceeding $250 per official for whom the individual is entitled to vote and (ii) state and local political parties, except for contributions by employees not exceeding $250 to state or local political parties in the locality where such individual is entitled to vote.[6] The definition of "contribution" under Rule G-37 is similar to the definition under SEC Rule 206(4)-5, and could conceivably include the value of gifts or entertainment provided to a political candidate or official or invitations, facility, food and refreshments associated with a social function or event attended by a political candidate or official.

III. Local Election Laws

Local election laws may place monetary limits on contributions to political parties and candidates and may prohibit contributions from certain sources. Ordinarily, where a broker-dealer or investment adviser sponsors a political or social event in which a political candidate or official appears, election laws should not be implicated so long as no contribution to a federal, state or local official, candidate, incumbent or political party is made or solicited at the event, and no solicitation is made on any invitation or in any literature made available at the event. However, should any solicitation or contribution, by anyone, take place at or in connection with the event, the event may be considered a "fundraising event" and could trigger the application of various election laws with respect to the broker-dealer or investment adviser including restrictions on the amount of contributions by individuals (which might include the value of the reception) or the bar on contributions by corporations and limited liability companies (depending on election for tax

[4] In each instance (*i.e.*, the bars on contributions and solicitations) Rule 206(4)-5(d) would prohibit the investment adviser and its respective covered associates from engaging indirectly in conduct prohibited by the rule, such as by directing or funding contributions through third parties such as spouses, lawyers or affiliated companies.

[5] Rule 206(4)-5(b)(1) contains a *de minimis* exception from the restrictions on contributions which would permit covered associates to make contributions of up to $350 per election per candidate for state or local office if the contributor is entitled to vote for the candidate, and up to $150 per election per candidate if the contributor is not entitled to vote for the candidate.

[6] Rule G-37(d) prohibits contributions and solicitations to be made indirectly if the rule would prohibit them from being made directly.

purposes) under federal law. Depending on the circumstances, a more detailed analysis in this area is advisable.

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Please contact us if you have any questions or would like more information on the material discussed in this memorandum.