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Complying on pay-to-play: tips for CCOs

In an election year, complying with the SEC's pay-to-play rule takes on even greater urgency than usual—particularly given the complexities it presents.

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As we move deeper into another election season, investment advisers should consider refreshing their efforts to comply effectively with the Securities and Exchange Commission's rule on their political contributions—known as the pay to play rule.

Although it's more than five years old, Rule 206(4)-5 has not been easily integrated into many advisers' compliance programs. The rule is nuanced and complicated enough to require significant attention—particularly given the serious sanctions for non compliance, which include a two year time out from receiving advisory fees from a government client or investor in certain circumstances. Once a contribution covered by the rule is made, there are only limited opportunities to avoid triggering this time out. So avoiding such contributions in the first place is paramount.

If your firm allows its covered persons to make political contributions, there is not one simple step to avoid triggering Rule 206(4)-5. A carefully designed program of training, pre approval and quarterly certifications can help reduce the risk. Incorporating these 10 tips for compliance can make the process more effective.

1) Focus on actions, not intentions

Your firm's personnel may never set out to influence a pension allocation decision by making political contributions. They may have the best of intentions. But once a covered contribution is made, you're digging yourself out of a hole.

According to the SEC, the rule "does not require a showing of quid pro quo or actual intent to influence an elected official or candidate." While exemptive relief may be sought where a contribution was made with no intent to influence a pension allocation decision, it is far better to stop the contribution in the first place.

2) Don't ignore candidates for federal offices

Rule 206(4)-5 is focused on candidates who can influence state or local pensions, and as a result many advisers believe it doesn't cover contributions related to federal offices. This is, of course, not the case.

A candidate for federal office who holds an existing state or local office that brings them under the rule is still covered by the rule.

3) Ask before you hire

If you wait until a new employee's first day of work to ask about previous political contributions, you may be too late. Make the question a standard part of your pre hiring process, particularly for employees who will be subject to the full two year look back because they will be involved in soliciting pensions.

4) Use quarterly certifications to catch returnable contributions

There is an opportunity to return a political contribution that would otherwise lead to a two-year time out in certain limited circumstances. To be returnable, the contribution must be less than $350 and must be discovered within four months and returned within 60 days of discovery. There are also limits on the number of times this exception can be invoked. To timely identify any contributions that may be subject to this exception, advisers can use quarterly, instead of annual, certifications of compliance with Rule 206(4)-5.

5) Don't make assumptions about covered contributions

A government official does not need to have sole decision-making authority with respect to pension allocations in order to be covered by Rule 206(4)-5. The government official need not control allocation decisions, they need only have "direct or indirect" responsibility or influence with respect to such decisions. For example, this can include someone who appoints three of the nine pension board members.

6) Check for coordination and solicitation

It doesn't take a financial contribution to invoke the pay to play rule. Make sure your personnel are aware that anything of value can be viewed as a contribution. And note that a covered person's coordination or solicitation of contributions of others can trigger Rule 206(4)-5.

7) Get it in writing

In some instances, the political campaign can be consulted about the candidate's status as a covered official under Rule 206(4)-5. Don't rely on their analysis alone—it could be viewed as self-serving—but if they have formal memoranda or legal opinions on the subject this can inform and back up your own analysis.

8) Train better

Why do there continue to be Rule 206(4)-5 violations more than five years after it went into effect? It's easy for employees to forget about the rule because it doesn't come up in the context of their work at your firm. To reinforce compliance, consider mixing up your training methods so the rule and its importance sinks in.

9) Be aware of funneling

The biggest risk of violating the rule's evasion provision may come from contributions to political parties or political action committee (PACs). If the party or PAC is "funneling" contributions to a candidate who would otherwise be covered by the rule, then those contributions may be viewed as an attempt to evade the rule. Copies of event invitations can be helpful here to show there was no intent to evade.

10) Don't forget state, local and pension-specific laws and requests

Rule 206(4)-5 is generally applicable—but there are also state, local and pension-specific provisions that may apply. One practical approach is to limit contributions to candidates in the states in which your covered persons reside, and then fully analyze the requirements applicable in those states. Allowing contributions more broadly is permissible but comes with a higher price tag in terms of additional research and analysis that should be performed prior to allowing such contributions.

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