CONSTELLATION
ADVISERS, LLC

REGULATORY NOTICE: 19-09

Answers to the 5 Most Frequent Questions About the Pay-to-Play Rule Asked by Investment Advisers

With the 2020 election steadily approaching, Constellation would like to remind its clients about the SEC's Pay-to-Play Rule, which relates to political contributions made by both investment advisers and covered associates. Accordingly, Constellation has summarized points we believe are most relevant to our clients in a question and answer format. This summary is not intended to be a thorough or complete analysis of every aspect of the Pay-to-Play rule. Keep in mind there are de minimis exceptions and other exemptions that may apply to specific situations. Also, Constellation does not practice law and this alert does not constitute legal advice. In the event you have questions regarding how the Pay-to-Play rule impacts you or your firm, we strongly encourage you to seek advice on the matter.

1. What is the Pay-to-Play Rule?

Investment Advisers Act Rule 206(4)-5 (the **"Pay-to-Play Rule"**) prohibits registered investment advisers, foreign private advisers, and exempt reporting advisers from receiving management fees from a government entity for two years after the firm or its covered associates make campaign contributions to state or local candidates seeking or holding office with that governmental entity. It also prohibits firms and covered associates from coordinating or soliciting any person or political action committee (**"PAC"**) to make campaign contributions to state and local candidates holding or seeking office of a governmental entity for whom the firm is providing or seeking to provide advisory services for compensation.

2. Why did the SEC promulgate the Pay-to-Play Rule?

The Pay-to-Play Rule is designed to prevent investment advisers from seeking to influence the award of advisory business from government entities by means of political contributions to the government officials charged with awarding the sought-after business.

3. To which political candidates does the Rule Apply?

The Pay-to-Play Rule covers candidates seeking office in a state or local election (and state or local officials running for federal office) if the candidate currently holds, or as a result of the election would:

- Have directly or indirectly, the responsibility for, or could influence the outcome of, the hiring of an investment adviser by a government entity; or
- Have authority to appoint any person who is directly or indirectly responsible for, or could influence the outcome of, the hiring of an investment adviser by a government entity.

For example, in 2016, Republican presidential nominee Donald Trump formally announced Indiana governor Mike Pence as his running mate. Given Pence's position as a state governor at the time he became a candidate in the presidential election, the SEC's Pay-to-Play Rule applied to all contributions made to the Trump/Pence campaign.

For this election cycle, please note that candidates running for president may currently hold state or local government positions that could trigger the Pay-to-Play Rule. For example, Bill de Blasio is the current mayor of New York City. Consequently, if an adviser currently or plans in the future to receive compensation for providing advisory services to programs or plans sponsored or established by New York City, it is possible that contributions to de Blasio's campaign would result in a violation of the Pay-to-Play Rule, which would prohibit the adviser from receiving that compensation.

4. What constitutes a contribution?

The Pay-to-Play Rule broadly defines "contributions" to include a gift, subscription, loan, advance, deposit of money, or anything of value made for the purpose of influencing a federal, state or local election. Contributions include:

- payments of campaign debts;
- payments of transition or inaugural expenses:
- an individual's donated time (if not the person's personal non-work time);
- providing a venue for hosting campaign or fundraising events; and
- charitable donations made at the request of a government entity.

5. Who is a covered associate?

The following are considered covered associates of an investment adviser:

- 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 the investment adviser and any person who supervises, directly or indirectly, such employee; and
- any PAC controlled by the investment adviser or by any person described in the first two bullet points under question 5.

TAKE ACTION!

Takeaways

Heading into the election season, clients should:

- Review policies and procedures regarding political contributions.
- Have discussions with employees, especially covered associates, regarding regulatory obligations restricting political contributions.
- Before donating as an individual or a company, confirm that advisory clients or investors do not include plans sponsored or established by state or local governmental entities.
- Place states and localities for whom the firm would be restricted from charging management fees due to campaign contributions on a list to avoid accepting restricted clients or investors during the 2-year prohibition following the donation.
- When in doubt, reach out to the Chief Compliance Officer, Counsel or Constellation Advisers.

1212 Avenue of the Americas, 6th Floor, New York, NY 10036 • 212.300.6250