SELECTION OF GOV. WALZ AS VP CANDIDATE IMPLICATES SEC PAY-TO-PLAY RULE

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US Asset Management and Investment Funds Alert

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Kamala Harris' selection of Tim Walz as running mate for her presidential campaign has implications under the Securities and Exchange Commission's (SEC) Rule 206(4)-5 under the Investment Advisers Act (SEC Pay-to-Play Rule). In particular, certain political contributions to vice presidential candidate Tim Walz, who serves as Chair of the Minnesota State Board of Investment (SBI), and other actions by investment advisers and certain of their personnel could trigger a two-year "time-out" that would prevent an investment adviser from collecting fees from any of the statewide retirement systems or other investment programs or state cash accounts managed by the SBI. As a result, all investment advisers should consider reviewing their existing policies and procedures relating to pay-to-play and political contributions, and they should remind employees of these policies in connection with the 2024 election cycle.

A FEW KEY TAKEAWAYS IN THIS REGARD

- The SEC Pay-to-Play Rule prohibits investment advisers, including exempt advisers and exempt reporting advisers,[1] from receiving compensation for providing advisory services to a government entity client for two years after the investment adviser or certain personnel, including executive officers and employees soliciting government entities,[2] has made a contribution to an "official"[3] of the government entity.
  - Governor Walz is an "official" of the SBI under the SEC Pay-to-Play Rule because he serves on the board of the SBI.
  - An investment adviser was recently fined by the SEC for violations of the SEC Pay-to-Play Rule following a contribution by a covered associate to a candidate who served as a member of the SBI.[4]
- As a result of Governor Walz's role with regard to the SBI, any contributions by a covered adviser (or any PAC controlled by the adviser) or any contributions by its covered associates above the de minimis amount of US$350[5] to the Harris and Walz campaign will trigger a two-year "time-out." This may have implications for investment advisers that are not currently seeking to do business with the SBI but may in the future, as the "time out" period applies for the entirety of the two-year period, even if Governor Walz ceases to be an "official" of the SBI after the election.
- Contributions by family members of covered associates and contributions to super PACs or multicandidate PACs (so long as contributions are not earmarked for the benefit of the Harris and Walz campaign) generally are not restricted under the SEC Pay-to-Play Rule, if not done in a manner designed to circumvent the rule.

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- In addition to the SEC Pay-to-Play Rule, financial services firms should be mindful of other restrictions under Municipal Securities Rule Making Board Rule G-37, Commodity Futures Trading Commission Regulation 23.451, Financial Industry Regulatory Authority Rule 2030, and SEC Rule 15Fh-6.
- Similar concerns were implicated when then-Governor Mike Pence of Indiana was the Republican vice presidential nominee in 2016[6]; however, former President Donald Trump and current US Senator J.D. Vance (R-OH) are not "officials" for purposes of the SEC Pay-to-Play Rule or other applicable pay-to-play rules, and contributions to the Trump and Vance campaign will not be restricted under these rules.

In addition to the SEC Pay-to-Play Rule and other federal pay-to-play rules noted above, many states and localities have also adopted pay-to-play rules that are applicable to persons who contract with their governmental agencies. Campaign contributions to other candidates may trigger disclosure obligations or certain restrictions under such rules. As political contributions can lead to unintended violations of the SEC Pay-to-Play Rule or other applicable pay-to-play rules, advisers should assess whether any of these rules present a business risk in the 2024 election cycle and take appropriate steps to protect themselves.

From a compliance standpoint, some investment advisers have implemented pre-clearance procedures for all employees, which can permit an investment adviser's compliance team to confirm that political contributions by employees will not lead to unintended consequences.Compliance teams may also consider periodic checks of publicly available campaign contribution data to confirm contributions by employees are being disclosed pursuant to applicable internal policies.

Should you have any questions regarding the content of this alert, please do not hesitate to contact one of the authors or our other lawyers.

FOOTNOTES

[1] The rule applies to "covered advisers," a term that includes investment advisers registered or required to be registered with the SEC, "foreign private advisers" not registered in reliance on Section 203(b)(3) of the Investment Advisers Act, and "exempt reporting advisers."

[2] The rule applies to "covered associates," which are defined for this purpose as: (i) any general partner, managing member, executive officer, or other individual with a similar status or function; (ii) any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) any political action committee (PAC) controlled by the investment adviser or by any person described in parts (i) or (ii).

[3] An "official" means any individual (including any election committee of the individual) who was, at the time of a contribution, a candidate (whether or not successful) for elective office or holds the office of a government entity, if the office (i) is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity; or (ii) has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity.

[4] Wayzata Investment Partners LLC, Investment Advisers Act Release No. 6590 (Apr. 15, 2024).

[5] Under the SEC Pay-to-Play Rule, covered associates (but not covered advisers) are permitted to make a *de*

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minimis contribution up to a US$350 amount in an election in which they are able to vote without triggering the two-year "time-out."

[6] Clifford J. Alexander, Ruth E. Delaney & Sonia R. Gioseffi, *Impact of Pay-to-Play Rules in the 2016 Election Cycle*, K&L GATES (Aug. 18, 2016), https://www.klgates.com/Impact-of-Pay-to-Play-Rules-in-the-2016-Election-Cycle-08-18-2016.

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