No. 19-___

IN THE

Supreme Court of the United States

NEW YORK REPUBLICAN STATE COMMITTEE,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

On August 25, 2016, the United States Securities and Exchange Commission (hereinafter "Respondent" or "Commission" or "SEC") approved Rule 2030, reproduced here as Appendix H (also, the "Rule"). Rule 2030 regulates the political contributions of those members of the Financial Industry Regulatory Authority ("FINRA") who act as "placement agents." Rule 2030 prohibits a placement agent from accepting compensation for soliciting government business from certain candidates and elected officials within two years of having contributed to such an official's electoral campaign or to the transition or inaugural expenses of a successful candidate. Rule 2030's prohibitions raise the following constitutional and Administrative Procedure Act questions:

1. Whether Rule 2030 violates the First Amendment by (a) imposing different contribution limits on candidates running for the same office, and/or (b) restricting otherwise lawful political activity despite the SEC's failure to identify one instance where a lawful political contribution alone led to quid pro quo corruption.

2. Whether the SEC has the authority to impose restrictions by regulation on the First Amendment rights of placement agents to make or solicit federal political contributions that are otherwise lawful under the Federal Election Campaign Act.

3. Whether Rule 2030 is arbitrary and capricious because it restricts otherwise lawful political activity despite the SEC's failure to identify one instance where a lawful political contribution alone led to fraudulent or manipulative practices.

PARTIES TO THE PROCEEDING

Petitioner New York Republican State Committee ("NYGOP" or the "Petitioner") is the state party organization of the Republican Party for the State of New York. It is composed of members from within the State of New York, many of whom are precluded from providing it with financial support due to the Rule. It also represents individuals who are, have been, or are considering running for elected office and who are harmed by Rule 2030 because it subjects them to different political contribution limits than those imposed on other candidates. Petitioner has its headquarters at 315 State Street, Albany, NY 12210. Petitioner was also a petitioner before the United States Court of Appeals for the D.C. Circuit (the "D.C. Circuit").

Respondent, the United States Securities and Exchange Commission (hereinafter "Respondent" or "Commission" or "SEC") is a federal agency created pursuant to the Securities Exchange Act of 1934, 15 U.S.C §§ 78a, 78d. Respondent's headquarters are located at 100 F Street, N.E., Washington, D.C. 20549. Respondent was the respondent before for the D.C. Circuit.

The Financial Industry Regulatory Authority, Inc. ("FINRA") was also a respondent in the D.C. Circuit, but FINRA was dismissed from the case by order of that Court on June 12, 2018.

CORPORATE DISCLOSURE

Pursuant to Rule 26.1 of Federal Rules of Appellate Procedure, no parent corporation or any publicly held corporation owns more than 10 percent of the Petitioner's ownership interests.

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INTRODUCTION

"There is no right more basic in our democracy than the right to participate in electing our political leaders." *McCutcheon v. FEC*, 134 S. Ct. 1434, 1440-41 (2014) (plurality op.). Thus, Congress has always reserved for itself the constitutionally sensitive task of regulating contributions to candidates for federal office and has never sought to limit contributions for state or local officials. This is fitting, for any restriction on the people's right to influence who will govern them should come from the representatives closest and most responsive to the people, not from unelected bureaucrats.

Nevertheless, the SEC contends that its grant of authority to combat fraudulent practices and protect investors under the Exchange Act, allows it to promulgate campaign finance rules by regulation for thousands of people. Specifically, Rule 2030 prohibits regulated placement agents from contributing more than a *de minimis* amount to certain elected officials and prohibits those agents from asking others to make contributions. While FINRA has authority to propose, and the SEC authority to approve, rules "to prevent fraudulent and manipulative acts and practices," to promote "a free and open market," and to protect participants in that market, 15 U.S.C. §78o-3(b)(6), that general authority does not allow FINRA or the SEC to stifle protected First Amendment activity. Rather, Congress expressly forbids FINRA from trying "to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter," *id*., and requires the SEC to disapprove any such proposed rule as inconsistent with the requirements of the Exchange Act, 15 U.S.C. §78s(b)(2)(C). Thus, while the SEC's end may be laudable, its chosen means exceed its statutory boundaries and are unconstitutional.

Rule 2030 exceeds the SEC's authority for three principle reasons. First, neither the text nor structure of the Exchange Act suggests that Congress granted the SEC the power to regulate lawful political speech. Second, Congress has consistently reserved for itself, or left for state legislatures, the constitutionally sensitive task of setting limits on campaign contributions, never delegating that authority to the FEC, much less the SEC. Had Congress intended to provide such authority to an agency, it would have spoken clearly. Third, the Exchange Act's proviso commands the SEC to stay in its lane—without regulating matters unrelated to securities transactions. The Court thus should reject the SEC's position that the Exchange Act's generic grant of authority to combat fraud is also a license to restrict fundamental First Amendment rights.

There are no factual disputes in this case. Even the concurring opinion below agreed with the facts, arriving only at a different conclusion. *New York Republican State Comm.* ("*NYRSC*") *v. SEC*, 927 F.3d 499, 512 (D.C. Cir. 2019) (Sentelle, J., concurring). As a result, this case is an ideal vehicle for this Court to address key First Amendment and regulatory legal questions presented.

OPINIONS BELOW

Petitioners challenged the SEC's Final Order Approving a Proposed Rule Change to Adopt FINRA Rule 2030 and FINRA Rule 4580 to Establish "Pay-To-Play" and Related Rules, 81 Fed. Reg. 60,051 (Aug. 31, 2016); App. 138a-224a, in the United States Court of Appeals for the D.C. Circuit.

The opinion of the D.C. Circuit is reported at 927 F.3d 499 (D.C. Cir. June 18, 2019).

JURISDICTION

This Court has jurisdiction to review the D.C. Circuit's opinion and order under 28 U.S.C. §1254.

STANDARD OF REVIEW

Rule 2030's Political Contribution Prohibition must be set aside if it violates the Constitution, exceeds the agency's statutory authority, or is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. §706(2)(A)-(C).

Further, questions pertaining to constitutionality are reviewed *de novo*. *See United States v. Quinones*, 313 F.3d 49, 60 (2d Cir. 2002).

CONSTITUTIONAL AND REGULATORY PROVISIONS INVOLVED

Appended are the relevant portions of Rule 2030. The First Amendment to the United States Constitution is incorporated by reference throughout the petition.

STATEMENT OF THE CASE

A. Statutory and Regulatory Background

Federal campaign finance regulation has long been the exclusive province of Congress and the FEC—the agency that Congress has given sole jurisdiction to "administer, seek to obtain compliance with, and formulate policy with respect to," federal campaign finance laws. 52 U.S.C. §30106(b)(1); *see also Galliano v. U.S. Postal Serv.*, 836 F.2d 1362, 1368 (D.C. Cir. 1988) (Ginsburg, J.). This Court has described the comprehensive nature of this regulatory scheme:

> Campaign finance regulations now impose unique and complex rules on 71 distinct entities. These entities are subject to separate rules for 33 different types of political speech. The FEC has adopted 568 pages of regulations, 1,278 pages of explanations and justifications for those regulations, and 1,771 advisory opinions since 1975.

Citizens United v. FEC, 558 U.S. 310, 334 (2010) (citations omitted).

Although Congress has left many aspects of campaign finance regulation to the discretion of the FEC, setting limits for contributions to federal candidates and to the federal accounts of political party committees is a power that Congress has consistently reserved for itself. Since Congress first enacted FECA in 1971, through its extensive revisions in the Bipartisan Campaign Reform Act of 2002 ("BCRA"), contribution limits have been set by statute, not regulation. *See* 52 U.S.C. §30116(a). Likewise, Congress has reserved for itself the decision whether, when, and how those statutorily prescribed limits may be altered. *Id*. §30116(c). When Congress has seen fit to make exceptions to the standard limits, or enact a federal law impacting state and local political contributions, it has done so itself. *See*, *e.g.*, *id*. §§30118, 30119, 30121. Congress has crafted one such exception for federal government contractors, who may not make political contributions to federal candidates, political parties, or political action committees while they are in the process of negotiating or performing a federal contract. *Id*. §30119. Congress likewise has prohibited foreign nationals from making contributions or expenditures to influence federal, state, or local elections. *Id*. §30121. But Congress has never enacted a comparable restriction for finance professionals who provide their services to public pension funds or other governmental clients. Instead, these individuals remain subject to the standard statutory contribution limit, which currently is fixed at $2,700 per candidate per election. *See* Price Index Adjustments for Contribution and Expenditure Limitations and Lobbyist Bundling Disclosure Threshold, 80 Fed. Reg. 5750, 5751 (Feb. 3, 2015). For elections at the state and local level, campaign contribution limits and other restrictions on participation in the political process have been determined by state and local governments.

To transact securities business with the public, all securities firms must be registered with FINRA. *See Fiero v. FINRA*, 660 F.3d 569, 576 (2d Cir. 2011). FINRA helps "conduct the day-to-day regulation and administration of the United States' stock markets, under the close supervision of the [SEC]." *Weissman v. Nat'l Ass'n of Sec. Dealers, Inc.*, 500 F.3d 1293, 1296 (11th Cir. 2007) (en banc). FINRA thus "perform[s] a variety of vital governmental functions" including "statutorily delegated adjudicatory, regulatory, and prosecutorial functions." *Id*.

Congress has granted FINRA the authority to propose rules to the SEC regarding the regulation of the securities industry. *See generally* 15 U.S.C. §78o-3(b). FINRA's rules must be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade," to "perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest." §78o-3(b)(6). FINRA's power, however, is expressly cabined by the Exchange Act, which provides that FINRA's rules must not be designed "to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the association." *Id*.

FINRA's proposed rules cannot "take effect unless approved by the Commission." 15 U.S.C. §78s(b)(1). The SEC must disapprove any proposed rule that is not "consistent with the requirements of" the Exchange Act. §78s(b)(2)(C). Once a rule has been approved by the SEC, it becomes binding law.

B. The SEC's Political Contribution Rules

Rule 2030 relates to and was preceded by the SEC's own political contribution rule, which has limited the rights of investment advisers to engage in certain First Amendment conduct since 2010. Rule 2030 is triggered when an investment adviser or any of its "covered associates" makes a political contribution to an "official of a government entity," 17 C.F.R. §275.206(4)-5(a)(2), which includes any state or local government official or candidate running for that elective office:

> if the office: (i) [i]s directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity; or (ii) [h]as 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 . . .

§275.206(4)-5(f)(6). When the SEC Rule is triggered, an investment adviser is barred for two years from receiving compensation for advisory services provided to the government entity whose public official received the political contribution. §275.206(4)-5(a)(1). There are only limited exceptions to the Rule's two-year ban, including what the Commission characterizes as a "*de minimis* exception" under which an individual may contribute:

> to officials for whom the covered associate was entitled to vote at the time of the contributions and which in the aggregate do not exceed $350 to any one official, per election, or to officials for whom the covered associate was not entitled to vote at the time of the contributions and which in the aggregate do not exceed $150 to any one official, per election.

§275.206(4)-5(b)(1).

The SEC Rule also prohibits any investment adviser covered under the rule from paying any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless that person is a "regulated person," as defined under the SEC Rule. A broker-dealer registered with FINRA qualifies as a "regulated person" only if FINRA imposes on its members restrictions on their political contributions and solicitation of contributions that the Commission finds are at least as stringent as the Rule. §§275.206(4)-5(a)(2)(i)(A), (f)(9). Recognizing the vital role placement agents play in connecting local governments with suitable investment options, the SEC repeatedly delayed the enforcement of this aspect of the Investment Adviser Rule until Rule 2030 was finally in place. *See* Political Contributions by Certain Investment Advisers, 75 Fed. Reg. 41,018, 41,042 (July 14, 2010).

On December 24, 2015, FINRA submitted its proposed Rules 2030 and 4580, which comprise the Rule, to the SEC for approval. *See* 80 Fed. Reg. 81,650, App.

33a-34a. Rule 2030 is modeled on the SEC Political Contribution Rule and "impose[s] substantially equivalent restrictions on member firms engaging in distribution or solicitation activities [as] those the SEC Pay-to-Play Rule imposes on investment advisers." App. 36a. Rule 2030 targets those member firms that "engage in distribution or solicitation activities with government entities on behalf of investment advisers." App. 37a. FINRA stated that the SEC had found that solicitors—who act as agents of the investment advisers to locate investment advisory clients—and placement agents—agents who find investors—were often used as intermediaries to influence the award of investment adviser contracts. App. 38a (citing 75 Fed. Reg. at 41,037). FINRA thus asserted that Rule 2030 is intended to permit member firms to act as placement agents while also deterring pay-to-play practices. *Id*.

Rule 2030 covers all FINRA members except those members whose activities would cause the member to qualify as a municipal adviser under the Exchange Act. *See* Rule 2030(g)(4). Rule 2030's prohibitions also apply to "covered associates," which includes any person of a covered member who supervises, directly or indirectly, the distribution or solicitation activities of a government entity; any person of a covered member who engages in solicitation or distribution activity with a government entity; any general partner, managing member, or executive officer of a covered member, or other similar person; and, finally, any political action committee that is controlled by a covered member or associate. *See* Rule 2030(g)(2).

Rule 2030 prohibits contributions to any person who, when the contribution was made, was an incumbent or candidate for a public office that is directly or indirectly responsible for, or can influence, a state or local government decisions to hire investment advisers. *See* Rule 2030(g)(8). Rule 2030 extends to any office that can appoint a person who is directly or indirectly responsible for, or can influence, the hiring of an investment adviser. *Id*. Rule 2030 also covers contributions to any such person's election committee. *Id*. The prohibition also covers any contributions that are made for inaugural committee expenses for a successful candidate for state or local office. *See* Rule 2030(g)(1)(C); App. 45a-46a.

Rule 2030 imposes a two-year ban on covered members from engaging in solicitation or distribution activities, for compensation, on behalf of investment advisers who are providing or seeking to provide investment advisory services to a government entity when the covered member or one of its covered associates makes a political contribution to an official of the government entity. This includes any person who at the time a contribution is made is not a covered associate, but who becomes a covered associate within two years of making the contribution. *See* Rule 2030(a); App. 109a. Thus, Rule 2030 discourages political activity not only by FINRA members who are currently covered associates, but also any individuals who anticipate that they may seek to engage in such work within the next two years.

In addition to the two-year compensation ban tied to contributions to candidates, covered members and their covered associates are flatly prohibited from soliciting or coordinating with any person or political action committee to make any contribution to an official of a government entity where the member is already engaged or is seeking to engage in distribution or solicitation of securities on behalf of an investment adviser. *See* Rule 2030(b)(1).

Covered members and their associates are also prohibited from soliciting or coordinating with any person or political action committee to make any payments to a state or local political party committee in a state where the covered member is engaged or is seeking to engage in the distribution or solicitation activities on behalf of an investment adviser. *See* Rule 2030(b)(2). According to FINRA's transmittal to the SEC, this provision is violated only if the contribution to the political party or political action committee was in fact earmarked for an official. *See* App. 52a. But the Rule itself does not contain such a limiting principle. Further, FINRA's explanation is contrary to the language of the Rule. The Rule first prohibits covered associates from coordinating or soliciting any person or PAC from making contributions to an official. Rule 2030(b)(1). But Rule 2030's prohibition on funding political party committees is broader because it prohibits the solicitation or coordination of payments to political party committees. Rule 2030(b)(2). As FINRA explains, a "payment" is broader than a contribution because a payment "does not include limitations on the purposes for which such money is given (*e.g.*, it does not have to be made for the purpose of influencing an election)." App. 51a, n.41 (emphasis added). Thus, a payment to a political party committee that is not earmarked to a specific official, or even for a specific election, could result in severe penalties for the donor and his employer.

Moreover, contributing to or soliciting for candidates and parties extends beyond merely writing a check or asking someone else to do the same. As FINRA explains, even placing a covered member's or associate's name on fundraising literature is now illegal. App. 50a, n.40. Nor can a covered member or associate sponsor a conference where an official is a guest speaker if the event involves fundraising for the official. *Id*. Thus, merely associating with a group that supports a covered official can run afoul of federal law.

Even inadvertent violations of these prohibitions may lead to disgorgement of fees and a temporary or even lifetime ban from the securities industry. *See* App. 190a; 15 U.S.C. §78o-3(k)(2)(C). And those who willfully transgress Rule 2030 can face fines of up to $5,000,000 and a prison term of up to 20 years. §78ff(a).

There are narrow exceptions to Rule 2030's two-year ban. A covered associate who is a natural person can make contributions of no more than $350 per election to government officials for whom the associate is entitled to vote, and no more than $150 per election to other government officials. *See* Rule 2030(c)(1). Unlike the contribution limits set by Congress and limits set by many states, the SEC's contribution limits are not indexed to inflation. *See* 52 U.S.C. §30116(c).

C. Procedural History

In November 2014, FINRA requested comments on the Rule as proposed. *See* FINRA Reg. Notice 14-50.[1] One commenter argued that FINRA failed to justify its contribution limits as a statutory or First Amendment matter, SR-FINRA-2015-056, Comment of Allen Dickerson, Center for Competitive Politics (Jan. 20, 2016), and that Rule 2030 violated the First Amend-

[1] FINRA, *Regulatory Notice* 14-50 (November 2014), http://bit.ly/2kI4f1M.

ment by banning the solicitation or coordination of contributions to political parties. *Id*.

After FINRA submitted its Rule to the SEC, state Political Parties, including Petitioner, submitted a comment to the SEC regarding Rule 2030. They argued first that the Rule is *ultra vires* because Congress did not empower FINRA to regulate federal elections through political contribution limits. Comment of H. Christopher Bartolomucci, Bancroft PLLC, on behalf of the New York Republican State Committee and the Tennessee Republican Party (Jan. 20, 2016). Second, the Parties contended that Rule 2030 violates the First Amendment by forcing member firms and their covered associates to choose between their First Amendment rights to support candidates and "continuing to work with investment advisers who are seeking work from public pensions." *Id*. Finally, the Parties noted that Rule 2030 establishes a campaign finance regime where covered officials running for a non-covered office will face lower contributions limits than their non-covered opponents. *Id*.

The Commission approved Rule 2030 on August 25, 2016. The Commission stated that Rule 2030 would discourage member firms and covered associates "from engaging in *quid pro quo* corruption that may create market distortions—when, for example, an investment adviser is chosen on the basis of a placement agent's political contributions rather than the adviser's merit." App. 192a.

Petitioner timely filed their petition in the U.S. Court of Appeals for the Eleventh Circuit on October 20, 2016. On April 26, 2018, the Eleventh Circuit held that the Georgia Republican Party lacked standing to challenge the SEC Order. *See Ga. Republican Party v. SEC*, 888 F.3d 1198 (11th Cir. 2018). The Eleventh

Circuit further held that it was not the proper venue to consider the challenges raised by the New York Republican State Committee or the Tennessee Republican Party. The court transferred those Petitioners' case to the D.C. Circuit.

Petitioner New York State Republican Committee petitioned the D.C. Circuit for review of the SEC's order approving Rule 2030, on the grounds that: (1) the SEC did not have authority to enact the Rule; (2) the order adopting the Rule is arbitrary and capricious because there was insufficient evidence it was needed; and (3) the Rule violates the First Amendment to the Constitution of the United States. *NYRSC*, 927 F.3d 499. The SEC challenged Petitioner's standing to bring the case and defended Rule 2030 against Petitioner's arguments. *Id*. at 504. The D.C. Circuit held that Petitioner had standing but denied its petition on the merits. Specifically, the D.C. Circuit held that the SEC acted within its authority in adopting Rule 2030; adopting Rule 2030 was not arbitrary and capricious because the SEC had sufficient evidence it was needed; and Rule 2030 does not violate the First Amendment in view of *Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995). *NYRSC*, 927 F.3d at 512. Senior Circuit Judge Sentelle dissented, opining that he would have dismissed the petition for lack of standing. *Id*. at 512-14.

REASONS FOR GRANTING THE PETITION

I. PETITIONER HAS STANDING TO MAINTAIN THIS APPEAL

To establish standing, a party must demonstrate that: "(1) it has suffered an 'injury in fact' that is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical; (2) the injury is fairly traceable to the challenged action of the defendant; and (3) it is likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision." *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 180-81 (2000). To establish associational standing, an association must demonstrate that "its members would otherwise have standing to sue in their own right, the interests at stake are germane to the organization's purpose, and neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit." *Id*. at 181. Petitioners readily satisfy these requirements, both on their own and in their capacity as representatives of their members and supporters.

A. Petitioner Has Direct Standing

Rule 2030 injures the Petitioners directly by preventing them from receiving contributions thereby harming their associational rights and economic interests. Specifically, Rule 2030 makes it unlawful for covered associates to coordinate with or to solicit any person or committee to make any payment to a political party, like Petitioners, of a state or locality where the covered member is "engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser." Rule 2030(b)(2). These prohibitions cause Petitioners precisely the kinds of associational and economic injuries that courts repeatedly have held sufficient to give organizations standing in their own right. *See*, *e.g.*, *Taxation with Representation of Wash. v. Regan*, 676 F.2d 715, 722-23 (D.C. Cir. 1982), *rev'd on other grounds*, 461 U.S. 540, 723 (1983) (it was "clearly evident that [the nonprofit organization] will be harmed if its contributors cease giving it money.").

Moreover, expenditures of scarce time and financial resources to inform candidates about the ramifications of Rule 2030 go beyond those Petitioner would normally expend to educate its members about campaign finance and political speech restrictions. App. 231a. By forcing Petitioner to divert these scarce resources, Rule 2030 has inhibited Petitioner's ability to pursue its day-to-day mission of promoting its candidates and their messages. App. 231a-232a. Petitioner's injuries would be redressed if the Court vacates Rule 2030 and lifts its restrictions on supporters of political parties. Thus, "[b]ecause [NYGOP] has expended resources to counter these injuries, it has established Article III organizational standing." *PETA v. USDA*, 797 F.3d 1087, 1095 (D.C. Cir. 2015).

B. Petitioner Has Associational Standing On Behalf Of Its Candidates

Petitioner also has associational standing on behalf of its candidates. *See Tex. Democratic Party v. Benkiser*, 459 F.3d 582, 587 (5th Cir. 2006) (holding that political party had "associational standing on behalf of its candidate"). Numerous NYGOP candidates running for election have been harmed by having to run in competitive environments in which the delicate competitive balance has been tipped by Rule 2030. App. 232a-233a. These candidates face obstacles related to raising campaign funds and recruiting supporters to solicit contributions on their behalf. One covered associate would have contributed more than $350 to several NYGOP candidates including Molinaro if not for Rule 2030's restrictions. Comment of Molly M. Diggins, Monument Group Inc. (Dec. 15, 2014).

Rule 2030 places a covered official at a particular disadvantage against an incumbent member of Congress. FINRA-regulated placement agents can give at most $350 to the covered official's campaign but can contribute up to $2700 to his competitor. App. 230a. That is why the courts have made clear that "because [campaign finance] regulations shape the environment in which Plaintiffs must operate as officeholders and candidates," candidates have standing to "bring suit challenging those rules." *Shays v. FEC*, 414 F.3d 76, 82 (D.C. Cir. 2005) (quotation omitted).

C. Petitioner Has Associational Standing On Behalf Of Its Contributors

Finally, Petitioner has standing to challenge Rule 2030 on behalf of its members, supporters, and donors whose First Amendment rights are inhibited by Rule 2030. Francis Calcagno is a supporter of the NYGOP and is just one of thousands of people to whom Rule 2030 applies. App. 235a-236a. He has contributed to NYGOP candidates in the past, and if Rule 2030 were not in effect, he would contribute more than the $350 limit to NYGOP candidates in this election cycle. *Id*. Calcagno would also ask his friends, family, and other contacts to contribute to the NYGOP and its candidates but for the fact that Rule 2030 prohibits that conduct. *Id*. Thus, Calcagno has adequately supported an injury that Rule 2030 has imposed on both him and the NYGOP. Nothing more is required for standing. *L.A. v. Taxpayers for Vincent*, 466 U.S. 789, 803 (1984)

("[A]ppellees certainly have standing to challenge the application of the ordinance to their own expressive activities.").

II. THE D.C. CIRCUIT'S DECISION PRESENT ISSUES OF NATIONAL IMPORTANCE THAT SHOULD BE RESOLVED BY THIS COURT

A. The Rule Violates The First Amendment To The U.S. Constitution

Unchanged, the D.C. Circuit's decision allows any federal agency with a mandate to fight corruption in its regulatory area to impose contribution limits on candidates for both federal *and* state office by regulation. This is more of an intrusion into State affairs than Congress itself took, prohibiting states only from allowing foreign contributions. 52 U.S.C. §30121(a)(1). In fact, states have enacted a kaleidoscope of contribution limits, with some states imposing no contribution limits and therefore permitting unlimited contributions to state candidates (*e.g.* Virginia), to some states imposing low contribution limits to state candidates (*e.g.* Colorado, Colo. Const. Art. XXVIII, §3(1)(b) (limiting individuals to $200 to state legislative candidates), and some localities impose bans on government contractors from making contributions to candidates for local office. (*e.g.* New York City, *Ognibene v. Parkes*, 671 F.3d 174, 178 (2d Cir. 2011)). It is one thing for Congress to preempt a state legislature's authority to enact contribution limits governing state elections through legislation related to foreign relations. It is a completely different matter for a federal agency to preempt a state legislature's decision governing contribution limits in a state election by regulation.

Compounding this problem is that the D.C. Circuit's decision also interferes with Congress's considered statutory campaign finance regime. In enacting the federal contribution limits, Congress was already infringing the First Amendment rights of individuals. *Buckley v. Valeo*, 424 U.S. 1, 23 (1976). The D.C. Circuit's decision now permits regulatory agencies to further infringe—in an unequal manner—the First Amendment rights of those contributors over whom the regulatory body oversees. As has already occurred, App. 230a, permitting regulatory agencies to impose their own contribution limits on individuals whom they regulate inexorably leads to different contribution limits for different candidates campaigning for the same office. This Court has never permitted this result. *Davis v. FEC*, 554 U.S. 724, 738 (2008); *See also Riddle v. Hickenlooper*, 742 F.3d 922, 931 (10th Cir. 2014) (Gorsuch, J., *concurring*). Congress already infringed the constitutional rights of contributors when it enacted FECA. Now the SEC and FINRA want to infringe the constitutional rights of contributors and candidates within their regulated community in an unequal manner through administrative regulations that directly override a statutory limit. This is not permissible under the Constitution. This Court should grant certiorari and reverse.

1. This Court Has Never Permitted A Campaign Finance Regime That Imposes Different Contribution Limits On Candidates Campaigning For The Same Office

The Supreme Court has "never upheld the constitutionality of a law that imposes different contribution limits for candidates who are competing against each other." *Davis*, 554 U.S. at 738. Nor has it upheld a law that prevents certain candidates running for one office from receiving contributions from certain individuals. Yet that is precisely what the Rule does, as it prevents placement agents from making $2,800 contributions to candidates like the NYGOP's James O'Donnell (who is a covered official who campaigned for Congress in 2018), but not from making the same contribution to his incumbent opponent. App. 230a.

That the Rule imposes different contribution limits on candidates competing for the same office is a problem. In the 2016 presidential campaign, a similar contribution rule imposed by the MSRB and the SEC tilted the playing field against the Republican ticket, as many municipal securities dealers could contribute up to $2,800 to Clinton-Kaine, but far less to Trump-Pence because of Pence's service as Indiana's governor.[2] If this Court does not intervene, Rule 2030 will impose the same unconstitutional handicap on candidates in 2020. *See* App. 232a-233a.

The D.C. Circuit casts *Davis* as standing for the proposition that the asymmetrical contribution limits regime that Congress imposed was unconstitutional because the government attempted to justify the limits as "level[ing] electoral opportunities for candidates of different personal wealth." App. at 26a. *NYRSC*, 927 F.3d at 511. But this Court has recognized only one legitimate interest in limiting campaign contributions: preventing corruption or the appearance thereof. *Davis*, 554 U.S. at 741.

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[2] Peter Overby, *How Picking Mike Pence As VP Might Cost The Trump Campaign Donations*, NPR (July 16, 2016), http://n.pr/29Q9ACf.

The D.C. Circuit's premise, therefore, leads to a conclusion that this Court prohibits. That court concluded that the Rule's imposing different contribution limits upon candidates competing for the same office was a "feature" not a "flaw." *NYRSC*, 927 F.3d at 512. This is because FINRA and the SEC had adduced evidence that office holders with the ability to award contracts are more susceptible to corruption and the appearance of corruption. *Id*. Accordingly, the D.C. Circuit concluded that a lower contribution limit and ban on soliciting contributions for political parties are justified when enacted by a regulatory agency.

This conclusion is contrary to this Court's categorical statement and holding: "We have never upheld the constitutionality of a law that imposes different contribution limits for candidates who are competing against each other…." *Davis*, 554 U.S. at 738. This Court rejected BCRA's asymmetrical campaign finance regime because allowing it would constitute "the *unprecedented step* of imposing different contribution and coordinated party expenditure limits on candidates vying for the same seat [which is] is *antithetical to the First Amendment*." *Id*. at 743-44 (emphasis added). The SEC's contribution limits enacted by regulation do exactly this and worse. Like the BCRA's Millionaire's Amendment, the SEC's contribution limits impose different contribution limits on candidates campaigning for the same federal office. But unlike the BCRA's Millionaire's Amendment, the SEC's contribution limits impose different contribution limits on candidates campaigning for the same federal, state, *and* local office. Left undisturbed, the Decision will permit this practice to continue in all elections *nationwide*.

2. The D.C. Circuit's Opinion Contradicts This Court's Precedent In *McCutcheon*

Congress has already significantly curtailed the constitutional right to support federal candidates through campaign contributions by limiting such contributions to $2,800 per candidate per election and states have done the same for their own races. *Buckley*, 424 U.S. at 23; 52 U.S.C. §30116(a)(1)(A); Price Index Adjustments for Contribution and Expenditure Limitations and Lobbyist Bundling Disclosure Threshold, 84 Fed. Reg. 2504, 2506 (Feb. 7, 2019). If FINRA and the SEC want to impose even more stringent restrictions on the First Amendment rights of covered members and covered associates by regulation, then they must prove that those restrictions are authorized by law, and necessary to further a sufficiently important interest, and that they do so in a sufficiently tailored manner. FINRA and the SEC do not and cannot satisfy this standard.

At the outset, there can be no serious dispute that the Rule severely burdens First Amendment rights. It forces placement agents to choose between exercising their constitutional right to support candidates through political contributions and continuing to work as placement agents. Under the Rule, the only way for a placement agent to do the latter is to forgo the former. FINRA itself characterizes its exception to this rule as "*de minimis*"—and with good reason, as it allows only covered associates—and not covered members—to contribute only $350 per election to candidates for whom they are entitled to vote, and only $150 per election to any other candidate. 81 Fed. Reg. at 60,055, App. 10a. Those limits are "substantially lower than … limits [that courts] have previously upheld," and are lower even than limits that courts have struck down. *Randall v. Sorrell*, 548 U.S. 230, 253 (2006) (plurality op.). FINRA and the SEC therefore bear an exceedingly high burden in establishing the constitutionality of the Rule. *Cf. McConnell v. FEC*, 540 U.S. 93, 141 n.43 (2003) ("the associational burdens imposed by a particular piece of campaign-finance regulation may at times be so severe as to warrant strict scrutiny").

As this Court recently reiterated, there is "only one legitimate governmental interest for restricting campaign finances: preventing corruption or the appearance of corruption." *McCutcheon*, 572 U.S. at 206-07. Further, there is only one type of corruption that campaign finance restrictions may target: *quid pro quo* corruption. *Id.* at 191. "Spending large sums of money in connection with elections, but not in connection with an effort to control the exercise of an officeholder's official duties, does not give rise to such *quid pro quo* corruption." *Id.* at 206-07. "Nor does the possibility that an individual who spends large sums may garner 'influence over or access to' elected officials or political parties." *Id.* at 208 (quoting *Citizens United*, 558 U.S. at 359). In short, "[i]ngratiation and access … are not corruption," and thus are not things that campaign finance restrictions may target. *Citizens United*, 558 U.S. at 360.

While Rule 2030 does not target the spending of "large sums of money" it does target fully disclosed federal political contributions of $2,800 or less and similar amounts at the state and local levels. Even setting aside that massive problem, this Court has never recognized "promot[ing] just and equitable principles of trade," "perfect[ing] the mechanism of a free and open market," or "protect[ing] investors and the public interest," 81 Fed. Reg. at 60,057, 60,063, App. 167a, as reasons for restricting the right to make political contributions.

The SEC, therefore, attempts to squeeze the Rule into the Supreme Court's case law by portraying it as an effort to combat *quid pro quo* contributions to officials by covered members and their associates when those same members and associates act as placement agents for investment advisers seeking to obtain business from the very government entities to which the covered members and associates contributed. *See* 81 Fed. Reg. at 60,065, App. 191a. Such argument is doomed by its sheer implausibility where *disclosed* contributions *within* the limits established by FECA and state laws are concerned. The SEC does not demonstrate instances in which a covered associate has made a fully disclosed federal campaign contribution of $2,800 or comparable state contribution "in connection with an effort to control the exercise of an officeholder's official duties." *McCutcheon*, 572 U.S. at 206-07. Instead, the SEC attempts to justify the Rule through the kind of "mere conjecture" that courts "have never accepted . . . as adequate to carry a First Amendment burden," *Nixon v. Shrink Mo. Gov't PAC*, 528 U.S. 377, 392 (2000), asserting that "the proposed rule change advances this government interest by seeking to halt an existing pay-to-play problem, *even though, in terms of a record, 'no smoking gun is needed*.'" 81 Fed. Reg. at 60,057, App. 167a (emphasis added). But such "speculation … cannot justify … substantial intrusion on First Amendment rights." *McCutcheon*, 572 U.S. at 218.

The SEC, therefore, acknowledges that the Rule is a broad prophylactic measure deterring constitutionally protected conduct when the government has no legitimate interest in doing so. *See* 81 Fed. Reg. at 60,057, App. 167a-168a (recognizing the "prophylactic" purpose of the Rule).

Congress has already enacted a broad prophylactic restriction on campaign contributions, limiting them to $2,800 per federal candidate per election, and states have enacted analogous legislation modeled on FECA. FECA's contribution limit "remain[s] the primary means of regulating campaign contributions." *McCutcheon*, 572 U.S. at 209. If FINRA or the SEC want to subject covered associates to more stringent restrictions "layered on top" of that statutory limit, *id.* at 221, they must provide evidence that the existing limit is insufficient to address *quid pro quo* corruption, or its appearance, when it comes to placement agents. FINRA and the SEC have, however, failed to offer "any special justification that might warrant a contribution limit so low or so restrictive as to bring about the serious associational and expressive problems" that the Rule creates. *Randall*, 548 U.S. at 261.

The D.C. Circuit asserts that it satisfied *McCutcheon* when it reviewed the MSRB's political contribution rule in *Blount v. SEC*, 61 F.3d 938. There, the D.C. Circuit applied strict scrutiny and upheld the MSRB's political contribution rule. *Id*. at 944-47. According to the court below, that satisfies *McCutcheon*.

McCutcheon requires more, and Petitioner urged more. What the D.C. Circuit needed to review was whether FINRA's additional prophylactic contribution limit—in addition to the federal contribution limit—was authorized by law and justified to prevent corruption or the appearance thereof. *McCutcheon*, 572 U.S. at 206, 221. This requires that the SEC demonstrate that Congress's base limits on candidates for federal office—$2,800 per election—are insufficient at preventing corruption, or its appearance, from covered associates to covered officials. *McCutcheon*, 572 U.S. at 210, 221 (stating that when the government restricts speech it is the government's burden to justify its actions and that when the government places restrictions in addition to the base contribution limits, the additional restriction must be justified).[3] To be clear, Petitioner does not deny the existence of pay-to-play schemes. Instead, the SEC's evidence is insufficient because it does not address the precise question here: why the SEC needs an additional campaign finance limit—$350/$150 *de minimis* contribution limit—on top of Congress's $2,800 per election as the base limit. *See McCutcheon*, 572 U.S. at 216-18 (ruling that the aggregate contribution limit was unconstitutional because the stated need for them involved scenarios that were either already illegal under current law or "divorced from reality"). The SEC does not adduce any evidence that Congress's prophylactic ban on disclosed contributions above $2,800 per election was ineffective.

The *McCutcheon* Court struck down aggregate contribution limits because there were no "real-world examples of circumvention of the base limits," and

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[3] An analogy to *Wagner* and the federal contractor ban is unpersuasive. The federal contractor ban does not impact candidates differently, it only prohibits certain individuals from contributing to *any and all* candidates for federal office. 52 U.S.C. §30119(a). Second, federal contractors can establish separate segregated funds. *Compare id*. §30119(b) (allowing contributions from the separate segregated fund of a federal contractor) *with* FINRA Rule 2030(a)-(b) and (g)(2)(D) (prohibiting covered members and associates, including PACs controlled by covered members and associates from contributing to covered officials). Third, the federal contractor ban is supported by a century of evidence. *Wagner v. FEC,* 793 F.3d 1, 10-14 (D.C. Cir. 2015) (*en banc*).

"speculation" about circumvention of the base limits alone could not "justify the substantial intrusion on First Amendment rights at issue in th[e] case." 572 U.S. at 217-18; *see also Lavin v. Husted,* 689 F.3d 543 (6th Cir. 2012) (declaring unconstitutional an Ohio statute prohibiting candidates for Ohio Attorney General or county prosecutor from accepting campaign contributions from Medicaid providers because there was no evidence of corruption by state or county prosecutors). Because the SEC likewise fails to provide evidence that placement agents have been corrupting candidates with legal, fully disclosed campaign contributions, FINRA's Rule fails because it does not identify a problem requiring the Rule, nor does the SEC demonstrate that its means ameliorate it.[4]

Additionally, the SEC also must adduce evidence that FINRA's Political Contribution Rule is closely drawn. *McCutcheon*, 572 U.S. at 210, 221. A regulation is closely drawn if it does not unnecessarily abridge First Amendment rights. *Id*. at 199. If a plausible less restrictive alternative is presented, it is the SEC's burden to prove that the alternative will be ineffective. *United States v. Playboy Entm't Grp.*, 529 U.S. 803, 816 (2000); *see also McCutcheon*, 572 U.S. at 220-21 (holding that more closely drawn alternatives existed to achieve anti-circumvention interests than the

[4] The SEC hypothesized before the D.C. Circuit that if 100 "covered associates" contribute $2,700, "the member firm may still be credited with a $270,000 contribution." (Opp.n Br. at 43). But if the covered associates conspired to contribute $270,000 to get the corporation credit to obtain a contract award, this might violate the prohibition on contributions in the name of another, 52 U.S.C. §30122, and potentially constitute bribery. 18 U.S.C. §201(b). Furthermore, absent evidence of this actually happening, it also seems divorced from reality and this Court should not credit it. *McCutcheon*, 572 U.S. at 216.

"indiscriminate" ban of all contributions to candidates above an annual aggregate limit). There is no evidence in the record demonstrating how FINRA arrived at the $350 contribution limit for covered associates to contribute to covered officials for whom the associate can vote, and $150 contribution limit for covered associates to contribute to other officials. By contrast, Congress, through ample evidence, arrived at the $1,000 per election contribution limit as the tipping point between the lawful exercise of First Amendment rights and *large* campaign contributions that are corrupting. *See Buckley*, 424 U.S. at 26-28. Congress had ample evidence that the problem of corruption is in *large* campaign contributions. *Id*. at 28. The SEC does not adduce evidence that $351 from a covered associate to a covered official is a *large* campaign contribution. That the SEC does not adduce this evidence is unsurprising given that "the legislature is better equipped to make such empirical judgments, as legislators have 'particular expertise' in matters related to the costs and nature of running for office." *Randall*, 548 U.S. at 248.

B. Congress Did Not Vest The SEC With The Authority To Regulate Federal Contribution Limits

This Court can declare the Rule unlawful because it is *ultra vires* and avoid the constitutional issue. If the Court leaves the Decision unaltered, then any federal government agency can impose contribution limits on those persons within its regulated community.

Congress has reserved the role for enacting contribution limits and prohibitions for itself, fixing by statute all limits on campaign contributions. This was so back when Congress first enacted FECA, and it remains so today, after Congress extensively revised

FECA through BCRA. Compare 18 U.S.C. §608(b) (1975), with 52 U.S.C. §30116(a). Although Congress has given the FEC broad and exclusive jurisdiction to enforce the statutorily prescribed contribution limits, *see id*. §30109, Congress has not granted the FEC discretion to increase or decrease those limits on its own initiative. Instead, that, too, is a judgment that Congress itself has made, dictating by statute the precise circumstances and way its contribution limits may be adjusted. *See id*. §30116(c)). Congress also has reserved for itself the power to establish exceptions to its statutorily fixed limits. For instance, Congress has prohibited national banks, corporations, labor organizations, and their officers or directors from making any contributions in connection with elections for federal offices. *Id*. §30118. Congress also has prohibited foreign nationals from making any contributions in connection with any election. *Id*. 52 U.S.C. §30121. And Congress has imposed restrictions on the circumstances under which people who contract their services to the government may make contributions, prohibiting them from doing so while they are negotiating or performing under a government contract. *Id*. §30119. Congress has not imposed any comparable restriction on investment advisers who are providing or seeking to provide their services to public pension funds. And, in each of these instances, Congress applied its restrictions to all candidates for federal office and not one set of rules for incumbents and another for challengers.

In the rare instance when Congress wants agencies other than the FEC to participate in the enforcement or administration of campaign finance laws, it says so directly. *See, e.g.,* 47 U.S.C. §315(b) (delegating to Federal Communications Commission authority to enforce proper sponsorship identification in political advertising); 26 U.S.C. §6096 (delegating authority to Internal Revenue Service to administer "check off program" that funds Presidential Election Campaign Fund).

FINRA's Political Contribution Rule vastly exceeds FINRA's authority to propose and the SEC's authority to approve rules that "prevent fraudulent and manipulative acts and practices," "promote just and equitable principles of trade," "perfect the mechanism of a free and open market and a national market system," or "protect investors and the public interest." *Id.* Rather, Congress expressly forbids FINRA "to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter . . . ," *id.*, and requires the SEC to disapprove any such proposed rule as inconsistent with the requirements of the Exchange Act, 15 U.S.C. §78s(b)(2)(C). Campaign finance is not a matter related to the purposes of the Exchange Act; it is outside both the SEC's expertise and its statutory authority. The Commission thus lacks the power to impose broad prophylactic prohibitions on conduct so far outside its statutory mandate—particularly when that conduct is protected by the Constitution and limited beyond what Congress authorized in FECA.

Not a single line of the Exchange Act mentions the regulation of campaign finance because Congress never delegated to *any* agency the sensitive undertaking of determining the point at which campaign contributions pose a risk of corruption or the appearance thereof. Congress consistently has reserved this role for itself. It makes sense Congress that would reserve these judgments for itself rather than delegate them to executive agencies, "as legislators have 'particular expertise' in matters related to the costs and nature of running for office." *Randall*, 548 U.S. at 248.

Moreover, Congress has never imposed contribution limits on *state and local* races, which would raise serious federalism concerns. Rather, Congress has been careful not to override state limits on contributions and expenditures that are devoted solely to state and local races. Thus, while BCRA limits the amount of money a state or local party can spend on federal election activity, *see, e.g.*, 52 U.S.C. §30125(b)(1), Congress elucidated that these restrictions do not apply to expenditures related "solely to a clearly identified candidate for State or local office." 52 U.S.C. §30125(b)(2)(B)(ii). Likewise, while federal officeholders are subject to certain BCRA restrictions related to their ability to solicit funds for other elections, this restriction does not apply if the federal officeholder is fundraising for his own race for state or local office. 52 U.S.C. §30125(e)(1)-(2).

All of that would make the Rule difficult enough to defend had it been promulgated by the FEC. After all, Congress may have granted the FEC "exclusive[]" "responsibility for the civil enforcement of matters specifically covered by" FECA and BCRA, *Galliano*, 836 F.2d at 1368; *see* 52 U.S.C. §30106(b)(1), but Congress has not granted the FEC discretion to displace Congressional judgment on the appropriate limits of political contributions with the agency's own judgment. Yet that is what the SEC and FINRA do in Rule 2030: By forcing placement agents to choose between providing their services or making political contributions at the amounts permitted by FECA, the rule has the same practical effect as the restriction that Congress chose to impose only on government contractors. *See* 52 U.S.C. §30119.

That Rule 2030 has been promulgated by the SEC and FINRA makes this an even easier case, as Congress has not granted the SEC or FINRA *any* authority to regulate federal campaign contributions or other campaign finance-related activities. Instead, FINRA claimed this power under its general grant of authority to propose rules "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest." 80 Fed. Reg. 81,650, 81,656 (Dec. 30, 2015), App. 192a (citing 15 U.S.C. §78o-3(b)(6)); 81 Fed. Reg. at 60,058. Giving this provision an expansive view, the SEC agreed with FINRA's finding that the proposed rule change is consistent with the Exchange Act. 81 Fed. Reg. at 60,062-63, App. 138a-244a. This boundless view of SEC authority would strain credulity even without the constitutional sensitivities or Congress' "comprehensive" and "first-amendment-sensitive" contribution limits regime. *Galliano*, 836 F.2d at 1368, 1370.

Any attempt to fit the regulation of political contributions and solicitation in under the SEC's authority to "protect[s] investors and the public interest," 15 U.S.C. §78o-3(b)(6), stretches the statutory language beyond its breaking point. The authority to target "fraudulent and manipulative acts and practices" does not give these financial regulatory agencies the authority to set contribution limits on political races or prohibit other political activity. *Id.*

If a statutory grant of authority like the statutes at issue here, which are for enacting regulations to "perfect the mechanism of a free and open market" or "to protect investors and the public interest," 15 U.S.C. §78o-3(b)(6), are read to include the power of imposing campaign contribution limits for all federal, state, and local elections, then any federal agency can do the same within its regulatory ambit. While the Exchange Act gives the SEC the authority to regulate how placement agents do their job and to punish them for actual fraud or bribery, the Act does not grant the SEC the authority to regulate their lawful political speech. Those matters are left to state and federal legislators, the experts at "weigh[ing] competing constitutional interests" inherent in any decision related to how we participate in electing our political leaders. *McConnell*, 540 U.S. at 137. To return the SEC and FINRA to their proper sphere, this Court should therefore grant certiorari.

C. The Rule Is Arbitrary and Capricious

Finally, even assuming that authority to regulate "fraudulent and manipulative practices" includes authority to create new campaign finance regimes, FINRA and the SEC have failed to justify this new prophylactic ban on otherwise lawful speech. At the outset, it is important to recognize that the Rule's application to candidates for federal office targets only those instances in which covered associates make *fully disclosed* federal political contributions in amounts *less than $2,800 to federal candidates or make fully disclosed donations to political party committees federal accounts*. Everything else already is prohibited directly by the campaign finance statutes and is therefore squarely within the enforcement jurisdiction of the FEC and the Department of Justice. *See* 52 U.S.C. §§30116, 30104, 30105. Moreover, similar contribution and disclosure requirements are imposed by states under state law, and "pay-to-play" conduct is already prohibited by both state and federal law, *see, e.g.*, 18 U.S.C. §201 (prohibiting payment of bribes to federal officials); N.Y. Penal Law §200.04 (McKinney 2016) (prohibiting bribes to state officials). Thus, Rule 2030 is necessarily premised on the notion that making fully disclosed contributions within state and federal limits is likely to result in some sort of "fraudulent and manipulative" act or will otherwise harm markets or the "public interest." 15 U.S.C. §78o-3(b)(6).

Yet, neither the SEC nor FINRA can identify with any specificity what "fraud" might result from the modest, publicly- disclosed contributions the Rule precludes. And FINRA offers only speculation that the Rule will cause more qualified advisers to offer their services, 81 Fed. Reg. at 60,063, 60,065 App. 121a, 122a, 135a, 167a, 169a, 192a, 199a, 203a, and provide government entities better advice, *id*. This fails scrutiny. *Ragsdale v. Wolverine World Wide, Inc.*, 535 U.S. 81, 93 (2002) ("When the generalizations fail to hold in the run of cases," however, "the justification for the categorical rule disappears."

In short, the Rule is unauthorized, unjustified, and massively overbroad in a way that raises grave First Amendment concerns. Because FINRA and the SEC exceeded their statutory authority and acted arbitrarily and capriciously in promulgating it, the Rule cannot be sustained. This Court should grant certiorari and reverse.

CONCLUSION

For the forgoing reasons, petitioners respectfully request that the Court grant this petition.

Respectfully submitted,

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September 16, 2019

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

[Filed: June 18, 2019]

No. 18-1111

NEW YORK REPUBLICAN STATE COMMITTEE AND TENNESSEE REPUBLICAN PARTY,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of a Final Order
of the Securities & Exchange Commission

September Term, 2018

Before: PILLARD, *Circuit Judge*, and GINSBURG and SENTELLE, *Senior Circuit Judges*

JUDGMENT

This cause came on to be heard on the petition for review of an order of the Securities & Exchange Commission and was argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED that the petition for review is denied, in accordance with the opinion of the court filed herein this date.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

BY: /s/

Ken Meadows
Deputy Clerk

Date: June 18, 2019

Opinion for the court filed by Senior Circuit Judge Ginsburg.

Dissenting opinion filed by Senior Circuit Judge Sentelle.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

[Filed: August 13, 2019]

No. 18-1111
SEC-34-78683

NEW YORK REPUBLICAN STATE COMMITTEE AND TENNESSEE REPUBLICAN PARTY,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

September Term, 2018

MANDATE

In accordance with the judgment of June 18, 2019, and pursuant to Federal Rule of Appellate Procedure 41, this constitutes the formal mandate of this court.

FOR THE COURT:
Mark J. Langer, Clerk

BY: /s/

Ken R. Meadows
Deputy Clerk

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 18-1111

NEW YORK REPUBLICAN STATE COMMITTEE AND TENNESSEE REPUBLICAN PARTY,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Argued November 15, 2018
Decided June 18, 2019

On Petition for Review of a Final Order
of the Securities & Exchange Commission

Edmund G. LaCour Jr. argued the cause for petitioners. With him on the briefs were *H. Christopher Bartolomucci* and *Jason B. Torchinsky*.

Jeffrey A. Berger, Senior Litigation Counsel, Securities and Exchange Commission, argued the cause for respondent. With him on the brief was *Michael A. Conley*, Solicitor.

Carter G. Phillips, *Joseph Guerra*, *Tobias S. Loss-Eaton*, and *Michael L. Post* were on the brief for *amicus curiae* Municipal Securities Rulemaking Board in support of respondent.

Before: PILLARD, *Circuit Judge*, and GINSBURG and SENTELLE, *Senior Circuit Judges*.

Opinion for the Court filed by *Senior Circuit Judge* GINSBURG.

Dissenting opinion filed by *Senior Circuit Judge* SENTELLE.

GINSBURG, *Senior Circuit Judge:* In 2016 the Securities and Exchange Commission adopted Rule 2030, which regulates the political contributions of those members of the Financial Industry Regulatory Authority (FINRA), a self-regulatory association of broker-dealers, who act as "placement agents" – *i.e.*, individuals and firms that investment advisers hire to help them secure contracts advising a government entity. The Rule prohibits a placement agent from accepting compensation for soliciting government business from certain candidates and elected officials within two years of having contributed to such an official's electoral campaign or to the transition or inaugural expenses of a successful candidate. The New York Republican State Committee (NYGOP) and the Tennessee Republican Party petition for review of the SEC's order approving Rule 2030, on the grounds that: (1) the SEC did not have authority to enact the Rule; (2) the order adopting the Rule is arbitrary and capricious because there was insufficient evidence it was needed; and (3) the Rule violates the First Amendment to the Constitution of the United States. The SEC challenges the petitioners' standing to bring the case and defends the Rule against these arguments.

We hold the NYGOP has standing and deny its petition on the merits. The SEC acted within its authority in adopting Rule 2030; doing so was not arbitrary and capricious because the SEC had sufficient evidence it was needed; and the Rule does not violate the First Amendment in view of our holding in *Blount v. SEC*, 61 F.3d 938 (1995), in which we upheld a functionally identical rule against the same challenge.

I. Background

The SEC adopted the challenged rule in response to longstanding concerns about so-called "pay-to-play" activity in the public pension market. We therefore begin by laying out what prompted the SEC's decision to regulate the contributions of placement agents to candidates and incumbents for elected office.

A. Pay-to-Play and Public Funds

In many instances, local and state government officials responsible for holding and managing public funds, such as pension funds and tuition plans, are also responsible for choosing investment advisers to manage plan assets. Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. IA–3043, 75 Fed. Reg. 41018, 41019/1 (July 14, 2010).[1] By 2010 an increasing number of enforcement actions had revealed that some of these elected officials chose investment advisers based upon whether the would-be adviser had given them money or donated to their campaign. 75 Fed. Reg. at 41019/3-20/3; *id.* at 41039 n.290. For example, the SEC brought cases against the former Treasurer of the State of Connecticut and other defendants, alleging the Treasurer had allocated pension fund investments to fund managers in exchange for political contributions and other payments made

[1] Henceforth, for the sake of simplicity, we follow the lead of the SEC in using the term "public pension plan" to refer to any investment program "sponsored or established" by a government entity, "regardless of whether they are retirement funds." 75 Fed. Reg. 41018 n.3.

through the Treasurer's "friends and political associates." *Id.* at 41020/1.

Concerned that these practices distort the market for investment advisory services, the SEC adopted a rule in 2010 regulating the political contributions of firms and individuals registered under the Investment Advisers Act of 1940, which prohibits any adviser from engaging "in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." 15 U.S.C. § 80b-6(4); *see* 17 C.F.R. § 275.206(4)-5. This "Advisers Act rule" makes it unlawful for an investment adviser to provide services "for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser." 17 C.F.R. § 275.206(4)-5(a)(1). The rule was "modeled on" Rule G-37 of the Municipal Securities Rulemaking Board (MSRB), 75 Fed. Reg. at 41020/3, which the SEC had approved in 1994 and which imposes a similar two-year "time-out" upon a dealer in the municipal securities market who has donated to a covered official. Self-Regulatory Organization - Municipal Securities Rulemaking Board, Exchange Act Release No. 34-33868, 59 Fed. Reg. 17621, 17622/3-25/3 (Apr. 13, 1994). The SEC modeled its rule upon MSRB Rule G-37 in part because we had upheld that rule against a first amendment challenge in *Blount*, and in part because the SEC believes G-37 was successful in "significantly curb[ing] pay to play practices in the municipal securities market." 75 Fed. Reg. at 41020/3, 41023/3; *see also* Order Approving a Proposed Rule Change To Adopt FINRA Rule 2030 and FINRA Rule 4580 To Establish "Pay-To-Play" and Related Rules, Exchange Act Release No. 34 78683, 81 Fed. Reg. 60051, 60065/1 (Aug. 31, 2016).

The SEC understood the Advisers Act rule would not address all instances of pay-to-play corruption. In particular, it was aware of several cases in which an investment adviser did not contribute directly to a candidate or incumbent but instead acted through a placement agent. *See* 75 Fed. Reg. at 41037/3-38/1; Notice of Filing of a Proposed Rule Change To Adopt FINRA Rule 2030 and FINRA Rule 4580 To Establish "Pay-to-Play" and Related Rules, Exchange Act Release No. 34-76767, 80 Fed. Reg. 81650, 81651/1 (Dec. 30, 2015). For example, a placement agent who funneled contributions to the New York State Comptroller secured contracts for its client to advise $250 million worth of pension fund investments. 81 Fed. Reg. at 60065/3; 75 Fed. Reg. at 41019/3-20/3. The SEC was therefore "concerned that a rule that failed to address the use of [placement agents] would be ineffective were advisers simply to begin using . . . placement agents" to get government clients. 75 Fed. Reg. at 41037/3.

Instead of barring investment advisers from hiring placement agents, however, the SEC allowed an adviser to retain a placement agent who is a member of the FINRA, 17 C.F.R. § 275.206(4)-5(a)(2)(i)(A); 15 U.S.C. § 78c(a)(26), if the FINRA would impose restrictions upon its members that were "substantially equivalent [to] or more stringent" than the SEC's parallel rule for investment advisers. 17 C.F.R. § 275.206(4)-5(f)(9)(ii); *see Ga. Republican Party v. SEC*, 888 F.3d 1198, 1200 (11th Cir. 2018); 81 Fed. Reg. at 60063/3 (noting the FINRA had agreed to "prepare rules for [the SEC's] consideration that would prohibit its [placement agent] members" from engaging in pay-to-play activity).

B. FINRA Rule 2030

In 2015 the FINRA proposed Rule 2030, which is modeled after the Advisers Act rule and MSRB Rule

G-37. 81 Fed. Reg. at 60053/1, 60057/2. Rule 2030(a), subject to some exceptions, prohibits a FINRA member from

> Engag[ing] in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by the covered member or a covered associate.

In other words, if a placement agent makes a contribution to a government official who can influence a government entity's choice of an investment adviser, *see* Rule 2030(g)(8) (defining "official"), then the placement agent must wait two years before he or his firm can accept payment for soliciting that government entity on behalf of a client. The "two-year time-out" is intended to serve as a "cooling-off period during which the effects of a political contribution on the selection process can be expected to dissipate." 81 Fed. Reg. at 60053/1.

Rule 2030(b) prevents circumvention of this primary prohibition by forbidding a covered member or a "covered associate" of a member from "solicit[ing] or coordinat[ing] any person or political action committee" to make any contributions to a covered official. *See also* Rule 2030(g)(2) (defining "covered associate"). The covered member or associate is also forbidden from "soliciting or coordinating any person or political action committee to make any payment to a political party of a state or locality of a government entity with which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser." Rule 2030(b)(2) (cleaned up). Put another way, a placement agent may not solicit contributions for a political party and later be paid to serve as a placement agent for the state or locality of that party.

Rule 2030(c)(1) sets forth an exception to the Rule for de minimis contributions, allowing an associate of a FINRA member firm to contribute up to $350 to a candidate or incumbent if he or she is eligible to vote for that person; otherwise the limit is $150.

When the SEC approved FINRA Rule 2030 in 2016, the NYGOP, along with the Tennessee and Georgia Republican Parties, filed a joint petition in the Eleventh Circuit for review of the SEC order. 81 Fed. Reg. at 60051; *Ga. Republican Party*, 888 F.3d at 1201. The Eleventh Circuit held the Georgia party did not have standing to challenge the order and transferred the case to this court based upon the applicable venue statute. *Id.* at 1205 (citing 15 U.S.C. § 78y(a)(1)).

II. Analysis

A. Standing

In order to bring their challenge, the petitioners must establish they have satisfied the "constitutional minimum" for standing to sue, which requires that (1) they have suffered an injury-in-fact, (2) caused by the challenged conduct; and (3) a favorable decision is likely to redress that injury. *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 560-61 (1992). If any one of the petitioners has standing to raise a claim, then this court has jurisdiction over that claim without regard to whether any other petitioner also has standing. *Carpenters Indus. Council v. Zinke*, 854 F.3d 1, 9 (D.C. Cir. 2017).

Although we are typically skeptical about a petitioner's standing where, as here, neither petitioner is regulated by the challenged rule, *Lujan*, 504 U.S. at 561-62, we hold the NYGOP has met its burden by advancing "specific facts" to support its claim to have suffered an injury-in-fact. *Id.* at 561; *Sierra Club v. EPA*, 292 F.3d 895, 899 (D.C. Cir. 2002). The NYGOP has submitted the affidavit of Francis Calcagno, a placement agent covered by Rule 2030, stating that "if Rule 2030 were no longer in effect," then he "would solicit contributions for the NYGOP from [his] friends, family, and other contacts." Add. to Pet'rs' Br. 18-19.

An organization is obviously "harmed if its contributors cease giving it money." *Taxation with Representation of Wash. v. Regan*, 676 F.2d 715, 723 (D.C. Cir. 1982) (holding a nonprofit has standing to bring a first amendment challenge against restrictions denying tax deductions to its contributors), *rev'd on other grounds*, 461 U.S. 540 (1983). Hence, we hold the NYGOP's reduced ability to raise funds due to Rule 2030 constitutes a concrete and particularized injury for purposes of Article III standing.

The SEC claims *Taxation* is inapplicable because the tax statute challenged in that case affected the entire donor base of a nonprofit organization, whereas the NYGOP has not shown placement agents affected by Rule 2030 constitute more than a minority of its potential contributors. As the petitioners point out, however, this argument addresses only the degree of their injury. As we have long held, even a slight injury is sufficient to confer standing; the size of the harm therefore poses no jurisdictional barrier to the NYGOP's claim. *See Tax Analysts & Advocates v. Blumenthal*, 566 F.2d 130, 138 (D.C. Cir. 1977).

The SEC next invokes *Clapper v. Amnesty International USA*, 568 U.S. 398 (2013), to argue the petitioners' risk of harm is too speculative because it relies upon the decisions of third parties not before us. In *Clapper*, the Supreme Court held that certain attorneys and organizations did not have standing to challenge a provision of the Foreign Intelligence Surveillance Act of 1978 because they failed to show their claimed injury – namely, that their communications with overseas clients and contacts would be intercepted by the Government – was "certainly impending." *Id.* at 410-14. As the Supreme Court later clarified, however, a plaintiff is not limited to establishing injury-in-fact by showing that a harm is "certainly impending"; it may instead show a "substantial risk" that the anticipated harm will occur. *See Susan B. Anthony List v. Driehaus*, 573 U.S. 149, 158 (2014). We have, therefore, determined that "the proper way to analyze an increased-risk-of-harm claim is to consider the ultimate alleged harm . . . as the concrete and particularized injury and then to determine whether the increased risk of such harm makes injury to an individual citizen sufficiently 'imminent' for standing purposes." *Attias v. Carefirst, Inc.*, 865 F.3d 620, 627 (D.C. Cir. 2017).

We have already determined that the NYGOP's reduced ability to raise funds is a concrete and particularized harm to the organization. The question now is whether the NYGOP has shown it faces a "substantial risk" of this harm materializing.

We hold the NYGOP has met its burden. To be sure, Calcagno has not shown with literal certainty that his contacts would have donated to the NYGOP upon his request. But *Clapper* does not require certainty; instead, it understandably holds a plaintiff's risk of harm cannot be based upon a "highly attenuated chain of possibilities." 568 U.S. at 410. Unlike in *Clapper*, where the chain comprised several links, "requir[ing] the assumption that independent decisionmakers" – the Attorney General, the Director of National Intelligence, and judges of the Foreign Intelligence Surveillance Court – "would exercise their discretion in a specific way," *Attias*, 865 F.3d at 626, here the plaintiff's standing requires only the single inference that at least one of Calcagno's family, friends, or contacts would have donated a few dollars to the NYGOP had Calcagno asked him or her to do so. In our view, that inference is eminently reasonable – indeed, irresistible; the increased risk of at least some harm as a result of the SEC's decision to adopt Rule 2030 is therefore substantial and not speculative. *Cf. id.* at 628-29 (contrasting the substantial risk of identity theft posed by a data hack with the "long sequence of uncertain contingencies" in *Clapper*). We do not believe that a practical application of Article III requires more than the affidavit before us.

In short, we hold the NYGOP has Article III standing to pursue this case. The NYGOP's reduced ability to raise funds due to Rule 2030 constitutes a non-speculative injury-in-fact, which would be redressed were we to grant its petition.

B. Authority of the SEC

We turn now to the petitioners' challenge to Rule 2030 as an ultra vires regulation of campaign finance. Pursuant to Section 15A of the Securities Exchange Act of 1934, the SEC "shall approve" a rule proposed by the FINRA – the only registered national securities association, *see Self-Regulatory Organization Rulemaking*, SEC. EXCH. COMM'N (Mar. 5, 2019), https://www.sec.gov/rules/sro.shtml – if it is "consistent with the requirements of [the Act]." 15 U.S.C. § 78s(b)(2)(C)(i). Section 15A also authorizes the FINRA to make rules to "prevent fraudulent and manipulative" practices, "to promote just and equitable principles of trade," and to "remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest." 15 U.S.C. § 78o-3(b)(6); *see also* 81 Fed. Reg. at 60062/3-63/1.

The SEC says Rule 2030 comes within this authority because pay-to-play transforms the process by which government officials select investment advisers into one in which political contributions, rather than the competence and cost of investment advisers, drive the award of contracts. *See* 81 Fed. Reg. at 60063/1-65/3. As a result, public pension funds are more likely to be managed by less qualified investment advisers and to pay higher fees, to the detriment both of the funds' beneficiaries and of taxpayers. *Id*. at 60065/2; 75 Fed. Reg. at 41022/2-3. Indeed, pay-to-play presents a familiar agency problem in which the agent, who selects advisers for the fund, has an interest that diverges from that of his principals – the beneficiaries. This is not a self-correcting problem: Investment advisers and placement agents who decline to pay are put at a competitive disadvantage. *See Blount*, 61 F.3d at 945-46.

We agree with the SEC's view of its authority. As we said in *Blount*, 61 F.3d at 945, regulating pay-to-play practices in the municipal bond market is within the authority of the SEC to reduce distortion in financial markets:

> "Pay to play" practices raise artificial barriers to competition for those firms that either cannot afford or decide not to make political contributions. Moreover, if "pay to play" is the determining factor in the selection of an underwriting syndicate, an official may not necessarily hire the most qualified under-

> writer for the issue . . . . "Pay to play" practices undermine [just and equitable] principles [of trade] since underwriters working on a particular issuance may be assigned similar roles, and take on equivalent risks, but be given different allocations of bonds to sell – resulting in differing profits – based on their political contributions or contacts.

Id. This reasoning, of course, is not limited to the market for municipal securities at issue in *Blount*; it applies with equal force to the pension funds at risk of corruption in this case. *See* 81 Fed. Reg. at 60063/2-3 ("[P]ublic pension plans are particularly vulnerable to pay-to-play practices").

The petitioners first complain this view of the SEC's authority is too expansive. In support, they cite *California Independent System Operator Corp. v. FERC*, 372 F.3d 395 (2004) (*CAISO*), in which we held the Federal Energy Regulatory Commission (FERC) exceeded its statutory authority when it ordered a state-created utility corporation to adopt a method for selecting members of its board, in derogation of the method prescribed by a state statute. The FERC claimed it was acting pursuant to its authority to regulate a "practice" affecting a rate collected by a public utility, *id.* at 399, but after analyzing the meaning of that word in the Federal Power Act, *id*. at 398-401, we concluded the "breathtaking scope" of the FERC's interpretation was unreasonable. *Id*. at 401.

The petitioners here do not explain how *CAISO* bears upon the present case. To be sure, both cases involve a federal agency accused of acting outside the bounds of its authority, but there the similarity ends. The reasoning in *CAISO* is addressed to the specific provisions of the Federal Power Act, and the petitioners do not explain how it might in any meaningful way affect our analysis of the Exchange Act. Nor do the petitioners marshal any evidence to draw into question our observation in *Blount* that there is a "self-evident" connection "between eliminating pay-to-play practices and the Commission's [twin] goals of 'perfecting the mechanism of a free and open market' and promoting 'just and equitable principles of trade.'" 61 F.3d at 945.

The petitioners argue in the alternative that the Congress surely "could not have intended to delegate a decision of such . . . significance to an agency." Pet'rs' Reply Br. 14 (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 160 (2000)). Rather, the argument goes, the Congress has reserved to itself the authority to determine when a political contribution poses a risk of corruption, because it has chosen to set limits directly through the Federal Election Campaign Act of 1971 (FECA). As evidence that the Congress intends to dictate when limits may be adjusted or imposed, the petitioners cite a provision of the FECA that specifies contribution limits shall increase based upon changes in the price index, 52 U.S.C. § 30116(c), as well as FECA provisions that bar contributions from certain groups, such as national banks and foreign nationals, §§ 30118, 30121, but not from placement agents.

Because none of these provisions bears upon the SEC's authority to uproot pay-to-play corruption in financial markets, we take the petitioners' argument to be that provisions of the later-enacted FECA work an implied repeal – a term the petitioners understandably reject – of the SEC's pre-existing authority to regulate pay-to-play activity under Section 15A of the Exchange Act.

As the SEC points out, however, the Supreme Court has instructed that when "statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc.*, 534 U.S. 124, 143-44 (2001); *see also Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 154 (1976) (describing "two well-settled categories of repeals by implication: (1) where provisions in the two acts are in irreconcilable conflict . . . ; and (2) if the later act covers the whole subject of the earlier one . . . . But, in either case, the intention of the legislature to repeal must be clear and manifest") (cleaned up). We do not take this duty lightly. *See FTC v. Ken Roberts Co.*, 276 F.3d 583, 593 (D.C. Cir. 2001) ("Because we live in an age of overlapping and concurring regulatory jurisdiction, a court must proceed with the utmost caution before concluding that one agency may not regulate merely because another may") (internal quotation omitted). In our view, that the Congress has increased the contribution limits to keep pace with inflation and that it has prohibited certain groups from making contributions is not evidence of a "clear congressional intention" to preclude the SEC from limiting campaign contributions that distort financial markets.

Finally, the petitioners make a related but distinct claim, based upon *Galliano v. U.S. Postal Service*, 836 F.2d 1362 (D.C. Cir. 1988), that the "first-amendment-sensitive" provisions of the FECA limiting individual contributions "displace" any authority the Exchange Act may have conferred upon the SEC to set further restrictions. Pet'rs' Br. 33-34 (citing *Galliano*, 836 F.2d at 1370). In *Galliano*, we held the United States Postal Service could not enforce its statutory authority to prevent "false representations" in the mail by imposing certain disclosure requirements for political mail on top of those specifically required by the detailed disclosure provisions of the FECA, which reflect a delicate "balance of interests . . . deliberately struck by Congress" in light of the first amendment considerations involved in regulating campaign finance. 836 F.2d at 1370. Similarly, as the SEC emphasizes, we were concerned that the procedures used by the Postal Service to adjudicate whether a defendant had made a "false representation" through the mail would have bypassed the "precisely drawn" dispute resolution process prescribed by the FECA. *Id.* at 1371.

At the outset, we note that in *Galliano*, which was decided prior to *Blount*, we were at pains to analyze the authority of the Postal Service in a manner that "reduce[d] constitutional doubt," *id.* at 1369, with respect to two questions: (1) whether the Postal Service's effort to "regulate solicitations for political contributions" was consistent with the First Amendment and (2) "if so, then as a matter of first amendment due process, [whether] such solicitations may be regulated without a prior judicial determination of the existence *vel non* of first amendment protections." *Id.* at 1370 n.7 (cleaned up); *see also Ken Roberts Co.*, 276 F.3d at 593 (describing *Galliano* as "relying on the First Amendment and the canon of constitutional doubt in holding that the [FECA] partially preempted the postal fraud prescriptions"). Although the First Amendment is surely implicated in the present case as well, *Blount*, as described below, has since clarified that the SEC's pay-to-play rules are not constitutionally infirm under the law of this Circuit. Moreover, our concern in *Galliano* with "first amendment due process" is simply not relevant here. Whereas we were concerned in *Galliano* about whether there would be sufficient judicial review of the Postal Service's case-by-case determinations of what is a misrepresentation and what is protected speech, *id.* at 1369, 1370 n.7, here we review only a facial challenge to whether the bright line of Rule 2030 violates the First Amendment. We are not therefore compelled by *Galliano* to resolve the allegedly overlapping authority of the SEC and the FEC by holding only one of them may regulate in a way that touches upon political contributions.

Galliano might nevertheless have given the petitioners some traction had the Supreme Court not later decided *POM Wonderful LLC v. Coca-Cola Co.*, 573 U.S. 102 (2014), which supersedes some of this court's reasoning in *Galliano*. (Indeed, it is unclear to what extent *Galliano* has survived that decision.) The Court in *POM* held that labeling regulations implementing the Food, Drug, and Cosmetic Act (FDCA) do not preclude a business from bringing a claim against a competitor for unfair competition arising from false or misleading advertising in violation of the Lanham Act. As the SEC rightly claims, the reasoning in *POM* weighs heavily in its favor. The Court began its analysis with the text of the two statutes, noting neither contains an express limitation on Lanham Act claims, which is "of special significance because the Lanham Act and the FDCA have coexisted" for 70 years. *Id.* at 113. Similarly, neither of the relevant statutes in this case contains a provision limiting the reach of the other, and the first pay-to-play rule adopted by the SEC (MSRB Rule G37) has coexisted with the FECA for 25 years. Furthermore, in determining that the Congress did not "intend the FDCA to preclude Lanham Act suits," *id*. at 121, the Court reasoned that the two statutes "complement each other in major respects . . . . Although both statutes touch on food and beverage labeling, the Lanham Act protects commercial interests against unfair competition, while the FDCA" and hence, we might add, the labeling regulation implementing it, "protects public health and safety." *Id.* at 115. Similarly, the FECA and the Exchange Act, as instantiated by the SEC's pay-to-play rules, can peacefully coexist: Although both regimes touch upon political contributions, the FECA is meant to protect elections from the perceived untoward effects of over-limit campaign contributions by whomever made, whilst the Exchange Act, as implemented by Rule 2030, is meant to protect the financial markets from the perceived untoward effects of over-limit contributions made by placement agents. *See Blount*, 61 F.3d at 944 ("[I]n *Buckley* and *Austin* the legislature was interested in clean elections, whereas here the SEC is interested in clean bond markets").

In so holding, we reject the petitioners' argument that the FECA is incompatible with the Exchange Act because the general $2,700 contribution limit set by the FECA serves as a "safe haven." Pet'rs' Reply Br. 18; *see Galliano*, 836 F.2d at 1370. This argument is not tenable after *POM*: The Court there considered and rejected a similar contention, reasoning that the implementing regulations of the FDCA should not be viewed as a "ceiling on the regulation of food and beverage labeling" because the "Congress intended the Lanham Act and the FDCA to complement each other." *Id.* at 119. Just as the Court observed in *POM* that "[i]t is unlikely that Congress intended the FDCA's protection of health and safety to result in less policing of misleading food and beverage labels than in competitive markets for other products," *id.* at 116, so too we think it unlikely the Congress intended the FECA's protection of the electoral process to result in less policing of corruption and inefficiency in the financial markets.

We are similarly unpersuaded by the petitioners' argument that the FECA leaves no room for the SEC to impose its own restrictions simply because the FECA is more detailed. As the Court said in *POM*, the "greater specificity [of one law] would matter only if [the two laws] cannot be implemented in full at the same time." 573 U.S. at 118. Because, as shown above, the Exchange Act and the FECA can both be fully implemented without conflict, it matters not that the FECA is more detailed.

Finally, the petitioners' assertions to the contrary notwithstanding, the "exclusive jurisdiction" of the FEC to enforce the FECA, *see* 52 U.S.C. § 30106(b)(1), is no bar to our conclusion that the SEC may enforce the Exchange Act to reduce distortion in financial markets. Rule 2030 does not purport to give the SEC the ability to enforce provisions of the FECA. *Cf. POM*, 573 U.S. at 116-17 (explaining that although the FDA has exclusive authority to enforce the FDCA, "POM seeks to enforce the Lanham Act, not the FDCA or its regulations").

C. Arbitrary and Capricious

In their next line of attack, the petitioners claim the order adopting Rule 2030 is arbitrary and capricious, in violation of the Administrative Procedure Act, 5 U.S.C. § 706(2)(A), because the SEC has not shown the Rule targets corruption beyond that already prevented by federal and state laws against bribery or by the FECA.

We do not believe the federal and state laws prohibiting bribery are adequate to address pay-to-play activity, as the petitioners suggest. Laws against bribery "deal with only the most blatant and specific attempts of those with money to influence governmental action," *Wagner v. FEC*, 793 F.3d 1, 15 (D.C. Cir. 2015) (quoting *Buckley v. Valeo*, 424 U.S. 1, 27-28 (1976)); "corruption and its appearance are no doubt more widespread in the contracting process than our criminal dockets reflect." *Id.*; *see also id.* at 25.

Nor is the FECA a solution to the problem: The SEC adopted Rule 2030 precisely because it was aware of several instances in which a placement agent's contribution to a government official – lawful under the FECA – influenced that official's decision to award an advisory services contract. *See* 75 Fed. Reg. 41019/2-20/3, 41037/3. In adopting the Rule, the agency explained that placement agents played a "central role" in several pay-to-play scandals involving FECA-compliant contributions to officials in New York, Connecticut, and California. 81 Fed. Reg. at 60065/3; *see also* 75 Fed. Reg. 41019/2-20/2; *id.* at 41019/3 n.17; *id.* at 41039/3 n.290.

The petitioners minimize the significance of this evidence, arguing the SEC's examples do not show that "most, many, or even more than a few publicly disclosed $2,700 federal contributions or similar contributions made to state and local officials by placement agents will involve the kind of *quid pro quo* arrangement" the Rule aims to prevent. Pet'rs' Br. 44. That is true, but it would make no sense to require the SEC to show that quid pro quo arrangements are, as the petitioners put it, "rampant," *id.*: A contribution is corrupting even if it cannot be traced to the subsequent award of a contract for advisory services because in this market "a contribution brings the donor merely a chance to be seriously considered, not the assurance of a contract." *Blount*, 61 F.3d at 945. (Indeed, it could hardly be otherwise whenever a candidate or incumbent receives several contributions from as many would-be advisers.) Not surprisingly, in *Blount* the record contained "no evidence of specific instances of quid pro quos," yet we rejected the same argument in the form that the harms being targeted by MSRB Rule G-37 were "merely conjectural." 61 F.3d at 944. As we explained then in analyzing whether MSRB Rule G-37 violated the First Amendment, the contributions at issue "self-evidently create[d] a conflict of interest" and, although actual corruption is difficult to detect, the "risk of corruption is obvious and substantial." *Id.* at 944-45. Accordingly, "no smoking gun is needed where . . . the conflict of interest is apparent, the likelihood of stealth great, and the legislative purpose prophylactic." *Id.* at 945; *see also Buckley*, 424 U.S. at 29-30 (rejecting a challenge to the contribution limit in the FECA that "most large contributors do not seek improper influence," because it is too "difficult to isolate suspect contributions").

D. The First Amendment

We turn, finally, to the petitioners' contention that Rule 2030 violates the First Amendment. As a threshold matter, however, we must determine the standard to which the Rule should be held. The petitioners, of course, urge us to subject Rule 2030 to strict scrutiny on the ground that we are reviewing an action by the SEC as opposed to the Congress, which they say alone has the "expertise" to weigh the first amendment considerations involved. Pet'rs' Br 52. This novel theory runs up against our precedent holding the "closely drawn" standard, which is "a lesser but still rigorous standard of review" prescribed by the Supreme Court, "remains the appropriate one for review of a ban on campaign contributions," *Wagner v. FEC*, 793 F.3d at 5-6 (citing several Supreme Court cases, the most recent of which is *McCutcheon v. FEC*, 572 U.S. 185, 197 (2014) (plurality opinion)). We therefore ask whether Rule 2030 is closely drawn to serve a "sufficiently important" governmental interest. *Id*. at 7-8.

As the SEC points out, we answered this question when we upheld MSRB Rule G-37 against the first amendment challenge in *Blount*. Because MSRB Rule G-37 is identical in every constitutionally relevant way to FINRA Rule 2030, *Blount* compels our holding for the SEC in this indistinguishable case. Then, as now, the Supreme Court has said that "preventing corruption or the appearance of corruption are the only legitimate and compelling government interests thus far identified for restricting campaign finances,'" *FEC v. Nat'l Conservative Political Action Comm.*, 470 U.S. 480, 496-97 (1985)); *Blount*, 61 F.3d at 944; *see also Wagner v. FEC*, 793 F.3d at 8, 22 (restrictions on the first amendment right to make political contributions may be particularly necessary in the "contracting context," which "greatly sharpens the risk of corruption and its appearance" because "there is a very specific quo for which the contribution may serve as the quid: the grant or retention of the contract"). We determined MSRB Rule G-37 survives even strict scrutiny because the rule restricts only a "narrow range of . . . activities for a relatively short period of time." *Blount*, 61 F.3d at 947-48; *see also Wagner v. FEC*, 793 F.3d at 26 ("The availability of other avenues of political communication can thus be relevant, although it is of course not dispositive"). Rule 2030 contains identical safeguards and therefore survives our review today; its restrictions are closely drawn to further a compelling governmental interest, as can be seen in the specific instances of quid pro quo conduct identified by the SEC. *See* Part II.C above; 81 Fed. Reg. at 60066/1-2.

Rather than attempt to twist the logic of *Blount* in their favor, the petitioners advance two reasons for thinking our precedent is no longer good law. First, they invoke the plurality opinion in *McCutcheon* for the proposition that "*Blount* relied heavily on several strands of reasoning that the Supreme Court has since rejected." Pet'rs' Br. 50. Under the petitioners' blinkered reading of that opinion, the present case runs afoul of the Court's admonition that a "'prophylaxis-upon-prophylaxis approach' requires that we be particularly diligent in scrutinizing the law's fit." 572 U.S. at 221.

McCutcheon, of course, involved an aggregate limit on political contributions that was "layered on top [of the base limits prescribed by the FECA], ostensibly to prevent circumvention of the base limits." *Id*. But the holding of *McCutcheon* is not that a belt and braces approach is necessarily unconstitutional, but that the court must be "particularly diligent in scrutinizing the law's fit" with the governmental interest it is supposed to serve. *Id*. And so we did in *Blount* by applying strict scrutiny, a standard even more exacting than the "closely drawn" standard we apply now, to evaluate the first amendment claim against MSRB G-37. 61 F.3d at 943-48.

Second, the petitioners would have us distinguish *Blount* because this court was not there asked to consider the "disparate impact that a restriction like Rule 2030 will have on candidates running for the same seat" where one candidate is a covered official and the incumbent (or another candidate) is not. Pet'rs' Br. 52. In support of their claim that this disparity necessarily makes the Rule unconstitutional, the petitioners quote dicta from two cases but disregard their reasoning: *Davis v. FEC*, 554 U.S. 724, 738 (2008), and

Riddle v. Hickenlooper, 742 F.3d 922, 929 (10th Cir. 2014).

The operative question in both cases was not simply whether the challenged rule had a disparate effect, but whether the difference was "justified by the primary governmental interest proffered in its defense." *Davis*, 554 U.S. at 738 (cleaned up); *see Riddle*, 742 F.3d at 928. In *Davis*, the Supreme Court held the Millionaire's Amendment to the Bipartisan Campaign Reform Act, which raised the contribution limit for a candidate if a rival candidate expended more than a certain amount of personal funds, could not withstand first amendment scrutiny. 554 U.S. at 740-41. Although the Court noted it has "never upheld the constitutionality of a law that imposes different contribution limits for candidates who are competing against each other," *id.* at 738, the Court invalidated the law not because of the disparate effect upon the candidates, as the petitioners suggest, but because the Government's interest in "level[ing] electoral opportunities for candidates of different personal wealth" is not a "legitimate government objective," *id.* at 741:

> Because § 319(a) imposes a substantial burden on the exercise of the First Amendment right to use personal funds for campaign speech, that provision cannot stand unless it is justified by a compelling state interest. No such justification is present here.

Id. at 740 (internal quotation omitted). In contrast, the Court has repeatedly – and, indeed, in the same case – recognized that the prevention of "corruption and the appearance of corruption" can justify an abridgment of first amendment rights as long as the limits are "closely drawn" to serve that important interest. *See id*. at 737; *McCutcheon*, 572 U.S. at 191-92; *FEC* *v. Nat'l Conservative Political Action Comm.*, 470 U.S. at 496-97.

Riddle, in which the Tenth Circuit invalidated a Colorado statute as a violation of the Equal Protection Clause of the Fourteenth Amendment to the Constitution of the United States, 742 F.3d at 930, is likewise no help to the petitioners. The state law at issue set a lower limit on contributions to write-in candidates ($200) than to major-party candidates ($400). *Id.* at 924, 926. The court determined those limits were "ill-conceived" to advance the State's claimed interest in preventing corruption or its appearance: "The statutory classification might advance the State's asserted interest if write-ins, unaffiliated candidates, or minor-party nominees were more corruptible (or appeared more corruptible) than their Republican or Democratic opponents. But the Defendants have never made such a suggestion." *Id.* at 928. In stark contrast, the SEC, in keeping with our observation in *Wagner v. FEC*, 793 F.3d at 22-23, persuasively counters that an elected official who can influence the award of contracts is indeed more susceptible to corruption than an opponent who cannot exert the same influence. Accordingly, we agree with the SEC that any disparate effect from Rule 2030 is a feature, not a flaw, of the narrow tailoring of the Rule; hence the Rule is indeed closely drawn to fit the important governmental interest behind it.

III. Conclusion

For the reasons set out in Part II above, we hold the NGYOP has standing to sue. On the merits, we conclude the SEC (1) had the authority to adopt Rule 2030, (2) has justified doing so based upon both specific instances of quid pro quo corruption and upon the inherent tendency toward an appearance of corruption arising from the targeted contributions of placement agents; and (3) has shown the Rule does not violate the First Amendment because it was closely drawn to advance a sufficiently important governmental interest. For those reasons the petition for review is

Denied.

SENTELLE, *Senior Circuit Judge*, dissenting: I do not join my colleagues in the judgment denying this petition, not because I would grant the petition, but because I would dispense with it by dismissal for want of jurisdiction. As the Supreme Court reminds us, in order to bring an action in federal court a petitioner carries the burden of establishing that it has standing to bring the action. *See, e.g.*, *Susan B. Anthony List v. Driehaus*, 573 U.S. 149, 158 (2014). To establish standing, the petitioners would have to show (1) that they have suffered an injury-in-fact; (2) that injury was caused by the challenged conduct of the defendant or respondent; and (3) that a favorable decision in the litigation would likely provide redress for the injury. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560–61 (1992). Petitioners have failed to meet the first and most basic step of this three-part constitutional minimum, as well as the second. First, they have established no injury-in-fact.

The majority opinion sets forth the facts underlying this litigation. I have no quarrel with their understanding of the facts, but reach a different legal conclusion based on the facts before the court. I therefore will make reference to the facts only as necessary to support my legal reasoning. As the majority acknowledges, neither petitioner's conduct is regulated by the respondent's action, Rule 2030, and therefore they do not claim the near-automatic standing of a regulated entity. Petitioners assert instead that NYGOP has established standing on the theory that an organization is "harmed if its contributors cease giving it money." *See Taxation with Representation of Washington v. Regan*, 676 F.2d 715, 723 (D.C. Cir. 1982), *rev'd on other grounds*, 461 U.S. 540 (1983). While this may be a valid theory, it simply does not apply to this case. Neither of petitioners has shown that any contributor has stopped contributing because of the action of the Securities and Exchange Commission.

For a harm to meet the standard for the first requirement of standing, it must be an actual or at least "certainly impending" injury. *Clapper v. Amnesty Int'l USA*, 568 U.S. 398, 401 (2013). The Supreme Court has, as the majority notes, given a slightly relaxed construction to the effect of the "certainly impending" standard by recognizing that a petitioner may cross the bar of the first standing requirement by establishing a "substantial risk" that the anticipated harm will occur. *See Susan B. Anthony*, 573 U.S. at 158. Nonetheless, the very language of the Supreme Court in *Susan B. Anthony* establishes that for the risk of an anticipated harm to substitute for actual injury at the first step of the standing analysis, that risk must not only exist but be substantial. Petitioners have not carried the burden of establishing a substantial risk.

In an attempt to meet its weighty burden, NYGOP has submitted the affidavit of Francis Calcagno, a placement agent covered by Rule 2030. Calcagno cannot attest to any injury-in-fact that has occurred to the petitioners, but only swears that if it were not for the SEC's rule he would solicit contributions for the NYGOP from his friends, family, and other contacts. As the majority recognizes, he cannot attest with certainty that any of his contacts would contribute to petitioners in the absence of the rule.

Petitioners argue that the affidavit brings them within the precedent of *Taxation with Representation*. However, that case only held that standing is established for an organization "if its contributors cease giving it money." Calcagno's affidavit establishes no such facts. At most, it establishes that he believes that if it were not for the rule he would speak to unnamed contacts, friends, and relatives on behalf of the petitioners, and that some of those unnamed contacts, friends, or relatives could contribute. This is not the establishment of a substantial risk. This is at most speculation.

Many cases hold that speculation is not the same as establishing injury-in-fact for purposes of standing. "Although imminence is concededly a somewhat elastic concept, it cannot be stretched beyond its purpose, which is to ensure that the alleged injury is not too speculative for Article III purposes—that the injury is *certainly* impending." *Clapper*, 568 U.S. at 409 (citing *Lujan*, 504 U.S. at 565 n.2). Thus, we have repeatedly reiterated that "threatened injury must be *certainly impending* to constitute injury in fact, and [] allegations of *possible* future injury are not sufficient." *Id*. at 398 (internal quotations omitted).

Petitioners' argument for standing does not survive examination as required by *Clapper*. Their "theory of *future* injury is too speculative to satisfy the well-established requirement that threatened injury must be 'certainly impending.'" *Id.* at 401 (quoting *Whitmore v. Arkansas*, 495 U.S. 149, 158 (1990)).

Even if the majority is correct in its holding that this is a sufficient showing of injury, petitioners' claims founder on the second step of the standing analysis. That is, even if petitioners have established that they suffer injury-in-fact, they have not established that the injury-in-fact is caused by the act of respondent. Both this court and the Supreme Court have held that when the establishment of injury depends on the volitional act of a third party, the claimant has not established standing as against the respondent.

Again, I would follow the teachings of the Supreme Court. In *Clapper* the Court stated, "[w]e decline to abandon our usual reluctance to endorse standing theories that rest on speculation about the decisions of independent actors." 568 U.S. at 414.

To summarize, as the Supreme Court did in *Clapper*, petitioners "bear the burden of pleading and proving concrete facts showing that the defendant's actual action has caused the substantial risk of harm. Plaintiffs cannot rely on speculation about 'the unfettered choices made by independent actors not before the court.'" *Id.* at 414 n.5 (quoting *Lujan*, 504 U.S. at 562).

Therefore, rather than deny the petition, I would dismiss it for want of jurisdiction.

APPENDIX D

SECURITIES AND EXCHANGE COMMISSION

Federal Register/Vol. 80, No. 250/
Wednesday, December 30, 2015/Notices

[Release No. 34–76767;
File No. SR–FINRA–2015–056]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Adopt FINRA Rule 2030 and FINRA Rule 4580 To Establish "Pay-To-Play" and Related Rules

December 24, 2015

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act," "Exchange Act" or "SEA")[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on December 16, 2015, Financial Industry Regulatory Authority, Inc. filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to adopt FINRA Rules 2030 (Engaging in Distribution and Solicitation Activities

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

with Government Entities)[3] and 4580 (Books and Records Requirements for Government Distribution and Solicitation Activities) to establish "pay-to-play"[4] and related rules that would regulate the activities of member firms that engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers.

The text of the proposed rule change is available on FINRA's Web site at *http://www.finra.org*, at the principal office of FINRA and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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[3] FINRA published the proposed rule change as FINRA Rule 2390 in *Regulatory Notice* 14–50 (Nov. 2014) ("*Regulatory Notice* 14–50"). FINRA has determined that the proposed rule change is more appropriately categorized under the FINRA Rule 2000 Series relating to "Duties and Conflicts."

[4] "Pay-to-play" practices typically involve a person making cash or in-kind political contributions (or soliciting or coordinating others to make such contributions) to help finance the election campaigns of state or local officials or bond ballot initiatives as a quid pro quo for the receipt of government contracts.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Background & Discussion

In July 2010, the SEC adopted Rule 206(4)–5 under the Investment Advisers Act of 1940 ("Advisers Act") addressing pay-to-play practices by investment advisers (the "SEC Pay-to-Play Rule").[5]

The SEC Pay-to-Play Rule prohibits an investment adviser from providing advisory services for compensation to a government entity for two years after the adviser or its covered associates make a contribution to an official of the government entity, unless an exception or exemption applies. In addition, it prohibits an investment adviser from soliciting from others, or coordinating, contributions to government entity officials or payments to political parties where the adviser is providing or seeking to provide investment advisory services to a government entity.

The SEC Pay-to-Play Rule also prohibits an investment adviser and its covered associates from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of the investment

[5] *See* Advisers Act Release No. 3043 (July 1, 2010), 75 FR 41018 (July 14, 2010) (Political Contributions by Certain Investment Advisers) ("SEC Pay-to-Play Rule Adopting Release"). *See also* Advisers Act Release No. 3221 (June 22, 2011), 76 FR 42950 (July 19, 2011) (Rules Implementing Amendments to the Investment Advisers Act of 1940); Advisers Act Release No. 3418 (June 8, 2012), 77 FR 35263 (June 13, 2012) (Political Contributions by Certain Investment Advisers; Ban on Third Party Solicitation; Extension of Compliance Date).

adviser unless the person is a "regulated person." A "regulated person" includes a member firm, provided that: (a) FINRA rules prohibit member firms from engaging in distribution or solicitation activities if political contributions have been made; and (b) the SEC finds, by order, that such rules impose substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and that such rules are consistent with the objectives of the SEC Pay-to-Play Rule.[6] The SEC stated that this SEC ban on third-party solicitations would be effective nine months after the compliance date of a final rule adopted by the SEC by which municipal advisors must register under the Exchange Act.[7] The SEC adopted such a final rule on September 20, 2013, with a compliance date of July 1, 2014.[8]

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[6] *See* SEC Pay-to-Play Rule 206(4)–5(f)(9). A "regulated person" also includes SEC registered investment advisers and SEC-registered municipal advisors, subject to specified conditions.

[7] *See* Advisers Act Release No. 3418 (June 8, 2012), 77 FR 35263 (June 13, 2012).

[8] *See* Exchange Act Release No. 70462 (Sept. 20, 2013), 78 FR 67468 (Nov. 12, 2013) (Registration of Municipal Advisors). On June 25, 2015, the SEC issued notice of the compliance date for its third party solicitation ban as July 31, 2015. *See* Advisers Act Release No. 4129 (June 25, 2015), 80 FR 37538 (July 1, 2015). In addition, staff of the Division of Investment Management added Question I.4 to its Staff Responses to Questions About the Pay to Play Rule stating, among other things, that until the later of (i) the effective date of a FINRA pay-to-play rule or (ii) the effective date of an MSRB pay-to-play rule, the Division of Investment Management would not recommend enforcement action to the Commission against an investment adviser or its covered associates under SEC Pay-to-Play Rule 206(4)–5(a)(2)(i) for the payment to any person to solicit a government entity for investment advisory services. *See https://www.sec.gov/divisions/investment/pay-to-play-faq.htm*. *See also infra Effective Date,* for a more

Based on this regulatory framework, FINRA is proposing a pay-to-play rule, Rule 2030, modeled on the SEC Pay-to-Play Rule that would impose substantially equivalent restrictions on member firms engaging in distribution or solicitation activities to those the SEC Pay-to-Play Rule imposes on investment advisers. FINRA is also proposing rules that would impose recordkeeping requirements on member firms in connection with political contributions.[9]

The proposed rules would establish a comprehensive regime to regulate the activities of member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers. FINRA believes that establishing requirements for member firms that are modeled on the SEC's Pay-to-Play-Rule is a more effective regulatory response to the concerns the SEC identified in the SEC Pay-to-Play Rule Adopting Release regarding third-party solicitations than an outright ban on such activity. For example, in the SEC Pay-to-Play Rule Adopting Release, the SEC stated that solicitors [10] or "placement agents"[11] have played a central role in actions that it

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detailed discussion regarding the effective date of FINRA Rules 2030 and 4580.

[9] In connection with the adoption of the SEC Pay-to-Play Rule, the Commission also adopted recordkeeping requirements related to political contributions by investment advisers and their covered associates. *See* Advisers Act Rule 204–2(a)(18) and (h)(1).

[10] "Solicitors" typically locate investment advisory clients on behalf of an investment adviser. *See* Advisers Act Release No. 2910 (Aug. 3, 2009), 74 FR 39840, 39853 n.137 (Aug. 7, 2009) (Political Contributions by Certain Investment Advisers).

[11] "Placement agents" typically specialize in finding investors (often institutional investors or high net worth investors) that are

and other authorities have brought involving pay-to-play schemes.[12] The SEC noted that in several instances, advisers allegedly made significant payments to placement agents and other intermediaries to influence the award of advisory contracts.[13] The SEC also acknowledged the difficulties that advisers face in monitoring or controlling the activities of their third-party solicitors.[14] Accordingly, the proposed rules are intended to enable member firms to continue to engage in distribution and solicitation activities with government entities on behalf of investment advisers while at the same time deterring member firms from engaging in pay-to-play practices.[15]

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willing and able to invest in a private offering of securities on behalf of the issuer of such privately offered securities. *See id.*

[12] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41037 (discussing the reasons for proposing a ban on using third parties to solicit government business).

[13] *See id.*

[14] *See id.*

[15] In response to a request from SEC staff, FINRA previously indicated its intent to prepare rules for consideration by the SEC that would prohibit its member firms from soliciting advisory business from a government entity on behalf of an adviser unless the member firms comply with requirements prohibiting pay-to-play practices. *See* Letter from Andrew J. Donohue, Director, Division of Investment Management, SEC, to Richard G. Ketchum, Chairman & CEO, FINRA (Dec. 18, 2009), available at *http://www.sec.gov/comments/s7-18-09/s71809-252.pdf* (requesting whether FINRA would consider adopting a rule preventing pay-to-play activities by registered broker-dealers acting as legitimate placement agents on behalf of investment advisers). *See also* Letter from Richard G. Ketchum, Chairman & CEO, FINRA, to Andrew J. Donohue, Director, Division of Investment Management, SEC (Mar. 15, 2010), available at *http://www.sec.gov/comments/s7-18-09/s71809-260.pdf* (stating "[w]e believe that a regulatory scheme targeting improper pay to play practices

FINRA sought comment on the proposed rule change in *Regulatory Notice* 14–50.[16] As discussed further in Item II.C below, commenters were generally supportive of the proposed rule change, but also expressed some concerns. In considering the comments, FINRA has engaged in discussions with SEC staff. In addition, as discussed in Item II.B below, FINRA has engaged in an analysis of the potential economic impacts of the proposed rule change. As a result, FINRA has revised the proposed rule change as published in *Regulatory Notice* 14–50. In particular, as discussed in more detail in Item II.C, FINRA has determined not to propose a disclosure requirement for government distribution and solicitation activities at this time. In addition, FINRA has determined not to propose a disgorgement requirement as part of the pay-to-play rule. FINRA believes that these revisions will more closely align FINRA's proposed pay-to-play rule with the SEC Pay-to-Play Rule and help reduce cost and compliance burden concerns raised by commenters.

The proposed rule change, as revised in response to comments on *Regulatory Notice* 14–50, is set forth in further detail below.

Proposed Pay-to-Play Rule

A. Two-Year Time Outcourt of appeals

Proposed Rule 2030(a) would prohibit a covered member from engaging in distribution[17] or solicita-

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by broker-dealers acting on behalf of investment advisers is . . . a viable solution to a ban on certain private placement agents serving a legitimate function").

[16] *See supra* note 3.

[17] As discussed in Item II.C below, FINRA is not eliminating the term "distribution" from the proposed rule as suggested by some commenters. Thus, subject to the limitations discussed in

tion[18] activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by the covered member or a covered associate (including a person who becomes a covered associate within two years after the contribution is made). As discussed in more detail below, the terms and scope of this prohibition are modeled on the SEC Pay-to-Play Rule.[19]

Item II.C, the proposed rule would apply to covered members engaging in distribution (as well as solicitation) activities with government entities. Specifically, the proposed rule would apply to distribution activities involving unregistered pooled investment vehicles such as hedge funds, private equity funds, venture capital funds, and collective investment trusts, and registered pooled investment vehicles such as mutual funds, but only if those registered pools are an investment option of a participant-directed plan or program of a government entity.

[18] Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(11) defines the term "solicit" to mean: "(A) With respect to investment advisory services, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser; and (B) With respect to a contribution or payment, to communicate, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment." The determination of whether a particular communication would be a solicitation would depend on the facts and circumstances relating to such communication. As a general proposition, any communication made under circumstances reasonably calculated to obtain or retain an advisory client would be considered a solicitation unless the circumstances otherwise indicate that the communication does not have the purpose of obtaining or retaining an advisory client. *See also infra* note 40.

[19] *See* SEC Pay-to-Play Rule 206(4)–5(a)(1).

The proposed rule would not ban or limit the amount of political contributions a covered member or its covered associates could make. Instead, it would impose a two-year time out on engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser after the covered member or its covered associates make a contribution to an official of the government entity. Consistent with the two-year time out in the SEC Pay-to-Play Rule, the two-year time out in the proposed rule is intended to discourage covered members from participating in pay-to-play practices by requiring a cooling-off period during which the effects of a political contribution on the selection process can be expected to dissipate.

1. Covered Members

Proposed Rule 2030(g)(4) defines a "covered member" to mean "any member except when that member is engaging in activities that would cause the member to be a municipal advisor as defined in Exchange Act Section 15B(e)(4), SEA Rule 15Ba1–1(d)(1) through (4) and other rules and regulations thereunder." As noted above, the SEC Pay-to-Play Rule includes within its definition of "regulated person" SEC-registered municipal advisors, subject to specified conditions.[20] Specifically, the SEC Pay-to-Play Rule prohibits an investment adviser from providing or agreeing to provide, directly or indirectly, payment to an SEC-registered municipal advisor unless the municipal advisor is subject to a Municipal Securities Rulemaking Board ("MSRB") pay-to-play rule.[21]

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[20] *See supra* note 6.

[21] *See* SEC Pay-to-Play Rule 206(4)–5(a)(2)(i)(A) and 206(4)–5(f)(9).

A member firm that solicits a government entity for investment advisory services on behalf of an unaffiliated investment adviser may be required to register with the SEC as a municipal advisor as a result of such activity.[22] Under such circumstances, MSRB rules applicable to municipal advisors, including any pay-to-play rule adopted by the MSRB, would apply to the member firm.[23] On the other hand, if the member firm solicits a government entity on behalf of an affiliated investment adviser, such activity would not cause the firm to be a municipal advisor. Under such circumstances, the member firm would be a

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[22] *See* Exchange Act Section 15B(e)(9) and Rule 15Ba1–1(n) thereunder (defining "solicitation of a municipal entity or obligated person" to mean "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser . . . that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity.")

[23] On August 18, 2014, the MSRB issued a *Regulatory Notice* requesting comment on draft amendments to MSRB Rule G–37, on political contributions made by brokers, dealers and municipal securities dealers and prohibitions on municipal securities business, to extend the rule to cover municipal advisors. *See* MSRB *Regulatory Notice* 2014–15 (Aug. 2014). MSRB Rule G–37 was approved by the Commission in 1994 and, since that time, has prohibited brokers, dealers and municipal securities dealers engaging in municipal securities business from participating in pay-to-play practices. *See* Exchange Act Release No. 33868 (Apr. 7, 1994), 59 FR 17621 (Apr. 13, 1994) (Order Approving File No. SR–MSRB–94–2).

"covered member" subject to the requirements of proposed Rule 2030.[24]

2. Investment Advisers

The proposed rule would apply to covered members acting on behalf of any investment adviser registered (or required to be registered) with the SEC, or unregistered in reliance on the exemption available under Section 203(b)(3) of the Advisers Act for foreign private advisers, or that is an exempt reporting adviser under Advisers Act Rule 204–4(a).[25] Thus, it would not apply to member firms acting on behalf of advisers that are registered with state securities authorities instead of the SEC, or advisers that are unregistered in reliance on exemptions other than Section 203(b)(3) of the Advisers Act. The proposed rule's definition of "investment adviser" is consistent with the definition of "investment adviser" in the SEC Pay-to-Play Rule.[26]

3. Official of a Government Entity

An official of a government entity would include an incumbent, candidate or successful candidate for

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[24] FINRA notes that a person that is registered under the Exchange Act as a broker-dealer and municipal advisor, and under the Advisers Act as an investment adviser could potentially be a "regulated person" for purposes of the SEC Pay-to-Play Rule. Such a regulated person would be subject to the rules that apply to the services the regulated person is performing. *See also supra* note 23 (noting that brokers, dealers and municipal securities dealers engaging in municipal securities business are subject to MSRB Rule G–37).

[25] *See* proposed Rule 2030(g)(7).

[26] *See* SEC Pay-to-Play Rule 206(4)–5(a)(1). FINRA notes that, consistent with the SEC Pay-to-Play Rule, the proposed rule would not apply to state-registered investment advisers as few of these smaller firms manage public pension plans or other similar funds. *See also infra* note 98 and accompanying text.

elective office of a government entity if the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser or 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.[27] Government entities would include all state and local governments, their agencies and instrumentalities, and all public pension plans and other collective government funds, including participant-directed plans such as 403(b),[28] 457,[29] and 529 plans.[30]

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[27] Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(8) defines an "official" to mean "any person (including any election committee for the person) who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of a government entity, if the office: (A) Is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity; or (B) 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."

[28] A 403(b) plan is a tax-deferred employee benefit retirement plan established under Section 403(b) of the Internal Revenue Code of 1986 (26 U.S.C. 403(b)).

[29] A 457 plan is a tax-deferred employee benefit retirement plan established under Section 457 of the Internal Revenue Code of 1986 (26 U.S.C. 457).

[30] A 529 plan is a "qualified tuition plan" established under Section 529 of the Internal Revenue Code of 1986 (26 U.S.C. 529). Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(6) defines a "government entity" to mean "any state or political subdivision of a state, including: (A) Any agency, authority or instrumentality of the state or political subdivision; (B) A pool of assets sponsored or established by the state or political subdivision or any agency, authority or instrumentality thereof, including but not limited to a "defined benefit plan" as defined in Section 414(j) of the Internal Revenue Code, or a state general fund; (C) A plan or program of a government entity; and (D) Officers,

Thus, the two-year time out would be triggered by contributions, not only to elected officials who have legal authority to hire the adviser, but also to elected officials (such as persons with appointment authority) who can influence the hiring of the adviser. As noted in the SEC Pay-to-Play Rule Adopting Release, a person appointed by an elected official is likely to be subject to that official's influences and recommendations. It is the scope of authority of the particular office of an official, not the influence actually exercised by the individual that would determine whether the individual has influence over the awarding of an investment advisory contract under the definition.[31]

4. Contributions

The proposed rule's time out provisions would be triggered by contributions made by a covered member or any of its covered associates. A contribution would include a gift, subscription, loan, advance, deposit of money, or anything of value made for the purpose of influencing the election for a federal, state or local office, including any payments for debts incurred in such an election. It would also include transition or inaugural expenses incurred by a successful candidate for state or local office.[32]

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agents or employees of the state or political subdivision or any agency, authority or instrumentality thereof, acting in their official capacity."

[31] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41029 (discussing the terms "official" and "government entity").

[32] Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(1) defines a "contribution" to mean "any gift, subscription, loan, advance, or deposit of money or anything of value made for: (A) The purpose of influencing any election for federal, state or local office; (B) Payment of debt incurred in connection with

Consistent with the SEC Pay-to-Play Rule, FINRA would not consider a donation of time by an individual to be a contribution, provided the covered member has not solicited the individual's efforts and the covered member's resources, such as office space and telephones, are not used.[33] Similarly, FINRA would not consider a charitable donation made by a covered member to an organization that qualifies for an exemption from federal taxation under the Internal Revenue Code,[34] or its equivalent in a foreign jurisdiction, at the request of an official of a government entity to be a contribution for purposes of the proposed rule.[35]

5. Covered Associates

As stated in the SEC Pay-to-Play Rule Adopting Release, contributions made to influence the selection process are typically made not by the firm itself, but

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any such election; or (C) Transition or inaugural expenses of the successful candidate for state or local office."

[33] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41030. The SEC also noted that a covered associate's donation of his or her time generally would not be viewed as a contribution if such volunteering were to occur during non-work hours, if the covered associate were using vacation time, or if the adviser is not otherwise paying the employee's salary (*e.g.,* an unpaid leave of absence). *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41030 n.157. FINRA would take a similar position in interpreting the proposed rule.

[34] Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. 501(c)(3)) contains a list of charitable organizations that are exempt from Federal income tax.

[35] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41030 (discussing the scope of the term "contribution" under the SEC Pay-to-Play Rule). Note, however, proposed Rule 2030(e) providing that it shall be a violation of Rule 2030 for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of the rule.

by officers and employees of the firm who have a direct economic stake in the business relationship with the government client.[36] Accordingly, consistent with the SEC Pay-to-Play Rule, under the proposed rule, contributions by each of these persons, which the proposed rule describes as "covered associates," would trigger the two-year time out.[37]

Contributions by an executive officer of a covered member would trigger the two-year time out. As discussed in Item II.C below, commenters requested that FINRA define the term "executive officer" for purposes of the proposed pay-to-play rule. Accordingly, consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(5) defines an "executive officer of a covered member" to mean: "(A) The president; (B) Any vice president in charge of a principal business unit, division or function (such as sales, administration or finance); (C) Any other officer of the covered member who performs a policy-making function; or (D) Any other person who performs similar policy-making functions for the covered member." Whether a person is an executive officer would depend on his or her function or activities and not his or her title. For

[36] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41031.

[37] Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(2) defines a "covered associate" to mean: "(A) Any general partner, managing member or executive officer of a covered member, or other individual with a similar status or function; (B) Any associated person of a covered member who engages in distribution or solicitation activities with a government entity for such covered member; (C) Any associated person of a covered member who supervises, directly or indirectly, the government entity distribution or solicitation activities of a person in subparagraph (B) above; and (D) Any political action committee controlled by a covered member or a covered associate."

example, an officer who is a chief executive of a covered member but whose title does not include "president" would nonetheless be an executive officer for purposes of the proposed rule.

In addition, a covered associate would include a political action committee, or PAC, controlled by the covered member or any of its covered associates as a PAC is often used to make political contributions.[38] Under the proposed rule, FINRA would consider a covered member or its covered associates to have "control" over a PAC if the covered member or covered associate has the ability to direct or cause the direction of governance or operations of the PAC.

6. "Look Back"

Consistent with the SEC Pay-to-Play Rule, the proposed rule would attribute to a covered member contributions made by a person within two years (or, in some cases, six months) of becoming a covered associate. This "look back" would apply to any person who becomes a covered associate, including a current employee who has been transferred or promoted to a position covered by the proposed rule. A person would become a "covered associate" for purposes of the proposed rule's "look back" provision at the time he or she is hired or promoted to a position that meets the definition of a "covered associate."

Thus, when an employee becomes a covered associate, the covered member must "look back" in time to that employee's contributions to determine whether the time out applies to the covered member. If, for example, the contributions were made more than two years (or, pursuant to the exception described below

[38] *See id.*

for new covered associates, six months) prior to the employee becoming a covered associate, the time out has run. If the contribution was made less than two years (or six months, as applicable) from the time the person becomes a covered associate, the proposed rule would prohibit the covered member that hires or promotes the contributing covered associate from receiving compensation for engaging in distribution or solicitation activities on behalf of an investment adviser from the hiring or promotion date until the two-year period has run.

In no case would the prohibition imposed be longer than two years from the date the covered associate made the contribution. Thus, if, for example, the covered associate becomes employed (and engages in solicitation activities) one year and six months after the contribution was made, the covered member would be subject to the proposed rule's prohibition for the remaining six months of the two-year period. This "look back" provision, which is consistent with the SEC Pay-to-Play Rule, is designed to prevent covered members from circumventing the rule by influencing the selection process by hiring persons who have made political contributions.[39]

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[39] Similarly, consistent with the SEC Pay-to-Play Rule, to prevent covered members from channeling contributions through departing employees, covered members must "look forward" with respect to covered associates who cease to qualify as covered associates or leave the firm. The covered associate's employer at the time of the contribution would be subject to the proposed rule's prohibition for the entire two-year period, regardless of whether the covered associate remains a covered associate or remains employed by the covered member. Thus, dismissing a covered associate would not relieve the covered member from the two-year time out. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41033 (discussing the "look back" in that rule).

B. Prohibition on Soliciting and Coordinating Contributions

Proposed Rule 2030(b) would prohibit a covered member or covered associate from coordinating or soliciting[40] any person or PAC to make any: (1) Contribution to an official of a government entity in respect of which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an

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[40] Proposed Rule 2030(g)(11)(B) defines the term "solicit" with respect to a contribution or payment as "to communicate, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment." This provision is consistent with a similar provision in the SEC Pay-to-Play Rule. *See* SEC Pay-to-Play Rule 206(4)–5(f)(10)(ii). Consistent with the SEC Pay-to-Play Rule, whether a particular activity involves a solicitation or coordination of a contribution or payment for purposes of the proposed rule would depend on the facts and circumstances. A covered member that consents to the use of its name on fundraising literature for a candidate would be soliciting contributions for that candidate. Similarly, a covered member that sponsors a meeting or conference which features a government official as an attendee or guest speaker and which involves fundraising for the government official would be soliciting contributions for that government official. Expenses incurred by the covered member for hosting the event would be a contribution by the covered member, thereby triggering the two-year ban on the covered member receiving compensation for engaging in distribution or solicitation activities with the government entity over which that official has influence. Such expenses may include, but are not limited to, the cost of the facility, the cost of refreshments, any expenses paid for administrative staff, and the payment or reimbursement of any of the government official's expenses for the event. The *de minimis* exception under proposed Rule 2030(c)(1) would not be available with respect to these expenses because they would have been incurred by the firm, not by a natural person. *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41043 n.328, 329 (discussing the term "solicit" with respect to a contribution or payment).

investment adviser; or (2) payment[41] to a political party of a state or locality of a government entity with which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser. This provision is modeled on a similar provision in the SEC Pay-to-Play Rule [42] and is intended to prevent covered members or covered associates from circumventing the proposed rule's prohibition on direct contributions to certain elected officials such as by "bundling" a large number of small employee contributions to influence an election, or making contributions (or payments) indirectly through a state or local political party.[43]

In addition, as discussed in Item II.C below, in response to a request for clarification from a commenter regarding the application of this provision of the proposed rule, FINRA notes that, consistent with

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[41] Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(9) defines the term "payment" to mean "any gift, subscription, loan, advance or deposit of money or anything of value." This definition is similar to the definition of "contribution," but is broader, in the sense that it does not include limitations on the purposes for which such money is given (*e.g.,* it does not have to be made for the purpose of influencing an election). Consistent with the SEC Pay-to-Play Rule FINRA is including the broader term "payments," as opposed to "contributions," to deter a covered member from circumventing the proposed rule's prohibitions by coordinating indirect contributions to government officials by making payments to political parties. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41043 n.331 and accompanying text (discussing a similar approach with respect to restrictions on soliciting and coordinating contributions and payments).

[42] *See* SEC Pay-to-Play Rule 206(4)–5(a)(2).

[43] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41043 (discussing restrictions on soliciting and coordinating contributions and payments).

guidance provided by the SEC in connection with SEC Pay-to-Play Rule 206(4)–5(a)(2), a direct contribution to a political party by a covered member or its covered associates would not violate the proposed rule unless the contribution was a means for the covered member to do indirectly what the rule would prohibit if done directly (for example, if the contribution was earmarked or known to be provided for the benefit of a particular government official).

C. *Direct or Indirect Contributions or Solicitations*

Proposed Rule 2030(e) further provides that it shall be a violation of Rule 2030 for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of the rule. This provision is consistent with a similar provision in the SEC Pay-to-Play Rule[44] and would prevent a covered member or its covered associates from funneling payments through third parties, including, for example, consultants, attorneys, family members, friends or companies affiliated with the covered member as a means to circumvent the proposed rule.[45] In addition, as discussed in Item II.C below, in response to a request for clarification from a commenter regarding

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[44] *See* SEC Pay-to-Play Rule 206(4)–5(d).

[45] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41044 (discussing direct and indirect contributions or solicitations). This provision would also cover, for example, situations in which contributions by a covered member are made, directed or funded through a third party with an expectation that, as a result of the contributions, another contribution is likely to be made by a third party to "an official of the government entity," for the benefit of the covered member. Contributions made through gatekeepers thus would be considered to be made "indirectly" for purposes of the rule.

the application of this provision of the proposed rule, FINRA notes that, consistent with guidance provided by the SEC in connection with SEC Pay-to-Play Rule 206(4)–5(d), proposed Rule 2030(e) would require a showing of intent to circumvent the rule in order for such persons to trigger the two-year time out.

D. Covered Investment Pools

Proposed Rule 2030(d)(1) provides that a covered member that engages in distribution or solicitation activities with a government entity on behalf of a covered investment pool[46] in which a government entity invests or is solicited to invest shall be treated as though the covered member was engaging in or seeking to engage in distribution or solicitation activities with the government entity on behalf of the investment adviser to the covered investment pool directly.[47]

[46] Consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(3) defines a "covered investment pool" to mean: "(A) Any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity, or (B) Any company that would be an investment company under Section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either Section 3(c)(1), 3(c)(7) or 3(c)(11) of that Act." Thus, the definition includes such unregistered pooled investment vehicles as hedge funds, private equity funds, venture capital funds, and collective investment trusts. It also includes registered pooled investment vehicles, such as mutual funds, but only if those registered pools are an investment option of a participant-directed plan or program of a government entity.

[47] Consistent with the SEC Pay-to-Play Rule, under the proposed rule, if a government entity is an investor in a covered investment pool at the time a contribution triggering a two-year time out is made, the covered member must forgo any compensation related to the assets invested or committed by the government entity in the covered investment pool. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41047.

Proposed Rule 2030(d)(2) provides that an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity.[48]

Proposed Rule 2030(d) is modeled on a similar prohibition in the SEC Pay-to-Play Rule [49] and would apply the prohibitions of the proposed rule to situations in which an investment adviser manages assets of a government entity through a hedge fund or other type of pooled investment vehicle. Thus, the provision would extend the protection of the proposed rule to public pension plans that access the services of investment advisers through hedge funds and other types of pooled investment vehicles sponsored or advised by investment advisers as a funding vehicle or investment option in a government-sponsored plan, such as a "529 plan."[50]

E. Exceptions and Exemptions

As discussed in more detail below, the proposed rule contains exceptions that are modeled on similar exceptions in the SEC Pay-to-Play Rule for *de minimis*

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[48] As discussed in Item II.C below, FINRA has added proposed Rule 2030(d)(2) in response to comments on *Regulatory Notice* 14–50 to clarify, for purposes of the proposed rule, the relationship between an investment adviser to a covered investment pool and a government entity that invests in the covered investment pool.

[49] *See* SEC Pay-to-Play Rule 206(4)–5(c).

[50] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41044 (discussing the applicability of the SEC Pay-to-Play Rule to covered investment pools).

contributions, new covered associates and returned contributions.[51]

In addition, proposed Rule 2030(f) includes an exemptive provision for covered members that is modeled on the exemptive provision in the SEC Pay-to-Play Rule[52] that would allow covered members to apply to FINRA for an exemption from the proposed rule's two-year time out. Under this provision, FINRA would be able to exempt covered members from the proposed rule's time out requirement where the covered member discovers contributions that would trigger the compensation ban after they have been made, and when imposition of the prohibition would be unnecessary to achieve the rule's intended purpose. This provision would provide covered members with an additional avenue by which to seek to cure the consequences of an inadvertent violation by the covered member or its covered associates that falls outside the limits of one of the proposed rule's exceptions. In determining whether to grant an exemption, FINRA would take into account the varying facts and circumstances that each application presents.

1. De Minimis Contributions

Proposed Rule 2030(c)(1) would except from the rule's restrictions contributions made by a covered associate who is a natural person to government entity officials for whom the covered associate was entitled to vote [53] at the time of the contributions, provided the

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[51] *See* SEC Pay-to-Play Rule 206(4)–5(b).

[52] *See* SEC Pay-to-Play Rule 206(4)–5(e).

[53] Consistent with the SEC Pay-to-Play Rule, for purposes of proposed Rule 2030(c)(1), a person would be "entitled to vote" for an official if the person's principal residence is in the locality in which the official seeks election. For example, if a government

contributions do not exceed $350 in the aggregate to any one official per election. If the covered associate was not entitled to vote for the official at the time of the contribution, the contribution must not exceed $150 in the aggregate per election. Consistent with the SEC Pay-to-Play Rule, under both exceptions, primary and general elections would be considered separate elections.[54] These exceptions are based on the theory that such contributions are typically made without the intent or ability to influence the selection process of the investment adviser.

2. New Covered Associates

Proposed Rule 2030(c)(2) would provide an exception from the proposed rule's restrictions for covered members if a natural person made a contribution more than six months prior to becoming a covered associate of the covered member unless the covered associate engages in, or seeks to engage in, distribution or solicitation activities with a government entity on behalf of the covered member. This provision is consistent with a similar provision in the SEC Pay-to-Play Rule.[55] As

official is a state governor running for re-election, any covered associate who resides in that state may make a *de minimis* contribution to the official without causing a ban on the covered member being compensated for engaging in distribution or solicitation activities with that government entity on behalf of an investment adviser. If the government official is running for president, any covered associate in the country would be able to contribute the *de minimis* amount to the official's presidential campaign. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41034 (discussing the applicability in the SEC Pay-to-Play Rule of the exception for *de minimis* contributions).

[54] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41034.

[55] *See* SEC Pay-to-Play Rule 206(4)–5(b)(2).

stated in the SEC Pay-to-Play Rule Adopting Release, the potential link between obtaining advisory business and contributions made by an individual prior to his or her becoming a covered associate who is uninvolved in distribution or solicitation activities is likely more attenuated than for a covered associate who engages in distribution or solicitation activities and, therefore, should be subject to a shorter look-back period.[56] This exception is also intended to balance the need for covered members to be able to make hiring decisions with the need to protect against individuals marketing to prospective employers their connections to, or influence over, government entities the employer might be seeking as clients.[57]

3. Certain Returned Contributions

Proposed Rule 2030(c)(3) would provide an exception from the proposed rule's restrictions for covered members if the restriction is due to a contribution made by a covered associate and: (1) The covered member discovered the contribution within four months of it being made; (2) the contribution was less than $350; and (3) the contribution is returned within 60 days of the discovery of the contribution by the covered member.

Consistent with the SEC Pay-to-Play Rule, this exception would allow a covered member to cure the consequences of an inadvertent political contribution to an official for whom the covered associate is not entitled to vote. As the SEC stated in the SEC Pay-to-Play Rule Adopting Release, the exception is limited to the types of contributions that are less likely to raise

[56] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41034 (discussing the applicability of the "look back" in the SEC Pay-to-Play Rule).

[57] *See id.*

pay-to-play concerns.[58] The prompt return of the contribution provides an indication that the contribution would not affect a government entity official's decision to award business. The 60-day limit is designed to give contributors sufficient time to seek the contribution's return, but still require that they do so in a timely manner. In addition, the relatively small amount of the contribution, in conjunction with the other conditions of the exception, suggests that the contribution was unlikely to have been made for the purpose of influencing the selection process. Repeated triggering contributions suggest otherwise. Thus, the proposed rule would provide that covered members with 150 or fewer registered representatives would be able to rely on this exception no more than two times per calendar year. All other covered members would be permitted to rely on this exception no more than three times per calendar year. In addition, a covered member would not be able to rely on an exception more than once with respect to contributions by the same covered associate regardless of the time period. These limitations are consistent with similar provisions in the SEC Pay-to-Play Rule.[59]

Proposed Recordkeeping Requirements

Proposed Rule 4580 would require covered members that engage in distribution or solicitation activities with a government entity on behalf of any investment adviser that provides or is seeking to provide investment

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[58] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41035.

[59] *See* SEC Pay-to-Play Rule 206(4)–5(b)(3). The SEC Pay-to-Play Rule includes different allowances for larger and smaller investment advisers based on the number of employees they report on Form ADV.

advisory services to such government entity to maintain books and records that would allow FINRA to examine for compliance with its pay-to-play rule. This provision is consistent with similar recordkeeping requirements imposed on investment advisers in connection with the SEC Pay-to-Play Rule.[60] The proposed rule would require covered members to maintain a list or other record of:

- The names, titles and business and residence addresses of all covered associates;
- the name and business address of each investment adviser on behalf of which the covered member has engaged in distribution or solicitation activities with a government entity within the past five years (but not prior to the rule's effective date);
- the name and business address of all government entities with which the covered member has engaged in distribution or solicitation activities for compensation[61] on behalf of an investment adviser, or which are or were investors in any covered investment pool on behalf of which the covered member has engaged in distribution or solicitation activities with the government entity on behalf of the investment adviser to the covered investment pool, within the past five years (but not prior to the rule's effective date); and

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[60] *See* Advisers Act Rule 204–2(a)(18) and (h)(1).

[61] As discussed in Item II.C below, FINRA has added "for compensation" to proposed Rule 4580(a)(3) to clarify that, consistent with the SEC recordkeeping requirements, FINRA's proposed recordkeeping requirements would apply only to government entities that become clients.

- all direct or indirect contributions made by the covered member or any of its covered associates to an official of a government entity, or direct or indirect payments to a political party of a state or political subdivision thereof, or to a PAC.

The proposed rule would require that the direct and indirect contributions or payments made by the covered member or any of its covered associates be listed in chronological order and indicate the name and title of each contributor and each recipient of the contribution or payment, as well as the amount and date of each contribution or payment, and whether the contribution was the subject of the exception for returned contributions in proposed Rule 2030.

Effective Date

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a *Regulatory Notice* to be published no later than 60 days following Commission approval. FINRA intends to establish an effective date that is no sooner than 180 days following publication of the *Regulatory Notice* announcing Commission approval of the proposed rule change, and no later than 365 days following Commission approval of the proposed rule change. This transition period will provide member firms with time to identify their covered associates and government entity clients and to modify their compliance programs to address new obligations under the rules.

Proposed Rule 2030(a)'s prohibition on engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution is made to the government entity, will not be triggered by contributions made prior to the effective date. Similarly, the prohibition will not apply to contributions made prior to the effective date by new covered associates to which the two years or, as applicable, six months "look back" applies.

As of the effective date, member firms must begin to maintain books and records in compliance with proposed Rule 4580. Member firms will not be required, however, to look back for the five years prior to the effective date of the proposed rule to identify investment advisers and government entity clients in accordance with proposed Rule 4580(a)(2) and (a)(3).

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,[62] which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

FINRA believes that the proposed rule change establishes a comprehensive regime to allow member firms to continue to engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers following the compliance date for the SEC's ban on third-party solicitations while deterring member firms from engaging in pay-to-play practices. In the absence of a FINRA pay-to-play rule, covered members will be prohibited from receiving compensation for engaging in distribution

[62] 15 U.S.C. 78*o*–3(b)(6).

and solicitation activities with government entities on behalf of investment advisers. FINRA believes that establishing a pay-to-play rule modeled on the SEC Pay-to-Play Rule is a more effective regulatory response to the concerns identified by the SEC regarding third-party solicitations than an outright ban on such activity. At the same time, FINRA believes that the proposed two-year time out will deter member firms from engaging in pay-to-play practices and, thereby, protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

As discussed above, FINRA published *Regulatory Notice* 14–50 to request comment on the proposed rule change.[63] *Regulatory Notice* 14–50 included an analysis of the economic impacts of the proposed rule change and requested comment regarding the analysis. The assessment below includes a summary of the comments received regarding the economic impact of the proposed rule change as set forth in *Regulatory Notice* 14–50 as well as FINRA's responses to the comments.[64]

Economic Impact Assessment

A. Need for the Rule

As discussed above, the SEC Pay-to-Play Rule prohibits an investment adviser and its covered associates

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[63] *See supra* note 3.

[64] All references to commenters are to comment letters as listed in Exhibit 2b and as further discussed in Item II.C of this filing.

from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless the person is a "regulated person." A "regulated person" includes a member firm, provided that: (a) FINRA rules prohibit member firms from engaging in distribution or solicitation activities if political contributions have been made; and (b) the SEC finds, by order, that such rules impose substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and that such rules are consistent with the objectives of the SEC Pay-to-Play Rule. Thus, FINRA must propose its own pay-to-play rule to enable member firms to continue to engage in distribution and solicitation activities for compensation with government entities on behalf of investment advisers.

B. Regulatory Objective

The proposed rule change would establish a comprehensive regime to regulate the activities of member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers. FINRA aims to enable member firms to continue to engage in such activities for compensation while at the same time deterring member firms from engaging in pay-to-play practices.

C. Economic Baseline

The baseline used to evaluate the impact of the proposed rule change is the regulatory framework under the SEC Pay-to-Play Rule and the MSRB pay-to-play rules.[65] In the absence of the proposed rules,

[65] *See supra* note 23 (discussing MSRB Rule G–37).

some member firms currently engaging in distribution or solicitation activities with government entities on behalf of investment advisers may not be able to receive payments from investment advisers for engaging in such activities. Since a "regulated person" also includes SEC-registered investment advisers and SEC-registered municipal advisors that would be subject to MSRB pay-to-play rules, member firms dually-registered with the SEC as investment advisers or municipal advisors may be able to engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers.[66]

The member firms that would have to cease their distribution or solicitation activities for compensation with government entities on behalf of investment advisers may bear direct losses as a result of the loss of this business. In addition, the absence of a FINRA pay-to-play rule that the SEC finds by order is substantially equivalent to or more stringent than the SEC Pay-to-Play Rule may impact investment advisers and public pension plans.

Specifically, without such a rule, there could be a decrease in the number of third-party solicitors which may reduce the competition in the market for solicitation services. Some investment advisers may need to search for and hire new solicitors as a result of the absence of a FINRA pay-to-play rule to continue their solicitation activities. Due to the potentially limited capacity of third-party solicitors, investment advisers may encounter difficulties in retaining solicitors or

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[66] *See supra* note 24 (noting that a regulated person that is registered under the Exchange Act as a broker-dealer and municipal advisor, and under the Advisers Act as an investment adviser would be subject to the rules that apply to the services the regulated person is performing).

delays in solicitation services. These changes would likely increase the costs to investment advisers that rely on third-party solicitors to obtain government clients.

To the extent that higher costs may reduce the number of investment advisers competing for government business, public pension plans may face more limited investment opportunities. In such an instance, there may be an opportunity cost to a government entity either as it may not invest its assets optimally, or when seeking capital due to limitations on its access to funding.

D. Economic Impacts

1. Benefits

The proposed rule change would enable member firms to continue to engage in distribution or solicitation activities for compensation with government entities on behalf of investment advisers within the regulatory boundaries of the proposed rule change. The proposed rule change would prevent a potentially harmful disruption in the member firms' solicitation business, and accordingly may help member firms avoid some of the likely losses associated with the absence of such a rule change. The proposed rule change may also help promote competition by allowing more third-party solicitors to participate in the market for solicitation services, which may in turn reduce costs to investment advisers and improve competition for advisory services.

The proposed rule change is intended to establish a comprehensive regime to allow member firms to continue to engage in distribution or solicitation activities with government entities on behalf of investment advisers while deterring member firms from engaging in pay-to-play practices. FINRA believes the proposed rules would curb fraudulent conduct resulting from pay-to-play practices and, therefore, help promote fair competition in the market and protect public pension funds and investors. FINRA also believes the proposed rules would likely reduce the search costs of government entities and increase their ability to efficiently allocate capital, and thereby would promote capital formation.

2. Costs

FINRA recognizes that covered members that engage in distribution or solicitation activities with government entities on behalf of investment advisers would incur costs to comply with the proposed rules on an initial and ongoing basis. Member firms would need to establish and maintain policies and procedures to monitor contributions the firm and its covered associates make and to ensure compliance with the proposed requirements. In addition, member firms that wish to engage in distribution or solicitation activities with government entities may face hiring constraints as a result of the two-year (or, in some cases, six months) "look back" provision.[67]

The compliance costs would likely vary across member firms based on a number of factors such as the number of covered associates, business models of member firms and the extent to which their compliance procedures are automated, whether the covered member is (or is affiliated with) an investment adviser subject to the SEC Pay-to-Play Rule, and whether the

[67] FINRA notes, however, the availability of the exemptive provision in proposed Rule 2030(f) that would allow covered members to apply to FINRA for an exemption from the proposed rule's two-year time out.

covered member is a registered municipal securities dealer and thus subject to MSRB pay-to-play rules.[68] A small covered member with fewer covered associates may expend fewer resources to comply with the proposed rules than a large covered member. Covered members subject to (or affiliated with entities subject to) the SEC Pay-to-Play Rule or MSRB pay-to-play rules may be able to borrow from or build upon compliance procedures already in place. For example, FINRA estimates that approximately 400 member firms are currently subject to the MSRB pay-to-play rules.

The potential burden arising from compliance costs associated with the proposed rules can be initially gauged from the SEC's cost estimates for the SEC Pay-to-Play Rule. The SEC has estimated that investment advisers would spend between 8 and 250 hours to establish policies and procedures to comply with the SEC Pay-to-Play Rule.[69] The SEC further estimated that ongoing compliance would require between 10 and 1,000 hours annually.[70] The SEC estimated compliance costs for firms of different sizes. The SEC assumed that a "smaller firm" would have fewer than five covered associates that would be subject to the SEC Pay-to-Play Rule, a "medium firm" would have between five and 15 covered associates, and a "larger firm" would have more than 15 covered associates.[71] The SEC estimated that the initial compliance costs associated with the SEC Pay-to-Play Rule would be

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[68] *See supra* note 23 (discussing MSRB Rule G–37).

[69] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41056.

[70] *See id.*

[71] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41055.

approximately $2,352 per smaller firm, $29,407 per medium firm, and $58,813 per larger firm.[72] It also estimated that the annual, ongoing compliance expenses would be approximately $2,940 per smaller firm, $117,625 per medium firm, and $235,250 per larger firm.[73]

In addition, the SEC estimated the costs for investment advisers to engage outside legal services to assist in drafting policies and procedures. It estimated that 75 percent of larger advisory firms, 50 percent of medium firms, and 25 percent of smaller firms subject to the SEC Pay-to-Play Rule would engage such services.[74] The estimated cost included fees for approximately 8 hours of outside legal review for a smaller firm, 16 hours for a medium firm and 40 hours for a larger firm, at a rate of $400 per hour.[75]

The SEC estimated that the recordkeeping requirements of the SEC Pay-to-Play Rule would increase an investment adviser's burden by approximately 2 hours per year,[76] which would cost the adviser $118 per year based on the SEC's assumption of a compliance clerk's hourly rate of $59.[77] In addition, the SEC estimated that some small and medium firms would incur one-time start-up costs, on average, of $10,000, and larger firms would incur, on average, $100,000 to establish or

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[72] *See supra* note 69.

[73] *See id.*

[74] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41057.

[75] *See id.*

[76] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41063.

[77] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41061 n.541.

enhance current systems to assist in their compliance with the recordkeeping requirements.[78]

FINRA requested comment on the economic impacts of the proposed rule change as set forth in *Regulatory Notice* 14–50, including on whether the proposed rule change would impose similar compliance costs on member firms as the SEC estimated for investment advisers. Several commenters raised cost and compliance burden concerns in connection with the disclosure requirements set forth in *Regulatory Notice* 14–50, stating among other things, that the disclosure requirements are "overly burdensome and create difficult compliance challenges"[79] and that FINRA's cost estimates in *Regulatory Notice* 14–50 "do not accurately reflect the true compliance costs associated with the Proposed Rules, and particularly the costs associated with the disclosure requirements . . . ."[80]

Monument Group stated that the vast majority of independent placement agents that would be subject to the proposed rules are small businesses, many of which are minority- or women-owned. Monument Group stated that these firms operate with focused staff and no revenues from other lines of business. Accordingly, Monument Group stated that incremental regulatory requirements that have little impact on larger firms can create significant resource and cost issues for these smaller firms. Specifically, Monument Group stated that the disclosure requirements would place significant and unique burdens on independent third-party private fund placement agents. Another commenter, 3PM, stated that the proposed rule

[78] *See supra* note 76.

[79] Monument Group.

[80] SIFMA.

change would add a new and significant burden on small firms in terms of the disclosure and record-keeping requirements. 3PM also stated that not only would small firms be impacted by cost, but also by their limited personnel resources who would have to take on additional responsibilities to comply with the proposed rule change.

Monument Group requested that FINRA consider the already existing state, municipal and local lobbying registration, disclosure and reporting requirements and pay-to-play regimes in calculating the cost and competitive impact of the proposed rule change. Monument Group stated that the proposed rule change disproportionately affects FINRA-registered placement agents (as compared with other broker-dealers) and has the largest economic and anti-competitive effect on small independent firms.

As discussed above and in more detail in Item II.C below, after considering the comments, FINRA has determined not to propose a disclosure requirement for government distribution and solicitation activities at this time. FINRA believes that this determination will reduce substantially the cost and compliance burden concerns raised by commenters regarding the proposed rule change. FINRA however may consider a disclosure requirement for government distribution and solicitation activities as part of a future rulemaking and would consider the economic impact of any such revised proposed disclosure requirement as part of that rulemaking.

Although FINRA has determined to retain a recordkeeping requirement, FINRA notes that, in response to commenter concerns to *Regulatory Notice* 14–50 regarding the significant costs associated with maintaining lists of unsuccessful solicitations,[81] FINRA has modified the proposed rule such that covered members would only be required to maintain lists of government entities that become clients.[82]

Since the scope of the proposed rule after the modifications is substantially equivalent to the SEC Pay-to-Play Rule, FINRA believes that the SEC's cost estimates serve as a reasonable reference for the potential compliance costs on member firms. In response to the question on the costs of engaging outside legal services to assist in drafting policies and procedures to comply with the proposed rule, 3PM estimated that the majority of member firms would spend between $1,500 and $2,500 or approximately five to 10 hours of a professional consultant's time. In addition, 3PM estimated that a member firm would exert approximately 10 to 20 additional hours of compliance oversight in connection with the proposed rule each year. These estimates are slightly lower than the SEC's estimates discussed above.

The proposed rule is not expected to have competitive effects among member firms engaging in distribution or solicitation activities, since all member firms will be subject to the same prohibitions. Moreover, because the restrictions imposed by the proposed rule are substantially equivalent to the restrictions imposed by the SEC Pay-to-Play Rule, the proposed rule is not expected to create an uneven playing field between member firms and investment advisers. There may be a potential impact on the competition between member firms and municipal advisors depending on the differences between the proposed rule and the finalized

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[81] *See, e.g.,* 3PM.

[82] *See* proposed Rule 4580(a)(3).

MSRB rules regulating similar activities of municipal advisors.[83]

E. Regulatory Alternatives

Since the SEC requires that FINRA impose "substantially equivalent or more stringent restrictions" on member firms that wish to act as "regulated persons" than the SEC Pay-to-Play Rule imposes on investment advisers, FINRA believes it is appropriate (and achieves the right balance between the costs and benefits) to model the proposed rule change on the SEC Pay-to-Play Rule rather than impose a regulatory alternative, including a more stringent regulatory alternative, on such member firms.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

In November 2014, FINRA published the proposed rule change for comment in *Regulatory Notice* 14–50. FINRA received 10 comment letters in response to *Regulatory Notice* 14–50. A copy of *Regulatory Notice* 14–50 is attached as Exhibit 2a to the proposed rule change that was filed with the Commission. A list of the comment letters received in response to *Regulatory Notice* 14–50 is attached as Exhibit 2b.[84] Copies of the comment letters received in response to *Regulatory Notice* 14–50 are attached as Exhibit 2c.

Most commenters expressed appreciation or support for FINRA's decision to propose a pay-to-play rule, noting the potential disruption of an SEC ban on third

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[83] *See supra* note 23.

[84] All references to commenters are to the comment letters as listed in Exhibit 2b to the proposed rule change.

party solicitations if FINRA were not to propose and adopt a pay-to-play rule. The commenters raised, however, a number of concerns with the proposed pay-to-play rule, as well as the related proposed disclosure and recordkeeping requirements. A summary of the comments and FINRA's responses are discussed below.[85]

First Amendment Concerns

CCP expressed First Amendment concerns with the proposed rule change. Among other things, CCP raised vagueness and over-breadth concerns with a number of the provisions in the proposed rule change,[86] and asserted that the prohibition on soliciting and coordinating contributions is a "grave infringement of the basic 'right to associate for the purpose of speaking.'"

In light of CCP raising these constitutional concerns, FINRA notes that the proposed pay-to-play rule does not impose any restrictions on making independent expenditures, ban political contributions, or attempt to regulate State and local elections. FINRA acknowledges that the two-year time out provision may affect the propensity of covered members and their covered associates to make political contributions.[87] As discussed

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[85] Comments that speak to the economic impacts of the proposed rule change are addressed in Item II.B above.

[86] *See* CCP (discussing, among other things, the proposed definitions of the terms "official of a government entity," "solicit" and "contribution," as well as the provision prohibiting any covered member or any of its covered associates from doing anything indirectly that, if done directly, would result in a violation of the proposed pay-to-play rule).

[87] CCP requested that FINRA state explicitly whether the proposed rule would permit contributions in support of independent expenditures. FINRA notes that, consistent with the SEC Pay-to-Play Rule, the proposed rule would not in any way impinge on a wide range of expressive conduct in connection with

in *Regulatory Notice* 14–50 and as recognized by CCP, however, establishing requirements to regulate the activities of member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers is a more effective response to the requirements of the SEC

Pay-to-Play Rule than an outright ban on such activity. If FINRA were not to have a pay-to-play rule, the result would be a ban on member firms soliciting government entities for investment advisory services for compensation on behalf of investment advisers.

Moreover, for an investment adviser and its covered associates to provide or agree to provide, directly or indirectly, payment to a member firm to solicit a government entity for investment advisory services on behalf of the investment adviser, the SEC must find that FINRA's pay-to-play rule imposes substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and that FINRA's rule is consistent with the objectives of the SEC Pay-to-Play Rule. CCP suggested alternative approaches to the proposed pay-to-play rule that it argued would be "less restrictive," but FINRA does not believe that CCP's suggested less restrictive alternatives would meet the SEC's requirements. Accordingly, FINRA has crafted

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elections. For example, the rule would not impose any restrictions on activities such as making independent expenditures to express support for candidates, volunteering, making speeches, and other conduct. *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41024 (discussing independent expenditures).

its proposal such that it is substantially similar to the SEC's Pay-to-Play Rule.[88]

FINRA notes that the SEC modeled the SEC Pay-to-Play Rule on similarly designed MSRB Rule G–37, which the United States Court of Appeals for the District of Columbia Circuit upheld against a First Amendment challenge in *Blount* v. *SEC.*[89] As stated in the SEC Pay-to-Play Rule Adopting Release, the *Blount* opinion served as an important guidepost in helping the SEC shape the SEC Pay-to-Play Rule.[90] Similar to MSRB Rule G–37 and the SEC Pay-to-Play Rule, FINRA believes it has closely drawn its proposal to accomplish the goal of preventing quid pro quo arrangements while avoiding unnecessary burdens on the protected speech and associational rights of covered members and their covered associates. This analysis is further supported by the Court of Appeals for the District of Columbia Circuit's recent unanimous *en banc* decision in *Wagner* v. *FEC,* which relied on *Blount* to uphold against a First Amendment challenge a law barring campaign contributions by federal contractors.[91]

As detailed below, the proposed rule is closely drawn in terms of the conduct it prohibits, the persons who

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[88] In addition, FINRA notes that, to the extent there are interpretive questions regarding the application and scope of the provisions and terms used in its pay-to-play rule, FINRA will work with the industry to understand the interpretive questions and provide additional guidance where warranted.

[89] 61 F.3d 938 (D.C. Cir. 1995), cert. denied, 517 U.S. 1119 (1996).

[90] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41023.

[91] *Wagner* v. *FEC,* No. 13–5162, 2015 U.S. App LEXIS 11625 (D.C. Cir. July 7, 2015).

are subject to its restrictions, and the circumstances in which it is triggered.

Proposed Pay-to-Play Rule

A. Two-Year Time Out

Consistent with *Regulatory Notice* 14–50, proposed Rule 2030(a) would impose a two-year time out on engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser after the covered member or its covered associates make a contribution to an official of the government entity. NASAA stated that member firms should be prohibited from engaging in distribution or solicitation activities on behalf of an investment adviser directed at any government entity for a period of four years following any qualifying contribution by the member firm. In addition, NASAA stated that if a member firm has engaged in solicitation or distribution activities with a government entity on behalf of an investment adviser, the member firm should be prohibited from making any qualifying contributions to that government entity for a period of four years following the conclusion of the solicitation or distribution activities. FINRA has declined to make NASAA's suggested changes. The proposed two-year time out is consistent with the time-out period in the SEC's Pay-to-Play Rule, and FINRA believes that a two-year time out from the date of a contribution is sufficient to discourage covered members from engaging in pay-to-play practices.

1. Government Entity

Government entities would include all state and local governments, their agencies and instrumentalities, and all public pension plans and other collective government funds, including participant-directed plans such as 403(b),[92] 457,[93] and 529[94] plans. CAI urged FINRA or the SEC to provide additional guidance as to the criteria for determining whether an entity is an "instrumentality" under the proposed rule. CAI noted that its members have struggled to understand the contours of this term in the context of the SEC Pay-to-Play Rule. As stated in *Regulatory Notice* 14–50 and above, the definition of a "government entity" is consistent with the definition of that term in the SEC Pay-to-Play Rule. The SEC has not provided additional guidance regarding the meaning of the term "instrumentality" in connection with its Pay-to-Play Rule. Thus, at this time, FINRA declines to provide additional guidance as part of the proposed rule. FINRA recognizes, however, the concerns raised by CAI and will continue to discuss with the industry interpretive questions relating to the proposed rule change.

2. Solicitation

Consistent with *Regulatory Notice* 14–50, the proposed pay-to-play rule defines the term "solicit" to mean, with respect to investment advisory services, "to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser" and, with respect to a contribution or payment, "to communicate, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment."[95] CAI sought confirmation that the proposed rule would not apply when a covered member communicates with a third party and has no intent to obtain a client for, or refer a client to, an

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[92] *See supra* note 28.

[93] *See supra* note 29.

[94] *See supra* note 30.

[95] Proposed Rule 2030(g)(11).

investment adviser (in the context of investment advisory services) and there is no intent to obtain or arrange a contribution or payment (in the context of contributions to officials of government entities and payments to political parties).

As stated in *Regulatory Notice* 14–50 and above, the determination of whether a particular communication is a solicitation for investment advisory services or a contribution or payment would be dependent upon the specific facts and circumstances relating to such communication. As a general proposition, if there is no intent to obtain a client for, or refer a client to, an investment adviser (in the context of investment advisory services) or to obtain or arrange a contribution or payment (in the context of contributions to officials of government entities and payments to political parties), FINRA would not consider the communication to be a solicitation.[96]

3. Investment Advisers

The proposed pay-to-play rule would apply to covered members acting on behalf of any investment adviser registered (or required to be registered) with the SEC, or unregistered in reliance on the exemption available under Section 203(b)(3) of the Advisers Act for foreign private advisers, or that is an exempt reporting adviser under Advisers Act Rule 204–4(a).[97] NASAA and 3PM suggested that FINRA expand the definition of "investment adviser" to include state-registered investment advisers, stating, among other things, that it would further reduce the disruptions created by pay-to-play schemes. To remain consistent

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[96] *See supra* notes 18 and 40.

[97] *See* proposed Rule 2030(g)(7).

with the SEC Pay-to-Play Rule, FINRA has determined not to expand the scope of the proposed rule as suggested by commenters. FINRA notes that the SEC declined to make a similar change to its proposed rule, stating that it is their understanding that few of these smaller firms manage public pension plans or other similar funds.[98]

4. Covered Associates/Executive Officers

A "covered associate" includes any general partner, managing member or executive officer of a covered member, or other individual with a similar status or function.[99] SIFMA requested that FINRA define the term "executive officer" for purposes of the proposed rule. Consistent with the SEC Pay-to-Play Rule and for purposes of the FINRA pay-to-play rule only, FINRA has added proposed Rule 2030(g)(5) to define an "executive officer of a covered member" to mean: "(A) The president; (B) Any vice president in charge of a principal business unit, division or function (such as sales, administration or finance); (C) Any other officer of the covered member who performs a policy-making function; or (D) Any other person who performs similar policy-making functions for the covered member."

A covered associate also would include a PAC controlled by the covered member or any of its covered associates. FSI asserted that the restrictions on PAC contributions, and the definition of "control" with respect to covered associates are vague and potentially over-broad. For example, FSI stated that "[i]t is unclear whether an employee or executive of a member firm that holds a position on a PAC board of directors or

[98] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41026.

[99] *See supra* note 37 (defining the term "covered associate").

other advisory committee would have 'control' of the PAC under the Proposed Rules. It would also cover PACs that are not connected to the employee or executive's member firm." As stated in *Regulatory Notice* 14–50 and above, FINRA would consider a covered member or its covered associates to have "control" over a PAC if the covered member or covered associate has the ability to direct or cause the direction of governance or operations of the PAC.

This position is consistent with the position taken by the SEC in connection with the SEC Pay-to-Play Rule.[100]

5. Distribution

a. Inclusion of Distribution Activities

Consistent with *Regulatory Notice* 14–50, proposed Rule 2030(a) would impose a two-year time out on engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser after the covered member or its covered associates makes a contribution to an official of the government entity. Some commenters questioned the meaning of the term "distribution" in the context of the proposed rule. For example, SIFMA stated that it is their understanding "that the phrase 'distribution and solicitation,' as used in the SEC Pay-to-Play Rule, is interpreted to mean 'the solicitation of investment advisory services.'" CAI stated that "[s]ince the term 'distribution' has no meaning in the context of an investment adviser and is inconsistent with the personal nature of the services provided by investment advisers, [it] strongly recommends that

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[100] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41032 (discussing PACs).

FINRA eliminate each and every reference to the word 'distribution' throughout the *Notice* and the Proposed Rules. . . . [I]t is not clear what activity the term 'distribution' is meant to cover that is not captured by the term 'solicitation.'"

The SEC Pay-to-Play Rule prohibits an investment adviser and its covered associates from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless the person is a "regulated person."[101] The SEC Pay-to-Play Rule defines a "regulated person" to include a member firm, provided that FINRA rules prohibit member firms from engaging in distribution or solicitation activities if political contributions have been made.[102] Thus, the SEC Pay-to-Play Rule requires FINRA to have a rule that prohibits member firms from engaging in distribution (as well as solicitation) activities if political contributions have been made.

Language in the SEC Pay-to-Play Rule Adopting Release further supports the inclusion of distribution activities by broker-dealers in a FINRA pay-to-play rule. For example, when discussing comments related to its proposed ban on using third parties to solicit government business, the SEC addressed commenters' concerns that the provision would interfere with traditional distribution arrangements of mutual funds and private funds by broker-dealers, by clarifying under what circumstances distribution payments would violate the SEC's Pay-to-Play Rule.[103]

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[101] *See* SEC Pay-to-Play Rule 206(4)–5(a)(2).

[102] *See* SEC Pay-to-Play Rule 206(4)–5(f)(9)(ii)(A).

[103] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41040 n.298 (stating that "[m]utual fund distribution fees are

Based on the SEC's definition of "regulated person" as well as its discussion regarding the treatment of distribution fees paid pursuant to a 12b–1 plan, FINRA believes its proposed rule must apply to member firms engaging in distribution activities. Accordingly, FINRA has not revised the proposed rule to remove references to the term "distribution."[104]

b. Scope of Distribution Activities

ICI requested confirmation that, with respect to mutual funds, the proposed rule would be triggered only when a member firm solicits a government entity to include a mutual fund in a government entity's plan or program and not when the member is selling mutual fund shares to a government entity. FSI asked for clarification with respect to the treatment of traditional brokerage activities by a financial advisor as "distribution or solicitation activities" in the context of government entity plans.

As discussed above, the proposed pay-to-play rule would apply to distribution activities by covered

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typically paid by the fund pursuant to a 12b–1 plan, and therefore generally would not constitute payment by the fund's adviser. As a result, such payments would not be prohibited [under the SEC Pay-to-Play Rule] by its terms. Where an adviser pays for the fund's distribution out of its 'legitimate profits,' however, the rule would generally be implicated. . . . For private funds, third parties are often compensated by the adviser or its affiliated general partner and, therefore, those payments are subject to the rule.")

[104] In addition, FINRA notes that many of the concerns raised by commenters in connection with including distribution activities in the proposed rule related to the additional burden associated with the proposed disclosure requirements and such activities. As discussed further below, FINRA has determined not to propose a disclosure rule relating to government distribution and solicitation activities.

members. FINRA notes, however, that based on the definition of a "covered investment pool," the proposed rule would not apply to distribution activities related to registered investment companies that are not investment options of a government entity's plan or program.[105] Thus, the proposed rule would apply to distribution activities involving unregistered pooled investment vehicles such as hedge funds, private equity funds, venture capital funds, and collective investment trusts, and registered pooled investment vehicles such as mutual funds, but only if those registered pools are an investment option of a participant-directed plan or program of a government entity.[106]

CAI requested clarification that "compensation" in the context of covered investment pools does not include conventional compensation arrangements for the distribution of mutual funds, variable annuity contracts and other securities included within the definition of "covered investment pool." Consistent with the SEC Pay-to-Play Rule, to the extent the mutual fund distribution fees are paid by the fund pursuant to a 12b–1 plan, such payments would not be prohibited under the proposed rule as they would not

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[105] Proposed Rule 2030(g)(3) defines a "covered investment pool" to mean: "(A) Any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity, or (B) Any company that would be an investment company under Section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either Section 3(c)(1), 3(c)(7) or 3(c)(11) of that Act."

[106] Although the proposed rule would not apply to distribution activities relating to all registered pooled investment vehicles, FINRA notes the language of proposed Rule 2030(e) that "[i]t shall be a violation of this Rule for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of this Rule."

constitute payments by the fund's investment adviser. If, however, the adviser pays for the fund's distribution out of its "legitimate profits," the proposed rule would generally be implicated.[107] For private funds, third parties are often compensated by the investment adviser or its affiliated general partner. Thus, such payments would be subject to the proposed rule. In addition, FINRA notes that structuring such a payment to come from the private fund for purposes of evading the rule would violate the rule.[108]

B. Prohibitions as Applied to Covered Investment Pools

1. General

In *Regulatory Notice* 14–50, proposed Rule 2390(e) (now proposed as Rule 2030(d)) provided that a covered member that engages in distribution or solicitation

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[107] For a discussion of a mutual fund adviser's ability to use "legitimate profits" for fund distribution, *see* Investment Company Act of 1940 Release No. 11414 (Oct. 28, 1980), 45 FR 73898 (Nov. 7, 1980) (Bearing of Distribution Expenses by Mutual Funds) (explaining, in the context of the prohibition on the indirect use of fund assets for distribution, unless pursuant to a 12b–1 plan, "[h]owever, under the rule there is no indirect use of fund assets if an adviser makes distribution related payments out of its own resources. . . . Profits which are legitimate or not excessive are simply those which are derived from an advisory contract which does not result in a breach of fiduciary duty under section 36 of the [Investment Company] Act.").

[108] *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41040 n.298 and accompanying text. CAI also asked FINRA to consider afresh the SEC's position in its Pay-to-Play Rule that payments originating with an investment adviser should be treated as a payment for solicitation, regardless of the purpose or context for the payment. As discussed above, for purposes of the proposed rule, FINRA is taking a position consistent with the SEC's position in its Pay-to-Play Rule.

activities with a government entity on behalf of an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though the covered member was engaging in or seeking to engage in distribution or solicitation activities with the government entity on behalf of the investment adviser directly. CAI raised concerns regarding the application of the prohibitions of the proposed rule to covered investment pools stating, among other things, "that a broker-dealer that offers and sells interests in a mutual fund or private fund cannot be characterized as soliciting on behalf of the investment adviser to a covered investment pool." CAI reasoned that "[t]here is no basis for this notion given the [SEC] staff's interpretation in the Mayer Brown no-action letter and the *Goldstein* case . . ., as well as the lack of any relationship between the selling firm and the investment adviser."[109]

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[109] *See Goldstein* v. *SEC,* 451 F.3d 873 (D.C. Cir. 2006) and *Mayer Brown LLP,* SEC No-Action Letter ("*Mayer Brown* letter"), available at *https://www.sec.gov/divisions/investment/noaction/2008/ mayerbrown072808-206.htm#P15_323*. In *Goldstein,* the court held that the SEC's "Hedge Fund Rule," which would have given the SEC greater oversight over hedge funds, was invalid because it was arbitrary and in conflict with the purpose of the underlying statute in which the new rule was included. The court concluded that hedge fund investors are not clients of fund advisers for the purpose of the Adviser's Act registration requirement.

In the *Mayer Brown* letter, SEC staff stated that Rule 206(4)–3 generally does not apply to a registered investment adviser's cash payment to a person solely to compensate that person for soliciting investors or prospective investors for, or referring investors or prospective investors to, an investment pool managed by the adviser. The letter distinguishes between a person referring other persons to the adviser where the adviser manages only investment pools and is not seeking to enter into advisory relationships with these other persons (but rather the other persons

After considering CAI's concerns, FINRA has modified the language of the proposed rule to recognize the relationship between the selling member and the covered investment pool, but also to clarify that for purposes of the proposed rule, a covered member engaging in distribution or solicitation activities on behalf of a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though the covered member was engaging in, or seeking to engage in, distribution or solicitation activities with the government entity on behalf of the investment adviser to the covered investment pool directly.[110]

As stated in *Regulatory Notice* 14–50, proposed Rule 2390(e) (now proposed as Rule 2030(d)) was modeled on a similar provision in the SEC Pay-to-Play Rule, Rule 206(4)–5(c),[111] and was intended to extend the protections of the proposed rule to government entities that access the services of investment advisers through hedge funds and other types of pooled investment vehicles sponsored or advised by investment advisers.[112] As

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will be investors or prospective investors in one or more of the investment pools managed by the adviser), versus referring other persons as prospective advisory clients. The letter notes that whether the rule applies will depend on the facts and circumstances.

[110] *See* proposed Rule 2030(d).

[111] SEC Pay-to-Play Rule 206(4)–5(c) provides that "an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity."

[112] In adopting this provision, the SEC noted a commenter's questioning of its authority to apply the rule in the context of covered investment pools in light of the opinion of the Court of Appeals for the District of Columbia Circuit in the *Goldstein* case.

noted by CAI, however, FINRA recognizes that without a provision corresponding more closely to SEC Pay-to-Play Rule 206(4)–5(c), there is nothing in the proposed rule that deems an investment adviser to a covered investment pool to have a direct investment advisory relationship with government entities investing in the pool. CAI noted that: "Without such a provision, proposed rule 2390(e) would *not* apply the two year time out restriction in proposed rule 2390(a) to advisers to [covered investment pools]. This is because proposed Rule 2390(a) would *only* apply where an investment adviser 'provides or is seeking to provide investment advisory services to such government entity.'"

Accordingly, FINRA has modified the proposed rule to include proposed Rule 2030(d)(2) that provides that for purposes of the proposed rule "an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity."

2. Two-Tiered Investment Products

CAI sought confirmation from FINRA that the proposed pay-to-play rule would not apply in the context of two-tiered investment products, such as variable annuities. CAI asserted, among other things, that "[o]rdinarily, there is no investment adviser providing investment advisory services to the separate account

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See supra note 109. The SEC concluded, however, that it has authority to adopt rules proscribing fraudulent conduct that is potentially harmful to investors in pooled investment vehicles pursuant to Section 206(4) of the Advisers Act and, therefore, adopted SEC Pay-to-Play Rule 206(4)–5(c) as proposed. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41045 n.355.

supporting the variable annuity contract, although there are investment advisers providing investment advisory services to the underlying mutual funds or unregistered investment pools." CAI requested clarification that a covered member selling two-tiered investment products is not engaging in solicitation activities on behalf of the investment adviser and sub-advisers managing the underlying funds. FINRA notes that the SEC did not exclude specific products from the SEC Pay-to-Play Rule and, therefore, FINRA has determined not to exclude specific products from its proposed rule.

C. Disgorgement

In *Regulatory Notice* 14–50, FINRA proposed a "disgorgement" provision that, among other things, would have required that the covered member pay, in the order listed, any compensation or other remuneration received by the covered member pertaining to, or arising from, distribution or solicitation activities during the two-year time out to: (A) A covered investment pool in which the government entity was solicited to invest, as applicable; (B) the government entity; (C) any appropriate entity designated in writing by the government entity if the government entity or covered investment pool cannot receive such payments; or (D) the FINRA Investor Education Foundation, if the government entity or covered investment pool cannot receive such payments and the government entity cannot or does not designate in writing any other appropriate entity.

NASAA expressed support for FINRA's inclusion of a disgorgement provision for violations of the proposed rule. Most commenters, however, opposed the requirement.[113] SIFMA stated that "[w]hile disgorgement is the almost universal remedy for violations of various pay-to-play rules, . . . making application of the remedy mandatory could have the deleterious effect of dissuading covered members from voluntary disgorgement of fees where such members discover pay-to-play violations themselves." ICI stated that "including disgorgement as a penalty is not necessary given that the SEC and FINRA both have full authority to require disgorgement of fees, and indeed, disgorgement has been the penalty universally applied (along with additional penalties) in enforcement actions under existing pay-to-play rules, such as MSRB Rule G–37 and SEC Rule 206(4)–5."

After considering the comments and, in particular, that FINRA has authority to require disgorgement of fees in enforcement actions, FINRA has determined not to include a disgorgement requirement in the proposed rule.

D. Prohibition on Soliciting and Coordinating Contributions

Consistent with *Regulatory Notice* 14–50, proposed Rule 2030(b) would prohibit a covered member or covered associate from coordinating or soliciting any person or PAC to make any: (1) Contribution to an official of a government entity in respect of which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser; or (2) payment to a political party of a state or locality of a government entity with which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser. As stated in

[113] *See, e.g.,* SIFMA, CAI and ICI.

Regulatory Notice 14–50 and above, this provision is modeled on a similar provision in the SEC Pay-to-Play Rule.[114]

CAI sought confirmation that the proposed prohibition on soliciting and coordinating contributions would not apply when a contribution is made to a political action committee, political party or other third party, where there is no knowledge or indication of how such contribution will be used. Similar to guidance provided in the context of SEC Pay-to-Play Rule 206(4)–5(a)(2), FINRA notes that a direct contribution to a political party by a covered member or its covered associates would not violate the proposed rule unless the contribution was a means for the covered member to do indirectly what the rule would prohibit if done directly (for example, if the contribution was earmarked or known to be provided for the benefit of a particular government official).[115]

E. Direct or Indirect Contributions or Solicitations

Consistent with *Regulatory Notice* 14–50, proposed Rule 2030(e) provides that it shall be a violation of the proposed pay-to-play rule for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of the rule. CAI requested that FINRA incorporate a knowledge and support requirement into this provision of the proposed rule so that it would be violated only if a covered member has direct knowledge of, and takes measures to aid and support, activities undertaken by its affiliates. As stated in *Regulatory Notice* 14–50 and

[114] *See* SEC Pay-to-Play Rule 206(4)–5(a)(2).

[115] *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41044 n.337.

above, this provision is modeled on SEC Pay-to-Play Rule 206(4)–5(d). Consistent with guidance provided by the SEC in connection with that provision, FINRA has clarified that it would require a showing of intent to circumvent the rule for a covered member or its covered associates funneling payments through a third party to trigger the two-year time out.[116]

F. Exceptions

In *Regulatory Notice* 14–50, FINRA included exceptions to the prohibition in the proposed pay-to-play rule for *de minimis* contributions and returned contributions. CAI and CCP stated that they believe that the $350 and $150 *de minimis* contribution limits are unreasonably low. CAI stated that it believes the $350 amount for returned contributions is unnecessary because "[i]f the contribution is returned as is required under the exception, then no harm will result as both the contributor and contributee are placed in the same position they would have been in had no contribution been made."

FINRA has determined not to modify the proposed exceptions. As stated in *Regulatory Notice* 14–50 and above, the exceptions are modeled on similar exceptions in the SEC Pay-to-Play Rule for *de minimis* contributions and returned contributions.[117] Moreover, FINRA believes that it is necessary to keep the amounts at the levels as proposed in *Regulatory Notice* 14–50 to meet the requirement in the SEC Pay-to-Play Rule that the restrictions in FINRA's rule must be substantially

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[116] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41044 n.340.

[117] *See* SEC Pay-to-Play Rule 206(4)–5(b).

equivalent to, or more stringent than, the restrictions in the SEC Pay-to-Play Rule.

Proposed Recordkeeping Requirements

A. Unsuccessful Solicitations

Proposed Rule 4580 would require covered members that engage in distribution or solicitation activities with a government entity on behalf of any investment adviser that provides or is seeking to provide investment advisory services to such government entity to maintain books and records that would allow FINRA to examine for compliance with its proposed pay-to-play rule. SIFMA requested that FINRA not extend the recordkeeping requirements to unsuccessful solicitations where the covered member does not receive compensation because maintaining such records would impose significant costs on covered members with little corresponding benefit. [118]

FINRA intends that the recordkeeping requirements of proposed Rule 4580 be consistent with similar recordkeeping requirements imposed on investment advisers in connection with the SEC Pay-to-Play Rule.[119] The SEC does not require investment advisers to maintain lists of government entities that do not become clients.[120] Accordingly, FINRA has added the term "for compensation" to proposed Rule 4580(a)(3) to clarify that the proposed Rule would not apply to unsuccessful solicitations.

[118] *See also* CAI, 3PM and FSI (requesting that FINRA not apply the proposed recordkeeping requirements to unsuccessful solicitations of government entities).

[119] *See* Advisers Act Rule 204–2(a)(18) and (h)(1).

[120] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41050.

B. Indirect Contributions

Consistent with *Regulatory Notice* 14–50, proposed Rule 4580(a)(4) would require a covered member to maintain books and records of all direct and indirect contributions made by the covered member or any of its covered associates to an official of a government entity, or direct or indirect payments to a political party of a state or political subdivision thereof or to a PAC. 3PM requested that FINRA eliminate the requirement to maintain a list of indirect contributions, arguing that "requiring firms to . . . track and monitor indirect contributions could become extremely time consuming and costly for firms." CAI asserted that not all payments to political parties or PACs should have to be maintained. Instead, CAI stated that only payments to political parties or PACs where the covered member or covered associate: (i) Directs the political party or PAC to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser, or (ii) knows that the political party or PAC is going to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser, should have to be maintained.

As stated in the *Regulatory Notice* and above, the proposed recordkeeping requirements are intended to allow FINRA to examine for compliance with its proposed pay-to-play rule. Thus, the reference to indirect contributions in proposed Rule 4580(a)(4) is intended to include records of contributions or payments a covered member solicits or coordinates another person or PAC to make under proposed Rule 2030(b) (Prohibition on Soliciting and Coordinating Contributions).[121] In addition, payments to political parties or PACs can be a means for a covered member or covered associate to funnel contributions to a government official without directly contributing. Thus, FINRA is proposing to require a covered member to maintain a record of all payments to political parties or PACs as such records would assist FINRA in identifying situations that might suggest an intent to circumvent the rule.[122]

Proposed Disclosure Requirements

In *Regulatory Notice* 14–50, FINRA proposed Rule 2271 to require a covered member engaging in distribution or solicitation activities for compensation with a government entity on behalf of one or more investment advisers to make specified disclosures to the government entity regarding each investment

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[121] This interpretation is consistent with the SEC's interpretation of a similar provision in Advisers Act Rule 204–2(a)(18)(i).

[122] ICI stated that if FINRA applies the requirements of proposed Rule 4580(a)(4) to a member firm holding an omnibus account on behalf of another broker-dealer that solicited a government entity, and the omnibus dealer is unaware of the broker-dealer's solicitation activities, the omnibus dealer will likely be unable to maintain records required by proposed Rule 4580. As a potential way in which to address this concern, ICI referenced an SEC staff no-action relief letter that addresses a similar concern regarding the recordkeeping requirements related to the SEC Pay-to-Play Rule. *See* ICI referencing Investment Company Institute, SEC No-Action Letter dated September 12, 2011, available at *http://www.sec.gov/divisions/investment/noaction/2011/ici091211–204-incoming.pdf*. FINRA recognizes the concern raised by ICI and will address interpretive questions as needed regarding the application of the proposed recordkeeping requirements to covered members holding omnibus accounts on behalf of other broker-dealers that engage in distribution or solicitation activities with government entities.

adviser. Several commenters raised concerns regarding the proposed disclosure requirements.[123] For example, commenters raised concerns regarding the scope and timing of the disclosure requirements [124]and that the requirements would be duplicative of existing federal and state investor protection-related disclosure requirements.[125] In addition, commenters raised concerns regarding the costs and compliance burdens associated with the proposed disclosure requirements.[126]

After considering the comments, FINRA has determined not to propose a disclosure rule at this time. FINRA will continue to consider whether such a rule would be appropriate. If FINRA determines to propose a disclosure rule at a later date, it would do so pursuant to FINRA's notice and comment rulemaking process.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve or disapprove such proposed rule change, or

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[123] *See, e.g.,* SIFMA, Monument Group, ICI, IAA, FSI, CAI and 3PM.

[124] *See, e.g.,* SIFMA, Monument Group, ICI, IAA, CAI and 3PM.

[125] *See, e.g.,* SIFMA, Monument Group and FSI.

[126] *See, e.g.,* SIFMA, Monument Group and 3PM.

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number SR–FINRA–2015–056 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–FINRA–2015–056. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the

Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–FINRA–2015–056 and should be submitted on or before January 20, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[127]

Brent J. Fields,
Secretary.

[FR Doc. 2015–32894 Filed 12–29–15; 8:45 am]
BILLING CODE 8011–01–P

[127] 17 CFR 200.30–3(a)(12).

APPENDIX E

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–77465;
File No. SR–FINRA–2015–056]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Instituting Proceedings To Determine Whether to Approve or Disapprove Proposed Rule Change To Adopt FINRA Rule 2030 and FINRA Rule 4580 to Establish "Pay-To-Play" and Related Rules

March 29, 2016

I. Introduction

On December 16, 2015, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act," "Exchange Act" or "SEA")[1] and Rule 19b–4 thereunder,[2] a proposed rule change to adopt FINRA Rules 2030 (Engaging in Distribution and Solicitation Activities with Government Entities) and 4580 (Books and Records Requirements for Government Distribution and Solicitation Activities) to establish "pay-to-play"[3] and related rules that would regulate the activities of member firms that engage in distribu-

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] "Pay-to-play" practices typically involve a person making cash or in-kind political contributions (or soliciting or coordinating others to make such contributions) to help finance the election campaigns of state or local officials or bond ballot initiatives as a quid pro quo for the receipt of government contracts.

tion or solicitation activities for compensation with government entities on behalf of investment advisers.

The proposed rule change was published for comment in the Federal Register on December 30, 2015.[4] The Commission received ten comment letters, from nine different commenters, in response to the proposed rule change.[5] On February 8, 2016, FINRA extended the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to March 29, 2016.[6] On March

[4] *See* Exchange Act Rel. No. 76767 (Dec. 24, 2015), 80 FR 81650 (Dec. 30, 2015) (File No. SR–FINRA–2015–056) ("Notice").

[5] *See* Letters from David Keating, President, Center for Competitive Politics ("CCP"), dated Jan. 20, 2016 ("CCP Letter"); Clifford Kirsch and Michael Koffler, Sutherland Asbill & Brennan LLP, for the Committee of Annuity Insurers ("CAI"), dated Jan. 20, 2016 ("CAI Letter No. 1"); Clifford Kirsch and Michael Koffler, Sutherland Asbill & Brennan LLP, for the CAI, dated Feb. 5, 2016 ("CAI Letter No. 2"); David T. Bellaire, Executive Vice President and General Counsel, Financial Services Institute ("FSI"), dated Jan. 20, 2016 ("FSI Letter"); Tamara K. Salmon, Assistant General Counsel, Investment Company Institute ("ICI"), dated Jan. 20, 2016 ("ICI Letter"); Patrick J Moran, Esq., dated Dec. 29, 2015 ("Moran Letter"); Gary A. Sanders, Counsel and Vice President, National Association of Insurance and Financial Advisors ("NAIFA"), dated Jan. 20, 2016 ("NAIFA Letter"); Judith M. Shaw, President, North American Securities Administrators Association, Inc. ("NASAA"), dated Jan. 20, 2016 ("NASAA Letter"); Hugh D. Berkson, President, Public Investors Arbitration Bar Association ("PIABA"), dated Jan. 20, 2016 ("PIABA Letter"); and H. Christopher Bartolomucci and Brian J. Field, Bancroft PLLC, for the New York Republican State Committee and the Tennessee Republican Party ("State Parties"), dated Jan. 20, 2016 ("State Parties Letter").

[6] *See* Letter from Victoria Crane, Associate General Counsel, FINRA, to Lourdes Gonzalez, Assistant Director, Sales Practices,

28, 2016, FINRA filed a letter with the Commission stating that it has considered the comments received by the Commission, and that FINRA is not intending to make changes to the proposed rule text in response to the comments.[7] The Commission is publishing this order to institute proceedings pursuant to Exchange Act Section 19(b)(2)(B)[8] to determine whether to approve or disapprove the proposed rule change.

Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change, nor does it mean that the Commission will ultimately disapprove the proposed rule change. Rather, as discussed below, the Commission seeks additional input on the proposed rule change and issues presented by the proposal.

II. Description of the Proposed Rule Change[9]

As described more fully in the Notice, FINRA is proposing a pay-to-play rule, Rule 2030,[10] that FINRA states is modeled on the Commission's Rule 206(4)–5

Division of Trading and Markets, Securities and Exchange Commission, dated Feb. 8, 2016.

[7] *See* Letter from Victoria Crane, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated Mar. 28, 2016 ("FINRA Response Letter"). The FINRA Letter is available on FINRA's Web site at *http://www.finra.org,* at the principal office of FINRA, and at the Commission's Public Reference Room.

[8] 15 U.S.C. 78s(b)(2)(B).

[9] The proposed rule change, as described in this Item II, is excerpted, in part, from the Notice, which was substantially prepared by FINRA. *See supra* note 4.

[10] *See* Notice, 80 FR at 81650–51 (citing Advisers Act Release No. 3043 (July 1, 2010), 75 FR 41018 (July 14, 2010) (Political Contributions by Certain Investment Advisers) ("SEC Pay-to-Play Rule Adopting Release")).

under the Investment Advisers Act of 1940 ("Advisers Act"), which addresses pay-to-play practices by investment advisers (the "SEC Pay-to-Play Rule").[11] The SEC Pay-to-Play Rule, among other things, prohibits an investment adviser and its covered associates from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless the person is a "regulated person."[12] A "regulated person," as defined in the SEC Pay-to-Play Rule, includes a FINRA member firm, provided that: (a) FINRA rules prohibit member firms from engaging in distribution or solicitation activities if political contributions have been made; and (b) the SEC finds, by order, that such rules impose substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and that such rules are consistent with the objectives of the SEC Pay-to-Play Rule.[13] Therefore, based on this regulatory framework, FINRA is proposing its own pay-to-play rule to enable

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[11] FINRA also published the proposed rule change in *Regulatory Notice* 14–50 (Nov. 2014) ("*Regulatory Notice* 14–50") and sought comment on the proposal. FINRA states that commenters were generally supportive of the proposed rule change, but also expressed some concerns. As such, FINRA revised the proposed rule change as published in *Regulatory Notice* 14–50 in response to those comments. As described more fully in the Notice, FINRA believes that the revisions it made more closely align FINRA's proposed rule with the SEC Pay-to-Play Rule and help reduce cost and compliance burden concerns raised by commenters *See* Notice, 80 FR at 81651, n. 16.

[12] *See* Notice, 80 FR at 81650, 81656. *See also* SEC Pay-to-Play Rule 206(4)–5(a)(2)(i)(A).

[13] *See* Notice, 80 FR at 81650, n. 6 (citing SEC Pay-to-Play Rule 206(4)–5(f)(9)).

its member firms to continue to engage in distribution and solicitation activities for compensation with government entities on behalf of investment advisers, while at the same time deterring its member firms from engaging in pay-to-play practices.[14] FINRA also believes that its proposed rule would establish a comprehensive regime to regulate the activities of its member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers and would impose substantially equivalent restrictions on FINRA member firms engaging in distribution or solicitation activities to those the SEC Pay-to-Play Rule imposes on investment advisers.[15]

Furthermore, FINRA is proposing Rule 4580, which would impose recordkeeping requirements on FINRA member firms in connection with its pay-to-play rule that would allow examination of member firms' books and records for compliance with the pay-to-play rule.[16] FINRA believes that its proposed Rule 4580 is consistent with similar recordkeeping requirements imposed on investment advisers in connection with the SEC Pay-to-Play Rule.[17]

The following is an overview of some of the key provisions in FINRA's proposed rules.

A. Proposed Rule 2030(a): Limitation on Distribution and Solicitation Activities

Proposed Rule 2030(a) would prohibit a covered member from engaging in distribution or solicitation

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[14] *See* Notice, 80 FR at 81651, 81656.

[15] *See id.* at 81651, 81656.

[16] *See id.* at 81651, 81655–56.

[17] *See id.* at 81655, n. 60 (citing Advisers Act Rule 204–2(a)(18) and (h)(1)).

activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by the covered member or a covered associate, including a person who becomes a covered associate within two years after the contribution is made.[18] FINRA states that the terms and scope of the prohibitions in proposed Rule 2030(a) are modeled on the SEC Pay-to-Play Rule.[19]

FINRA explains that proposed Rule 2030(a) would not ban or limit the amount of political contributions a covered member or its covered associates could make.[20] Rather, FINRA states that, consistent with the SEC Pay-to-Play Rule, the proposed rule would impose a two-year "time out" on engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser after the covered member or its covered associates make a contribution to an official of the government entity.[21] According to FINRA, the two-year time out period is intended to discourage covered members from participating in pay-to-play practices by requiring a cooling-off period during which the effects of a political contribution on the selection process can be expected to dissipate.[22]

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[18] *See* Notice, 80 FR at 81651.

[19] *See id.* (citing SEC Pay-to-Play Rule 206(4)–5(a)(1)).

[20] *See* Notice, 80 FR at 81651.

[21] *See id.*

[22] *Id.*

1. Distribution Activities

FINRA states that, based on the definition of "regulated person" in the SEC Pay-to-Play Rule, it is required to adopt a rule that prohibits its member firms from engaging in distribution activities (as well as solicitation activities) with government entities if political contributions have been made.[23] FINRA also notes that certain language in the SEC Pay-to-Play Rule Adopting Release further supports the inclusion of distribution activities by broker-dealers in a FINRA pay-to-play rule.[24]

However, FINRA also explains that, based on the definition of a "covered investment pool" in proposed Rule 2030(g)(3),[25] the proposed rule would not apply to distribution activities related to registered investment companies that are not investment options of a

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[23] *See id.* at 81660–61 (explaining that FINRA believes its proposed rule must apply to member firms engaging in distribution activities and that FINRA did not revise the proposed rule to remove references to the term distribution as requested by comments received in response to *Regulatory Notice* 14–50).

[24] *See id.* at 81660–61 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41040 n. 298 where, according to FINRA, the Commission "clarif[ied] under what circumstances distribution payments would violate the SEC's Pay-to-Play Rule").

[25] *See id.* at 81654, n. 46 (proposed Rule 2030(g)(3) defines a "covered investment pool" to mean: "(A) Any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity, or (B) Any company that would be an investment company under Section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either Section 3(c)(1), 3(c)(7) or 3(c)(11) of that Act").

government entity's plan or program.[26] Therefore, the proposed rule would apply to distribution activities involving unregistered pooled investment vehicles such as hedge funds, private equity funds, venture capital funds, and collective investment trusts, and registered pooled investment vehicles such as mutual funds, but only if those registered pools are an investment option of a participant-directed plan or program of a government entity.[27] FINRA also notes that, consistent with the SEC Pay-to-Play Rule, to the extent mutual fund distribution fees are paid by the fund pursuant to a 12b–1 plan, such payments would not be prohibited under the proposed rule as they would not constitute payments by the fund's investment adviser.[28] However, if the adviser pays for the fund's distribution out of its "legitimate profits," the proposed rule would generally be implicated.[29]

2. Solicitation Activities

FINRA also states that, consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(11) defines the term "solicit" to mean: "(A) With respect to investment advisory services, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser; and (B) With respect to a contribution or payment, to

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[26] *See* Notice, 80 FR at 81661, nn. 105–106 (explaining that the proposed rule would not apply to distribution activities relating to all registered pooled investment vehicles).

[27] *See id.* at 81661. *See also id.* at 81651, n. 17 and 81654, n. 46.

[28] *See id.* at 81661.

[29] *See id.* (noting, among other things, that "for private funds, third parties are often compensated by the investment adviser or its affiliated general partner").

communicate, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment."[30] FINRA also notes that, although the determination of whether a particular communication would be a solicitation would depend on the facts and circumstances relating to such communication, as a general proposition FINRA believes that any communication made under circumstances reasonably calculated to obtain or retain an advisory client would be considered a solicitation unless the circumstances otherwise indicate that the communication does not have the purpose of obtaining or retaining an advisory client.[31]

B. Proposed Rule 2030(b): Prohibition on Soliciting and Coordinating Contributions

Proposed Rule 2030(b) would also prohibit a covered member or covered associate from coordinating or soliciting any person or political action committee (PAC) to make any: (1) Contribution to an official of a government entity in respect of which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser; or (2) payment to a political party of a state or locality of a government entity with which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser.[32] FINRA states that this provision is modeled on a similar provision in the SEC Pay-to-Play Rule [33] and is intended to prevent covered members or covered associates from circumventing the proposed rule's prohibition on direct contributions to

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[30] *See id.* at 81651, n. 18. *See also id.* at 81653, n. 40.

[31] *See id.*

[32] *See id.* at 81654. *See also id.* at 81662.

[33] *See id.* at 81654 (citing SEC Pay-to-Play Rule 206(4)–5(a)(2)).

certain elected officials such as by "bundling" a large number of small employee contributions to influence an election, or making contributions (or payments) indirectly through a state or local political party.[34]

C. Proposed Rule 2030(c): Exceptions

FINRA's proposed pay-to-play rule contains three exceptions from the proposed rule's prohibitions: (1) *De minimis* contributions, (2) new covered associates, and (3) certain returned contributions.[35] FINRA states that these exceptions are modeled on similar exceptions in the SEC Pay-to-Play Rule.[36]

1. De Minimis Contribution Exception

Proposed Rule 2030(c)(1) would except from the rule's restrictions contributions made by a covered associate who is a natural person to government entity officials for whom the covered associate was entitled to vote at the time of the contributions, provided the contributions do not exceed $350 in the aggregate to any one official per election.[37] However, if the covered associate was not entitled to vote for the official at the time of the contribution, the contribution must not exceed $150 in the aggregate per election.[38] FINRA states that, consistent with the SEC Pay-to-Play Rule, under this exception, primary and general elections would be considered separate elections.[39] FINRA also explains that this exception is based on the theory that

[34] *See* Notice, 80 FR at 81654.

[35] *See id.*

[36] *See id.* (citing SEC Pay-to-Play Rule 206(4)–5(b)).

[37] *See* Notice, 80 FR at 81655.

[38] *See id.*

[39] *See id.* (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41034).

such contributions are typically made without the intent or ability to influence the selection process of the investment adviser.[40]

2. Exception for Certain New Covered Associates

The proposed rule would attribute to a covered member contributions made by a person within two years (or, in some cases, six months) of becoming a covered associate. However, proposed Rule 2030(c)(2) would provide an exception from the proposed rule's restrictions for covered members if a natural person made a contribution more than six months prior to becoming a covered associate of the covered member unless the covered associate engages in, or seeks to engage in, distribution or solicitation activities with a government entity on behalf of the covered member.[41] FINRA states that this exception is consistent with the SEC Pay-to-Play Rule [42] and is intended to balance the need for covered members to be able to make hiring decisions against the need to protect against individuals marketing to prospective employers their connections to, or influence over, government entities the employer might be seeking as clients.[43] FINRA also provides, with respect to the "look back" provisions in the proposed rules generally, the following illustrations of how the "look back" provisions work: if, for example, the contributions were made more than two years (or six months for new covered associates) prior to the employee becoming a covered associate, the time

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[40] *See* Notice, 80 FR at 81655.

[41] *See id.*

[42] *See id.* (citing SEC Pay-to-Play Rule 206(4)–5(b)(2)).

[43] *See* Notice, 80 FR at 81655.

out has run.[44] According to FINRA, however, if the contribution was made less than two years (or six months, as applicable) from the time the person becomes a covered associate, the proposed rule would prohibit the covered member that hires or promotes the contributing covered associate from receiving compensation for engaging in distribution or solicitation activities on behalf of an investment adviser from the hiring or promotion date until the applicable period has run.[45] FINRA also states that the "look back" provisions are designed to prevent covered members from circumventing the rule by influencing the selection process by hiring persons who have made political contributions.[46]

3. Exception for Certain Returned Contributions

Proposed Rule 2030(c)(3) would provide an exception from the proposed rule's restrictions for covered members if the restriction is due to a contribution made by a covered associate and: (1) The covered member discovered the contribution within four months of it being made; (2) the contribution was less than $350; and (3) the contribution is returned within 60 days of the discovery of the contribution by the covered member.[47] FINRA explains that, consistent with the SEC Pay-to-Play Rule, this exception would allow a covered member to cure the consequences of an inadvertent political contribution.[48] The proposed rule would also provide that covered members with 150 or fewer

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[44] *See id.*

[45] *See id.*

[46] *See id.* at 81653, 81655.

[47] *See id.* at 81655.

[48] *See id.*

registered representatives would be able to rely on this exception no more than two times per calendar year, while covered members with more than 150 registered representatives would be permitted to rely on this exception no more than three times per calendar year.[49] Furthermore, a covered member would not be able to rely on an exception more than once with respect to contributions by the same covered associate regardless of the time period, which is consistent with similar provisions in the SEC Pay-to-Play Rule.[50]

D. Proposed Rule 2030(d): Prohibitions as Applied to Covered Investment Pools

Proposed Rule 2030(d)(1) provides that a covered member that engages in distribution or solicitation activities with a government entity on behalf of a covered investment pool[51] in which a government entity invests or is solicited to invest shall be treated as though the covered member was engaging in or seeking to engage in distribution or solicitation activities with the government entity on behalf of the

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[49] *See id.* FINRA notes that these limitations are consistent with similar provisions in the SEC Pay-to-Play Rule 206(4)–5(b)(3), although the SEC Pay-to-Play Rule includes different allowances for larger and smaller investment advisers based on the number of employees they report on Form ADV. *See id.* at 81655, n. 59.

[50] *See* Notice, 80 FR at 81655.

[51] *See id.* at 81654, n. 46 (proposed Rule 2030(g)(3) defines a "covered investment pool" to mean: "(A) Any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity, or (B) Any company that would be an investment company under Section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either Section 3(c)(1), 3(c)(7) or 3(c)(11) of that Act").

investment adviser to the covered investment pool directly.[52] Proposed Rule 2030(d)(2) provides that an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity.[53] FINRA states that proposed Rule 2030(d) is modeled on a similar prohibition in the SEC Pay-to-Play Rule and would apply the prohibitions of the proposed rule to situations in which an investment adviser manages assets of a government entity through a hedge fund or other type of pooled investment vehicle.[54] Therefore, according to FINRA, the provision would extend the protection of the proposed rule to public pension plans that access the services of investment advisers through hedge funds and other types of pooled investment vehicles sponsored or advised by investment advisers as a funding vehicle or investment

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[52] *See* Notice, 80 FR at 81654, n. 47 (FINRA notes that, consistent with the SEC Pay-to-Play Rule, under the proposed rule, if a government entity is an investor in a covered investment pool at the time a contribution triggering a two-year time out is made, the covered member must forgo any compensation related to the assets invested or committed by the government entity in the covered investment pool) (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41047).

[53] *See* Notice, 80 FR at 81654, n. 48 (FINRA states that it added proposed Rule 2030(d)(2) in response to comments on *Regulatory Notice* 14–50 to clarify, for purposes of the proposed rule, the relationship between an investment adviser to a covered investment pool and a government entity that invests in the covered investment pool).

[54] *See id.* at 81654 (citing SEC Pay-to-Play Rule 206(4)–5(c)).

option in a government-sponsored plan, such as a 529 plan.[55]

E. Proposed Rule 2030(e): Prohibition on Indirect Contributions or Solicitations

Proposed Rule 2030(e) provides that it shall be a violation of Rule 2030 for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of the rule.[56] FINRA states that this provision is consistent with a similar provision in the SEC Pay-to-Play Rule[57] and would prevent a covered member or its covered associates from funneling payments through third parties, including, for example, consultants, attorneys, family members, friends or companies affiliated with the covered member as a means to circumvent the proposed rule.[58] FINRA also notes that, consistent with guidance provided by the SEC in connection with SEC Pay-to-Play Rule 206(4)–5(d), proposed Rule 2030(e) would require a showing of intent to circumvent the rule in order for such persons to trigger the two-year "time out."[59]

[55] *See* Notice, 80 FR at 81654 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41044, which discusses the applicability of the SEC Pay-to-Play Rule to covered investment pools).

[56] *See* Notice, 80 FR at 81654.

[57] *See id.* (citing SEC Pay-to-Play Rule 206(4)–5(d)).

[58] *See* Notice, 80 FR at 81654 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41044, which discusses direct and indirect contributions or solicitations).

[59] *See* Notice, 80 FR at 81654.

F. Proposed Rule 2030(f): Exemptions

Proposed Rule 2030(f) includes an exemptive provision for covered members, modeled on the exemptive provision in the SEC Pay-to-Play Rule, that would allow covered members to apply to FINRA for an exemption from the proposed rule's two-year time out.[60] As proposed, FINRA states that this provision would allow FINRA to exempt covered members, either conditionally or unconditionally, from the proposed rule's time out requirement where the covered member discovers contributions that would trigger the compensation ban after they have been made, and when imposition of the prohibition would be unnecessary to achieve the rule's intended purpose.[61] In determining whether to grant an exemption, FINRA would take into account varying facts and circumstances, outlined in the proposed rule, that each application presents (*e.g.,* the timing and amount of the contribution, the nature of the election, and the contributor's apparent intent or motive in making the contribution).[62] FINRA notes that this provision would provide covered members with an additional avenue by which to seek to cure the consequences of an inadvertent violation by the covered member or its covered associates that falls outside the limits of one of the proposed rule's exceptions.[63]

G. Proposed Rule 2030(g): Definitions

The following is an overview of some of the key definitions in FINRA's proposed rules.

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[60] *See id.* at 81654–55.

[61] *See id.* at 81655.

[62] *See id.*

[63] *See id.*

1. Contributions

Proposed Rule 2030(g)(1) defines "contribution" to mean any gift, subscription, loan, advance, deposit of money, or anything of value made for the purpose of influencing the election for a federal, state or local office, and includes any payments for debts incurred in such an election or transition or inaugural expenses incurred by a successful candidate for state or local office.[64] FINRA states that this definition is consistent with the SEC Pay-to-Play Rule.[65] FINRA also states that it would not consider a donation of time by an individual to be a contribution, provided the covered member has not solicited the individual's efforts and the covered member's resources, such as office space and telephones, are not used.[66] FINRA further states that it would not consider a charitable donation made by a covered member to an organization that qualifies for an exemption from federal taxation under the Internal Revenue Code, or its equivalent in a foreign jurisdiction, at the request of an official of a government entity to be a contribution for purposes of the proposed rule.[67]

2. Covered Associates

Proposed Rule 2030(g)(2) defines the term "covered associates" to mean: "(A) Any general partner, managing member or executive officer of a covered member, or other individual with a similar status or function; (B) Any associated person of a covered member who

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[64] *See id.* at 81652.

[65] *See id.*

[66] *See id.* (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41030).

[67] *See* Notice, 80 FR at 81652.

engages in distribution or solicitation activities with a government entity for such covered member; (C) Any associated person of a covered member who supervises, directly or indirectly, the government entity distribution or solicitation activities of a person in subparagraph (B) above; and (D) Any political action committee controlled by a covered member or a covered associate."[68] FINRA states that, as also noted in the SEC Pay-to-Play Rule Adopting Release, contributions made to influence the selection process are typically made not by the firm itself, but by officers and employees of the firm who have a direct economic stake in the business relationship with the government client.[69] For example, contributions by an "executive officer of a covered member" (as defined in proposed Rule 2030(g)(5)) would trigger the two-year time out.[70] FINRA also notes that whether a person is an executive officer would depend on his or her function or activities and not his or her title.[71] In addition, FINRA states that a covered associate would include a PAC controlled by the covered member or any of its covered associates, as a PAC is often used to make political contributions.[72] FINRA explains that it would consider a "covered member" (as defined in proposed Rule 2030(g)(4)) or its covered associates to have "control" over a PAC if the covered member or covered associate has the

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[68] *Id.* at 81653, n. 37.

[69] *See id.* (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41031).

[70] *See* Notice, 80 FR at 81653.

[71] *See id.*

[72] *See id.*

ability to direct or cause the direction of governance or operations of the PAC.[73]

3. Official of a Government Entity

FINRA explains that an "official" (as defined in proposed Rule 2030(g)(8)) of a "government entity" (as defined in proposed Rule 2030(g)(7))—both of which FINRA states are consistent with the SEC Pay-to-Play Rule definitions—would include an incumbent, candidate or successful candidate for elective office of a government entity if the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser or 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.[74] FINRA also explains that government entities would include all state and local governments, their agencies and instrumentalities, and all public pension plans and other collective government funds, including participant-directed plans such as 403(b), 457, and 529 plans.[75]

FINRA further states that the two-year time out would be triggered by contributions, not only to elected officials who have legal authority to hire the adviser, but also to elected officials (such as persons with appointment authority) who can influence the hiring of the adviser.[76] FINRA notes that it is the scope of authority of the particular office of an official, not the influence actually exercised by the individual that would determine whether the individual has influence

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[73] *See id.*

[74] *See id.* at 81652.

[75] *See id.*

[76] *See id.*

over the awarding of an investment advisory contract under the definition.[77]

H. Proposed Rule 4580: Recordkeeping Requirements

Proposed Rule 4580 would require covered members that engage in distribution or solicitation activities with a government entity on behalf of any investment adviser that provides or is seeking to provide investment advisory services to such government entity to maintain books and records that would allow FINRA to examine for compliance with its pay-to-play rule.[78] FINRA states that this provision is consistent with similar recordkeeping requirements imposed on investment advisers in connection with the SEC Pay-to-Play Rule.[79] The proposed rule would also require covered members to maintain a list or other record of certain specific information.[80] FINRA states that the proposed rule would, among other things, require that the direct and indirect contributions or payments made by the covered member or any of its covered associates be listed in chronological order and indicate the name and title of each contributor and each recipient of the contribution or payment, as well as the amount and date of each contribution or payment, and whether the contribution was the subject of the exception for returned contributions in proposed Rule 2030.[81]

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[77] *See id.* (citing SEC Pay-to-Play Rule Adopting Release, 75 FR 41018, 41029 (discussing the terms "official" and "government entity").

[78] *See* Notice, 80 FR at 81655.

[79] *See id.* (citing Advisers Act Rule 204–2(a)(18) and (h)(1)).

[80] *See* Notice, 80 FR at 81655–56.

[81] *See id.*

III. Summary of Comments

As noted above, the Commission received ten comment letters, from nine different commenters, on the proposed rule change.[82] Six commenters generally expressed support for FINRA's proposal.[83] However, five of those commenters, while generally expressing support for the goals of the proposal, also raised certain concerns regarding various aspects of the proposal as drafted and recommended amendments to the proposal.[84] The other three commenters did not support the proposed rule as drafted based largely on concerns involving the First Amendment to the U.S. Constitution.[85] These comments are summarized below.[86] On March 28, 2016, FINRA filed a letter with the Commission stating that it has considered the comments received by the Commission, and that FINRA is not intending to make changes to the proposed rule text in response to the comments.[87]

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[82] *See supra* note 5. CAI submitted two separate comment letters. *See* CAI Letter No. 1 and CAI Letter No. 2.

[83] *See* CAI Letter No. 1; CAI Letter No. 2; FSI Letter; ICI Letter; NAIFA Letter; NASAA Letter; and PIABA Letter.

[84] *See* CAI Letter No. 1; CAI Letter No. 2; FSI Letter; NAIFA Letter; NASAA Letter; and PIABA Letter. ICI did not raise additional concerns, but states that it is satisfied with FINRA's revisions and responses to the proposal as drafted in *Regulatory Notice* 14–50. *See* ICI Letter.

[85] *See* CCP Letter; Moran Letter; and State Parties Letter.

[86] For further detail, the comments that the Commission received on the Notice are available on the Commission's Web site at *http://www.sec.gov/comments/sr-finra-2015–056/finra2015056.shtml.*

[87] *See* FINRA Response Letter, *supra* note 7.

A. First Amendment Comments

As noted above, three commenters oppose the proposed rule as drafted based on First Amendment concerns.[88] One commenter simply noted that he thinks FINRA may have some First Amendment issues and suggested that FINRA consider raising the amount and restricted political donations limitations to Congressional committee members that might influence government decision-making in the relevant area.[89]

Another commenter urged the Commission to reject FINRA's proposal because, according to that commenter, it impermissibly restricts core political speech in violation of the First Amendment.[90] As more fully explained in the commenter's letter, this commenter makes the following general arguments in support of its position: (1) That FINRA's proposal is not narrowly tailored to achieve a compelling government interest and thus cannot survive First Amendment scrutiny and (2) that the Commission should examine FINRA's proposal on its own merits and should not take comfort from the opinion of the United States Court of Appeals for the DC Circuit in *Blount* v. *SEC,* 61 F.3d 938 (D.C. Cir. 1995), which upheld MSRB's Rule G–37 against a First Amendment challenge.[91] More specifically, this commenter also makes the following arguments regarding FINRA's proposal, including that: (i) The proposed contributions limits are too low to allow citizens to exercise their constitutional right to participate in the political process; (ii) the rule discriminates between

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[88] *See* CCP Letter; Moran Letter; and State Parties Letter.

[89] *See* Moran Letter.

[90] *See* CCP Letter (also urging rejection of MSRB's proposed amendments to its pay-to-play rules, MSRB Rule G–37).

[91] *See* CCP Letter.

contributions to a candidate for whom an individual is entitled to vote and other candidates and cannot be squared with the Supreme Court's decision in *McCutcheon* v. *FEC,* 134 S. Ct. 1434 (2014); (iii) FINRA did not consider less restrictive alternatives; (iv) the "look-back" provisions are overbroad and insufficiently tailored to support the governmental interest claimed to be served by these rules; (v) the rules are preempted, with respect to federal elections, by the Federal Election Campaign Act; (vi) the rules are impermissibly vague and overbroad; and (vii) the rules are overbroad as applied to independent broker-dealers and their registered representatives who operate as independent contractors because they are not are tailored to the manner in which services are provided by financial advisors in the independent broker-dealer model.[92]

Similarly, another commenter opposes FINRA's proposed rule, stating that the proposal is unlawful and unconstitutional.[93] This commenter makes the following general arguments in support of its position. First, the commenter claims that the proposal is unlawful as it is *ultra wires* because Congress did not empower entities like FINRA—nor agencies like the SEC—to regulate federal political contributions and the proposal is a direct effort to deter member firms and their employee from engaging in conduct that is protected by the First Amendment and permitted by federal statute.[94] As more fully explained in the commenter's

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[92] *See id.*

[93] *See* State Parties Letter (attaching its opening and reply appellate briefs filed in the *Republican State Committee* v. *SEC,* No. 14–1194 on Dec. 22, 2014 and Feb. 4, 2015, respectively).

[94] *See* State Parties Letter.

letter, this commenter makes the following claims in support of its argument, including that: (i) Campaign finance regulation has long been the exclusive province of Congress and the Federal Election Commission; (ii) Congress' comprehensive regime of political contribution limits forecloses FINRA's effort to regulate the same conduct; and (iii) even assuming Congress' contribution limits regime does not preclude FINRA from enacting its own rules, the proposal exceeds FINRA's authority to issue rules "designed to prevent fraudulent and manipulative acts and practices[.]"[95] Second, the commenter also claims that the proposal violates the First Amendment.[96] In support of this argument, the commenter states that FINRA cannot show that the proposal's restrictions are necessary to further a sufficiently important interest, and do so in a sufficient tailored manner.[97] As more fully explained in the commenter's letter, this commenter makes the following claims in support of its argument, including that: (i) The proposal severely burdens First Amendment rights and, therefore, FINRA bears an exceedingly high burden in establishing the constitutionality of the proposal; (ii) FINRA openly acknowledges that its proposal is a broad prophylactic measure that deters constitutionally protected conduct even when the government has no legitimate interest in doing so; (iii) the *Blount* opinion overlooked the disparate impact that a restriction like the FINRA proposal has on candidates; and (iv) the *Blount* opinion also did not discuss the constitutionality of anything comparable to the FINRA proposal's prohibition on coordinating or soliciting contributions "to a political party of a State or locality

[95] *See id.* (quoting 15 U.S.C. 78o–3(b)(6)).

[96] *See* State Parties Letter.

[97] *See id.*

where the investment adviser is providing or seeking to provide investment advisory services to a government entity."[98]

Although not expressly opposing the proposed rules on First Amendment grounds, two other commenters also raise First Amendment comments.[99] One of these commenters submits that Rule 2030 is not closely drawn in terms of the conduct it prohibits, the persons who are subject to its restrictions, and the circumstances in which it is triggered.[100] This commenter claims that the proposed rule's ambiguity may contravene one of the "key animating principles of the Commission in crafting the [SEC Pay-to-Play Rule]" which, according to the commenter, was to ensure its rule was narrowly tailored to serve a compelling governmental interest, namely, the elimination of pay-to-play practices by investment advisers by preventing fraudulent acts and practices in the market for the provision of investment advisory services to government entities.[101] Another commenter states that the proposed rules may "inadvertently capture activity that does not present the risk of *quid pro quo* corruption," and this commenter believes that FINRA must "define the contours of its proposal as clearly and

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[98] *See id.*

[99] *See* CAI Letter No. 1 and FSI Letter.

[100] *See* CAI Letter No. 1 (arguing that "[f]ailing to meet this objective of the [SEC Pay-to-Play Rule] would appear to be fatal to Rule 2030 inasmuch as the [SEC Pay-to-Play Rule] requires the Commission to find, by order, that Rule 2030 meets the objectives of the [SEC Pay-to-Play Rule]").

[101] *See* CAI Letter No. 1 (stating that in adopting the SEC Pay-to-Play Rule, "the Commission demonstrated its sensitivity to, and careful consideration of, potential First Amendment concerns because of the Rule's potential impact on political contributions").

distinctly as possible to avoid an unnecessary limitation on one's First Amendment rights, especially in the area of political speech."[102]

B. Variable Annuity-Related Comments

Two commenters raised concerns regarding the application of the proposed rules to variable annuities.[103]

Both of these commenters requested, as a threshold matter, that FINRA confirm that Rule 2030 would not apply to variable annuities.[104] In support of one of these commenter's request that the proposed rule should not apply to the sales of variable annuity contracts which are supported by a separate account that invests in mutual funds, the commenter argues that the nature of variable annuities and the way investment options are selected does not implicate the investment advisory solicitation activities contemplated by the SEC Pay-to-Play Rule.[105] This same commenter claims that the relationship between a variable annuity contract holder and the investment adviser to a mutual fund supporting the variable annuity does not rise to a level such that it should implicate a pay-to-play obligation.[106] Another one of these commenter's claims, in support of its argument that Rule 2030 should not apply to variable annuities, is that compliance with

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[102] FSI Letter.

[103] *See* CAI Letter No. 1 and FSI Letter. *See also* CAI Letter No. 2 (reflecting CAI's suggested revisions to the certain language in some of FINRA's proposed rules).

[104] *See* CAI Letter No. 1 and FSI Letter.

[105] *See* FSI Letter (claiming that applying the proposed rule to variable annuities will significantly increase the compliance burden and as such may limit the options our members make available to 403(b) and 457 plans).

[106] *See* FSI Letter.

Rule 2030 would be impractical for broker-dealers selling variable annuities in the government market.[107] This commenter also argues, for example, that a covered member selling a variable annuity, particularly where the separate account is a registered as a unit investment trust, cannot fairly be seen to be engaging in solicitation activities on behalf of all of the investment advisers and sub-advisers that manage the covered investment pools available as investment options under the separate account and subaccounts.[108]

One of these commenters also requests that proposed Rule 2030 be modified to, among other things, clarify that the distribution of a two-tiered product such as a variable annuity is not solicitation activity for an investment adviser and sub-advisers managing the funds available as investment options.[109] Furthermore, this same commenter states that if FINRA or the Commission determines that broker-dealers selling variable annuities constitute solicitation activities for purposes of Rule 2030, that determination raises a host of interpretive questions that, in this commenter's view, will require further guidance from FINRA or the Commission.[110]

C. Comments Regarding the Scope of the Proposed Rule

Two commenters also expressed concern that proposed rule 2030(d) would, in their view, re-characterize "ordinary" or "customary" distribution activities for covered investment pools as the solicitation of clients

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[107] *See* CAI Letter No. 1.

[108] *See id.*

[109] *See id.*

[110] *See id.*

on behalf of the investment adviser to the covered investment pools.[111] One of these commenters requests that such customary distribution activity by member firms for covered investment pools sold to government entities *not* be treated as solicitation activity for an investment adviser for purposes of Rule 2030 simply because an investment adviser provides advisory services to a covered investment pool that is available as an investment option.[112] As more fully explained in the commenter's letter, the commenter claims, for example, that proposed Rule 2030(d) would recast "traditional" broker-dealer activity (*i.e.,* the offer and sale of covered investment pool securities pursuant to a selling or placement agent agreement) into something it is not: The solicitation of investment advisory services on behalf of an investment adviser.[113] This commenter also claims that the decision in *Goldstein* v. *SEC,* 451 F.3d 873 (D.C. Cir. 2006) and the Commission staff's interpretive position under Advisers Act Rule 206(4)–3 make proposed Rule 2030(d) impractical, as it would put selling firms in a contradictory position under FINRA rules and Advisers Act rules.[114] This commenter states that a broker-dealer that offers and sells interests in a mutual fund or private fund cannot be characterized as soliciting on behalf of the investment adviser to a covered investment pool.[115]

Similarly, another commenter expressed concern with the apparent application of proposed Rule 2030(d)

[111] *See* CAI Letter No. 1 and FSI Letter.

[112] *See* CAI Letter No. 1.

[113] *See id.*

[114] *See id.*

[115] *See id.*

to traditional brokerage sales of mutual funds and variable annuities to participant-directed government-sponsored retirement plans.[116] As more fully explained in the commenter's letter, this commenter states that it continues to be concerned that the provisions in proposed Rule 2030(d) "go beyond that which is required under Rule 206(4)–5(a)(2)(i) and Rule 206(4)–5(c) to the detriment of investors."[117] This same commenter also claims that mutual fund sales, as well as variable annuity sales, should be excluded, claiming that the proposed rules serve to redefine the sale of mutual funds as solicitation by a broker-dealer on behalf of an investment adviser and also conflicts with the realities of conventional mutual fund selling agreements.[118]

D. Comments Regarding the Inclusion of Distribution Activity in the Proposed Rule

One commenter generally expressed concern that Rule 2030 is unnecessarily ambiguous regarding the term distribution activities in Rule 2030(a).[119] This commenter claims that it is unclear what distribution activities "with" a government entity would be prohibited, what compensation is covered by the proposed rule and who must pay it, and when a member firm might be deemed to be acting "on behalf of" an investment adviser.[120] For example, this commenter states that the ambiguity of Rule 2030 may result in its misapplication in a variety of contexts.

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[116] *See* FSI Letter.

[117] FSI Letter.

[118] *See id.*

[119] *See* CAI Letter No. 1.

[120] *See id.*

This commenter also claims that, while the SEC Pay-to-Play Rule requires regulated persons to be subject to rules that prohibit them from engaging in certain distribution activities if certain political contributions have been made, Rule 206(4)–5 does not mandate the use of the term "distribution" in describing the conduct prohibited by the proposed rule, and suggested revised rule text reflecting that assertion.[121]

The commenter believes that its suggested revisions would, among other things, eliminate the potential concern that a selling firm might violate Rule 2030 unknowingly due to being deemed to be acting on behalf of investment advisers or sub-advisers of underlying funds with which it has no relationship.[122]

E. Comments Regarding Defined Terms Used in the Proposed Rules

Two commenters requested clarification of certain defined terms used in the proposed rules.[123] One commenter urged FINRA, or the Commission, to clarify the meaning of the term "instrumentality" as it is used in the definition of "government entity."[124] This commenter claims that, without additional guidance, covered members will continue to struggle with whether a contribution to a given entity should be treated as a

[121] *See* CAI Letter No. 1 and CAI Letter No. 2 (reflecting CAI's suggested revisions to certain language in some of FINRA's proposed rules).

[122] *See* CAI Letter No. 1 (claiming that the commenter's suggested revisions would not result in any inappropriate narrowing of the scope of Rule 2030).

[123] *See* CAI Letter No. 1 and NAIFA Letter.

[124] *See* CAI Letter No. 1 (claiming that CAI's members have struggled to understand the contours of this term in the context of the SEC Pay-to-Play Rule).

contribution to an instrumentality of a state or state agency, thus triggering the two-year time out.[125] This same commenter also asked for clarification as to whether each and every "contribution" (as defined in proposed Rule 2030(g)(1)) is, by definition, also a "payment" (as defined in proposed Rule 2030(g)(9)).[126]

Another commenter requests that FINRA clarify the definition of a "covered associate" and clarify and delineate the positions that would qualify someone as a covered "official."[127] This commenter clams that, in response to the same definition of "covered associate" as used in the SEC Pay-to-Play Rule, many investment advisers and broker dealers have classified all of their representatives as covered associates regardless of whether they actually engage in the solicitation activity specified in the definition.[128] This commenter believes that additional clarification on when an associated person of a covered member would (or would not) qualify as a "covered associate" would ease compliance burdens, curtail overly broad limits on legitimate political activity, and increase the consistency of procedures amongst member firms who seek to comply with both the letter and the spirit of the proposed rule.[129] This same commenter requests additional details or guidance from the Commission with respect to this

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[125] *See id.*

[126] *See* CAI Letter No. 1 (discussing Notice, 80 FR at 81654, n. 41: "Consistent with the SEC Pay-to-Play Rule, FINRA is including the broader term "payments," as opposed to "contributions," to deter a cover member from circumventing the proposed rule's prohibitions by coordinating indirect contributions to government officials by making payments to political parties").

[127] *See* NAIFA Letter.

[128] *See id.*

[129] *See id.*

definition of "official" because, according to that commenter, that definition has caused, and will continue to spark confusion over exactly what offices subject the holder to be classified as an "official" given that the term is defined the same way in the SEC Pay-to-Play Rule.[130]

F. Comments Regarding PAC Contributions That Trigger the Anti-Circumvention Provision of the Proposed Rule

This commenter also claims that statements made by FINRA in the Notice regarding the proposed rule's anti-circumvention provision, proposed Rule 2030(e), combined with statements made in SEC staff guidance concerning whether contributions through PACs would violate the SEC Pay-to-Play Rule and section 208(d) of the Advisers Act, have the ability to chill contributions to PACs.[131] This commenter claims, for example, that prospective contributors who simply want to donate to a PAC have been hesitant to or restricted from doing so out of fear that they may be making an indirect contribution in violation of the SEC Pay-to-Play Rule.[132] Accordingly, this commenter requests further guidance from the Commission on the factors by which contributions to PACs would or would not trigger the anti-circumvention provision of the proposed rule.[133]

G. Comments Regarding the De Minimis Exception Under Proposed Rule 2030(c)

Several commenters raised concerns regarding the *de minimis* contribution exception under proposed

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[130] *See id.*

[131] *See id.*

[132] *See id.*

[133] *See id.*

Rule 2030(c)(1). One commenter requested that the $350 and $150 amounts "be raised substantially" in both SEC Pay-to-Play Rule and in proposed Rule 2030(c)(1), and further requested that the $350 limitation on the proposed exception for returned contributions under proposed Rule 2030(c)(3), be eliminated in both the SEC Pay-to-Play Rule and in FINRA's proposed rule.[134]

H. Comments Regarding the Grandfathering of Existing Accounts and Contracts

One commenter requested that FINRA clarify the application of the proposed rule to existing government entity accounts or contracts.[135] This commenter requests that, in the event that FINRA does not amend the application of its proposed rule to covered investment pools (as requested by this same commenter), FINRA apply the proposed rule only to accounts and variable contracts opened after the effective date.[136]

I. Comments Regarding Application of the Proposed Rules to the Independent Business Model

One commenter claims that its members will face difficulties in attempting to comply with the proposed rules, and that these difficulties stem, primarily, from a requirement for independent firms to implement a rule that is premised on the notion that solicitation of clients is performed pursuant to a centralized process controlled by the management of a registered

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[134] *See* CAI Letter No. 1.

[135] *See* FSI Letter.

[136] *See id.*

investment adviser.[137] This same commenter claims that the lack of clarity as to the application of the SEC Pay-to-Play Rule to its members' business model, and the scope of government officials that trigger the requirements, has led some firms to adopt aggressive compliance programs that prohibit political contributions.[138] Accordingly, this commenter claims that absent clarity concerning the application of the proposed rule to the brokerage services provided to 403(b) and 457 plans, its members will be faced with the choice of either adopting similarly aggressive policies or prohibiting sales to government-sponsored retirement plans.[139]

J. Comments Regarding Proposed Rule 4580: Books and Records Requirements

One commenter claims that it continues to believe that not all payments to political parties or PACs should have to be maintained under the books and records requirements of proposed Rule 4580.[140] Rather, this commenter believes that only payments to political parties or PACs where the covered member or a covered associate (i) directs the political party or PAC to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser or (ii) knows that the political party or PAC is going to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser,

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[137] *See* FSI Letter (claiming FSI believes that the SEC Pay-to-Play Rule has inadvertently captured non-corrupting activity and it fears that the proposed rule may do the same).

[138] *See id.*

[139] *See id.*

[140] *See* CAI Letter No. 1.

should have to be maintained.[141] This commenter states that, while it appreciates FINRA's rationale for proposed Rule 4580, it believes the costs and burdens associated with the request far outweigh the benefits to FINRA in ensuring compliance with the rule and will lead to periodic "fishing expeditions" by FINRA examiners.[142]

K. Comments Requesting More Stringent Requirements in the Proposed Rules

Two commenters suggested including more stringent requirements in FINRA's proposed rule.[143] First, both commenters request that FINRA expand the applicability of its proposed rules to include state-registered investment advisers.[144] More specifically, one of these commenters suggests that FINRA include state-registered investment advisers in its definition of "investment adviser" for the purposes of its proposed rule.[145] These commenters note, for example, that FINRA states in the Notice that relatively few state-registered investment advisers manage public pension plans.[146] However, one of these commenters believes that this alone does not justify permitting FINRA-member firms that do manage public pension plans, but happen to work with smaller investment advisers, to engage in pay-to-play activities with no repercussions.[147] One of these commenters also claims that

[141] *See id.*

[142] *See id.*

[143] *See* NASAA Letter and PIABA Letter.

[144] *See* NASAA Letter and PIABA Letter.

[145] *See* NASAA Letter.

[146] *See* NASAA Letter and PIABA Letter.

[147] *See* PIABA Letter.

state-registered investment advisers now include larger firms and, therefore, it is much more likely that state-registered investment advisers advise or manage public pension plans or similar funds.[148]

Second, these same two commenters request that FINRA include a mandatory disgorgement provision for violations of its proposed rule.[149] These commenters state that they are disappointed that FINRA removed the mandatory disgorgement provisions from the proposal as outlined in FINRA's *Regulatory Notice* 14–50.[150] These commenters believe that a mandatory disgorgement provision would act as a significant deterrent to engaging in pay-to-play schemes, and it should remain in FINRA's final rule.[151]

Finally, one of these commenters believes that the current two-year cooling-off period in the proposal should be at least four years.[152] This commenter believes that the two-year cooling-off period does not adequately reduce the incentive for FINRA member firms to make political contributions in order to obtain pay-to-play advantages.[153] This commenter states FINRA should start with the most comprehensive rule, and that it would welcome the deterrent effect of a four-year cooling off period.[154]

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[148] *See* NASAA Letter.

[149] *See* NASAA Letter and PIABA Letter.

[150] *See* NASAA Letter and PIABA Letter.

[151] *See* NASAA Letter and PIABA Letter.

[152] *See* PIABA Letter.

[153] *See id.*

[154] *See id.*

IV. Proceedings To Determine Whether To Approve or Disapprove SR–FINRA–2015–056 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Exchange Act Section 19(b)(2)(B) to determine whether the proposed rule change should be approved or disapproved.[155] Institution of proceedings appears appropriate at this time in view of the legal and policy issues raised by the proposal. As noted above, institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the proposed rule change, including the comments received, and provide the Commission with additional comment to inform the Commission's analysis as to whether to approve or disapprove the proposal.

Pursuant to Exchange Act Section 19(b)(2)(B),[156] the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from, commenters with regard to the proposed rule change's consistency with Section 15A of the Exchange Act, and in particular Sections 15A(b)(6)

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[155] 15 U.S.C. 78s(b)(2). Exchange Act Section 19(b)(2)(B) provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. The time for conclusion of the proceedings may be extended for up to an additional 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding or if the self-regulatory organization consents to the extension.

[156] 15 U.S.C. 78s(b)(2)(B).

and 15A(b)(9). Exchange Act Section 15A(b)(6)[157] requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. In addition, Exchange Act Section 15A(b)(9)[158] requires that FINRA rules not impose any unnecessary or inappropriate burden on competition.

V. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues raised by the proposed rule change. In particular, the Commission invites the written views of interested persons on whether the proposed rule change is inconsistent with Sections 15A(b)(6) and 15A(b)(9), or any other provision, of the Exchange Act, or the rules and regulations thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b–4, any request for an opportunity to make an oral presentation.[159]

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[157] 15 U.S.C. 78*o*–3(b)(6).

[158] 15 U.S.C. 78*o*–3(b)(9).

[159] Exchange Act Section 19(b)(2), as amended by the Securities Acts Amendments of 1975, Pub. L. 94–29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on

Interested persons are invited to submit written data, views, and arguments by April 25, 2016 concerning whether the proposed rule change should be approved or disapproved. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by May 19, 2016. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number SR–FINRA–2015–056 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–FINRA–2015–056. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public

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Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. The Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

All submissions should refer to File Number SR–FINRA–2015–056 and should be submitted on or before April 25, 2016. If comments are received, any rebuttal comments should be submitted by May 19, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[160]

Robert W. Errett,
Deputy Secretary.

[FR Doc. 2016–07513 Filed 4–1–16; 8:45 am]
BILLING CODE 8011–01–P

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[160] 17 CFR 200.30–3(a)(12); 17 CFR 200.30–3(a)(57).

APPENDIX F

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-78683;
File No. SR-FINRA-2015-056)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Adopt FINRA Rule 2030 and FINRA Rule 4580 to Establish "Pay-To-Play" and Related Rules

August 25, 2016

I. Introduction

On December 16, 2015, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to adopt FINRA Rules 2030 (Engaging in Distribution and Solicitation Activities with Government Entities) and 4580 (Books and Records Requirements for Government Distribution and Solicitation Activities) to establish "pay-to-play"[3] and related rules that would regulate the activities of member firms that engage in distribution or solicitation activities for compensation with

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.

[3] "Pay-to-play practices," "play-to-play arrangements" or "play-to-play activities," as referred to throughout this order, typically involve a person making cash or in-kind political contributions (or soliciting or coordinating others to make such contributions) to help finance the election campaigns of state or local officials or bond ballot initiatives as a *quid pro quo* for the receipt of government contracts.

government entities on behalf of investment advisers. Member firms serving this role—sometimes referred to as "placement agents" or "solicitors" (collectively referred to herein as "placement agents")—assist investment advisers with obtaining advisory business from such entities. In this context, pay-to-play has historically presented a problem, including when investment advisers retain placement agents who have made contributions to government officials who are responsible for, or can influence the outcome of, the selection process for investment advisers. When investment advisers are chosen on the basis of a placement agent's political contributions, rather than on, for example, the adviser's merit, performance, or costs, the market and selection process for advisers becomes distorted. Ultimately, pay-to-play harms investors and the public interest if government entities, including public pension plans, and their beneficiaries receive inferior services or pay higher fees.

The proposed rule change was published for comment in the *Federal Register* on December 30, 2015.[4] The Commission received ten comment letters, from nine different commenters, in response to the Notice.[5]

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[4] *See* Exchange Act Rel. No. 76767 (Dec. 24, 2015), 80 FR 81650 (Dec. 30, 2015) (File No. SR-FINRA-2015-056) ("Notice").

[5] *See* Letters from David Keating, President, Center for Competitive Politics ("CCP"), dated Jan. 20, 2016 ("CCP Letter 1"); Clifford Kirsch and Michael Koffler, Sutherland Asbill & Brennan LLP, for the Committee of Annuity Insurers ("CAI"), dated Jan. 20, 2016 ("CAI Letter 1"); Clifford Kirsch and Michael Koffler, Sutherland Asbill & Brennan LLP, for the CAI, dated Feb. 5, 2016 ("CAI Letter 2"); David T. Bellaire, Executive Vice President and General Counsel, Financial Services Institute ("FSI"), dated Jan. 20, 2016 ("FSI Letter 1"); Tamara K. Salmon, Assistant General Counsel, Investment Company Institute ("ICI"), dated Jan. 20, 2016 ("ICI Letter"); Patrick J Moran, Esq.,

On February 8, 2016, FINRA extended the time period by which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to March 29, 2016.[6] On March 28, 2016, FINRA filed a letter with the Commission stating that it considered the comments received by the Commission in response to the Notice, and that FINRA is not intending to make changes to the proposed rule text in response to the comments.[7]

On March 29, 2016, pursuant to delegated authority, the Commission issued an order instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[8] to determine whether to approve or disapprove the pro-

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dated Dec. 29, 2015 ("Moran Letter"); Gary A. Sanders, Counsel and Vice President, National Association of Insurance and Financial Advisors ("NAIFA"), dated Jan. 20, 2016 ("NAIFA Letter"); Judith M. Shaw, President, North American Securities Administrators Association, Inc. ("NASAA"), dated Jan. 20, 2016 ("NASAA Letter"); Hugh D. Berkson, President, Public Investors Arbitration Bar Association ("PIABA"), dated Jan. 20, 2016 ("PIABA Letter"); and H. Christopher Bartolomucci and Brian J. Field, Bancroft PLLC, for the New York Republican State Committee and the Tennessee Republican Party ("State Parties"), dated Jan. 20, 2016 ("State Parties Letter 1"). The comment letters filed with the Commission in connection with the proposed rule change are available at: http://www.sec.gov/comments/sr-finra-2015-056/finra2015056.shtml.

[6] *See* Letter from Victoria Crane, Associate General Counsel, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel—Sales Practices, Division of Trading and Markets, Commission, dated Feb. 8, 2016.

[7] *See* Letter from Victoria Crane, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, Commission, dated Mar. 28, 2016 ("FINRA Response Letter 1").

[8] 15 U.S.C. 78s(b)(2)(B).

posed rule change, and solicited additional comment.[9] The Commission received an additional four comments regarding the proceedings,[10] including two letters requesting an opportunity to make an oral presentation in the proceedings.[11] On July 6, 2016, FINRA submitted a letter responding to all comments and to the Order Instituting Proceedings.[12] On June 21, 2016, FINRA extended the time period by which the Commission must determine whether to approve or disapprove the proposed rule change to August 26, 2016.[13]

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[9] *See* Securities Exchange Act Release No. 77465 (Mar. 29, 2016), 81 FR 19260 (Apr. 4, 2016) ("Order Instituting Proceedings").

[10] *See* Letters from David T. Bellaire, Executive Vice President and General Counsel, FSI, dated Apr. 27, 2016 ("FSI Letter 2"); Jason Torchinsky, Holtzman Vogel Josefiak Torchinsky PLLC, on behalf of the Georgia Republican Party and the State Parties, dated April 12, 2016, filed April 21, 2016 ("State Parties Letter 2"); Allen Dickerson, Legal Director, CCP, dated April 21, 2016 ("CCP Letter 2"); Allen Dickerson, Legal Director, CCP, dated April 15, 2016 ("CCP Letter 3").

[11] *See* CCP Letter 2; State Parties Letter 2. The Commission denied both requests. *See* Letter from Brent J. Fields, Secretary, Commission, to Allen Dickerson, Legal Director, CCP dated July 11, 2016; Brent J. Fields, Secretary, Commission, to Jason Torchinsky, Holtzman Vogel Josefiak Torchinsky PLLC, on behalf the State Parties, dated July 11, 2016.

[12] *See* Letter from Victoria Crane, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, Commission, dated July 6, 2016 ("FINRA Response Letter 2"). Both of FINRA's Responses Letters are available on FINRA's website at http://www.finra.org, at the principal office of FINRA, and at the Commission's Public Reference Room.

[13] *See* Letter from Victoria Crane, Associate General Counsel, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel—Sales Practices, Division of Trading and Markets, Commission, dated June 21, 2016.

This order approves the rule change as proposed. Section II provides an overview of the rule and summarizes the rule as described by FINRA in its filing and as published in the Notice, Section III is a summary of the comments received and FINRA's responses, and Section IV contains the Commission's findings in approving the proposal.

II. Description of the Proposed Rule Change[14]

As described more fully in the Notice, FINRA modeled proposed Rule 2030[15] on the Commission's Rule 206(4)-5 under the Investment Advisers Act of 1940 ("Advisers Act"), which addresses pay-to-play practices by investment advisers (the "SEC Pay-to-Play Rule").[16]

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[14] The proposed rule change, as described in Item II, is excerpted, in part, from the Notice, which was substantially prepared by FINRA. *See supra* note 4. A more detailed description of the proposed rule change is in the Notice.

[15] *See* Notice, 80 FR at 81650–51 (citing Advisers Act Release No. 3043 (July 1, 2010), 75 FR 41018 (July 14, 2010) (Political Contributions by Certain Investment Advisers) ("SEC Pay-to-Play Rule Adopting Release")).

[16] FINRA also published the proposed rule change in *Regulatory Notice* 14-50 (Nov. 2014) ("*Regulatory Notice* 14-50") and sought comment on the proposal. FINRA states that commenters were generally supportive of the proposed rule change, but also expressed some concerns. As such, FINRA revised the proposed rule change as published in *Regulatory Notice* 14-50 in response to those comments. As described more fully in the Notice, FINRA believes that the revisions it made more closely align FINRA's proposed rule with the SEC Pay-to-Play Rule and should help reduce cost and compliance burden concerns raised by commenters. *See* Notice, 80 FR at 81651 n.16.

The SEC Pay-to-Play Rule, in part, prohibits any investment adviser covered under the rule[17] or any of its covered associates from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of such investment adviser unless such person is a "regulated person,"[18] as defined under the rule, or an executive officer, general partner, managing member, or employee of the investment adviser.[19] A "regulated person," as defined in the SEC Pay-to-Play Rule, includes a registered broker-dealer, provided that: (a) FINRA rules prohibit member firms from engaging in distribution or solicitation activities if certain political contributions have been made to certain public officials; and (b) the Commission finds, by order, that such rules impose substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and that such rules are consistent with the objectives of the SEC Pay-to-Play Rule.[20]

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[17] The SEC Pay-to-Play Rule applies to investment advisers registered or required to be registered with the Commission, foreign private advisers that are unregistered in reliance on Section 203(b)(3) of the Advisers Act, and exempt reporting advisers as defined in Rule 204-4(a) under the Advisers Act. *See* 17 CFR 275.206(4)-5(a)(2).

[18] *See* Notice, 80 FR at 81650 n.6, 81656. *See also* 17 CFR 275.206(4)-5(a)(2)(i)(A).

[19] *See* 17 CFR 275.206(4)-5(a)(2)(i)(B) (or, in each case, a person with a similar status or function to an executive officer, general partner, or managing member of the investment adviser).

[20] *See* Notice, 80 FR at 81650 n.6 (citing 17 CFR 275.206(4)-5(f)(9)). The definition of "regulated person" also includes SEC-registered investment advisers and SEC-registered municipal advisors, subject to specified conditions. The Commission amended the SEC Pay-to-Play Rule to add SEC-registered municipal

In light of this regulatory framework, FINRA proposed its own pay-to-play rule to enable its member firms to continue to engage in distribution and solicitation activities for compensation with government entities on behalf of investment advisers, while subjecting its member firms to appropriate safeguards that will discourage them from engaging in pay-to-play practices.[21] Because one of the objectives of FINRA's proposal is to satisfy the "regulated person" definition in the SEC Pay-to-Play Rule, the elements of and terms used in FINRA's proposal are substantially equivalent to and consistent with the objectives of the SEC Pay-to-Play Rule.[22] As discussed below, this threshold objective precludes many of the modifications proposed by commenters given that a more permissive FINRA proposal would not meet the stringency requirements of the SEC Pay-to-Play Rule. FINRA believes that its proposed rule would establish a comprehensive regime to regulate the activities of its member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers, and would impose substantially equivalent restrictions on FINRA member firms engaging in distribution or

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advisors to the definition of "regulated persons." *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Rel. No. 3221 (June 22, 2011), 76 FR 42950 (July 19, 2011).

[21] *See* Notice, 80 FR at 81651, 81656.

[22] On August 25, 2016, the Commission issued a notice stating that it intends to issue an order pursuant to Section 206 of the Advisers Act and SEC Pay-to-Play Rule 206(4)-5 finding that FINRA's proposed Rule 2030 (i) imposes substantially equivalent or more stringent restrictions on broker-dealers than the SEC Pay-to-Play Rule imposes on investment advisers and (ii) is consistent with the objectives of the SEC Pay-to-Play Rule.

solicitation activities to those that the SEC Pay-to-Play Rule imposes on investment advisers.[23]

Furthermore, FINRA's proposed Rule 4580 would impose recordkeeping requirements on FINRA member firms in connection with its pay-to-play rule that would allow examination of member firms' books and records for compliance with Rule 2030.[24] FINRA believes that proposed Rule 4580 is consistent with similar recordkeeping requirements imposed on investment advisers in connection with the SEC Pay-to-Play Rule.[25]

The following is an overview of the key provisions in FINRA's proposed rules, as described by FINRA in the Notice.

A. Proposed Rule 2030(a): Limitation on Distribution and Solicitation Activities

Proposed Rule 2030(a) would prohibit a covered member from engaging in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by the covered member or a covered associate, including a person who becomes a covered associate within two years after the contribution is made.[26] FINRA states that the terms and scope of the prohibitions in proposed Rule 2030(a) are modeled on

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[23] *See* Notice, 80 FR at 81651, 81656.

[24] *See id.* at 81651, 81655–56.

[25] *See id.* at 81655 n.60 (citing Advisers Act Rule 204-2(a)(18) and (h)(1)).

[26] *See* Notice, 80 FR at 81651.

the SEC Pay-to-Play Rule.[27] According to FINRA, the two-year time-out period is intended to discourage covered members from participating in pay-to-play practices by requiring a cooling-off period during which the effects of a political contribution on the selection process can be expected to dissipate.[28]

The following is an overview of some of the key terms used in FINRA's proposed Rule 2030, as discussed by FINRA in its filing and published in the Notice or as defined in proposed Rule 2030(g).

1. Covered Members

The SEC Pay-to-Play Rule includes within its definition of "regulated person" SEC-registered municipal advisors, subject to specified conditions.[29] Specifically, the SEC Pay-to-Play Rule prohibits an investment adviser from providing or agreeing to provide, directly or indirectly, payment to an SEC-registered municipal advisor unless the municipal advisor is subject to a Municipal Securities Rulemaking Board ("MSRB") pay-to-play rule.[30]

FINRA addresses the interplay between its proposed rule and the application of the MSRB's municipal advisor pay-to-play rule by exempting from the definition of "covered member" a member when it is "engaging in activities that would cause the member to be a municipal advisor as defined in Exchange Act Section 15B(e)(4), SEA Rule 15Ba1-1(d)(1) through (4) and

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[27] *See id.* at 81651. *See also id.* at 81651 n.19 (citing 17 CFR 275.206(4)-5(a)(1)).

[28] *Notice*, 80 FR at 81651, 81659.

[29] *See* 17 CFR 275.206(4)-5(a)(2)(i)(A) and 17 CFR 275.206(4)-5(f)(9).

[30] *See supra* note 29.

other rules and regulations thereunder."[31] FINRA states that a member firm that solicits a government entity for investment advisory services on behalf of an *unaffiliated* investment adviser may be required to register with the SEC as a municipal advisor as a result of such activity.[32] Under such circumstances, FINRA notes that the MSRB rules applicable to municipal advisors, including the pay-to-play rule adopted by the MSRB,[33] would apply to the member firm.[34] On the other hand, if the member firm solicits a government entity on behalf of an *affiliated* investment adviser, such activity would not cause the firm to be a municipal advisor.[35] Under such circumstances, the member firm would be a "covered member" subject

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[31] Proposed Rule 2030(g)(4). *See also* Notice, 80 FR at 81652 (explaining that the SEC Pay-to-Play Rule includes within its definition of "regulated person" SEC-registered municipal advisors, subject to specified conditions, and prohibits an investment adviser from providing or agreeing to provide, directly or indirectly, payment to an SEC-registered municipal advisor unless the municipal advisor is subject to a MSRB pay-to-play rule).

[32] *See* Notice, 80 FR at 81652.

[33] On February 17, 2016, the MSRB published a regulatory notice announcing that its pay-to-play rule was deemed approved pursuant to section 19(b)(2)(D) of the Exchange Act on February 13, 2016 and that the effective date of the rule is August 17, 2016. *See* Amendments to MSRB Rule G-37 on Political Contributions and Prohibitions on Municipal Securities Business and Related Amendments are Deemed Approved under the Securities Exchange Act of 1934, Regulatory Notice 2016-06, dated February 17, 2016 (the "MSRB Regulatory Notice"), available at http://www.msrb.org/~/media/Files/Regulatory-Notices/Announcements/2016-06.ashx?n=1.

[34] *See* Notice, 80 FR at 81652.

[35] *See id.*

to the requirements of proposed Rule 2030.[36] This distinction is the result of the definitions of "municipal advisor" and "solicitation of a municipal entity or obligated person" in the Exchange Act, which only covers a person who is not affiliated with the broker, dealer, municipal securities dealer, municipal advisor, or investment adviser for whom the person is soliciting.[37]

2. Distribution Activities

With respect to the triggering activities for FINRA's proposed Rule 2030(a), FINRA states that, based on the definition of "regulated person" in the SEC Pay-to-

[36] *See id.* FINRA also notes that a person that is registered under the Exchange Act as a broker-dealer and municipal advisor, and under the Advisers Act as an investment adviser could potentially be a "regulated person" for purposes of the SEC Pay-to-Play Rule and that such a regulated person would be subject to the rules that apply to the services the regulated person is performing. *See id.* at n.24.

[37] Exchange Act Section 15B(e)(4) provides that a "municipal advisor" includes a person that undertakes solicitation of a municipal entity or obligated person. 15 U.S.C. 78o-4(e)(4). Exchange Act Section 15B(e)(9) provides that the term "solicitation of a municipal entity or obligated person" means "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser (as defined in section 202 of the Investment Advisers Act of 1940) that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity." 15 U.S.C. 78o-4(e)(9).

Play Rule,[38] it is proposing a rule that prohibits its member firms from engaging in distribution activities (as well as solicitation activities) for compensation with government entities for two years after certain political contributions have been made to certain officials.[39] FINRA also notes, in response to certain comments discussed below, that certain language in the SEC Pay-to-Play Rule Adopting Release further supports the inclusion of distribution activities by broker-dealers in FINRA's proposed Rule 2030.[40]

FINRA explains that the proposed rule would not apply to distribution activities related to registered investment companies that are not investment options of a government entity's plan or program because in these circumstances a member firm is not providing or seeking to provide investment advisory services to a

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[38] A "regulated person," as defined in the SEC Pay-to-Play Rule, includes a FINRA member firm, provided that: (a) FINRA rules "prohibit member firms from engaging in distribution or solicitation activities if certain political contributions have been made;" and (b) "[t]he Commission finds, by order, that such rules impose substantially equivalent or more stringent restrictions on broker-dealers than [the SEC Pay-to-Play Rule] imposes on investment advisers and that such rules are consistent with the objectives of [the SEC Pay-to-Play Rule]." 17 CFR 275.206(4)-5(f)(9)(ii).

[39] *See* Notice, 80 FR at 81660–61 (explaining that FINRA believes its proposed rule must apply to member firms engaging in distribution activities and that FINRA did not revise the proposed rule to remove references to the term "distribution" as requested by comments received in response to *Regulatory Notice* 14-50).

[40] *See* Notice, 80 FR at 81660. *See also id.* at 81661 n.103 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41040 n.298 where, according to FINRA, the Commission "clarif[ied] under what circumstances distribution payments would violate the SEC's Pay-to-Play Rule").

government entity.[41] Therefore, the proposed rule would apply to distribution activities involving unregistered pooled investment vehicles such as hedge funds, private equity funds, venture capital funds, collective investment trusts, and registered pooled investment vehicles such as mutual funds, but only if those registered pools are an investment option of a participant-directed plan or program of a government entity.[42] FINRA also notes that, consistent with the SEC Pay-to-Play Rule, to the extent mutual fund distribution fees are paid by the fund using fund assets pursuant to a 12b-1 plan, such payments generally would not constitute payments by the fund's investment adviser.[43] However, if the adviser pays for the fund's distribution out of its "legitimate profits," the proposed rule would generally be implicated.[44]

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[41] *See* Notice, 80 FR at 81661 n.106 (explaining that, although the proposed rule would not apply to distribution activities relating to all registered pooled investment vehicles, pursuant to proposed Rule 2030(e) "[i]t shall be a violation of this Rule for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of this Rule").

[42] *See id.* at 81661. *See also id.* at 81651 n.17 and 81654 n.46.

[43] *See id.* at 81661 n.103. *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41040 n.298 (discussing how broker-dealers may be compensated by advisers according to distribution arrangements and noting that "[m]utual fund distribution fees are typically paid by the fund pursuant to a 12b-1 plan, and therefore generally would not constitute payment by the fund's adviser. As a result, such payments would not be prohibited [under the SEC Pay-to-Play Rule] by its terms").

[44] *See* Notice, 80 FR at 81661 n.103 (noting, among other things, that "for private funds, third parties are often compensated by the investment adviser or its affiliated general partner"). For a discussion of a mutual fund adviser's ability to use "legitimate profits" for fund distribution, *see* Investment Company Act

3. Solicitation Activities

FINRA states that, consistent with the SEC Pay-to-Play Rule, proposed Rule 2030(g)(11) defines the term "solicit" to mean:

> (A) With respect to investment advisory services, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser; and (B) With respect to a contribution or payment, to communicate, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment.[45]

FINRA notes that, although the determination of whether a particular communication would be a solicitation would depend on the facts and circumstances relating to such communication, as a general proposition FINRA believes that any communication made under circumstances reasonably calculated to obtain or retain an advisory client would be considered a solicitation unless the circumstances otherwise indicate that the communication does not have the purpose of obtaining or retaining an advisory client.[46]

4. Investment Advisers

Proposed Rule 2030 would apply to covered members acting on behalf of (as defined in proposed Rule 2030(g)(7)) any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under Section 203(b)(3) of the Advisers Act for foreign private advisers, or that

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of 1940 Release No. 11414 (Oct. 28, 1980), 45 FR 73898 (Nov. 7, 1980) (Bearing of Distribution Expenses by Mutual Funds).

[45] Notice, 80 FR at 81651 n.18. *See also id.* at 81653–54 n.40.

[46] *See id.* at 81651 n.18. *See also id.* at 81653–54 n.40.

is an exempt reporting adviser under Advisers Act Rule 204-4(a).[47] Thus, proposed Rule 2030 would not apply to member firms acting on behalf of advisers that are registered with state securities authorities instead of the SEC, or advisers that are unregistered in reliance on exemptions other than Section 203(b)(3) of the Advisers Act or Advisers Act Rule 204-4(a). The proposed rule's definition of "investment adviser" is consistent with the definition of "investment adviser" in the SEC Pay-to-Play Rule.[48]

5. Official of a Government Entity

FINRA explains that an "official" (as defined in proposed Rule 2030(g)(8)) of a "government entity" (as defined in proposed Rule 2030(g)(7))—both of which FINRA states are consistent with the SEC Pay-to-Play Rule definitions—would include an incumbent, candidate or successful candidate for elective office of a government entity if the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser or 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.[49] FINRA also notes that it is the scope of authority of the particular office of an official, not the influence actually exercised by the individual, that would determine whether the individual has influence over the awarding of an investment advisory contract under the definition.[50] FINRA also

[47] *See* Proposed Rule 2030(g)(7).

[48] *See* 17 CFR 275.206(4)-5(a)(1).

[49] *See* Notice, 80 FR at 81652.

[50] *See id.* (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41029 (discussing the terms "official" and "government entity").

explains that government entities would include all state and local governments, their agencies and instrumentalities, and all public pension plans and other collective government funds, including participant-directed plans such as 403(b), 457, and 529 plans.[51]

6. Contributions

Proposed Rule 2030(g)(1) defines "contribution" to mean any gift, subscription, loan, advance, deposit of money, or anything of value made for the purpose of influencing the election for a federal, state or local office, and includes any payments for debts incurred in such an election or transition or inaugural expenses incurred by a successful candidate for state or local office.[52] FINRA states that this definition is consistent with the SEC Pay-to-Play Rule.[53] FINRA also states that it would not consider a donation of time by an individual to be a contribution, provided the covered member has not solicited the individual's efforts and the covered member's resources, such as office space and telephones, are not used.[54] FINRA further states that it would not consider a charitable donation made by a covered member to an organization that qualifies for an exemption from federal taxation under the Internal Revenue Code, or its equivalent in a foreign jurisdiction, at the request of an official of a government entity to be a contribution for purposes of the proposed rule.[55]

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[51] *See* Notice, 80 FR at 81652.

[52] *See id.* at 81652.

[53] *See id.* at 81652 n.32. *See also id.* at 81653.

[54] *See id.* at 81653 n.33 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41030).

[55] *See* Notice, 80 FR at 81653.

7. Covered Associates

Proposed Rule 2030(g)(2) defines the term "covered associates" to mean:

> (A) Any general partner, managing member or executive officer of a covered member, or other individual with a similar status or function; (B) Any associated person of a covered member who engages in distribution or solicitation activities with a government entity for such covered member; (C) Any associated person of a covered member who supervises, directly or indirectly, the government entity distribution or solicitation activities of a person in subparagraph (B) above; and (D) Any political action committee controlled by a covered member or a covered associate.[56]

FINRA states that, as also noted in the SEC Pay-to-Play Rule Adopting Release, contributions made to influence the selection process are typically made not by the firm itself, but by officers and employees of the firm who have a direct economic stake in the business relationship with the government client.[57] For example, contributions by an "executive officer of a covered member" (as defined in proposed Rule 2030(g)(5)) would trigger the two-year "time-out."[58] FINRA also notes that whether a person is an executive officer would depend on his or her function or activities and not his or her title.[59] In addition, FINRA states that a

[56] *Id.* at 81653 n.37.

[57] *See id.* (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41031).

[58] *See* Notice, 80 FR at 81653.

[59] *See id.*

covered associate would include a PAC controlled by the covered member or any of its covered associates.[60] FINRA explains that it would consider a "covered member" (as defined in proposed Rule 2030(g)(4)) or its covered associates to have "control" over a PAC if the covered member or covered associate has the ability to direct or cause the direction of governance or operations of the PAC.[61]

B. Proposed Rule 2030(b): Prohibition on Soliciting and Coordinating Contributions

Proposed Rule 2030(b) also would prohibit a covered member or covered associate from soliciting or coordinating any person or political action committee ("PAC") to make any: (1) contribution to an official of a government entity in respect of which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser; or (2) payment to a political party of a state or locality of a government entity with which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser.[62] FINRA states that this provision is modeled on a similar provision in the SEC Pay-to-Play Rule[63] and is intended to prevent covered members or covered associates from circumventing the proposed rule's two-year "time-out" by "bundling," either by soliciting a large number of contributions by employees, or by soliciting payments to a State or local political party.[64]

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[60] *See id.*

[61] *See id.*

[62] *See id.* at 81653–54. *See also id.* at 81662.

[63] *See id.* at 81654 n.42 (citing 17 CFR 275.206(4)-5(a)(2)).

[64] *See* Notice, 80 FR at 81654.

C. Proposed Rule 2030(c): Exceptions

FINRA's proposed pay-to-play rule contains three exceptions from the proposed rule's prohibitions: (1) *de minimis* contributions; (2) new covered associates; and (3) certain returned contributions.[65] FINRA states that these exceptions are modeled on similar exceptions in the SEC Pay-to-Play Rule.[66]

1. *De Minimis* Contribution Exception

Proposed Rule 2030(c)(1) would except from the rule's restrictions contributions made by a covered associate who is a natural person to government entity officials for whom the covered associate was entitled to vote at the time of the contributions, provided the contributions do not exceed $350 in the aggregate to any one official per election.[67] If the covered associate was not entitled to vote for the official at the time of the contribution, the contribution must not exceed $150 in the aggregate per election.[68] FINRA states that, consistent with the SEC Pay-toPlay Rule, under this exception, primary and general elections would be considered separate elections.[69] FINRA also explains that this exception is based on the theory that such contributions are typically made without the intent or ability to influence the selection process of the investment adviser.[70]

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[65] *See id.*

[66] *See id.* at n.51 (citing 17 CFR 275.206(4)-5(b)).

[67] *See* Notice, 80 FR at 81655.

[68] *See id.*

[69] *See id.* at 81655 n.54 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41034).

[70] *See* Notice, 80 FR at 81655.

2. Exception for Certain New Covered Associates

The proposed rule would attribute to a covered member contributions made by a person within two years (or, in some cases, six months) of becoming a covered associate. However, proposed Rule 2030(c)(2) would provide an exception from the proposed rule's restrictions for covered members if a natural person made a contribution more than six months prior to becoming a covered associate of the covered member unless the covered associate engages in, or seeks to engage in, distribution or solicitation activities with a government entity on behalf of the covered member.[71] FINRA states that this exception is consistent with the SEC Pay-to-Play Rule[72] and is intended to balance the need for covered members to be able to make hiring decisions against the need to protect against individuals marketing to prospective employers their connections to, or influence over, government entities the employer might be seeking as clients.[73] FINRA also provides, with respect to the "look back" provisions in the proposed rules generally, the following illustrations of how the "look back" provisions will work: if, for example, the contributions were made more than two years (or six months for new covered associates) prior to the employee becoming a covered associate, the "time-out" has run.[74] According to FINRA, however, if the contribution was made less than two years (or six months, as applicable) from the time the person becomes a covered associate, the proposed rule would

[71] *See id.*

[72] *See id.* at 81655 n.55 (citing 17 CFR 275.206(4)-5(b)(2)).

[73] *See* Notice, 80 FR at 81655.

[74] *See id.* at 81656.

prohibit the covered member that hires or promotes the contributing covered associate from receiving compensation for engaging in distribution or solicitation activities on behalf of an investment adviser from the hiring or promotion date until the applicable period has run.[75]

3. Exception for Certain Returned Contributions

Proposed Rule 2030(c)(3) would provide an exception from the proposed rule's restrictions for covered members if the restriction is due to a contribution made by a covered associate and: (1) the covered member discovered the contribution within four months of it being made; (2) the contribution was less than $350; and (3) the contribution is returned within 60 days of the discovery of the contribution by the covered member.[76] FINRA explains that, consistent with the SEC Pay-to-Play Rule, this exception would allow a covered member to cure the consequences of an inadvertent political contribution.[77] The proposed rule also would provide that covered members with 150 or fewer registered representatives would be able to rely on this exception no more than two times per calendar year, while covered members with more than 150 registered representatives would be permitted to rely on this exception no more than three times per calendar year.[78] Furthermore, a covered member would not be

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[75] *See id.* at 81655–56.

[76] *See id.* at 81655.

[77] *See id.*

[78] *See id.* FINRA notes that these limitations are consistent with similar provisions in the SEC Pay-to-Play Rule 206(4)-5(b)(3), although the SEC Pay-to-Play Rule includes different allowances for larger and smaller investment advisers based on

able to rely on an exception more than once with respect to contributions by the same covered associate regardless of the time period, which is consistent with similar provisions in the SEC Pay-to-Play Rule.[79]

D. Proposed Rule 2030(d): Prohibitions as Applied to Covered Investment Pools

Proposed Rule 2030(d)(1) provides that a covered member that engages in distribution or solicitation activities with a government entity on behalf of a covered investment pool,[80] in which a government entity invests or is solicited to invest, shall be treated as though the covered member was engaging in or seeking to engage in distribution or solicitation activities with the government entity on behalf of the investment adviser to the covered investment pool directly.[81] Proposed Rule 2030(d)(2) provides that an investment adviser to a covered investment pool in

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the number of employees they report on Form ADV. *See id.* at 81655 n.59.

[79] *See* Notice, 80 FR at 81655.

[80] *See id.* at 81654 n.46 (proposed Rule 2030(g)(3) defines a "covered investment pool" to mean: "(A) Any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity; or (B) Any company that would be an investment company under Section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either Section 3(c)(1), 3(c)(7) or 3(c)(11) of that Act").

[81] *See* Notice, 80 FR at 81654 n.47 (FINRA notes that, consistent with the SEC Pay-to-Play Rule, under the proposed rule, if a government entity is an investor in a covered investment pool at the time a contribution triggering a two-year time-out is made, the covered member must forgo any compensation related to the assets invested or committed by the government entity in the covered investment pool) (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41047).

which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity.[82] FINRA states that proposed Rule 2030(d) is modeled on a similar prohibition in the SEC Pay-to-Play Rule and would apply the prohibitions of the proposed rule to situations in which an investment adviser manages assets of a government entity through a hedge fund or other type of pooled investment vehicle.[83] Therefore, according to FINRA, the provision would extend the protection of the proposed rule to public pension plans that access the services of investment advisers through hedge funds and other types of pooled investment vehicles sponsored or advised by investment advisers as a funding vehicle or investment option in a government-sponsored plan, such as a 529 plan.[84]

As noted above, the proposed rule would not apply to distribution activities related to registered investment companies that are not investment options of a government entity's plan or program because in these circumstances a member firm is not providing or seeking to provide investment advisory services to a

[82] *See* Notice, 80 FR at 81654 n.48 (FINRA states that it added proposed Rule 2030(d)(2) in response to comments on *Regulatory Notice* 14-50 to clarify, for purposes of the proposed rule, the relationship between an investment adviser to a covered investment pool and a government entity that invests in the covered investment pool).

[83] *See* Notice, 80 FR at 81654 n.49 (citing 17 CFR 275.206(4)-5(c)).

[84] *See* Notice, 80 FR at 81654 n.50 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41044, which discusses the applicability of the SEC Pay-to-Play Rule to covered investment pools).

government entity.[85] The proposed rule would apply to distribution activities involving unregistered pooled investment vehicles such as hedge funds, private equity funds, venture capital funds, collective investment trusts, and registered pooled investment vehicles such as mutual funds, but only if those registered pools are an investment option of a participant-directed plan or program of a government entity.[86]

E. Proposed Rule 2030(e): Prohibition on Indirect Contributions or Solicitations

Proposed Rule 2030(e) provides that it shall be a violation of Rule 2030 for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of the rule.[87] FINRA states that this provision is consistent with a similar provision in the SEC Pay-to-Play Rule[88] and would prevent a covered member or its covered associates from funneling payments through third parties, including, for example, consultants, attorneys, family members, friends, or companies affiliated with the covered member as a means to circumvent the proposed rule.[89] FINRA also notes that, consistent with guidance provided by the Commission in connection with SEC Pay-to-Play Rule 206(4)-5(d), proposed Rule 2030(e) requires a showing of intent to circumvent the

[85] *See* Notice, 80 FR at 81661.

[86] *See id.*

[87] *See* Notice, 80 FR at 81654.

[88] *See id.* at n.44 (citing 17 CFR 275.206(4)-5(d)).

[89] *See* Notice, 80 FR at 81654 n.45 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41044, which discusses direct and indirect contributions or solicitations).

rule for such persons to trigger the two-year "time-out."[90]

F. Proposed Rule 2030(f): Exemptions

Proposed Rule 2030(f) includes an exemptive provision for covered members, modeled on the exemptive provision in the SEC Pay-to-Play Rule, that would allow covered members to apply to FINRA for an exemption from the proposed rule's two-year "time-out."[91] As proposed, FINRA states that this provision would allow FINRA to exempt covered members, either conditionally or unconditionally, from the proposed rule's time-out requirement where the covered member discovers contributions that would trigger the compensation ban after they have been made, and when imposition of the prohibition would be unnecessary to achieve the rule's intended purpose.[92] In determining whether to grant an exemption, FINRA would take into account varying facts and circumstances, outlined in the proposed rule, that each application presents[93] (*e.g.*, the timing and amount of the contribution, the nature of the election, and the contributor's apparent intent or motive in making the contribution).[94] FINRA

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[90] *See* Notice, 80 FR at 81654. *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41044 n.340 (explaining that like MSRB Rule G-37(d), SEC Pay-to-Play Rule 206(4) 5(d) "requires a showing of intent to circumvent the rule for such persons to trigger the time out") (citing *Blount*, 61 F.3d at 948 ("In short, according to the SEC, the rule restricts such gifts and contributions only when they are intended as end-runs around the direct contribution limitations.")).

[91] *See* Notice, 80 FR at 81654–55.

[92] *See id.* at 81655.

[93] *See id.*

[94] *See* Order Instituting Proceedings, 81 FR at 19263.

notes that this provision would provide covered members with an additional avenue by which to seek to cure the consequences of an inadvertent violation by the covered member or its covered associates that falls outside the limits of one of the proposed rule's exceptions.[95]

G. Proposed Rule 4580: Recordkeeping Requirements

Proposed Rule 4580 would require covered members that engage in distribution or solicitation activities with a government entity on behalf of any investment adviser that provides or is seeking to provide investment advisory services to such government entity to maintain books and records that would allow FINRA to examine for compliance with its pay-to-play rule.[96] FINRA states that this provision is consistent with similar recordkeeping requirements imposed on investment advisers in connection with the SEC Pay-to-Play Rule.[97] The proposed rule also would require covered members to maintain a list or other record of certain specific information.[98] FINRA states that the proposed rule would require, among other things, that the direct and indirect contributions or payments made by the covered member or any of its covered associates be listed in chronological order and indicate the name and title of each contributor and each recipient of the contribution or payment, as well as the amount and date of each contribution or payment, and whether the

[95] *See* Notice, 80 FR at 81655.

[96] *See id.*

[97] *See id.* (citing 17 CFR 275.204-2(a)(18) and (h)(1)).

[98] *See* Notice, 80 FR at 81655–56.

contribution was the subject of the exception for returned contributions in proposed Rule 2030.[99]

III. Summary of Comments and FINRA's Responses

In response to the Notice, the Commission received ten comment letters, from nine different commenters.[100] Six commenters generally express support for FINRA's proposal.[101] However, five of those commenters, while generally expressing support for the goals of the proposal, also raise certain concerns regarding various aspects of the proposal as drafted and recommended amendments to the proposal.[102] The other three commenters did not support the proposed rule as drafted based largely on concerns involving the First Amendment to the U.S. Constitution.[103] FINRA responded, stating that it considered the comments received by the Commission in response to the Notice, and that FINRA is not intending to make changes to the proposed rule text in response to the comments.[104]

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[99] *See id.*

[100] *See supra* note 5. CAI submitted two separate comment letters in response to the Notice. See CAI Letter 1 and CAI Letter 2.

[101] *See* CAI Letter 1; CAI Letter 2; FSI Letter 1; ICI Letter; NAIFA Letter; NASAA Letter; and PIABA Letter.

[102] *See* CAI Letter 1; CAI Letter 2; FSI Letter 1; NAIFA Letter; NASAA Letter; and PIABA Letter. ICI did not raise additional concerns, but states that it is satisfied with FINRA's revisions and responses to the proposal as drafted in *Regulatory Notice* 14-50. *See* ICI Letter.

[103] *See* CCP Letter 1; Moran Letter; and State Parties Letter 1. Other commenters also raise certain First Amendment-related concerns. *See* FSI Letter 1; and CAI Letter 1.

[104] *See* FINRA Response Letter 1.

The Commission received an additional four comments in response to the Order Instituting Proceedings.[105] On July 6, 2016, FINRA submitted a letter responding to all comments and to the Order Instituting Proceedings.[106] The comments, as well as FINRA's responses, are summarized below.[107]

A. First Amendment Comments and FINRA's Responses

As noted above, five commenters either oppose the proposed rule[108] or raise certain issues regarding the proposed rule as drafted based largely on First Amendment concerns.[109] As a general matter, these commenters argue that FINRA's proposed rule is not narrowly tailored to serve a compelling government interest. While acknowledging that the D.C. Circuit upheld the constitutionality of a comparable MSRB pay-to-play rule in *Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995), which also used analogous restrictions to discourage pay-to-play practices, these commenters

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[105] *See supra* note 10. *See* also Memorandum from the Division of Trading and Markets regarding a May 10, 2016 conference call with representatives of CAI; Memorandum from the Division of Trading and Markets regarding a May 19, 2016 conference call with representatives of FSI.

[106] *See supra* note 12.

[107] The comments received in response to the Notice were summarized when the Commission instituted proceedings. *See supra* note 9. For further detail, the comments that the Commission received on both the Notice and the Order Instituting Proceedings are available on the Commission's website at http://www.sec.gov/comments/sr-finra-2015-056/finra2015056.shtml.

[108] *See* CCP Letter 1; and State Parties Letter 1. *See also* CCP Letter 2; CCP Letter 3; and State Parties Letter 2.

[109] *See* CAI Letter 1; FSI Letter 1; FSI Letter 2; and Moran Letter.

believe that Supreme Court precedent has changed since *Blount* was decided.

In response to these comments, FINRA states that the points raised by the commenters do not warrant changes to, or disapproval of, its proposed rule change.[110] FINRA notes that the Commission has already reviewed and rejected these arguments in a nearly identical context.[111] As FINRA explains, the State Parties filed an unsuccessful lawsuit in 2014 challenging the SEC

Pay-to-Play Rule on First Amendment grounds.[112] FINRA explains that the State Parties' comments opposing FINRA's proposed rule reiterate the arguments advanced in their suit against the Commission and, although the court of appeals decided the challenge on jurisdictional grounds, the brief that the Commission filed in the D.C. Circuit is persuasive in demonstrating that the State Parties' arguments lack merit.[113] FINRA also notes that the SEC Pay-to-Play Rule, upon which FINRA's proposed rule change is based, was modeled on pay-to-play rules that the MSRB drafted, that the Commission approved, and

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[110] *See* FINRA Response Letter 2 at 3 (noting that FINRA's responses to the First Amendment arguments raised by the State Parties and CCP also address the concerns raised by CAI, FSI and Moran). A copy of FINRA Response Letter 2 is available at: https://www.sec.gov/comments/sr-finra-2015-056/finra2015056-18.pdf.

[111] *See id.* (citing *N.Y. Republican State Comm. v. SEC*, 799 F.3d 1126 (D.C. Cir. 2015) (affirming dismissal of the petition for lack of subject matter jurisdiction and also dismissing the petition as time-barred).

[112] *See* FINRA Response Letter 2 at 3.

[113] *See id.* at 3–4.

that the D.C. Circuit upheld against a constitutional challenge in *Blount*.[114]

Furthermore, FINRA states that the proposed rule change is justified by a sufficiently important governmental interest to withstand constitutional scrutiny. For example, FINRA explains that, as in *Blount*, the Commission's interest in preventing fraud and in protecting market actors from "unfair, corrupt market practices," are "not only substantial, but . . . compelling."[115] FINRA also notes that the Commission's interest in "clean advisory markets is equally important."[116] FINRA acknowledges the D.C. Circuit's observation in *Blount* that "the link between eliminating pay-to-play practices and the Commission's goals of 'perfecting the mechanism of a free and open market' and promoting 'just and equitable principles of trade' is self-evident."[117] In addition to noting the important interests served by its proposal, FINRA also notes that, as explained in *Blount*, the proposed rule change advances this government interest by seeking to halt an existing pay-to-play problem, even though, in terms of a record, "no smoking gun is needed;" however, "here, the con-

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[114] *See id.* at 5 (citing *Blount*, 61 F.3d at 944).

[115] *See, e.g.*, FINRA Response Letter 2 at 5 (quoting *Blount*, 61 F.3d at 944).

[116] *See*, *e.g.*, FINRA Response Letter 2 at 5 (quoting an observation made in *Blount* that the Commission's interest "in clean bond markets" is just as important as a legislature's interest "in clean elections") (quoting *Blount*, 61 F.3d at 944)).

[117] *See, e.g.*, FINRA Response Letter 2 at 5 (quoting *Blount*, 61 F.3d at 945).

flict of interest is apparent, the likelihood of stealth great, and the [Commission's] purpose prophylactic."[118]

FINRA further believes that the proposed rule change also is "closely drawn" to avoid unnecessary abridgment of associational freedoms.[119] FINRA explains that, like the pay-to-play rule upheld in *Blount*, its proposed rule change only "restricts a narrow range of . . . activities for a relatively short period of time," and leaves available the "vast majority of political activities."[120] For example, FINRA notes that the proposal does not attempt to regulate State and local elections, nor does it impose restrictions on independent expenditures or ban political contributions, and that each of those significant avenues for political expression remains unaffected by the proposed rule change.[121] FINRA also does not agree with arguments made by a commenter that FINRA did not consider less restrictive alternatives in drafting its proposal and that aspects of the proposal are vague or overbroad. FINRA notes that, because the Commission must find that FINRA's proposal imposes substantially equivalent or more stringent restrictions on its member firms as the SEC Pay-to-Play Rule imposes on investment advisers for FINRA members to be "regulated persons" under the SEC Pay-to-Play Rule, the provisions and definitions to which the commenter

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[118] *See, e.g.*, FINRA Response Letter 2 at 6 (quoting *Blount*, 61 F.3d at 945).

[119] *See, e.g.*, FINRA Response Letter 2 at 6.

[120] *See, e.g.*, *id.* (quoting *Blount*, 61 F.3d at 947–48).

[121] *See, e.g.*, FINRA Response Letter 2 at 4. *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41024 n.71 (explaining that the SEC Pay-to-Play rule "imposes no restrictions on activities such as making independent expenditures to express support for candidates, volunteering, making speeches, and other conduct").

objects are modeled on and substantially similar to provisions in the SEC Pay-to-Play Rule.[122] FINRA also states that it will work with the industry and Commission to address interpretive questions and provide additional guidance, as needed, to the extent that questions arise regarding the application and scope of the provisions and terms used in the proposed rule change.[123]

B. Comments Regarding FINRA's Authority To Propose a Pay-To-Play Rule and FINRA's Responses

Several commenters contend that FINRA does not have the authority to adopt a pay-to-play rule because only Congress or the Federal Election Commission may regulate contributions for federal elections.

In response, FINRA states that the proposed rule change is consistent with the authority Congress granted a registered national securities association like FINRA under Section 15A(b)(6) of the Act to adopt rules that are designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.[124] FINRA believes that the proposed rule change accomplishes the goals of Section 15A(b)(6) by, for example, allowing member firms to continue to engage in distribution or solicitation activities for compensation with governmental entities on behalf of investment advisers, while at the same time

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[122] *See, e.g.*, FINRA Response Letter 2 at 7.

[123] *See, e.g.*, *id.*

[124] *See id.*

deterring member firms from engaging in pay-to-play practices.[125] FINRA also believes that the proposed rule change is reasonably designed to address the distortion of the investment advisory market and collective action problems created by pay-to-play practices.[126]

Although FINRA acknowledges that the proposed rule's two-year "time-out" provision might result in fewer covered members and their covered associates making certain political contributions to certain officials, FINRA notes that if it did not adopt a pay-to-play rule, the SEC Pay-to-Play Rule would prohibit member firms from soliciting government entities for investment advisory services for compensation on behalf of investment advisers.[127] FINRA explains that the SEC Pay-to-Play Rule provides that the rules of a self-regulatory organization ("SRO"), like FINRA, must impose "substantially equivalent or more stringent restrictions" on its member firms that wish to act as "regulated persons" as the SEC Pay-to-Play Rule imposes on investment advisers.[128] Therefore, unless FINRA imposes sufficiently stringent restrictions, investment advisers and covered associates will be barred from providing or agreeing to provide, directly

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[125] *See id.*

[126] *See id.* at 9. As outlined in the SEC Pay-to-Play Adopting Release, pay-to-play activities create a "collective action" problem in two respects. First, government officials who participate in such activities may have an incentive to continue to accept contributions to support their campaigns for fear of being disadvantaged relative to their opponents. Second, advisers may have an incentive to participate out of concern that they may be overlooked if they fail to make a contribution. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR at 40122.

[127] *See* FINRA Response Letter 2 at 4–5.

[128] *See id.* at 4.

or indirectly, payment to FINRA member firms to solicit a government entity for investment advisory services on behalf of the investment adviser.[129] FINRA believes that the proposed rule change is a more effective response to the issues addressed in the SEC Pay-to-Play Rule than a complete ban on solicitation,[130] and notes throughout its response that the proposal imposes substantially equivalent restrictions on FINRA member firms as the SEC Pay-to-Play Rule imposes on investment advisers.[131]

C. Variable Annuity-Related Comments and FINRA's Responses

Two commenters raise concerns regarding the application of the proposed rules to variable annuities.[132] Both of these commenters request, as a threshold matter, that FINRA confirm that Rule 2030 would not apply to variable annuities.[133] One of these commenters requests that the proposed rule not apply to the sales of variable annuity contracts supported by a separate account that invests in mutual funds, arguing that the nature of variable annuities and the way investment options are selected does not implicate the investment advisory solicitation activities contemplated by the SEC Pay-to-Play Rule.[134] This

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[129] *See id. See also* Notice, 80 FR at 81659.

[130] *See* FINRA Response Letter 2 at 4.

[131] *See, e.g.*, *id.* at 4, 7.

[132] *See* CAI Letter 1 and FSI Letter 1. *See also* CAI Letter 2 (reflecting CAI's suggested revisions to the certain language in some of FINRA's proposed rules).

[133] *See* CAI Letter 1 and FSI Letter 1.

[134] *See* FSI Letter 1 (claiming that applying the proposed rule to variable annuities will significantly increase the compliance

commenter claims that the relationship between a variable annuity contract holder and the investment adviser to a mutual fund supporting the variable annuity does not rise to a level such that it should implicate the proposed pay-to-play rule's restrictions.[135] The other commenter claims, in support of its argument that Rule 2030 should not apply to variable annuities, that compliance with Rule 2030 would be impractical for broker-dealers selling variable annuities in the government market.[136] This commenter also argues, for example, that a covered member selling a variable annuity, particularly where the separate account is registered as a unit investment trust, cannot fairly be seen to be engaging in solicitation activities on behalf of all of the investment advisers and sub-advisers that manage the covered investment pools available as investment options under the separate account and subaccounts.[137]

This commenter also requests that proposed Rule 2030 be modified to, among other things, clarify that the distribution of a two-tiered product such as a variable annuity is not solicitation activity for an investment adviser and sub-advisers managing the funds available as investment options.[138] Furthermore, this same commenter states that if FINRA or the Commission

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burden and as such may limit the options their members make available to 403(b) and 457 plans).

[135] *See* FSI Letter 1.

[136] *See* CAI Letter 1 (claiming that the dynamics and structure of variable annuities, particularly those with separate accounts registered as a unit investment trust, and the number of advisers and sub-advisers to the funds underlying sub-accounts, makes compliance with proposed Rule 2030 impractical).

[137] *See id.*

[138] *See id.*

determines that broker-dealers selling variable annuities constitute solicitation activities for purposes of Rule 2030, that determination raises a host of interpretive questions that, in this commenter's view, would require further guidance from FINRA or the Commission.[139]

In response, FINRA states that its proposed rules must impose substantially equivalent or more stringent restrictions on member firms as the SEC Pay-to-Play Rule imposes on investment advisers.[140] Therefore, because the Commission did not exclude specific products from the SEC Pay-to-Play Rule, such as variable annuities, FINRA does not believe that excluding specific products from its proposed rule would satisfy the Commission's stringency requirements.[141] FINRA notes, however, that to the extent interpretive questions arise regarding the application and scope of the provisions and terms used in its proposed rules, FINRA will work with the industry and Commission

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[139] *See id.* For example, CAI requests guidance on the following questions: Is the selling broker-dealer deemed to be soliciting on behalf of the adviser of each of the underlying funds or only of advisers and sub-advisers of funds underlying investment options that are selected by contract holders? If an underlying fund is managed by an adviser that uses multiple sub-advisers, is the selling firm deemed to be soliciting on behalf of all of the sub-advisers? How does the rule apply when a contract holder on his or her own allocates funds in the variable annuity to an option at a point of time (for example, five years) subsequent to the purchase of the variable annuity without any involvement of the selling firm? *See id.*

[140] *See* FINRA Response Letter 2 at 16.

[141] *See id.*

to address those interpretive questions and provide additional guidance as needed.[142]

D. Comments Regarding the Scope of the Proposed Rule and FINRA's Responses

Two commenters also express concern that proposed Rule 2030(d) would, in their view, re-characterize "ordinary" or "customary" distribution activities for covered investment pools as the solicitation of clients on behalf of the investment adviser to the covered investment pools.[143] One of these commenters requests that such customary distribution activity by member firms for covered investment pools sold to government entities *not* be treated as solicitation activity for an investment adviser for purposes of Rule 2030 simply because an investment adviser provides advisory services to a covered investment pool that is available as an investment option.[144] As more fully explained in the commenter's letter, the commenter claims, for example, that proposed Rule 2030(d) would recast "traditional" broker-dealer activity *(i.e.*, the offer and sale of covered investment pool securities pursuant to a selling or placement agent agreement) into something it is not: the solicitation of investment advisory services on behalf of an investment adviser.[145] This commenter also claims that the decision in *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006) and the Commission staff's interpretive position under Advisers Act Rule 206(4)-3 suggest that proposed Rule 2030(d) would be

[142] *See id.*

[143] *See* CAI Letter 1 and FSI Letter 1.

[144] *See* CAI Letter 1.

[145] *See id.*

impractical.[146] This commenter also notes that Rule 206(4)-3 puts selling firms in a contradictory position under FINRA rules and Advisers Act rules.[147] This commenter further states that, in its view, a broker-dealer that offers and sells interests in a mutual fund or private fund cannot be characterized as soliciting on behalf of the investment adviser to a covered investment pool.[148]

Similarly, another commenter expresses concern with the apparent application of proposed Rule 2030(d) to "traditional" brokerage sales of mutual funds and variable annuities to participant-directed government-sponsored retirement plans.[149] As more fully explained in the commenter's letter, this commenter continues to be concerned that the provisions in proposed Rule 2030(d) go beyond that which is required under Rule 206(4)-5(a)(2)(i) and Rule 206(4) 5(c) to the detriment of investors.[150] This same commenter also claims that mutual fund sales, as well as variable annuity sales, should be excluded, claiming that the proposed rules serve to redefine the sale of mutual funds as solicitation by a broker-dealer on behalf of an investment adviser and also conflict with the realities of conventional mutual fund selling agreements.[151]

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[146] *See id.* (claiming that "[i]t would create significant confusion in the industry and undermine settled practices and understandings, while creating doubt as to the application of the *Goldstein* case and the Commission staff's guidance in the Mayer Brown no-action letter").

[147] *See id.*

[148] *See id.*

[149] *See* FSI Letter 1. *See also* FSI Letter 2

[150] *See* FSI Letter 1. *See also* FSI Letter 2.

[151] *See* FSI Letter 1. *See also* FSI Letter 2.

In response, FINRA explains that, in proposing FINRA Rule 2030(d), it did not intend to re-characterize broker-dealers' selling interests in variable annuities, mutual funds and private funds as soliciting an investment advisory relationship with investors who invest in those products.[152] Rather, FINRA states that the purpose of proposed Rule 2030(d) is to clarify that the prohibition of proposed Rule 2030(a) would apply when the covered member is engaging in distribution or solicitation activities with a government entity on behalf of a covered investment pool.[153] FINRA further explains that proposed Rule 2030(d) is modeled on a similar provision in the SEC Pay-to-Play Rule, Rule 206(4)-5(c).[154] As such, and consistent with SEC Pay-to-Play Rule 206(4)-5(c), proposed Rule 2030(d) is intended to extend the protections of the proposed rule to government entities that access the services of investment advisers through hedge funds and other types of pooled investment vehicles sponsored or advised by investment advisers.[155] Finally, FINRA notes that the applicability of proposed Rule 2030(d) is for purposes of FINRA's pay-to-play rule only and, as such, would not impact or otherwise affect other FINRA

[152] *See* FINRA Response Letter 2 at 14.

[153] *See id.*

[154] *See id.*

[155] *See id.* at 15 (noting that when adopting SEC Pay-to-Play Rule 206(4)-5(c), the Commission stated that although "an investment in a pooled investment vehicle may not involve a direct advisory relationship with a government sponsored plan [that] does not change the nature of the fraud or the harm that may be inflicted as a consequence of the adviser's pay-to-play activity") (quoting SEC Pay-to-Play Rule Adopting Release, 75 FR at 41044–45)).

rules or guidance. Therefore, FINRA has determined not to make the changes suggested by the commenters.[156]

E. Comments Regarding the Inclusion of Distribution Activity in the Proposed Rule and FINRA's Responses

One commenter generally expresses concern that proposed Rule 2030 is unnecessarily ambiguous regarding the term "distribution" activities in Rule 2030(a).[157] This commenter claims that it is unclear what distribution activities "with" a government entity would be prohibited, what compensation is covered by the proposed rule and who must pay it, and when a member firm might be deemed to be acting "on behalf of" an investment adviser.[158] This commenter states that the ambiguity of proposed Rule 2030 may result in its misapplication in a variety of contexts, such as: where a selling firm is affiliated with one, but not all, underlying fund advisers and none of the sub-adviser(s) to any underlying funds, or none of the underlying fund advisers, but some of the sub-advisers.[159]

This commenter also claims that, while the SEC Pay-to-Play Rule requires regulated persons to be subject to rules that prohibit them from engaging in certain distribution activities if certain political contributions have been made, SEC Pay-to-Play Rule 206(4)-5 does not mandate the use of the term "distribution" in describing the conduct prohibited by the proposed rule, and suggested revised rule text reflecting that

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[156] *See* FINRA Response Letter 2 at 15.

[157] *See* CAI Letter 1.

[158] *See id.*

[159] *See id.*

assertion.[160] The commenter believes that its suggested revisions would eliminate, among other things, the potential concern that a selling firm might violate proposed Rule 2030 unknowingly due to being deemed to be acting on behalf of investment advisers or sub-advisers of underlying funds with which it has no relationship.[161]

In response, FINRA states that it continues to maintain the position, outlined in the Notice, that it will not remove references to the term "distribution."[162] FINRA explains that the Notice pointed to language in the SEC Pay-to-Play Rule Adopting Release supporting the inclusion of distribution activities by broker-dealers in FINRA's proposed Rule 2030.[163] Specifically, FINRA pointed to the Commission's discussion regarding under what circumstances distribution payments would violate the SEC's Pay-to-Play Rule.[164] FINRA also notes that based on the Commission's definition of "regulated person"[165] in the SEC's Pay-to-

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[160] *See* CAI Letter 1 and CAI Letter 2 (reflecting CAI's suggested revisions to certain language in some of FINRA's proposed rules).

[161] *See* CAI Letter 1 (claiming that the commenter's suggested revisions would not result in any inappropriate narrowing of the scope of Rule 2030).

[162] *See* FINRA Response Letter 2 at 12.

[163] *See id.* at 11–12 (citing Notice, 80 FR at 81660–61).

[164] *See* FINRA Response Letter 2 at 12 n.52 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 4104 n.298).

[165] *See* FINRA Response Letter 2 at 12 (explaining that the SEC Pay-to-Play Rule defines a "regulated person" to include a member firm, provided that FINRA rules prohibit member firms from engaging in *distribution* or solicitation activities if political contributions have been made) (citing 17 CFR 275. 206(4)-5(f)(9)(ii)(A)) (emphasis in original).

Play Rule, as well as the Commission's discussion regarding the treatment of distribution fees paid pursuant to a 12b-1 plan as compared to legitimate profits, FINRA believes that its proposed rule must apply to member firms engaging in distribution activities.[166] FINRA mentioned previously, to the extent that interpretive questions arise regarding the application and scope of the provisions and terms used in the proposed rule change, FINRA will work with the industry and Commission to address the interpretive questions and provide additional guidance as needed.[167]

F. Comments Regarding Defined Terms Used in the Proposed Rules and FINRA's Responses

Two commenters request clarification of certain defined terms used in the proposed rules.[168] One commenter urged FINRA, or the Commission, to clarify the meaning of the term "instrumentality" as it is used in the definition of "government entity."[169] This commenter claims that, "[w]ithout additional guidance, covered members will continue to struggle with whether a contribution to a given entity should be treated as a contribution to an 'instrumentality' of a state or state agency, thus triggering the two-year time out. . . ."[170] This same commenter also asked for clarification as to whether each and every "contribution" (as defined in

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[166] *See* FINRA Response Letter 2 at 12 (citing Notice, 80 FR at 81660–61).

[167] *See id.*

[168] *See* CAI Letter 1 and NAIFA Letter.

[169] *See* CAI Letter 1 (claiming that CAI's members have struggled to understand the contours of this term in the context of the SEC Pay-to-Play Rule).

[170] *See id.*

proposed Rule 2030(g)(1)) is, by definition, also a "payment" (as defined in proposed Rule 2030(g)(9)).[171]

Another commenter requests that FINRA clarify the definition of a "covered associate" and clarify and delineate the positions that would qualify someone as a covered "official."[172] This commenter claims that, in response to the same definition of "covered associate" as used in the SEC Pay-to-Play Rule, many investment advisers and broker-dealers have classified all of their representatives as covered associates regardless of whether they actually engage in the solicitation activity specified in the definition.[173] This commenter believes that additional clarification on when an associated person of a covered member would (or would not) qualify as a "covered associate" would ease compliance burdens, curtail overly broad limits on legitimate political activity, and increase the consistency of procedures amongst member firms who seek to comply with both the letter and the spirit of the proposed rule.[174] This same commenter requests additional details or guidance from the Commission with respect to this definition of "official" because, according to that commenter, that definition has caused, and will continue to spark confusion over exactly what offices subject the holder to be classified

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[171] *See* CAI Letter 1 (discussing Notice, 80 FR at 81654 n.41: "Consistent with the SEC Pay-to-Play Rule, FINRA is including the broader term 'payments,' as opposed to 'contributions,' to deter a cover member from circumventing the proposed rule's prohibitions by coordinating indirect contributions to government officials by making payments to political parties").

[172] *See* NAIFA Letter.

[173] *See id.*

[174] *See id.*

as an "official" given that the term is defined the same way in the SEC Pay-to-Play Rule.[175]

In response, FINRA states that it recognizes, as did the commenters, that these terms are defined in the SEC Pay-to-Play Rule and that FINRA modeled the definitions in its proposal on those in the SEC Pay-to-Play Rule.[176] With respect to CAI's request for clarification as to whether each and every "contribution" (as defined in proposed FINRA Rule 2030(g)(1)) is, by definition, also a "payment" (as defined in proposed FINRA Rule 2030(g)(9)), FINRA states that the definition of "payment" is similar to the definition of "contribution," but is broader because it does not include limitations on the purposes for which such money is given (*e.g.*, it does not have to be made for the purpose of influencing an election).[177] Finally, FINRA also acknowledges the concerns raised by the commenters and the requests for clarification and additional guidance from the Commission and FINRA as to certain terms.[178] FINRA again states that to the extent that interpretive questions arise regarding the application and scope of the provisions and terms used in the proposed rule change, FINRA will work with the industry and Commission to address the interpretive questions and provide additional guidance as needed.[179]

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[175] *See id.*

[176] *See* FINRA Response Letter 2 at 18.

[177] *See id.* at 17.

[178] *See id.* at 19.

[179] *See id.*

G. Comments Regarding PAC Contributions and FINRA's Responses

One commenter claims that statements made by FINRA in the Notice regarding the proposed rule's anti-circumvention provision, proposed Rule 2030(e), combined with statements made in Commission staff guidance concerning whether contributions through PACs would violate the SEC Pay-to-Play Rule and Section 208(d) of the Advisers Act, have the ability to chill contributions to PACs.[180] This commenter claims, for example, that prospective contributors who simply want to donate to a PAC have been hesitant to or restricted from doing so out of fear that they may be making an indirect contribution in violation of the SEC Pay-to-Play Rule.[181] Accordingly, this commenter requests further guidance from the Commission on the factors by which contributions to PACs would or would not trigger the anti-circumvention provision of the proposed rule.[182]

In response, FINRA again acknowledges the concerns raised by the commenter and the requests for clarification and additional guidance from the Commission and FINRA.[183] FINRA states that, to the extent that interpretive questions arise regarding the application and scope of the provisions and terms used in the proposed rule change, FINRA will work with the industry and Commission to address the interpretive questions and provide additional guidance as needed.[184]

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[180] *See* NAIFA Letter.

[181] *See id.*

[182] *See id.*

[183] *See* FINRA Response Letter 2 at 19.

[184] *See id.* at 18.

Another commenter claims that it continues to believe that not all payments to political parties or PACs should have to be maintained under the books and records requirements of proposed Rule 4580.[185] Rather, this commenter believes that only payments to political parties or PACs where the covered member or a covered associate: (i) directs the political party or PAC to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser; or (ii) knows that the political party or PAC is going to make a contribution to an official of a government entity which the covered member is soliciting on behalf of an investment adviser, should have to be maintained.[186] This commenter states that, while it appreciates FINRA's rationale for proposed Rule 4580, it believes the costs and burdens associated with the request far outweigh the benefits to FINRA in ensuring compliance with the rule and would lead to periodic "fishing expeditions" by FINRA examiners.[187]

In response, FINRA states that it disagrees with these comments and has determined to retain the recordkeeping requirements as proposed in FINRA Rule 4580.[188] FINRA notes that, as discussed in the Notice, payments to political parties or PACs can be a means for a covered member or covered associate to funnel contributions to a government official without directly contributing.[189] Therefore, FINRA states that

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[185] *See* CAI Letter 1.

[186] *See id.*

[187] *See id.*

[188] *See* FINRA Response Letter 2 at 20.

[189] *See id.* As FINRA explains in the Notice, a covered associate would include a PAC controlled by the covered member or any of

it is proposing to require a covered member to maintain a record of all payments to political parties or PACs as such records would assist FINRA in identifying situations that might suggest an intent to circumvent the rule.[190]

H. Comments Regarding the *De Minimis* Exception under Proposed Rule 2030(c) and FINRA's Responses

As discussed above, certain commenters raise concerns regarding the exception for *de minimis* contributions under proposed Rule 2030(c)(1) on First Amendment grounds.[191] In addition, one commenter requests that the $350 and $150 amounts "be raised substantially" in both the SEC Pay-to-Play Rule and in proposed Rule 2030(c)(1), and further requests that the $350 limitation on the proposed exception for returned contributions under proposed Rule 2030(c)(3)

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its associates. FINRA states that it would consider a covered member or its covered associates to have "control" over a PAC if the covered member or covered associate has the ability to direct or cause the direction of governance or operations of the PAC. *See* Notice, 80 FR at 81653, 81660 (noting that this position is consistent with the position taken by the SEC in connection with the SEC Pay-to-Play Rule) (citing SEC Pay-to-Play Adopting Release, 75 FR at 41032).

[190] *See* FINRA Response Letter 2 at 20–21. FINRA states in the Notice that the proposed recordkeeping requirements are intended to allow FINRA to examine for compliance with its proposed pay-to-play rule, and the reference to indirect contributions in proposed Rule 4580(a)(4) is intended to include records of contributions or payments a covered member solicits or coordinates another person or PAC to make under proposed Rule 2030(b). *See* Notice, 80 FR at 81663.

[191] For a discussion of these First Amendment comments and FINRA's responses, *see* Section III.A, *supra*.

be eliminated in both the SEC Pay-to-Play Rule and in FINRA's proposed rule.[192]

In response, FINRA explains that its proposed rules must impose substantially equivalent or more stringent restrictions on member firms as the SEC Pay-to-Play Rule imposes on investment advisers.[193] Therefore, FINRA has proposed exceptions for *de minimis* contributions and returned contributions that are consistent with similar exceptions in the SEC Pay-to-Play Rule.[194] FINRA does not believe that raising the limits for the *de minimis* exception or eliminating the limit for returned contributions would impose substantially equivalent or more stringent restrictions on member firms as the SEC Pay-to-Play Rule imposes on investment advisers.[195]

I. Comments Regarding the Grandfathering of Existing Accounts and Contracts and FINRA's Responses

One commenter requests that FINRA clarify the application of the proposed rule to existing government entity accounts or contracts.[196] FSI requests that, in the event that FINRA does not amend the application of its proposed rule to covered investment pools (as requested by this same commenter), FINRA apply

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[192] *See* CAI Letter 1 (claiming that these contribution amounts fail to take inflation into consideration and are "unreasonably low").

[193] *See* FINRA Response Letter 2 at 19.

[194] *See id.*

[195] *See id.*

[196] *See* FSI Letter 1.

the proposed rule only to accounts and variable contracts opened after the effective date.[197]

In response, FINRA explains that, as discussed above, its proposed rules must impose substantially equivalent or more stringent restrictions on member firms as the SEC Pay-to-Play Rule imposes on investment advisers.[198] The Commission did not apply its rule only to contracts or accounts opened after the effective date of the rule.[199] FINRA also explains in the Notice that, if the Commission approves the proposed rule change, proposed Rule 2030(a) will not be triggered by contributions made prior to the rule's effective date, and that the rule will not apply to contributions made prior to the effective date by new covered associates to which the two years or, as applicable, six months "look back" applies.[200] FINRA states that the transition period—the time between the Commission approving the proposal and FINRA announcing the effective date of the rule—will provide member firms with time to identify their covered associates and government entity clients and to modify their supervisory systems to address new obligations under the rules.[201] Therefore, FINRA does not believe that limiting the application of its rule in the way suggested by FSI would impose substantially equivalent

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[197] *See id.*

[198] *See* FINRA Response Letter 2 at 16.

[199] *See id. See also* Notice, 80 FR at 81656.

[200] *See* Notice, 80 FR at 81656.

[201] *See* id. ("FINRA intends to establish an effective date that is no sooner than 180 days following publication of the Regulatory Notice announcing Commission approval of the proposed rule change, and no later than 365 days following Commission approval of the proposed rule change.").

or more stringent restrictions on member firms as the SEC Pay-to-Play Rule imposes on investment advisers.[202]

J. Comments Regarding Application of the Proposed Rules to the Independent Business Model and FINRA's Responses

One commenter claims that its members "will face difficulties" in attempting to comply with the proposed rules, and that these difficulties stem, primarily, from a requirement for independent firms to implement a rule that is premised on the notion that solicitation of clients is performed pursuant to a centralized process controlled by the management of a registered investment adviser.[203] This same commenter claims that the "lack of clarity" as to the application of the SEC Pay-to-Play Rule to its members' independent business model, and the scope of government officials that trigger the requirements, has led some firms to adopt aggressive compliance programs that prohibit political contributions.[204]

In response, FINRA states that, consistent with the SEC Pay-to-Play Rule, it has determined not to except from its proposed pay-to-play rule member firms engaged in the independent business model.[205] FINRA, however, states that, to the extent that interpretive

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[202] *See* FINRA Response Letter 2 at 16.

[203] *See* FSI Letter 1 (claiming FSI believes that the SEC Pay-to-Play Rule has inadvertently captured non-corrupting activity and fears that the proposed rule may do the same).

[204] *See id.* (claiming that, absent clarity concerning the application of the proposed rule to the brokerage services provided to 403(b) and 457 plans, FSI's members will be faced with the choice of either adopting similarly aggressive policies or prohibiting sales to government-sponsored retirement plans).

[205] *See* FINRA Response Letter 2 at 18.

questions arise regarding the application and scope of the provisions and terms used in the proposed rule change, FINRA will work with the industry and Commission to address the interpretive questions and provide additional guidance as needed.[206]

K. Comments Requesting More Stringent Requirements in the Proposed Rules and FINRA's Responses

Two commenters suggested that proposed Rule 2030 include more stringent requirements in certain respects.[207] First, both commenters request that FINRA expand the applicability of its proposed rules to include state-registered investment advisers.[208] More specifically, one of these commenters suggests that FINRA include state-registered investment advisers in its definition of "investment adviser" for the purposes of its proposed rule.[209] Although FINRA states in the Notice that relatively few state-registered investment advisers manage public pension plans,[210] one commenter believes that this alone does not justify permitting FINRA-member firms that do manage public pension plans, but happen to work with smaller investment advisers, to engage in pay-to-play activities with no repercussions.[211] Another commenter claims

[206] *See id.*

[207] *See* NASAA Letter and PIABA Letter.

[208] *See* NASAA Letter and PIABA Letter.

[209] *See* NASAA Letter.

[210] *See* NASAA Letter and PIABA Letter.

[211] *See* PIABA Letter. Unless the commenter is discussing dually-registered intermediaries, we do not understand the commenter's reference to "FINRA-member firms that do manage public pension plans" as those plans are managed by investment advisers, not broker-dealers.

that state-registered investment advisers now include larger firms and, therefore, it is much more likely that state-registered investment advisers will manage or advise public pension plans or similar funds.[212]

In response, FINRA states that, as discussed in the Notice,[213] to remain consistent with the SEC Pay-to-Play Rule, FINRA has determined not to expand the scope of the proposed rule as suggested by commenters to include state-registered investment advisers in its definition of "investment adviser" for the purposes of its proposed rule.[214] As discussed in the Notice, FINRA explains that the Commission also declined to make a similar change to its proposed rule, stating that it was the Commission's understanding that few of these smaller firms manage public pension plans or other similar funds.[215]

Second, these two commenters request that FINRA include a mandatory disgorgement provision for violations of its proposed rule.[216] These commenters state that they are disappointed that FINRA removed the mandatory disgorgement provisions from the proposal as outlined in FINRA's *Regulatory Notice* 14-50.[217] These commenters believe that a mandatory disgorgement

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[212] *See* NASAA Letter.

[213] *See* Notice, 80 FR at 81652 n.26 (explaining that "consistent with the SEC Pay-to-Play Rule, the proposed rule would not apply to state-registered investment advisers as few of these smaller firms manage public pension plans or other similar funds"). *See also id.* at 81660 n.98 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41026).

[214] *See* FINRA Response Letter 2 at 10.

[215] *See* Notice, 80 FR at 81652 n.26. *See also id.* at 81660 n.98.

[216] *See* NASAA Letter and PIABA Letter.

[217] *See* NASAA Letter and PIABA Letter.

provision would act as a significant deterrent to engaging in pay-to-play schemes, and it should remain in FINRA's final rule.[218]

In response, FINRA states that, after considering similar comments made in response to its *Regulatory Notice* 14-50, in particular, that FINRA has authority to require disgorgement of fees in enforcement actions, FINRA determined not to include a disgorgement requirement in its proposal.[219] For those same reasons, which also are discussed in the Notice,[220] FINRA also has determined not to revise the proposal to include a disgorgement requirement.[221]

Finally, one commenter believes that the cooling-off period in the proposal should be at least four years.[222] PIABA believes that the two-year cooling-off period does not adequately reduce the incentive for FINRA member firms to make political contributions to obtain pay-toplay advantages.[223] PIABA states FINRA should start with the most comprehensive rule, and that it

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[218] *See* NASAA Letter and PIABA Letter.

[219] *See* FINRA Response Letter 2 at 19–20.

[220] *See* Notice, 80 FR at 81662 (noting, for example, ICI's comment made in connection with *Regulatory Notice* 14-50 that "including disgorgement as a penalty is not necessary given that the SEC and FINRA both have full authority to require disgorgement of fees, and indeed, disgorgement has been the penalty universally applied (along with additional penalties) in enforcement actions under existing pay-to-play rules, such as MSRB Rule G-37 and SEC Rule 206(4)-5").

[221] *See* FINRA Response Letter 2 at 20.

[222] *See* PIABA Letter.

[223] *See id.*

would welcome the deterrent effect of a four-year cooling off period.[224]

FINRA declines to make PIABA's suggested change.[225] FINRA explains that the proposed two-year time-out is consistent with the time-out period in the SEC's Pay-to-Play Rule and, FINRA believes that a two-year time-out period from the date of a contribution is sufficient to discourage covered members from engaging in pay-to-play practices.[226] As FINRA explains in the Notice, the two-year time-out in the proposed rule is intended to discourage covered members from participating in pay-to-play practices by requiring a cooling-off period during which the effects of a *quid pro quo* political contribution on the selection process can be expected to dissipate.[227]

IV. Discussion and Commission Findings

After carefully considering the proposed rule change, the comments submitted, and FINRA's responses thereto, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered national securities association.[228]

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[224] *See id.*

[225] *See* FINRA Response Letter 2 at 10.

[226] *See id.*

[227] *See* Notice, 80 FR at 81651. As the Commission explained, the two-year "cooling-off period'" is not a penalty but, rather, is intended to be a period during which any effects of a *quid pro quo* are expected to dissipate. *See* SEC Pay-to-Play Adopting Release, 75 FR at 41026 n.104.

[228] In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. In this regard, the Commission considered FINRA's extensive discussion of these effects in its

In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act.[229] Section 15A(b)(6), which governs registered national securities associations like FINRA, requires, among other things, that the association's rules be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, . . . to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest."[230] As discussed in more detail below, we believe that FINRA's proposal is consistent with Section 15A(b)(6). FINRA's proposed rule will address the regulatory concerns that underlie, and thus support the objectives of, the SEC Pay-to-Play Rule, discussed below, by discouraging FINRA member firms and certain of their covered associates from engaging in *quid pro quo* corruption that may create market distortions—when, for example, an investment adviser is chosen on the basis of a placement agent's political contributions rather than the adviser's merit. Such conduct impedes a free and open market, and may harm investors and the public interest if government entities, including public pension plans, and their beneficiaries receive inferior

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Notice and FINRA's response to comments on that discussion. Moreover, the Commission observes that, in response to the Commission's Notice, no commenter suggested that FINRA's analysis was incorrect or incomplete, or that the proposed rule change would have a negative effect on efficiency, competition, or capital formation. *See* 15 U.S.C. 78c(f).

[229] 15 U.S.C. 78o-3(b)(6).

[230] *Id.*

services or pay higher fees.[231] FINRA's proposed rule also promotes a free and open market and the protection of investors and the public interest by avoiding the outright ban on distribution and solicitation activity that would result if FINRA member firms were not "regulated person[s]" under the SEC Pay-to-Play Rule.[232] The fact that FINRA's proposed rule may have implications for a small subset of political contributions made by certain covered associates to certain elected officials does not somehow eliminate FINRA's ability to adopt rules pursuant to the Act, or the Commission's authority to approve such rules under Section 19(b)(2) of the Act.[233]

As support for the need for the proposed rule, FINRA outlined certain regulatory concerns in the Notice that also were identified by the Commission in connection with its adoption of the SEC Pay-to-Play Rule.[234] These concerns, which also implicate the investor and public interest protections described in

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[231] *See* FINRA Response Letter 2 at 8. *See also* Notice, 80 FR at 81651, 81656 (discussing the regulatory objectives of and statutory basis for the proposal).

[232] *See* FINRA Response Letter 2 at 5 ("FINRA believes that the proposed rule change is a more effective response to the issues addressed in the SEC Pay-to-Play Rule than a complete ban on solicitation."). *See also* Notice, 80 FR at 81652, 81656 (discussing the regulatory objectives of and statutory basis for the proposal).

[233] While FINRA's proposed rule does not bar member firms and their covered associates from making contributions, it may affect the propensity of member firms and certain employees to make the subset of contributions that would trigger the two-year time-out. FINRA's rule does not impose a requirement that member firms publicly disclose political contributions.

[234] *See* Notice, 80 FR at 81651, nn.12–14 (discussing concerns the Commission identified in the SEC Pay-to-Play Rule Adopting Release, 75 FR at 41037).

Section 15A(b)(6) of the Act, recognize the central role intermediaries, such as "solicitors" or "placement agents," have played in actions that the Commission and other authorities have brought involving pay-to-play schemes.[235] FINRA also acknowledges the Commission's observation of how investment advisers, in several instances, allegedly made significant payments to placement agents and other intermediaries to influence the award of advisory contracts.[236] Moreover, FINRA points out the difficulties that investment advisers face in monitoring or controlling the activities of their third-party solicitors.[237]

As we explained in adopting the SEC Pay-to-Play Rule, public pension plans are particularly vulnerable to pay-to-play practices, and we have been particularly concerned that the engagement of placement agents who have made political contributions to key officials is viewed by investment advisers as a necessary step

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[235] *See* Notice, 80 FR at 81651. *See also id.* at nn.10–11 (explaining that "solicitors" typically locate investment advisory clients on behalf of an investment adviser, and that "placement agents" typically specialize in finding investors, often institutional investors or high net worth investors, that are willing and able to invest in a private offering of securities on behalf of the issuer of such privately offered securities) (citing Advisers Act Release No. 2910 (Aug. 3, 2009), 74 FR 39840, 39853 n.137 (Aug. 7, 2009) (Political Contributions by Certain Investment Advisers)).

[236] *See* Notice, 80 FR at 81651. *See also e.g.*, SEC Pay-to-Play Adopting Release, 75 FR at 41037.

[237] *See* Notice, 80 FR at 81651. *See also* SEC Pay-to-Play Adopting Release, 75 FR at 41032 n.182, 40137 n.266 (acknowledging commenters' concerns regarding the difficulties that advisers may have when monitoring the activities of their third-party solicitors).

to securing a contract with a public pension plan.[238] In connection with the SEC Pay-to-Play Rule, we initially proposed a complete bar on investment advisers engaging third parties to solicit government clients on their behalf because of concerns about investment advisers' use of third-party solicitors and placement agents to engage in pay-to-play activities.[239] However, persuaded by commenters, we revised the proposed SEC Pay-to-Play Rule to permit advisers to make payments to certain "regulated persons" to solicit government clients on their behalf, provided that they are themselves subject to prohibitions against participating in pay-to-play practices, are subject to Commission oversight and, in the case of broker-dealers, the oversight of a registered national securities association such as FINRA.[240] FINRA agreed and informed us that it would prepare rules for our consideration that would prohibit its members from soliciting advisory business from a government entity on behalf of an adviser unless they comply with pay-to-play restrictions.[241]

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[238] *See* SEC Pay-to-Play Adopting Release, 75 FR at 41019–20, nn.16–25 (collecting examples of SEC litigation releases as well as state and federal criminal actions with pay-to-play schemes involving placement agents among other intermediaries). *See also id.* at 40137, n.262 (collecting examples of state and local legislative actions undertaken to prohibit or regulate pay-to-play practices involving placement agents in response to concerns about pay-to-play activities in their jurisdictions).

[239] *See id.* at 41037 nn.259–68 (discussing the Commission's observations in the SEC Pay-to-Play Rule proposing release).

[240] *See* id. at 41041.

[241] *See* Notice, 80 FR at 81651 n.15 (citing a letter from Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA, to Andrew J. Donohue, Director, Division of Investment Management, Commission (Mar. 15, 2010) ("Ketchum Letter"), available at http://www.sec.gov/comments/s7-18-09/s71809-260.pdf (stating

Pay-to-play practices are harmful. They create an impediment to a free and open market by, for example, distorting the investment adviser selection process from one that is based on merit, performance and cost, to one that is influenced by a placement agent's contributions to the campaigns of government officials who are responsible for, or can influence the outcome of, selecting an investment adviser.[242] As a result of this distortion, government entities, including pension funds, and their citizen beneficiaries may be harmed by receiving inferior services or paying higher fees.[243] Investors and the public interest ultimately suffer, including taxpayers, residents who rely on municipal services, and the beneficiaries of public pension funds, such as firemen, police officers, teachers, and other civil servants.[244] Investment advisers also are harmed because their ability to participate in the market is

that FINRA "believe[s] that a regulatory scheme targeting improper pay to play practices by broker-dealers acting on behalf of investment advisers is . . . a viable solution to a ban on certain private placement agents serving a legitimate function")). FINRA also notes that in developing its proposal it intended to draw closely upon all the substantive and technical elements of the Commission's rule as well as FINRA's regulatory expertise in examining and enforcing the MSRB rules, upon which the SEC Pay-to-Play Rule is based. *See* Ketchum Letter. *See also* SEC Pay-to-Play Adopting Release, 75 FR at 41042 n.317 (discussing same).

[242] *See, e.g.*, SEC Pay-to-Play Adopting Release, 75 FR at 41023, 41039.

[243] SEC Pay-to-Play Adopting Release, 75 FR at 41019.

[244] SEC Pay-to-Play Adopting Release, 75 FR at 41019 (noting that the management of public pension plans "most significantly . . . affects taxpayers and the beneficiaries of these funds, including the millions of present and future State and municipal retirees who rely on the funds for their pensions and other benefits").

impeded unless they are willing to engage in pay-to-play practices by, for example, hiring placement agents that make certain political contributions.[245]

The Commission also believes that the stealth in which pay-to-play practices occur and the inability of markets to properly address these practices argue strongly for rules like the SEC Pay-to-Play Rule and FINRA's proposal.[246] Pay-to-play practices create a "collective action" problem in two respects: (1) government officials who participate in such activities have an incentive to continue to accept contributions to support their campaigns for fear of being disadvantaged relative to their opponents; and (2) investment advisers have an incentive to participate out of concern that they may be overlooked if they fail to make a contribution.[247]

We believe that application of FINRA's proposed pay-to-play rules will effectively discourage covered members and their covered associates who act as placement agents for investment advisers from participating in pay-to-play practices because their political contributions or payments will be subject to restrictions

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[245] *See, e.g.*, SEC Pay-to-Play Adopting Release, 75 FR at 41023, 41039 (explaining that "pay to play practices may hurt smaller advisers that cannot afford the required contributions. Curtailing pay to play arrangements enables advisory firms, particularly smaller advisory firms, to compete on merit, rather than their ability or willingness to make contributions").

[246] *See* SEC Pay-to-Play Adopting Release, 75 FR at 40122–23. *See also* FINRA Response Letter at 6 (noting that, as explained in *Blount*, "no smoking gun is needed;" however, "where, as here, the conflict of interest is apparent, the likelihood of stealth great, and the [Commission's] purpose prophylactic").

[247] *See* FINRA Response Letter at 9; SEC Pay-to-Play Adopting Release, 75 FR at 40122.

similar to those imposed on investment advisers under the SEC Pay-to-Play Rule.[248] The Commission therefore believes that FINRA's proposed rule change will help address the concerns identified in the SEC Pay-to-Play Rule

Adopting Release regarding the distortion of the investment advisory market.[249] As a result, like the SEC Pay-to-Play rule, FINRA's proposal should help protect investors and the public interest by, among other things, reducing the costs to plans and their beneficiaries of inferior asset management services arising from adviser selection based on a placement agent's political contributions rather than prudential investment considerations.[250] Further, in the Commission's view, FINRA's proposed rule strikes an appropriate balance in addressing these regulatory concerns by providing for FINRA member firms to be "regulated person[s]" under the SEC Pay-to-Play Rule.[251] As a

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[248] *See* Notice, 80 FR at 81651.

[249] *See* FINRA Response Letter at 9 (stating that "[f]or example, the proposed rule change is reasonably designed to address the distortion of the investment advisory market and collective action problems created by pay-to-play practices"). As the Commission has explained, by addressing distortions in the process by which investment advisers are selected regarding public investments, pay-to-play rules provide important protections to public pension plans and their beneficiaries, as well as participants in other important plans or programs sponsored by government entities. *See* SEC Pay-to-Play Adopting Release, 75 FR at 41023, 41054.

[250] *See* SEC Pay-to-Play Adopting Release, 75 FR at 41039.

[251] *See, e.g.*, FINRA Response Letter at 5 ("FINRA believes that the proposed rule change is a more effective response to the issues addressed in the SEC Pay-to-Play Rule than a complete ban on solicitation.") *See also* Notice, 80 FR at 81652, 81656 (discussing the regulatory objectives of and statutory basis for the proposal).

result, investment advisers will be able to continue to benefit from the use of placement agents in obtaining investment advisory business with government entities without political contributions distorting the process by which a government entity, such as a public pension fund, selects an adviser.[252] The two-year time-out period imposed by the proposed rule change is not a penalty but, rather, is intended to discourage participation in pay-to-play practices by requiring a "cooling-off period" during which the effects of a *quid pro quo* political contribution on the selection process are expected to dissipate.[253] This time-out will help promote fair competition in the market and protect public pension funds and investors by curbing fraudulent conduct resulting from pay-to-play practices.[254] In addition, according to FINRA, the proposal can be expected to help promote competition by allowing more third-party solicitors to participate in the market for solicitation services, which in turn may reduce costs to investment advisers and improve competition for advisory services.[255] For these reasons and as discussed throughout, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act.[256]

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[252] *See, e.g.*, FINRA Response Letter 2 at 8 ("The proposed rule change accomplishes these goals by allowing member firms to continue to engage in distribution or solicitation activities for compensation with governmental entities on behalf of investment advisers, while at the same time deterring member firms from engaging in pay-to-play practices.").

[253] *See* Notice, 80 FR at 81651. *See also* SEC Pay-to-Play Adopting Release, 75 FR at 41026 n.104.

[254] *See* Notice, 80 FR at 81657.

[255] *See id.*

[256] *See* 15 U.S.C. 78o-3(b)(6).

The Commission notes that most commenters to the Notice[257] and some of the commenters responding to the Order Instituting Proceedings[258] generally express support for FINRA's proposal. For example, one commenter states that it is pleased that, like the SEC and the MSRB, FINRA is adopting rules to govern the activities of its members that solicit government clients on behalf of an investment adviser and also is pleased that FINRA's proposal is designed to complement, and be consistent with, the SEC's pay-to-play rule.[259] Similarly, another commenter states that, although it requests certain revisions, it also supports FINRA's attempt to deter pay-to-play activity among covered members and supports the regulatory objectives underlying the Proposed Rules.[260]

The Commission acknowledges the concerns and questions raised by some commenters, which are outlined in further detail above in Section III. As discussed below, the Commission believes, however, that FINRA has responded to the commenters' concerns and questions in light of, among other things, the regulatory framework established by the SEC Pay-to-Play Rule, which provides that FINRA's proposed rules must impose substantially equivalent or more stringent restrictions on its members than the SEC

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[257] *See* CAI Letter 1; CAI Letter 2; FSI Letter 1; ICI Letter; NAIFA Letter; NASAA Letter; and PIABA Letter.

[258] *See* FSI Letter 2 (claiming that the proposal creates "compliance uncertainties" for FSI's members, but noting that FSI "support[s] regulatory efforts to combat pay-to-play corruption activity").

[259] *See* ICI Letter.

[260] *See* CAI Letter 1 (recognizing "the challenges in crafting the Proposed Rules so that they reach all of the activity sought to be eliminated without also prohibiting activity that is harmless").

Pay-to-Play Rule imposes on investment advisers for FINRA members to be "regulated persons" under the SEC Pay-to-Play Rule.

A. Comments Concerning the First Amendment and Related Concerns

Several commenters express the view that FINRA's proposed rule violates the First Amendment.[261] The Commission is sensitive to the constitutional concerns raised by the commenters, but after careful consideration of their arguments, for the reasons discussed below, concludes that FINRA's rule is consistent with the First Amendment.

FINRA's rule, which focuses on covered members who serve as placement agents, tracks the SEC Pay-to-Play Rule for investment advisers, which, in turn, tracks the MSRB's pay-to-play rule, Rule G-37, which the D.C. Circuit upheld against First Amendment challenge in 1995.[262] The Supreme Court has issued several decisions regarding political speech since *Blount* was decided,[263] and none of these decisions call into

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[261] *See* CCP Letter 1; FSI Letter 1; FSI Letter 2; and State Parties Letter 1. *See also* CCP Letter 2; CCP Letter 3; Moran Letter and State Parties Letter 2.

[262] *Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995), *cert. denied*, 517 U.S. 1119 (1996). One significant difference between the MSRB rule, on one hand, and the SEC's and FINRA's rules, on the other, is that the MSRB rule requires the public disclosure of political contributions whereas the SEC's and FINRA's rules do not.

[263] *See, e.g.*, *McCutcheon v. FEC*, 134 S. Ct. 1434 (2014); *Citizens United v. FEC*, 558 U.S. 310 (2010); *Davis v. FEC*, 554 U.S. 724 (2008); *FEC v. Wisc. Right To Life, Inc.*, 51 U.S. 449 (2007); *Randall v. Sorrell*, 548 U.S. 230 (2006); *FEC v. Beaumont*, 539 U.S. 146 (2003); *Nixon v. Shrink Mo. Gov't PAC*, 528 U.S. 377 (2000).

question *Blount's* holding that a tailored pay-to-play rule, which is nearly identical in purpose and form to FINRA's proposed rule and which also furthers an important public interest, is constitutional. Indeed, the *en banc* D.C. Circuit recently and unanimously upheld a broader pay-to-play restriction—a bar on all contributions to federal candidates by federal contractors—in its decision in *Wagner* that analyzed the post-Blount Supreme Court decisions and cited *Blount* with approval.[264] Various pay-to-play restrictions imposed by other jurisdictions also have withstood First Amendment challenge in recent years.[265]

Decisions like *Wagner* confirm that even an outright limitation on contributions—as opposed to FINRA's rule, which may indirectly discourage contributions—is permissible if it is justified by a sufficiently important government interest and is closely drawn to avoid unnecessary abridgement of the type of political speech represented by a political contribution.[266]

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[264] *Wagner v. FEC*, 793 F.3d 1 (D.C. Cir. 2015) (en banc), *cert. denied sub nom.*, *Miller v. FEC*, 136 S. Ct. 895 (2016).

[265] *See, e.g., Yamada v. Snipes*, 786 F.3d 1182 (9th Cir.), *cert. denied,* 136 S. Ct. 569 (2015); *Preston v. Leake,* 660 F.3d 726, 729–30, 736 (4th Cir. 2011); *Ognibene v. Parkes,* 671 F.3d 174, 179–80 (2d Cir. 2011); *Green Party of Connecticut v. Garfield,* 616 F.3d 189, 200 (2d Cir. 2010).

[266] *Wagner,* 793 F.3d at 6–8. We note that FINRA's rule is not an absolute bar on contributions, but the two-year time-out may have the effect of discouraging member firms and certain covered associates who may act as placement agents for investment advisers from making certain contributions to certain covered officials. To the extent that the commenters suggest that such an indirect limitation on contributions would be reviewed by a court under strict scrutiny, they misstate applicable Supreme Court precedent, which has maintained that limitations on contributions are reviewed under a more intermediate form of scrutiny

We believe that FINRA's proposed rule serves a vitally important governmental interest: discouraging a specific type of *quid pro quo* corruption in which political contributions made by placement agents may influence the award of investment advisory business by government entities. The Supreme Court has long held that halting *quid pro quo* corruption is an important government interest that justifies limitations—or outright bans—on contributions.[267]

We do not understand FINRA to be engaging in broad electoral reform or trying to clean up the electoral process. Rather, to avoid the outright ban on placement agent activity resulting from FINRA member firms not being "regulated person[s]" under the SEC Pay-to-Play Rule, the two-year time-out in FINRA's proposal, like the SEC Pay-to-Play Rule, discourages ***quid*** *pro quos* that affect government entities, including public pension funds, served by investment advisers. *Quid pro quos* involving placement agents, who make contributions to certain elected officials and then assist investment advisers in obtaining business from the government entities those officials serve may be: fraudulent, run counter to just and equitable principles of trade, impede a free and open market, and harm investors and the public interest.[268] When pay-to-play is a factor in the selection or retention of an investment adviser—when the adviser is chosen on

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because "[c]ontribution limits impose a lesser restraint on political speech" that permits "'symbolic expression of support evidence by a contribution" but do not "'in any way infringe the contributor's freedom to discuss candidates and issues.'" *McCutcheon,* 134 S. Ct. at 1444, quoting *Buckley v. Valeo,* 424 U.S. 1, 21 (1976).

[267] *McCutcheon,* 134 S. Ct. at 1452; *Buckley,* 424 U.S. at 27–28 (1976).

[268] *Blount,* 61 F.3d at 944–48. *See also* 15 U.S.C. 78o-3(b)(6).

the basis of a placement agent's political contributions rather than its merit—the most qualified adviser may not be hired, which may lead to inferior performance and payment of higher fees.[269] Ultimately, taxpayers and fund beneficiaries suffer the harm. Moreover, pay-to-play distorts free and open markets by requiring investment advisers and their placement agents to "play the game" or risk being left out.[270] In short, while FINRA's rule resembles other contribution limitations by serving a government interest in discouraging *quid quo pro* corruption, it is a targeted effort that should protect investors and the public by promoting the integrity of the investment advisory market.

FINRA's proposed rule advances this important governmental interest because the two-year time-out discourages pay-to-play. As explained above, pay-to-play has been and is a serious problem when placement agents assist investment advisers in obtaining advisory business from government entities.[271] Placement agents "played a central role in actions that [the Commission] and other authorities have brought involving pay-to-play schemes," and, in several instances, advisers used placement agents, who had made campaign contributions to elected officials, to influence the award of investment advisory contracts.[272] Most notably, Alan Hevesi, the Comptroller of New York

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[269] SEC Pay-to-Play Adopting Release, 75 FR at 41022, 41053–54.

[270] *Id.* at 41019, 41022, 41053. *See also Blount,* 61 F.3d at 945–46.

[271] SEC Pay-to-Play Adopting Release, 75 FR at 41019–20. Pay-to-play that affects State and local pension funds is not limited to the investment advisory context.

[272] SEC Pay-to-Play Adopting Release, 75 FR at 41019–20, 41037.

State who was responsible for investment of state pension funds, accepted campaign contributions from a placement agent and steered over $250 million in pension funds to investment advisers that had retained the placement agent.[273]

In response to these incidents, the Commission proposed a ban on the use of placement agents by investment advisers and ultimately adopted a final rule that permitted use of placement agents so long as they were "regulated persons" governed by the type of pay-to-play rule that FINRA has proposed here.[274] FINRA is not alone in addressing these issues. For example, several State and local governments have barred or restricted placement agents from playing a role in the contracting process.[275] Although the Supreme Court has never required a certain amount of past *quid pro quo* corruption to sustain a contribution limitation, there is more than sufficient evidence of pay-to-play practices to support FINRA's rule.[276]

The contours of FINRA's proposed rule reflect how pay-to-play practices involving placement agents affect the hiring and retention of investment advisers by State and local pension funds. One scenario implicated by FINRA's rule (and reflected in the Hevesi matter) involves an investment adviser that seeks business from a State pension fund and retains a firm, or an individual at a firm, that has made contributions to an elected official responsible for selecting investment

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[273] *Id.* at 41019–20.

[274] *Id.* at 41037–42.

[275] *Id.* at 41037 n. 262.

[276] *McCutcheon,* 134 S. Ct. at 1445, 1458; *Nixon,* 528 U.S. at 390–91; *Buckley,* 424 U.S. at 29-30.

advisers.[277] The elected officials who participate have no incentive to stop accepting contributions for fear of being disadvantaged relative to their opponents. Similarly neither the placement agents that make the contributions nor the investment advisers that hire the placement agents have an incentive to stop out of concern that if they abstain, their competitors will continue to engage in the practice profitably and without adverse consequences.[278] FINRA's rule should resolve this collective-action problem by interposing a time-out that creates a disincentive to engage in pay-to-play.

The proposed FINRA rule, like the SEC Pay-to-Play Rule that it is modeled on, is a tailored solution to a particularly pernicious form of *quid pro quo* corruption that affects the beneficiaries of public pension funds, such as teachers, law enforcement officers, firefighters, and other public servants, as well as the beneficiaries of other collective government funds, includeing participant-directed plans such as 403(b), 457 and 529 plans. The proposed FINRA rule would affect a small segment of the electorate: in general, member firms acting as placement agents for investment advisers seeking to obtain advisory business from government entities. And the proposed FINRA rule would affect only a small number of elected officials—those who are responsible for or have authority to

[277] SEC Pay-to-Play Adopting Release, 75 FR at 41019–20 & nn.18–20 (citing examples).

[278] *Id.* at 41022, 41040, 41053. *See also Blount,* 61 F.3d at 945–46. Even if the public is aware of the *quid pro quo* relationship, there is little that can be done because the official is compromised by the receipt of the contribution, and beneficiaries of a pension fund cannot easily shift their assets out of the fund, reverse the hiring decision, or remove the official. *Id*. at 41027. *See also id.* at 41053 n.459.

appoint any person who is responsible for or can influence the outcome of the hiring of an investment adviser by a government entity—and has no bearing on the vast majority of elections where the elected office's scope of authority does not encompass the awarding of investment advisory contracts. Moreover, the proposed FINRA rule's *de minimis* exception permits some campaign contributions to be made in all instances without triggering the time-out—thus allowing "the symbolic expression of support evidenced by a contribution"—and it does not restrict other forms of political speech, such as independent expenditures.[279]

B. Comments Regarding the Scope and Coverage of the Proposal

As discussed in detail above, the commenters raise several concerns regarding the scope and coverage of the proposed rules, including with respect to: the inclusion of variable annuities and mutual funds;[280] the inclusion of distribution activities;[281] the application

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[279] *McCutcheon*, 134 S. Ct. at 1444, quoting *Buckley,* 424 U.S. at 21 (internal quotation marks omitted).

[280] *See* CAI Letter 1 and FSI Letter 1. *See also* CAI Letter 2 (reflecting CAI's suggested revisions to certain language in some of FINRA's proposed rules). In FINRA's view, because the Commission did not exclude specific products from the SEC Pay-to-Play Rule, such as variable annuities or mutual funds, excluding specific products from its proposed rule would not satisfy the Commission's stringency requirements. *See* FINRA Response Letter 2 at 16.

[281] *See* CAI Letter 1. *See also* CAI Letter 2 (reflecting CAI's suggested revisions to certain language in some of FINRA's proposed rules). FINRA notes that, among other things, language in the SEC Pay-to-Play Rule Adopting Release supports the inclusion of "distribution" activities by broker-dealers in FINRA's proposed Rule 2030(a). *See Notice*, 80 FR at 81660–61 (citing SEC Pay-to-Play Rule Adopting Release, 75 FR at 41040 n.298 where,

to covered investment pools;[282] the level of the *de minimis* contribution exception and the returned

according to FINRA, the Commission "clarif[ied] under what circumstances distribution payments would violate the SEC's Pay-to-Play Rule"). FINRA believes that based on the Commission's definition of "regulated person" in the SEC's Pay-to-Play Rule, as well as the Commission's discussion regarding the treatment of distribution fees paid pursuant to a 12b-1 plan as compared to legitimate profits, its proposed rule must apply to member firms engaging in distribution activities. *See* FINRA Response Letter 2 at 12 (citing Notice, 80 FR at 81660–61) and FINRA Response Letter 2 at 12 n.53 (explaining that the SEC Pay-to-Play Rule defines a "regulated person" to include a member firm, provided that FINRA rules prohibit member firms from engaging in *distribution* or solicitation activities if political contributions have been made, and citing SEC Pay-to-Play Rule 206(4)-5(f)(9)(ii)(A)) (emphasis in original).

[282] *See* CAI Letter 1; FSI Letter 1; FSI Letter 2. FINRA clarifies that it is not intending in this proposal to re-characterize broker-dealers' selling interests in variable annuities, mutual funds, and private funds as soliciting an investment advisory relationship with investors who invest in those products. *See* FINRA Response Letter 2 at 14–15 (noting, for example, that the applicability of proposed FINRA Rule 2030(d) is for purposes of FINRA's pay-to-play rule only). FINRA also explains that FINRA Rule 2030(d) is modeled on a similar provision in the SEC Pay-to-Play Rule, Rule 206(4)-5(c) and, as such, proposed FINRA Rule 2030(d) is intended to extend the protections of the proposed rule to government entities that access the services of investment advisers through hedge funds and other types of pooled investment vehicles sponsored or advised by investment advisers. *See* FINRA Response Letter 2 at 15 (noting that when adopting SEC Pay-to-Play Rule 206(4)-5(c), the Commission stated that although "an investment in a pooled investment vehicle may not involve a direct advisory relationship with a government sponsored plan [that] does not change the nature of the fraud or the harm that may be inflicted as a consequence of the adviser's pay-to-play activity") (quoting SEC Pay-to-Play Rule Adopting Release, 75 FR at 41044–45). Finally, FINRA notes that the applicability of proposed FINRA

contribution exception;[283] the inclusion of the independent business model;[284] and the application to existing contracts or accounts.[285] FINRA generally responded that its proposed rules are designed to be at least as stringent as the SEC Pay-to-Play Rule so that FINRA's member firms will meet the definition of

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Rule 2030(d) is for purposes of FINRA's pay-to-play rule only. See FINRA Response Letter 2 at 15.

[283] *See* CAI Letter 1. In response, FINRA explains that it has proposed exceptions for *de minimis* contributions and returned contributions that are consistent with similar exceptions in the SEC Pay-to-Play Rule as FINRA's proposed rules must impose substantially equivalent or more stringent restrictions on member firms as the SEC Pay-to-Play Rule imposes on investment advisers. FINRA does not believe that raising the limits for the *de minimis* exception or eliminating the limit for returned contributions would satisfy the Commission's stringency requirements set forth in the SEC Pay-to-Play Rule.

[284] *See* FSI Letter and FSI Letter 2. FINRA explains that the Commission did not exempt application of the rule for firms engaged in the independent business model. *See* FINRA Response Letter 2 at 16. As a result, in FINRA's view, excluding independent business model firms from its proposed rule would not satisfy the Commission's stringency requirements, although FINRA is willing to work with the industry and Commission to address the interpretive questions and provide additional guidance as needed.

[285] *See* FSI Letter 1. In response, FINRA explains that the Commission did not apply its rule only to contracts or accounts opened after the effective date of the rule; therefore, FINRA does not believe that limiting the application of its rule in the way suggested by FSI would satisfy the Commission's stringency requirements set forth in the SEC Pay-to-Play Rule. However, FINRA also explains that, if the Commission approves the proposed rule change, proposed Rule 2030(a) will not be triggered by contributions made prior to the rule's effective date, and that the rule will not apply to contributions made prior to the effective date by new covered associates to which the two years or, as applicable, six months "look back" applies. *See* Notice, 80 FR at 81656.

"regulated persons" such that they are subject to rules that impose substantially equivalent or more stringent restrictions on its members than the SEC Pay-to-Play Rule imposes on investment advisers.[286]

As noted above, the SEC Pay-to-Play Rule, in part, prohibits any investment adviser covered under the rule or any of its covered associates from providing or agreeing to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser unless such person is a "regulated person," as defined under the rule.[287] The definition of "regulated person" includes a FINRA member firm, provided that: (a) FINRA rules prohibit member firms from engaging in distribution or solicitation activities if political contributions have been made; and (b) the Commission finds, by order, that such rules impose substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and that such rules are consistent with the objectives of the SEC Pay-to-Play Rule.[288] Thus, any changes to the proposed rules that would result in FINRA's rules not being found to impose at least substantially equivalent restrictions on its member firms and to be otherwise consistent with the objectives of the SEC Pay-to-Play Rule would result in a ban on such activity.

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[286] *See, e,g.*, FINRA Response Letter 2 at 4, 16.

[287] *See* Notice, 80 FR at 81650 n.6, 81656. *See also* 17 CFR 275.206(4)-5(a)(2)(i)(A).

[288] *See* Notice, 80 FR at 81650 n.6. *See also* SEC Pay-to-Play Rule 206(4)-5(f)(9). The definition of "regulated person" also includes SEC-registered investment advisers and SEC-registered municipal advisors, subject to specified conditions.

The Commission believes that it is appropriate and consistent with Section 15A(b)(6) of the Act for FINRA to design its proposed rules to have the same scope and provisions as the SEC Pay-to-Play Rule. If the Commission were unable to make the required stringency finding, this would result in FINRA member firms not being a "regulated person" under the SEC Pay-to-Play Rule and therefore prohibited from receiving compensation for engaging in distribution and solicitation activities with government entities on behalf of investment advisers.[289]

One commenter states that the proposal is ambiguous regarding the term "distribution" activities in Rule 2030(a).[290] This term in FINRA's proposed rule is taken directly from the definition of "regulated person" in the SEC Pay-to-Play Rule.[291] Although the term "distribution" is not defined specifically in the SEC Pay-to-Play Rule, to preserve the identified benefits of the rule, the Commission interprets the term broadly in the context of the SEC Pay-to-Play Rule to mean generally engaging in any activity that is primarily intended to result in the sale of securities.[292] In view

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[289] *See* Notice, 80 FR at 81650 n.6. *See also id.* at 81651, 81656 (discussing the regulatory objectives of and statutory basis for the proposal).

[290] *See* CAI Letter 1.

[291] A "regulated person," as defined in the SEC Pay-to-Play Rule, includes a FINRA member firm, provided that, among other things, FINRA rules "prohibit member firms from engaging in *distribution* or solicitation activities if certain political contributions have been made." 17 CFR 275.206(4)-5(f)(9)(ii) (emphasis added).

[292] By way of example in other contexts, the Commission has recognized that, because new distribution activities may continuously evolve in the future, it would be impracticable to develop, for example, an all-inclusive definition or list of such activities

of the Commission's prior statements regarding the term, including those contained in the SEC Pay-to-Play Rule Adopting Release,[293] we believe the term is not ambiguous and could be applied by FINRA members for purposes of the proposed rule in a way that is consistent with the prophylactic nature of the proposal. However, we note that in connection with adopting the SEC Pay-to-Play Rule, the Commission did clarify under what circumstances distribution payments would violate the SEC's Pay-to-Play Rule.[294] For example, the Commission explained that mutual fund distribution fees are typically paid by the fund from fund assets pursuant to a 12b-1 plan and generally would not constitute payment by the fund's adviser; therefore, such payments would not be prohibited under Rule 206(4)-5.[295] The Commission also explained that where an adviser pays for the fund's distribution out of its "legitimate profits," the

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and related expenses, and declined to do so when it adopted the SEC Pay-to-Play Rule. *See* Bearing of Distribution Expenses by Mutual Funds, Investment Company Act Release No. 11414 (Oct. 28, 1980), 45 FR 73898, 73903 (Nov. 7, 1980) ("Rule 12b-1 Adopting Release"). *See also* 17 CFR.12b-1(a)(2) (explaining, in the context of registered open-end funds, that one will be deemed to be acting as a distributor of securities if they engage in "any activity which is primarily intended to result in the sale of shares issued by such [fund], including, but not necessary limited to, the compensation of underwriters, dealers and other sales personnel, the printing and mailing of prospectuses to other than current shareholders, and the printing and mailing of sales literature").

[293] *See infra* notes 294–296 and accompanying text.

[294] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41040 n.298. *See also* FINRA Response Letter 2 at 12 (citing Notice, 80 FR at 81660–61).

[295] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41040 n.298 (citing Rule 12b-1 Adopting Release).

rule would generally be implicated.[296] Based on the foregoing, we believe it is appropriate for FINRA not to have specifically defined the term "distribution" activities for purposes of its proposal.

One commenter claims that, among other things, the "lack of clarity as to the application of the SEC Pay-to-Play Rule to [its] members' business model, and the scope of government officials that trigger the requirements, has led some firms to adopt aggressive compliance programs that prohibit political contributions."[297] As discussed above, FINRA states that, consistent with the SEC Pay-to-Play Rule, it has determined not to except from its proposed pay-to-play rule member firms that use an independent business model.[298] We note that FINRA's rules and the federal securities laws do not distinguish so-called independent business model firms from other broker-dealer business models.[299] Rather, although a broker-dealer may organize its operations under a variety of business models, and different business models may

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[296] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41040 (citing Rule 12b-1 Adopting Release).

[297] *See* FSI Letter 1 (claiming FSI believes that the SEC Pay-to-Play Rule has inadvertently captured non-corrupting activity and it fears that the proposed rule may do the same).

[298] *See* FINRA Response Letter 2 at 18.

[299] While a firm may accept independent contractor status for purposes other than the federal securities laws, such treatment does not alter such person's status as a person associated with a broker or dealer or the firm's responsibility to supervise under the federal securities laws. *See, e.g., Hollinger v. Titan Capital Corp.,* 914 F.2d 1564, 1572–76 (9th Cir. 1990) *(en banc)* (explaining that, even if a broker-dealer and registered representative contractually agree that a representative is an independent contractor, the broker-dealer is still required to supervise its representatives).

present unique compliance challenges, it is up to the broker-dealer to sufficiently discharge its regulatory obligations in light of the business model it has elected, and to tailor its supervisory system appropriately so that it is reasonably designed[300] to achieve compliance with applicable federal securities laws and regulations and FINRA rules.[301]

We also note that FINRA has committed to working with the industry and the Commission to address interpretive questions that may arise regarding the application and scope of the provisions and terms used in the proposed rule change and to provide additional guidance as needed.[302]

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[300] *See* FINRA Rule 3110(a) ("Each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable FINRA rules.") and Exchange Act Section 15(b)(4)(E), 15 U.SC. 78o(b)(4)(E) (authorizing the Commission to sanction a broker-dealer that "has failed reasonably to supervise, with a view to preventing violations of" the federal securities laws and rules and regulations thereunder).

[301] Giving guidance on its supervision rule, FINRA (then-NASD) noted that to fulfill its obligations to establish and maintain a supervisory system, a member firm must determine the types of business it conducts, how the firm is organized and operated, and the current regulatory requirements. *See* NASD Notice to Members 99-45 (NASD Provides Guidance on Supervisory Responsibilities) (June 1999) (stating that this analysis will enable the member to design a supervisory system that is current and appropriately tailored to its specific attributes and structure). *See also* FINRA Regulatory Notice 14-10 (SEC Approves New Supervision Rules) (Mar. 2014), at 17 n.4 (discussing NASD Notice to Members 99-45).

[302] *See* FINRA Response Letter 2 at 18. We note that the proposed rule does contain a provision—modeled on an analogous provision in the SEC Pay-to-Play Rule—allowing member firms

C. Comments Requesting Clarification of Terms and Provisions in the Proposal

Commenters asked for clarification of certain defined terms and provisions in the proposed rule, including clarification with respect to: the term "instrumentality" as it is used in the definition of "government entity;"[303] the definition of "covered associate" and the positions that would qualify someone as a covered "official;"[304] whether a "contribution" is also a "payment;"[305] and the factors by which contributions to a PAC would trigger the proposed anti-circumvention rule.[306] In response to these comments, FINRA generally acknowledges, as did the commenters, that these terms are defined in the SEC Pay-to-Play Rule and that FINRA modeled the definitions in its proposal on those in the SEC Pay-to-Play Rule.[307]

The Commission believes that FINRA's definition of "covered associate" in proposed Rule 2030(g) is functionally identical to the definition of the same term in the SEC Pay-to-Play Rule.[308] The definition brings within the ambit of the rule—and its two-year "time-out"—only those contributions made by employees of a member firm who, by virtue of their position or

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to apply to FINRA for an exemption, conditional or unconditional, from the proposed rule's two-year "time-out," and enumerates factors for FINRA to consider in deciding whether to grant such an exemption. *See* Proposed Rule 2030(f).

[303] *See* CAI Letter 1.

[304] *See* NAIFA Letter.

[305] *See* CAI Letter 1.

[306] *See* NAIFA Letter.

[307] *See* FINRA Response Letter 2 at 17, 18.

[308] *Compare* Proposed Rule 2030(g)(2), *with* 17 CFR 275.206(4)-5(f)(2).

responsibilities, are best positioned to engage in pay-to-play activities as placement agents. It includes "[a]ny general partner, managing member or executive officer of a covered member," any "associated person of a covered member who engages in distribution or solicitation activities with a government entity for such covered member," any associated person who supervises such an employee, and any "political action committee controlled by a covered member or a covered associate." FINRA's rule also adopts the Commission's definition of "executive officer," which was designed to tailor the trigger for the time-out to those officers whose position is most likely to incentivize them to engage in solicitation or distribution activities—and thus most likely to incentivize them to engage in pay-to-play.[309]

FINRA's definition of "official" also tracks the Commission's definition of that same term in the SEC Pay-to-Play Rule and, therefore, limits the rule so that a time-out is triggered only by contributions to certain officials.[310] Under FINRA's proposed rule, the time-out for a placement agent is not triggered by a contribution to every public official running for office; it is triggered only by contributions to a person "who was, at the time of the contribution, an incumbent, candi-

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[309] At least one commenter points out that some entities have precluded all employees from making contributions as a result of the Commission's pay-to-play rule and that FINRA's rule will have the same effect. *See* FSI Letter 2. However, under FINRA's rule (and the SEC Pay-to-Play Rule), only certain employees' contributions will trigger the time-out and the rules on their face do not cover contributions by *all* employees. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR at 40131–32.

[310] *Compare* Proposed Rule 2030(g)(8), *with* 17 CFR 275.206(4)-5(f)(6).

date or successful candidate for elective office of a government entity, if the office . . . [i]s directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity" or a person with authority to appoint someone whose office had the hiring responsibility.[311] FINRA's definition, like the Commission's, is flexible enough to accommodate the myriad State and local political structures while still limiting the reach of the rule to those officials who are responsible for or have authority to appoint any person who is responsible for or can influence the outcome of the hiring of an investment adviser by a government entity.[312]

Additionally, FINRA's definitions of "contribution" and "payment" are functionally identical to those same definitions in the SEC Pay-to-Play Rule.[313] We note that under FINRA's rule, the time-out is *not* triggered by direct contributions to political parties. Therefore, a member firm will not violate the time-out if it receives compensation for solicitation and distribution activities in the wake of contributions that it or its covered associates make to a political party. Instead,

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[311] *See supra* note 310.

[312] If FINRA were to define "official" by reference to a particular title, such as "Comptroller," the definition would be both over- and under- inclusive. Some officials who have hiring responsibility for investment advisers do not hold the title of "Comptroller," and some officials with the title of "Comptroller" do not have hiring responsibility for investment advisers. Because we understand FINRA's definition to track the definition that we adopted in the SEC Pay-to-Play Rule, we note that it is the scope of authority of the office, not *de facto* influence, that determines whether a contribution will trigger the time-out. *See* SEC Pay-to-Play Adopting Release, 75 FR at 41029.

[313] *Compare* Proposed Rules 2030(g)(8)-(9), *with* 17 CFR 275.206(4)-5(f)(1), 206(4)-5(f)(7).

FINRA's proposed rule only precludes a covered member from soliciting or coordinating payments to a political party of a State or locality of a government entity with which the covered member is engaging in distribution or solicitation activities on behalf of an investment adviser.[314] FINRA notes in response to a commenter's request for clarification as to whether each and every "contribution" (as defined in proposed FINRA Rule 2030(g)(1)) is, by definition, also a "payment" (as defined in proposed FINRA Rule 2030(g)(9)), that the definition of "payment" is similar to the definition of "contribution," but is broader in the sense that it does not include limitations on the purposes for which such money is given (*e.g.*, it does not have to be made for the purpose of influencing an election).[315]

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[314] *See* Proposed Rule 2030(b). This aspect of the rule serves an anti-circumvention function, along with proposed Rule 2030(e), which makes it a violation of the rule "for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of this Rule." As FINRA notes, Rule 2030(e) precludes only intentional efforts to circumvent the time-out and a covered member would not violate the rule's prohibition on the receipt of compensation unless there is a showing that the covered member intended to evade the time-out. Thus, a contribution to a PAC—other than a PAC controlled by the covered member, which would be a "covered associate" for purposes of the time-out—would not trigger the time-out and the receipt of compensation in the wake of that contribution would not violate the rule unless it can be shown that the covered member or covered associate who made the contribution intended to circumvent the time-out provision. This provision, which is analogous to a provision in the Commission's Pay-to-Play Rule, precludes a member or its covered associates from, for example, funneling contributions or payments through third parties, such as attorneys, family members, or friends, to complete a pay-to-play arrangement without triggering the time-out.

[315] *See* FINRA Response Letter 2 at 17.

The Commission believes that FINRA's definitions, which mirror or are functionally equivalent to similar definitions in the SEC's Pay-to-Play Rule, will help to achieve the objectives of the SEC Pay-to-Play Rule and, as described above, the requirements governing the rules of a registered national securities association.[316] The Commission believes that it is appropriate and consistent with the Act for FINRA to encompass in its rule the same definitions and discussion regarding its pay-to-play rules as the Commission did in adopting the SEC Payto-Play Rule. The Commission emphasizes that FINRA has committed to working with the industry and the Commission to address interpretive questions and provide additional guidance as needed.[317]

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[316] *See* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41042–44.

[317] There are several ways for industry members to obtain guidance from FINRA about the application of its rules. Such guidance may include FINRA's publication of Notices to Members and Regulatory Notices, as well as interpretative and exemptive letters. Although FINRA can address interpretive questions with respect to its own rules, for its member firms to satisfy the "regulated person" definition in the SEC Pay-to-Play Rule, the Commission must find that FINRA's pay-to-play rule (i) imposes substantially equivalent or more stringent restrictions on member firms than the SEC Pay-to-Play Rule imposes on investment advisers and (ii) that such rule is consistent with the objectives of the SEC Pay-to-Play Rule. *See supra* note 22 (discussing the Commission's notice of stringency findings dated August 25, 2016). Given the stringency requirements of the SEC Pay-to-Play Rule, we expect our staff to work closely with FINRA regarding interpretive questions about the application and scope of the provisions and terms used in FINRA's rule to the extent those interpretations do not otherwise require FINRA to file a proposed rule change with the Commission pursuant to Section 19(b) of the Act and the rules and regulations thereunder.

D. Comments Regarding the Books and Records Requirements

One commenter claims that not all payments to political parties or PACs should have to be maintained under the books and records requirements of proposed Rule 4580.[318] In response, FINRA states that it has determined to retain the recordkeeping requirements as proposed in the Notice.[319] FINRA notes that, as discussed in the Notice, payments to political parties or PACs can be a means for a covered member or covered associate to funnel contributions to a government official without directly contributing.[320] FINRA states that it proposed requiring a covered member to maintain a record of all payments to political parties or PACs because such records would assist FINRA in identifying situations that might suggest an intent to circumvent the rule.[321]

[318] *See* CAI Letter 1.

[319] *See* FINRA Response Letter 2 at 20–21.

[320] *See id*. As FINRA explains in the Notice, a covered associate would include a PAC controlled by the covered member or any of its associates. FINRA states that it would consider a covered member or its covered associates to have "control" over a PAC if the covered member or covered associate has the ability to direct or cause the direction of governance or operations of the PAC. *See* Notice, 80 FR at 81653, 81660 (noting that this position is consistent with the position taken by the Commission in connection with the SEC Pay-to-Play Rule) (citing SEC Pay-to-Play Adopting Release, 75 FR at 41032).

[321] *See* FINRA Response Letter 2 at 20. FINRA states in the Notice that the proposed recordkeeping requirements are intended to allow FINRA to examine for compliance with its proposed pay-to-play rule, and the reference to indirect contributions in proposed Rule 4580(a)(4) is intended to include records of contributions or payments a covered member solicits or coordinates

The Commission acknowledges the comment, but agrees, as noted by FINRA, that payments to political parties or PACs can be a means for a covered member or covered associate to contribute indirectly to a government official in contravention of the proposed rule. The Commission also agrees that requiring FINRA members to maintain a record of all payments to political parties or PACs would assist FINRA in identifying situations that might suggest an intent to violate proposed Rules 2030(b) and 2030(e).[322] The Commission therefore believes that it is appropriate and consistent with the Act for FINRA to require its members to keep records of all such payments to assist FINRA in carrying out its regulatory responsibilities to enforce compliance with the Act and with FINRA's rules.[323]

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another person or PAC to make under proposed Rule 2030(b). *See* Notice, 80 FR at 81663.

[322] We note that proposed Rule 2030(e) would require a showing of intent to circumvent the rule for such persons to trigger the two-year "time-out." *See* Notice, 80 FR at 81654. *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41044 n.340 (explaining that like MSRB Rule G-37(d), SEC Pay-to-Play Rule 206(4)-5(d) also "requires a showing of intent to circumvent the rule for such persons to trigger the time out") (citing *Blount*, 61 F.3d at 948 ("In short, according to the SEC, the rule restricts such gifts and contributions only when they are intended as end-runs around the direct contribution limitations.")).

[323] Section 15A(b)(2) of the Act requires, among other things, that a registered national securities association, such as FINRA, has the capacity to enforce compliance by its members and persons associated with its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the association. *See* 15 U.S.C. 78o-3(b)(2).

E. Additional Comments

Certain commenters also suggested that FINRA should include more stringent requirements in its proposed rule.[324] Both commenters suggested that FINRA expand the applicability of its proposed rules to include state-registered investment advisers.[325] In response, FINRA explains that to remain consistent with the SEC Pay-to-Play Rule, FINRA has determined not to expand the scope of the proposed rule as suggested by commenters to include state-registered investment advisers.[326]

The Commission acknowledges this comment but believes that it is appropriate for FINRA to determine to provide for the same scope of its pay-to-play rule as that of the SEC Pay-to-Play Rule. As FINRA notes, the Commission previously declined to make a similar change to the SEC Pay-to-Play Rule stating, among other things, that it was the Commission's understanding that few of these smaller state-registered firms manage public pension plans or other similar funds.[327]

These same commenters suggest that FINRA include a mandatory disgorgement provision for violations of

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[324] *See* NASAA Letter and PIABA Letter.

[325] *See* NASAA Letter and PIABA Letter.

[326] *See* FINRA Response Letter 2 at 10.

[327] *See* Notice, 80 FR at 81652 n.26, 81660 n.98. *See also* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41026, 41060. The Commission also explained in connection with the SEC Pay-to-Play Rule that we do not have regulatory authority to oversee the activities of state-registered advisers through examination and our recordkeeping rules, nor does the Commission have authority over the states to oversee their enforcement of their rules. *See* SEC Pay-to-Play Rule Adopting Release, 75 FR at 41026, 41060.

its proposed rule.[328] In response, FINRA explains that it determined not to include a disgorgement requirement in its proposal because it has existing authority to require disgorgement of fees in enforcement actions.[329] The Commission believes that it is appropriate and consistent with the Act for FINRA not to separately require mandatory disgorgement for violations of its proposed rules.

Finally, one of these commenters suggests that the current two-year cooling-off period in the proposal should be at least four years.[330] In response, FINRA states that it believes a two-year time-out from the date of a contribution is sufficient to discourage covered members from participating in pay-to-play practices by requiring a cooling-off period during which the effects of a *quid pro quo* political contribution on the selection process can be expected to dissipate.[331] In addition, FINRA explains that the proposed two-year time-out is consistent with the time-out period in the SEC's Pay-to-Play Rule. The Commission believes that it is appropriate and consistent with the Act for FINRA to determine that a two-year time-out is sufficient to support the objective of the rule to deter pay-to-play activity among its covered members. The Commission notes that the same time period applies in the SEC's Pay-to-Play Rule.

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[328] *See* NASAA Letter and PIABA Letter.

[329] *See* FINRA Response Letter 2 at 19–20.

[330] *See* PIABA Letter.

[331] *See* FINRA Response Letter 2 at 10. As the Commission explained, the two-year "cooling-off period" is not a penalty but, rather, is intended to be a period during which any effects of a *quid pro quo* are expected to dissipate. *See* SEC Pay-to-Play Adopting Release, 75 FR at 41026 n.104.

The Commission recognizes these commenters suggest that the rule could have a broader scope. The Commission, however, must evaluate the proposed rule before it and approve a proposed rule if it finds that the proposed rule is consistent with the requirements of the Act and the applicable rules and regulations thereunder. As discussed above, because the rule is consistent with the Act, the Commission is required to approve the FINRA rule.

V. Conclusion

Accordingly, for the reasons discussed above, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to such organization.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[332] that the proposed rule change (SR-FINRA-2015-056) be, and hereby is, approved.

By the Commission.

Brent J. Fields
Secretary

[332] 15 U.S.C. 78s(b)(2).

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 18-1111

NEW YORK REPUBLICAN STATE COMMITTEE AND TENNESSEE REPUBLICAN PARTY,

Petitioners,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Petition for Review of Final Rule of the Financial Industry Regulatory Authority, Inc., Approved by the United States Securities and Exchange Commission

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July 25, 2018

I, Edward F. Cox, pursuant to 28 U.S.C. § 1746, declare as follows under penalty of perjury:

1. My name is Edward F. Cox. I have personal knowledge of the facts set forth herein and am otherwise competent to testify.

2. I am a United States Citizen, and I reside in Westhampton Beach, New York.

3. I am the chairman of the New York Republican State Committee ("NYGOP" or the "Party").

4. The NYGOP is the entity constituted under Article 2 of the New York State Election Law that represents the interests and manages the affairs of the Republican Party in the State of New York.

5. The NYGOP's chief purpose is to support Republican candidates for local, state, and federal offices who will promote the Party's goals and policies.

6. To fulfill this purpose, the Party assists Republican candidates for office in their election campaigns. The Party raises its own funds, which it uses to promote the Party in general through political messaging and organizing volunteers to spread the Party's message and generate interest among voters. The Party also uses its funds to assist candidates in their campaigns.

7. The Party also supports its candidates by assisting them in their efforts to raise funds for their campaigns. A key aspect of those operations is advising candidates about various campaign finance regulations that apply to them and the candidates' potential donors.

8. For example, N.Y. Election Law § 14-114 sets various contribution limits for primary and general elections for every state and local office, and those

limits can vary based on factors including how many enrolled active voters are eligible to vote for the candidate, how many of those voters are members of the candidate's party, and whether the potential donor is a family member of the candidate. Some local governments also have campaign finance boards that can impose additional limitations on donations.

9. Each election cycle, the NYGOP fields candidates who run for local, state, and federal elected offices. In 2018, the NYGOP has candidates in hundreds of races across the state from statewide offices, both houses of the state legislature, congressional races, local legislatures and local offices.

10. One of the NYGOP's main purposes is to continue to field candidates to run for and secure these offices so the Party can more effectively pursue its policy goals. As such, the NYGOP will continue to assist candidates not just in the 2018 election, but in elections in 2019 and beyond.

11. The NYGOP has over 2,800,000 registered Republicans statewide. In 2014, 2016 and 2018, the Party's candidates for state and local office have received hundreds of thousands of contributions from their supporters in New York and elsewhere. In 2016, the Republican nominee for President received over 2.8 million votes from New York residents.

12. As chairman, it is my duty to ensure that the NYGOP is successful in convincing the voters of New York to elect Republican candidates.

13. Included in this duty is the ability to raise the funds needed to spread the NYGOP's message to the public, and to assist local, state, and federal candidates with their fundraising efforts. I thus have knowledge about the NYGOP's fundraising operations.

14. Since Financial Industry Regulatory Authority's ("FINRA") Rule 2030 took effect on August 20, 2017, I have had conversations with numerous potential contributors who are currently covered by Rule 2030.

15. Just one example is Francis J. Calcagno, a FINRA-registered broker (FINRA CRD#: 1344774) who serves as a Managing Director at Pickwick Capital Partners, LLC (FINRA CRD#: 130672). Pickwick is a FINRA member located at 445 Hamilton Avenue, Suite 1102, White Plains, NY 10601.

16. Pickwick serves and seeks to serve as a placement agent for investment advisers that provide or are seeking to provide investment advisory services to government entities, including public pensions. Thus, as part of its placement advisory business, Pickwick has engaged in distribution and solicitation activities with government entities' public pension funds. Pickwick thus is a "covered member" under Rule 2030.

17. Because Calcagno is a Managing Director at Pickwick, he is a "covered associate" under Rule 2030, which defines "covered associate" to include any "general partner, managing member or executive officer of a covered member, or other individual with a similar status or function." Rule 2030(g)(2)(A). Calcagno has contributed to NYGOP candidates in the past.

18. Calcagno informed me that he wants to make further political contributions to NYGOP candidates who are "covered officials" under Rule 2030. Specifically, he would contribute more than $350 to Marcus Molinaro, the Duchess County Executive who is the NYGOP candidate for governor.

19. But he—like many other Party members—has declined to make such contributions because of

Rule 2030, which would prevent his entire firm from receiving compensation for its work on behalf of any investment adviser that provides or is seeking to provide investment advisory services to state or local government entities associated with these covered officials' current offices or the offices they seek. Calcagno also informed me that he would contribute more than $350 to other Party candidates in elections beyond 2018 if not for Rule 2030.

20. Additionally, Calcagno—like many other Party members—informed me that he would solicit contributions for these candidates from his friends, family, and other contacts but for the restrictions placed on him and his employer by Rule 2030.

21. Similarly, Calcagno—like many other Party members—informed me that he would solicit contributions for the NYGOP from his friends, family, and contacts but for the restrictions placed on him and his employer by Rule 2030.

22. Thus, Calcagno and many other people have completely refrained from contributing or have decreased their contribution amounts to NYGOP candidates during the 2018 election cycle because of Rule 2030. Calcagno and others likewise have refused to ask others to contribute to NYGOP candidates or to the Party itself because of Rule 2030. And Calcagno and others will continue to limit their contributions to NYGOP candidates and continue to refrain from soliciting contributions to NYGOP candidates and the Party itself after the November 6, 2018 election.

23. Thus, numerous NYGOP candidates running for election this cycle have been harmed by having to compete in competitive environments that have been misshapen by Rule 2030's regulations. Included among these NYGOP candidates are Marcus Molinaro, the

Duchess County Executive who is the NYGOP candidate for governor; Jerry Fremouw, the Mayor of Clyde, who is running for state assembly; John Kennedy, the Suffolk County Comptroller, who is running for re-election; and James O'Donnell, an Orange County legislator who is running to represent New York's 18th District in Congress. All of them face new obstacles related to raising campaign funds and recruiting supporters to solicit contributions on their behalf.

24. And Rule 2030 places officials like James O'Donnell at a particular disadvantage. As a legislator for Orange County, Mr. O'Donnell can influence the outcome of the hiring of an investment adviser by Orange County, meaning that Rule 2030 imposes additional restrictions on the ability of some of his potential supporters to contribute to or solicit on behalf of his campaign. Mr. O'Donnell is running for Congress against incumbent Democratic Congressman Sean Patrick Maloney, who is not a covered official under Rule 2030. Thus, FINRA regulated placement agents can give at most $350 to Mr. O'Donnell's campaign, but can contribute up to $2700 to his competitor for the same seat.

25. In addition to depressing contributions to the Party and its candidates, Rule 2030 has also forced the Party to divert scarce resources away from the Party's regular activities, such as promoting Republican candidates and assisting them with their fundraising efforts. FINRA's new layer of campaign finance law has frustrated the Party's ordinary fundraising activities and forced to the Party to incur new operational costs it would not have otherwise had to bear.

26. For example, a crucial part of the NYGOP's mission is to elect Republican candidates to office on the local, state, and federal levels. The Party accom-

plishes this mission through assisting in recruiting, advising, and supporting Republican candidates for office. One of the primary ways in which we assist Republican candidates is by advising and supporting these candidates in their fundraising efforts. We regularly provide such assistance with fundraising to candidates for local, state, and federal office, including state and local officeholders who are running for federal offices.

27. By imposing unlawful restrictions on contributions to candidates and solicitation of contributions to the candidates and Party, Rule 2030 has frustrated the NYGOP's efforts to provide these services. Among other things, Rule 2030 has forced the Party to expend time and financial resources beyond those the Party would normally expend to educate state and local officeholders about FINRA's additional layer of campaign finance and political speech restrictions.

28. It is important for our candidates to understand these additional restrictions, both to ensure that their supporters do not suffer negative consequences for supporting their campaigns, and to protect against receiving contributions that "covered associates" are likely going to request to be returned. When a campaign has to return contributions, the process causes disruption in a campaign's ability to budget and effectively allocate scarce resources. Thus, to respond to Rule 2030, the NYGOP has provided new educational services to almost all of our federal and state candidates about the Rule with whom we interact on a regular basis and to our statewide and local party officials with whom we discuss these rules and who in turn interact with other federal, state and local candidates.

29. Rule 2030 has also frustrated the NYGOP's efforts to promote its candidates by forcing the Party to expend time and financial resources beyond those the Party would normally expend to help local office-holders find alternative sources of contributions to counteract the negative impact of the Rule on the size and number of contributions from covered associates and those supporters who have refrained from political activity because they may want or need to become a covered associate within the next two years.

30. Rule 2030 has also frustrated the NYGOP's efforts to promote its candidates by forcing the Party to expend time and financial resources beyond those the Party would normally expend on advising the Party's supporters on the amount and types of contributions that they are allowed to make to local, state, and federal candidates. Covered associates, for example, need to know that they would violate Rule 2030 by asking their friends to donate to covered officials or the Party, and that even some in-kind contributions to candidates can run afoul of the Rule.

31. The NYGOP would not have needed to expend these resources if not for Rule 2030. And if it prevails in this action, the NYGOP will no longer have to expend as many resources on counteracting the negative impact of Rule 2030.

32. Moreover, one of the primary ways the NYGOP identifies new supporters and donors is through contributions from first-time donors. Thus, because there are thousands of broker-dealers currently covered by Rule 2030, and countless more people who may be refraining from making contributions to candidates or soliciting on behalf of candidates or the NYGOP in anticipation of becoming a covered placement agent within the next two years, Rule 2030 has substantially

increased the risk that the NYGOP and its candidate-members will be deprived of (i) first-time contributions from individuals who otherwise would have been first-time donors to the NYGOP's candidates as well as (ii) the knowledge that these individuals are potential supporters of the NYGOP and its candidates. Based on the large number of placement agents and people who will seek to become placement agents, this substantial increase in the risk of harm to the NYGOP and its numerous candidates for local, state, and federal offices has created a substantial probability of harm to the NYGOP and its members.

I declare under the penalty of perjury that the foregoing is true and correct.

Executed this 24th day in July, 2018

New York, New York

/s/ Edward F. Cox
Edward F. Cox

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Nos. 18-1111

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NEW YORK REPUBLICAN STATE COMMITTEE AND TENNESSEE REPUBLICAN PARTY,

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July 25, 2018

I, Francis J. Calcagno, pursuant to 28 U.S.C. § 1746, declare as follows under penalty of perjury:

1. My name is Francis J. Calcagno. I have personal knowledge of the facts set forth herein and am otherwise competent to testify.

2. I am a United States Citizen, and I reside in Basking Ridge, New Jersey.

3. I am a member in good standing of the New Jersey Republican State Committee ("NJGOP" or the "Party").

4. I am registered with the Financial Industry Regulatory Authority ("FINRA") as a broker (FINRA CRD#: 1344774). I serve as a Managing Director at Pickwick Capital Partners, LLC (FINRA CRD#: 130672). Pickwick is a FINRA member located at 445 Hamilton Avenue, Suite 1102, White Plains, NY 10601.

5. Pickwick serves and will continue to serve as a placement agent for investment advisers that provide or are seeking to provide investment advisory services to government entities. Thus, as part of its placement advisory business, Pickwick has engaged in and will continue to engage in distribution and solicitation activities with state and local government entities' public pension funds. Pickwick thus is and will continue to be a "covered member" under Rule 2030.

6. Because I am a Managing Director at Pickwick, I am a "covered associate" under Rule 2030.

7. I have contributed to NYGOP candidates in the past, including to the NYGOP' s nominee for governor in 2014.

8. If Rule 2030 did not apply to me and my employer, I would contribute more than $350 to several NYGOP candidates for elected office including Marcus Molinaro, the Duchess County Executive who

is the NYGOP candidate for governor. But I have declined to make such contributions because of Rule 2030, which would prevent Pickwick from receiving compensation for its work on behalf of any investment adviser that provides or is seeking to provide investment advisory services to Duchess County or the State of New York.

9. Additionally, I would solicit contributions for these candidates from my friends, family, and other contacts but for the restrictions placed on me and my employer by Rule 2030.

10. Similarly, I would solicit contributions for the NYGOP from my friends, family, and other contacts but for the restrictions placed on me and my employer by Rule 2030.

11. Thus, I have decreased my contribution amounts to the NYGOP candidates mentioned above because of Rule 2030. And I have refrained from asking others to contribute to NYGOP candidates or to the Party itself because of Rule 2030. Moreover, I will continue to limit my contributions to NYGOP candidates and refrain from soliciting contributions to NYGOP candidates and the Party itself after the November 6, 2018 election. But if Rule 2030 were no longer in effect, I would contribute more than $350/150 to NYGOP candidates, including Marcus Molinaro, and other NYGOP candidates in future elections, and I would solicit contributions for these candidates. I would also solicit contributions for the NYGOP.

I declare under the penalty of perjury that the foregoing is true and correct.

Executed this 25th day in July, 2018

Basking Ridge, New Jersey

/s/ Francis J. Calcagno

Francis J. Calcagno

APPENDIX H

FINRA Rule 2030

No date in original

FINRA Rules
FINRA Rules 2000
DUTIES AND CONFLICTS

2030. Engaging in Distribution and Solicitation Activities with Government Entities

(a) Limitation on Distribution and Solicitation Activities

No covered member shall engage in distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser that provides or is seeking to provide investment advisory services to such government entity within two years after a contribution to an official of the government entity is made by the covered member or a covered associate (including a person who becomes a covered associate within two years after the contribution is made).

(b) Prohibition on Soliciting and Coordinating Contributions

No covered member or covered associate may solicit or coordinate any person or political action committee to make any:

(1) Contribution to an official of a government entity in respect of which the covered member is engaging in, or seeking to engage in, distribution or solicitation activities on behalf of an investment adviser; or

(2) Payment to a political party of a state or locality of a government entity with which the covered member is engaging in, or seeking to engage in,

distribution or solicitation activities on behalf of an investment adviser.

(c) Exceptions

(1) De minimis Exception

Paragraph (a) shall not apply to contributions made by a covered associate that is a natural person, to officials for whom the covered associate was entitled to vote at the time of the contributions and which in the aggregate do not exceed $350 to any one official, per election, or to officials for whom the covered associate was not entitled to vote at the time of the contributions and which in the aggregate do not exceed $150 to any one official, per election.

(2) Exception for Certain New Covered Associates

The prohibitions of paragraph (a) shall not apply to a covered member as a result of a contribution made by a natural person more than six months prior to becoming a covered associate of the covered member unless such person, after becoming a covered associate, engages in, or seeks to engage in, distribution or solicitation activities with a government entity on behalf of the covered member.

(3) Exception for Certain Returned Contributions

(A) A covered member that is prohibited from engaging in distribution or solicitation activities with a government entity pursuant to paragraph (a) as a result of a contribution made by a covered associate is excepted from such prohibition, subject to subparagraphs (B) and (C) below, upon satisfaction of the following requirements:

(i) The covered member must have discovered the contribution that resulted in the prohibition within four months of the date of such contribution;

(ii) Such contribution must not have exceeded $350; and

(iii) The contributor must obtain a return of the contribution within 60 calendar days of the date of discovery of such contribution by the covered member.

(B) In any calendar year, a covered member that has reported on its annual Schedule I to Form X-17A-5 that it has more than 150 registered persons is entitled to no more than three exceptions pursuant to subparagraph (A), and a covered member that has reported on its annual Schedule I to Form X-17A-5 that it has 150 or fewer registered persons is entitled to no more than two exceptions pursuant to subparagraph (A).

(C) A covered member may not rely on the exception provided in subparagraph (A) more than once with respect to contributions by the same covered associate of the covered member regardless of time period.

(d) Prohibitions as Applied to Covered Investment Pools For purposes of this Rule;

(1) A covered member that engages in distribution or solicitation activities with a government entity on behalf of a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that covered member was engaging in or seeking to engage in distribution or solicitation activities with the government entity on behalf of the investment adviser to the covered investment pool directly; and

(2) An investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity.

(e) Further Prohibitions

It shall be a violation of this Rule for any covered member or any of its covered associates to do anything indirectly that, if done directly, would result in a violation of this Rule.

(f) Exemptions

FINRA, upon application, may conditionally or unconditionally exempt a covered member from the prohibition described in paragraph (a). In determining whether to grant an exemption, FINRA shall consider, among other factors;

(1) Whether the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this Rule;

(2) Whether the covered member:

(A) Before the contribution resulting in the prohibition was made, adopted and implemented policies and procedures reasonably designed to prevent violations of this Rule;

(B) Prior to or at the time the contribution that resulted in such prohibition was made, had no actual knowledge of the contribution; and

(C) After learning of the contribution:

(i) Has taken all available steps to cause the contributor involved in making the contribution that resulted in such prohibition to obtain a return of the contribution; and

(ii) Has taken such other remedial or preventive measures as may be appropriate under the circumstances;

(3) Whether, at the time of the contribution, the contributor was a covered associate or otherwise an associated person of the covered member, or was seeking to become an associated person, or covered associate of the covered member;

(4) The timing and amount of the contribution that resulted in the prohibition;

(5) The nature of the election (e.g., federal, state or local); and

(6) The contributor's apparent intent or motive in making the contribution that resulted in the prohibition, as evidenced by the facts and circumstances surrounding such contribution.

(g) Definitions

For purposes of this Rule:

(1) "Contribution" means any gift, subscription, loan, advance, or deposit of money or anything of value made for:

(A) The purpose of influencing any election for federal, state or local office;

(B) Payment of debt incurred in connection with any such election; or

(C) Transition or inaugural expenses of the successful candidate for state or local office.

(2) "Covered associate" means:

(A) Any general partner, managing member or executive officer of a covered member, or other individual with a similar status or function;

(B) Any associated person of a covered member who engages in distribution or solicitation activities with a government entity for such covered member;

(C) Any associated person of a covered member who supervises, directly or indirectly, the government entity distribution or solicitation activities of a person in subparagraph (B) above; and

(D) Any political action committee controlled by a covered member or a covered associate.

(3) "Covered investment pool" means:

(A) Any investment company registered under the Investment Company Act that is an investment option of a plan or program of a government entity; or

(B) Any company that would be an investment company under Section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either Section 3(c)(1), 3(c)(7) or 3(c)(11) of that Act.

(4) "Covered member" means any member except when that member is engaging in activities that would cause the member to be a municipal advisor as defined in Exchange Act Section 15B(e)(4), SEA Rule 15Ba1-1(d)(1) through (4) and other rules and regulations thereunder;

(5) "Executive officer of a covered member" means:

(A) The president;

(B) Any vice president in charge of a principal business unit, division or function (such as sales, administration or finance);

(C) Any other officer of the covered member who performs a policy-making function; or

(D) Any other person who performs similar policy-making functions for the covered member.

(6) "Government entity" means any state or political subdivision of a state, including;

(A) Any agency, authority or instrumentality of the state or political subdivision;

(B) A pool of assets sponsored or established by the state or political subdivision or any agency, authority or instrumentality thereof, including but not limited to a defined benefit plan as defined in Section 414(j) of the Internal Revenue Code, or a state general fund;

(C) A plan or program of a government entity; and

(D) Officers, agents or employees of the state or political subdivision or any agency, authority or instrumentality thereof, acting in their official capacity.

(7) "Investment adviser" means any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under Section 203(b)(3) of the Investment Advisers Act, or that is an exempt reporting adviser, as defined in Rule 204-4(a) of that Act.

(8) 'Official" means any person (including any election committee for the person) who was, at the time of the contribution, an incumbent, candidate or

successful candidate for elective office of a government entity, if the office:

(A) Is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity; or

(B) 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.

(9) "Payment" means any gift, subscription, loan, advance or deposit of money or anything of value.

(10) "Plan" or "program" or a "government entity" means any participant-directed investment program or plan sponsored or established by a state or political subdivision or any agency, authority or instrumentality thereof, including but not limited to a qualified tuition plan authorized by Section 529 of the Internal Revenue Code, a retirement plan authorized by Section 403(b) or 457 of the Internal Revenue Code, or any similar program or plan.

(11) "Solicit" means:

(A) With respect to investment advisory services, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser; and

(B) With respect to a contribution or payment, to communicate, directly or indirectly, for the purpose of obtaining or arranging a contribution or payment.

Adopted by SR-FINRA-2015-056 eff. Aug. 20, 2017.