Pay to Play Ban Trumps Pence Fundraising: Application of the SEC Rule to the 2016 Presidential Election

By Suzanne M. Dugan

After presidential candidate Donald Trump announced the selection of Indiana Governor Mike Pence as his running mate, the New York Times noted that Mr. Pence's addition to the ticket could make it harder for Mr. Trump to raise money from the business community because of an "obscure" Securities and Exchange Commission ("SEC") provision meant to prevent pay to play efforts for public pension plans.

It is unlikely that readers of PERSist would call the rule "obscure", as most public pension plan trustees and administrators are familiar with SEC Rule 206(4)-5, widely known as the "pay to play" rule. The rule prohibits an investment adviser from receiving compensation for advisory services to a government entity for two years after the adviser or its covered associates makes a political contribution to a public official or candidate who is or would be in a position to influence the award of advisory business. What was "obscure" now is timely – the application of the rule to the 2016 Presidential campaign.

SEC Pay to Play Rule

In adopting the rule in 2010, the SEC noted that public pension plans are particularly vulnerable to pay to play practice, and that "[i]nvestment advisers that seek to influence the award of advisory contracts by public pension plans, by making political contributions to, or soliciting them for, those officials who are in a position to influence the awards, compromise their fiduciary obligations to the public pension plans they advise and defraud prospective clients".

The SEC pay to play rule is now well established: it has survived a court challenge seeking to invalidate it , and the SEC has brought both an enforcement action under the rule and granted a waiver from the rule.

Application of Rule to the Presidential Election

A sitting Governor who can appoint members of a state pension board, as Governor Pence can, is considered a covered government official under the SEC rule. This means that direct or indirect contributions to the Trump-Pence ticket could trigger the rule's two year period prohibiting an investment adviser from collecting fees for advisory services rendered to the Indiana systems over which Pence has authority.

In fact, the SEC specifically considered the present scenario and declined to offer an exemption for sitting state officials running for federal office, stating: "we are not persuaded that an incumbent state or local official should be excluded from the definition solely because he or she is running for federal office". The rationale - as long as an official has influence over the hiring of investment advisers as a function of his or her current office, contributions by an adviser could have the same effect, regardless to which of the official's campaigns the adviser contributes.

Goldman Sachs Takes Action

Effective September 1, 2016, Goldman Sachs took action designed to prevent inadvertent violation of the SEC pay to play rule. The firm named all its partners as "restricted persons" under the rule and instituted a policy prohibiting them from making any contribution or solicitation in connection with a federal candidate who is a sitting state or local official, such as the Trump/Pence ticket, noting that the penalties for failing to comply with the SEC rules can be severe and may include fines as well as a two year ban on doing business with certain government clients.

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Conclusion

While the SEC pay to play rule may be "obscure" to some commentators, it now is front and center in this year's Presidential campaign. Public pension plans are undoubtedly familiar with this rule and its fiduciary implications in ways that others from more "obscure" perspectives may not. ❖

[1]Andrew Ross Sorkin, "Trump and Pence: On the Same Ticket but Not the Same Page", *The New York Times,* July 18, 2016.

[2]17 C.F.R. § 275.206(4)-5.

[3]SEC Release No. IA-3043, at 17.

[4]New York Republican State Comm. v. S.E.C., 799 F.3d 1126, (D.C. Cir., 2015).

[5]A private equity firm, TL Ventures, paid nearly $300,000 in disgorgement and fines for political contributions made an associate in the amount of $2,500 to a candidate for Mayor of Philadelphia and $2,000 to the Governor of Pennsylvania. https://www.sec.gov/litigation/admin/2014/ia-3859.pdf

[6]The SEC granted an exemption from Rule 206(4)-5 to Starwood Capital Group Management, LLC, after their chief operating officer tripped the wire when he made a $1,000 contribution to an exploratory committee for an Illinois gubernatorial candidate that was clawed back 9 days later. https://www.sec.gov/rules/ia/2015/ia-4203.pdf

[7]Contributions to the Clinton-Kaine campaign are not subject to the SEC rule since neither candidate holds state or local office.

[8]SEC Release No. IA-3043, at 46.

[9]SEC Release No. IA-3043, at 45.

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appetite are all significant in explaining farmland total returns in the NCREIF index. But, their significance points to more complex underlying structural linkages rather than any straightforward effects. In total, these factors only explain 12% of the variation in farmland return versus 48% for commercial real estate return. Nor are farmland returns driven by the ten-year Treasury yield, a commonly offered explanation of farmland returns. Although returns for farmland and commercial real estate might be somewhat correlated, there is more to the story than that metric (Exhibit 2).

Drivers of farmland returns

So, what does drive farmland returns? In contrast with commercial real estate, which is used in localized domestic activities, farmland yields products that are consumed and traded globally. Foreign exchange rates for the dollar account for 13% of farmland's total return versus an inconsequential effect for commercial property. The productivity of the land and farm operations, combined with foreign exchange rates, accounts for over 33% of farmland's variation in total return. That percentage rises to 43% with the inclusion of U.S. inflation.

Another consideration is the low turnover and limited availability of U.S. farmland, with a market value of only $6.7 billion vs. $472 billion for commercial real estate, as measured by NCREIF data as of Dec. 31, 2015. This limited availability offers a buffer to the value of farmland.

Diversification implications

Commercial real estate and farmland offer different flavors of diversification, due to the differences in their performance drivers. This makes them good diversifiers for each other, as well as for stocks and bonds.

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