GUNDERSON DETTMER

Client Insight: Harris-Walz Pay to Play Rule Considerations

Insights
August 8, 2024

To: Our Private Fund Adviser Clients

Re: Harris-Walz Pay to Play Rule Considerations

On August 6th, Vice President Kamala Harris announced Minnesota Governor Tim Walz as her running mate. The fact that Walz is a current state official will create implications for SEC-registered investment advisers and exempt reporting advisers with respect to contributions (by them or their covered associates) to directly or indirectly support the Harris-Walz campaign. Specifically, Harris's selection of Governor Walz implicates Rule 206(4)-5 under the U.S. Investment Advisers Act of 1940, as amended (***"Pay to Play Rule"***)

Key Takeaways

- Contributions above the de minimis threshold by an investment adviser or its covered associates (including certain family members) to the Harris-Walz campaign, or to PACs or political parties that support or earmark funds for the Harris-Walz campaign implicate the Pay to Play Rule and will trigger a two year ban on providing compensated advisory services to certain Minnesota state and local government entities under the Pay to Play Rule. As explained more fully below, this ban will apply even if the contractual arrangements under which the compensation is paid by the Minnesota state or local government entity were established in the past (e.g., such ban will apply to prohibit collecting compensation from existing investors in legacy funds).

- The SEC has historically brought enforcement actions related to the Pay to Play Rule for technical and inadvertent violations and expects strict compliance with the Pay to Play Rule.

- Investment advisers should take action as soon as possible to ensure that their covered associates are aware of the unique Pay to Play issues that result from the selection of Walz as a vice presidential candidate.

Pay to Play Rule Overview

The Pay to Play Rule is intended to restrict investment advisers and their personnel from using political contributions to influence state and local elected officials with authority to select investment managers on behalf of public entity investors such as state university endowments and state or local retirement systems. With respect to the Harris-Walz campaign, the Pay to Play Rule prohibits SEC-registered and exempt reporting advisers from providing compensated advisory services to certain Minnesota state government entities for a two year period following contributions to the Harris-Walz campaign, whether directly or indirectly. The Pay to Play Rule applies to both investment advisers and their “covered associates,” who are broadly defined to include an investment adviser’s executive officers, employees who solicit government entities, and any person who directly or indirectly supervises those employees. The Pay to Play Rule includes a de minimis exemption that permits a covered associate to make the following contributions per candidate per election (with primary and general elections treated as two separate elections):

- $350 per election to a candidate if the covered associate is entitled to vote for the candidate; and

- $150 per election to a candidate if the covered associate is not entitled to vote for the candidate.

If a covered associate makes a contribution to the Harris-Walz campaign, directly or indirectly, in excess of these de minimis thresholds, then the investment adviser is prohibited from receiving compensation from certain Minnesota state government entity clients and investors for a two year period. To the extent a Minnesota state government entity is an existing investor in a private fund advised by an investment adviser, the investment adviser would be prohibited from receiving any compensation (management fee, carried interest, or in some instances expense reimbursements) from the government entity for a two year period following the contribution.

The Pay to Play Rule includes an anti-circumvention provision that prohibits an investment adviser from indirectly doing anything which, if done directly, would result in a violation. As such, investment advisers should be particularly mindful of family member contributions and contributions by covered associates to political parties or PACs that are intended to or may be seen as an attempt to circumvent the Pay to Play Rule.

In general, contributions to federal officials and candidates, such as a candidate for president, are not covered by the Pay to Play Rule. However, the Pay to Play Rule applies both to candidates for state or local office as well as current state and local officials. As such, the Pay to Play Rule applies to direct or indirect contributions to the Harris-Walz campaign given that Tim Walz is a sitting governor.

Best Practices

- Investment advisers should take this opportunity to review policies and procedures to ensure that Pay to Play risks are adequately addressed.
- Investment advisers should review their lists of covered associates and ensure their policies cover all such persons.
- Investment advisers should as soon as possible ensure that their covered associates are aware of the Pay to Play issues that result from the selection of Walz as a vice presidential candidate, and more broadly consider additional targeted training and reminders regarding Pay to Play policies and restrictions.
- Investment advisers should also pay close attention to any political contributions that may be related to the Harris-Walz campaign, directly or indirectly. While direct contributions to the campaign are clearly in scope, contributions made to a PAC, political party or national committee may implicate the Pay to Play Rule if earmarked for a specific candidate or made as a means to circumvent the restrictions in the Pay to Play Rule.
- Investment advisers should continue to be mindful of any applicable state and local pay-to-play and lobbying regulations as the Pay to Play Rule does not preempt such regulations.

Please reach out to insights@gunder.com or your primary Gunderson Dettmer attorney if you have any questions.

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