

# FINRA Rules 2030 and 4580: Pay-to-Play? FINRA Says No Way

Travis R. Chapin, Esq.  
Beth A. Black, Esq.

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## Rule 2030

# Engaging in Distribution and Solicitation Activities with Government Entities

## Rule 4580

# Books and Records Requirements for Government Distribution and Solicitation Activities

**Effective August 20, 2017**

**“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.

FINRA Regulatory Notice 16-40

# Background

The purpose of the rules was to “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 Regulatory Notice 14-50

# Background

In July 2010, SEC adopted Rule 206(4)-5 regarding “pay-to-play” practices of investment advisers.

In response to the SEC Rule, FINRA was compelled to enact “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.”

FINRA Regulatory Notice 14-50



# Background

Many of these concepts in the new FINRA Rules are likely familiar to you and your firms.

SEC Rule 206(4)-5 and MSRB Rule G-37 are very similar and also have companion record and book keeping rules.

# Background

These issues touch on a wide range of firm practices:

- Compliance
- Government Securities
- Legal
- Municipal
- Registered Representatives
- Senior Management

FINRA Regulatory Notice 16-40

## Rule 2030

# Engaging in Distribution and Solicitation Activities with Government Entities

# Rule 2030: Limitations on 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).

Rule 2030(a)

# Rule 2030: Defined Terms

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).

Rule 2030(a)

# Rule 2030: Covered Member

No covered member shall...

"Covered member" means:

[A]ny 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[.]

Rule 2030(g)(4)

# Rule 2030: Solicit

...engage in **distribution or solicitation** activities for compensation...

"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.

Rule 2030(g)(11)

# Rule 2030: Government Entity

...with a government entity...

Government entity means:

[A]ny 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;

Rule 2030(g)(6)



# Rule 2030: Government Entity

Government entity means:

[A]ny state or political subdivision of a state, including:

(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.

# Rule 2030: Investment Adviser

...on behalf of an **investment adviser** that provides or is seeking to provide investment advisory services to such government entity...

"Investment adviser" means:

[A]ny 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.

Rule 2030(g)(7)

# Rule 2030: Official

...to an **official** of the government entity...

"Official" means:

[A]ny 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.

Rule 2030(g)(8)

# Rule 2030: Contribution

...within two years after a contribution...

Contribution means:

[A]ny 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**.

Rule 2030(g)(1)

# Rule 2030: Covered Associate

...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).

(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;

Rule 2030(g)(2)

# Rule 2030: Covered Associate

(2) "Covered associate" means:

(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.

Rule 2030(g)(2)

# Rule 2030: Executive Officer

"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.

Rule 2030(g)(5)

# Rule 2030: Limitations on 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).

Rule 2030(a)



# Rule 2030: Two-Year Lookback

The “look back” applies to any person who becomes a covered associate, including a current employee who has been transferred or promoted to a position covered by the rule.

A person becomes a “covered associate” for purposes of the 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.”

FINRA Regulatory Notice 16-40

# Rule 2030: Exceptions

1. *De Minimis* Contributions
2. Certain New Covered Associates
3. Certain Returned Contributions

Rule 2030(c)

# Rule 2030: Exceptions *De Minimis*

**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.

Rule 2030(c)(1)

# Rule 2030: Exceptions 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.

Rule 2030(c)(2)

# Rule 2030: Exceptions Certain Returned Contributions

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...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.

Rule 2030(c)(3)

# Rule 2030: FINRA Exemptions

FINRA is authorized to “conditionally or unconditionally exempt a covered member from the prohibition described in **paragraph (a).**”

Rule 2030(f)

# Rule 2030: Prohibitions

1. Soliciting and Coordinating Contributions
2. Covered Investment Pools
3. Catch-all

Rule 2030(b), (d), (e)

# Rule 2030: Prohibitions 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.

Rule 2030(b)



# Rule 2030: Payment

"Payment" means any gift, subscription, loan, advance or deposit of money or anything of value.

Rule 2030(g)(9)

# Rule 2030: Prohibitions Covered Investment Pools

For purposes of this Rule:

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...

Rule 2030(d)(1)

# Rule 2030: Prohibitions Covered Investment Pools

For purposes of this 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.

Rule 2030(d)(2)

# Rule 2030: Covered Investment Pool

"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.

Rule 2030(g)(3)

# Rule 2030: Prohibitions Catch-all

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.

Rule 2030(e)

## Rule 4580

# Books and Records Requirements for Government Distribution and Solicitation Activities

# Rule 4580: Recordkeeping

A covered member that engages 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 shall maintain books and records that pertain to Rule 2030, including a list or other record of:

Rule 4580(a)

# Rule 4580: Recordkeeping

(1) The names, titles and business and residence addresses of all covered associates of the covered member;

Rule 4580(a)



# Rule 4580: Recordkeeping

(2) 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 August 20, 2017;

Rule 4580(a)

## Rule 4580: Recordkeeping

(3) The name and business address of all government entities with which the covered member has engaged in distribution or solicitation activities for compensation 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 August 20, 2017; and

Rule 4580(a)

# Rule 4580: Recordkeeping

(4) 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 political action committee.

Rule 4580(a)

# Rule 4580: Recordkeeping

Records relating to the contributions and payments referred to in paragraph (a)(4) must be listed in chronological order and indicate:

- (1) The name and title of each contributor;
- (2) The name and title (including any city/county/state or other political subdivision) of each recipient of a contribution or payment;
- (3) The amount and date of each contribution or payment; and
- (4) Whether any such contribution was the subject of the exception for certain returned contributions pursuant to Rule 2030.

Rule 4580(b)

# Takeaways