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–BX–2016–047 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–BX–2016–047. 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 the filing also will be available for inspection and copying at the principal office of the Exchange. 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–BX–2016–047 and should be submitted on or before September 21, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[17]

Brent J. Fields,

Secretary.

[FR Doc. 2016–20961 Filed 8–30–16; 8:45 am]

BILLING CODE 8011–01–P

[17] 17 CFR 200.30–3(a)(12).

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 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] 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 proposed rule change,

[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.

[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., 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).

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]

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] 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]

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 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

[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 Web site 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.

[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.

[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 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.

[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)).

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 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 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 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-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 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

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

[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.

[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.*

[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).

[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'').

[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.

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]

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 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 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]

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 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

[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 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.

[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'').

[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.

[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.*

[60] *See id.*

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]

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-to-Play 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]

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 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 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

[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.

[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.

[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.

[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 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'').

investment pool directly.[81] 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.[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 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 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 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 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

[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).

[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).

[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).

[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.

[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.

[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.

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]

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 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 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 conflict 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 objects are modeled on and substantially similar to provisions in the

[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.

[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 Web site 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.

[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.

[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).

[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'').

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 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 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 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 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

[122] *See, e.g.,* FINRA Response Letter 2 at 7.

[123] *See, e.g., id.*

[124] *See id.*

[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.

[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 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.*

[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.*

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 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 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]

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 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 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

[140] *See* FINRA Response Letter 2 at 16.

[141] *See id.*

[142] *See id.*

[143] *See* CAI Letter 1 and FSI Letter 1.

[144] *See* CAI Letter 1.

[145] *See id.*

[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.

[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)).

[156] *See* FINRA Response Letter 2 at 15.

[157] *See* CAI Letter 1.

[158] *See id.*

[159] *See id.*

[160] *See* CAI Letter 1 and CAI Letter 2 (reflecting CAI's suggested revisions to certain language in some of FINRA's proposed rules).

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-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 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 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]

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

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).

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.*

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.*

175 *See id.*

176 *See* FINRA Response Letter 2 at 18.

177 *See id.* at 17.

178 *See id.* at 19.

179 *See id.*

180 *See* NAIFA Letter.

181 *See id.*

182 *See id.*

183 *See* FINRA Response Letter 2 at 19.

proposed rule change, FINRA will work with the industry and Commission to address the interpretive questions and provide additional guidance as needed.[184]

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 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) 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 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 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

[184] *See id.* at 18.

[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 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.*

[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.

[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.'').

[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).

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 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 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 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-to-play advantages.[223] PIABA states FINRA should start with the most comprehensive rule, and that it 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]

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

[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.

[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.

[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.

[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.*

[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 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. 78*o*–3(b)(6).

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 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 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 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]

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

[230] *Id.*

[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).

[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).

[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 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.

servants.[244] Investment advisers also are harmed because their ability to participate in the market is 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 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 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]

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 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

---

[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'').

[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.

[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).

[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. 78*o*–3(b)(6).

[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'').

[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.

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 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] 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 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 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

[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).

[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 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. 78*o*–3(b)(6).

[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.

[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.

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 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, including 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 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 to covered investment pools;[282] the level of the *de minimis* contribution exception and the returned 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 ''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''

[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.

[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, 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 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.

[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).

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.

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 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 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 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]

---

[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.

[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 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).

[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).

[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.S.C. 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 to apply to FINRA for an exemption, conditional or

Continued

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 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, candidate 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, 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]

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 Pay-to-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]

---

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).

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).

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).

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.

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

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]

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]

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 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.

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.

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.

[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 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. 78*o*–3(b)(2).

[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.

[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.

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.

[FR Doc. 2016–20888 Filed 8–30–16; 8:45 am]

BILLING CODE 8011–01–P

[332] 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–78696; File No. SR–BatsEDGX–2016–50]

Self-Regulatory Organizations; Bats EDGX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Rule 19.6, Series of Options Contracts Open for Trading, To Allow Wednesday Expirations for SPY Options

August 26, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that, on August 25, 2016, Bats EDGX Exchange, Inc. (the ''Exchange'' or ''EDGX'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has designated this proposal as a ''non-controversial'' proposed rule change pursuant to Section 19(b)(3)(A) of the Act [3] and Rule 19b–4(f)(6) thereunder,[4] which renders it effective upon filing with the Commission. 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

The Exchange filed a proposal to amend Rule 19.6, entitled ''Series of Options Contracts Open for Trading,'' related to the Short Term Option Series (''STOS'') Program to allow Wednesday expirations for SPY options. The Exchange also proposes to make corresponding changes to Rule 16.1, entitled ''Definitions.''

The text of the proposed rule change is available at the Exchange's Web site at *www.batstrading.com,* at the principal office of the Exchange, 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, the Exchange 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. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

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

1. Purpose

The purpose of the proposed rule change is to harmonize the Exchange's rules with the rules governing Short Term Options Series programs of other options exchanges. Specifically, the Exchange proposes to amend Rule 19.6, entitled ''Series of Options Contracts Open for Trading,'' related to the STOS Program to allow Wednesday expirations for SPY options. The Exchange also proposes to make certain corresponding changes to 16.1, entitled ''Definitions.'' The proposed rule change is based on the recent approval of a filing submitted by the BOX Options Exchange LLC (''BOX'').[5]

Currently, under the STOS Program, the Exchange may open for trading on any Thursday or Friday that is a business day series of options on that class that expire on each of the next five Fridays, provided that such Friday is not a Friday in which monthly options series or Quarterly Options Series expire (''Short Term Option Series''). The Exchange is now proposing to amend its rule to permit the listing of options expiring on Wednesdays. Specifically, the Exchange is proposing that it may open for trading on any Tuesday or Wednesday that is a business day, series of options on the SPDR S&P 500 ETF Trust (''SPY'') to expire on any Wednesday of the month that is a business day and is not a Wednesday in which Quarterly Options Series expire (''Wednesday SPY Expirations'').[6] The proposed Wednesday SPY Expiration series will be similar to the current Short Term Option Series, with certain exceptions, as explained in greater detail below. The Exchange notes that having Wednesday expirations is not a novel proposal. Specifically, the Chicago Board Options Exchange, Incorporated (''CBOE'') recently received approval to list Wednesday expirations for broad-based indexes.[7]

In regards to Wednesday SPY Expirations, the Exchange is proposing to remove the current restriction preventing it from listing Short Term Option Series that expire in the same week in which monthly option series in the same class expire. Specifically, the Exchange will be allowed to list Wednesday SPY Expirations in the same week in which monthly option series in SPY expire. The current restriction to prohibit the expiration of monthly and Short Term Option Series from expiring on the same trading day is reasonable to avoid investor confusion. This confusion will not apply with Wednesday SPY Expirations and standard monthly options because they will not expire on the same trading day, as standard monthly options do not expire on Wednesdays. Additionally, it would lead to investor confusion if Wednesday SPY Expirations were not listed for one week every month because there was a monthly SPY expiration on the Friday of that week.

Under the proposed Wednesday SPY Expirations, the Exchange may list up to five consecutive Wednesday SPY Expirations at one time. The Exchange may have no more than a total of five Wednesday SPY Expirations listed. This is the same listing procedure as Short Term Option Series that expire on Fridays. The Exchange is also proposing to clarify that the five series limit in the current Short Term Option Series Program Rule will not include any Wednesday SPY Expirations.[8] This means, under the proposal, the Exchange would be allowed to list five Short Term Option Series expirations for SPY expiring on Friday under the current rule and five Wednesday SPY Expirations. The interval between strike prices for the proposed Wednesday SPY Expirations will be the same as those for the current Short Term Option Series.

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

[2] 17 CFR 240.19b–4.

[3] 15 U.S.C. 78s(b)(3)(A).

[4] 17 CFR 240.19b–4(f)(6).

[5] *See* Securities and Exchange Act Release No. 78668 (August 24, 2016) (SR–BOX–2016–28).

[6] *See* proposed paragraph (g) of Interpretation and Policy .05 to Rule 19.6.

[7] *See* Securities Exchange Act Release No. 76909 (January 14, 2016), 81 FR 3512 (January 21, 2016) (SR–CBOE–2015–106).

[8] *See* proposed changes to Interpretation and Policy .05 to Rule 19.6.