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Three Political Law Landmines for Hedge Funds, Private Equity Funds, and Investment Firms: Covington & Burling

Last year, an asset manager with offices in New York, Texas, and Vermont was publicly censured by the Securities and Exchange Commission and ordered to pay a substantial fine. Its offense? The asset manager hired an individual who had previously made a personal political donation to the campaign of a state official who appointed members to a board that could influence the investment decisions of one of the asset manager's current investors. Even though the individual made the contribution more than six months before joining the firm and even though the new hire received a refund for the offending contribution, that was not enough to stop the SEC from slapping penalties on the firm.

Perhaps no industry faces more scrutiny and regulation of its political activities than the financial industry. These rules are often not intuitive and failure to comply with them can result in big penalties, loss of business, and debilitating reputational consequences. This primer describes three sometimes overlooked risk areas for investment firms: (i) ensuring that covered employees and others affiliated with the investment firm do not make or solicit political contributions that result in "pay-to-play" problems for the firm; (ii) identifying when investor relations activities trigger state or local lobbying registration requirements; and (iii) conducting political law due diligence on prospective investments and portfolio companies. For each risk area, this advisory outlines best practices for avoiding these common compliance traps.

Protecting Against a Potentially Crippling Pay-to-Play Violation

Most investment firms by now are aware of the complex pay-to-play regulations that restrict the ability of the firms and certain of their employees to make political contributions. But even firms well-versed in these restrictions might overlook some of the nuances and risks presented by this complicated patchwork of laws and regulations.

Continue reading.

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