

Pay to Play in Investment Management^{*}

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August 15, 2019

Abstract

From 2001 to 2016, using the population of all investment advisory firms registered with the U.S. Securities and Exchange Commission (SEC), we document that the presence of government clients (e.g., public pension plans) for an investment advisory firm is strongly associated with past owner and officer contributions to state government officials. To help establish a causal link, we use the adoption of the SEC's pay to play rules for investment advisors in 2011. Post implementation of the SEC's pay to play rules, we find that this relationship weakens considerably. Further consistent with a pay to play explanation, the results are driven by advisors whose political contributions are made by senior officers likely to be involved in capital raising for the firm including CEOs, owners/partners, and sales executives. The results are most pronounced for advisors offering pension consulting services, advisors catering to institutional accounts (e.g., institutional asset managers), and advisory firms headquartered in states with a high concentration of public pension plans and a culture of political corruption.

JEL classification: G11, G23

Keywords: Investment management, public pension plans, political contributions

^{*} We thank Denis Barber from the National Institute on Money on Politics for helping us obtain data on state-level political donations. All errors and omissions are our own.

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1. Introduction

Investment managers provide a wide array of services to state and local governments, including providing advice to public pension plans. As of 2016, state and local public retirement systems held \$3.8 trillion in assets. With the retirement security of 19 million current and former state and local employees at stake, sound and transparent investment strategies are essential for these plans. State and local plans are often administered by government officials and/or their appointees, who are responsible for selecting investment advisory firms to manage plan assets. The decisions made by plan trustees directly affect millions of retirees who rely on the funds for their retirement income.

Recent literature has documented that firms, in general, enjoy benefits when they initiate relationships with politicians³. These relationships can be built through political contributions during election campaigns⁴. Managers of firms may make political contributions strategically to gain favorable treatment from politicians. Our study broadly examines whether there is evidence of this type of quid pro quo activity in the investment management industry. In our case, we hypothesize that managers of investment advisory firms may contribute to the campaigns of politicians who will gain the authority to appoint trustees to public pension plans in order to win business managing plan assets.⁵ The tests in our paper are straightforward and ask whether investment advisory firms obtain a greater fraction of their business from government clients if their owners and officers have donated to politicians in the recent past.

³ See for example: Boubakri et al (2012), Duchin & Sosyura (2012), Faccio & Hsu (2017), Faccio, Masulis & McConnell (2006), Tahoun (2014)

⁴ See, for example, Kostovetsky (2015), Khokhar & Shahriari (2017), Fulmer, Knill & Yu (2019), Correia (2014), Cooper, Gulen & Ovtchinnikov (2010), Claessens, Feijen & Laeven (2008), Bourveau, Coulomb & Sangnier (2016), Akey (2015), Aggarwal, Meschke & Wang (2012)

⁵ See, for example, Hochburg and Rauh (2013). In the authors sample of public pension plans, every state sponsored pension plan has at least one board member appointed by the state governor.

Our study uses political contribution data from the US Federal Election Commission (FEC) and the National Institute on Money on Politics. We identify if any of the direct owners and officers from each investment advisory firm disclosed on Schedule A of the investment advisor's Form ADV have donated to a state-level election campaign or a Political Action Committee (PAC) in each election cycle. We focus on state-level elections as opposed to federal elections since there is a much greater opportunity to engage in pay to play activities at the state or local level. Additionally, Hochburg and Rauh (2013) find that state officials (such as governors or treasurers) are highly likely to be involved in the nomination process for plan trustees, and trustees are ultimately responsible for the selection and termination of plan service providers, including investment advisors. Our data on the presence of government clients of each investment advisor come from annual Form ADV filings obtained via Freedom of Information Act (FOIA) request from the SEC. Our sample consists of 22,017 unique investment advisory firms registered with the SEC between 2001 and 2016.

We perform panel regressions of an investment advisor's percentage of an investment advisor's state and municipal government clients on whether any of its owners or officers have donated to a state government official or a PAC in the past three election cycles. We find a strong positive and significant relation between past political donating activities and the presence of government clients. Specifically, donor advisors have 0.5 percentage points more government clients within their client base. This number is equivalent to about 390 more government accounts for the average advisor. Given that investment manager mandates allocated by public pension plans are relatively large (in the tens to hundreds of millions of dollars) compared to those made by other client types, this suggests a potentially substantial economic benefit to advisors whose

officers have made past contributions. Furthermore, our results hold with the inclusion of variables controlling for other determinants of the presence government clients for investment advisors.

To provide more convincing evidence of a causal effect, we employ the implementation of the pay to play rules for investment advisors adopted by the SEC in 2011 as a quasi-shock. To address the concerns that the selection of some advisors had been influenced by political contributions, on July 1, 2010, the SEC adopted a new antifraud rule, Rule 206(4)-5 to deter pay to play behavior. Specifically, the rule makes it illegal for an investment advisor to provide advisory services to a government entity for two years after the advisor or any of its officers, owners, employees or associates contribute to elected officials or candidates who hold influence over the plan or selection of plan trustees. Rule 206(4)-5 was made effective on September 13, 2010 and investment advisors were required to comply with the rule by March 14, 2011.

Consistent with the hypothesis that the presence of public clients for investment advisory firms is affected by officers' political contributions, we find the prevalence of pay to play activities declines after the adoption of SEC's rule. We also observe a sharp drop in the percentage of advisors with a significant presence of government clients making political contributions post rule enactment, consistent with the notion that donations play a role in securing public clients. Even though the rule does not explicitly stop officers and owners of investment advisory firms from donating to politicians, the sharp drop in political contribution participation is consistent with our hypothesis that investment advisors may strategically seek to influence government officials' award of advisory contract through political contributions.

We provide further evidence of pay to play activities as an explanation for our main results by performing a set of cross-sectional tests. First, we examine the relation between political contributions and the presence of public clients for different sets of officers and owners at the

advisor. Within the management team of an investment advisory firm, there are typically different managers overseeing various areas of the advisor's operations. It would be expected that officers involved in capital raising would be more likely to participate in pay to play activities as compared to officers involved in other operational areas (e.g., fund accounting) at the firm. Consistent with this prediction, we find that the relationship between political contributions and an increased presence of public clients only holds when past political donations are made by CEOs, owners/partners, or marketing/sales executives as opposed to officers overseeing other operational activities.

Second, we explore geographic variation in the opportunity for advisors to engage in pay to play activities. We hypothesize that advisors headquartered in states with larger populations of public pension plans and a history of political corruption may be more likely to engage in pay to play activities. Related to this point, Hochberg and Rauh (2013) find that public retirement systems are more likely to invest in private equity funds managed by locally headquartered private equity firms. They also show that this home-bias is more pronounced in politically corrupt states. Consistent with our hypothesis that political contributions play a role in securing mandates from public clients, we find our results are stronger for investment advisors headquartered in states with greater number of public pension plans and states with a history of political corruption.

Lastly, we investigate differences among investment manager types. We find that our results are more pronounced for investment advisors who have large institutional client bases and advisors who disclose that they provide pension consulting services. These types of advisors are likely to offer services that are of interest to public pension plans.

Our paper contributes to two broad branches of existing literature. In investment management, we add to the broad literature on capital allocation to institutional investment

managers. For example, Goyal and Wahal (2008) and Del Geurcio and Tkac (2002) examine the hiring and firing of investment managers by institutional plan sponsors and find that while institutional plan sponsors tend to use risk-adjusted fund performance (in contrast to individual investors) in their investment decisions, plan sponsors do not seem to add value via selection and termination. The most closely related paper to ours within this literature is Hochburg and Rauh (2013) who investigate private equity manager selection by public pension plans specifically. The authors show that public pension plans exhibit home-bias and are more likely to invest in private equity funds managed by advisors headquartered in the plan's home state. Consistent with our findings, they also document that this home bias is stronger in states with a history of political corruption suggesting the presence of quid pro quo activities or political pressure to invest in local firms. In contrast, our work examines the entire population of registered advisors and tests for the effects of past contributions on the presence of government clients for the advisor. Our study is also closely related to a recent working paper by Agarwal, Lu and Ray (2018) who document another type of pay to play practice: hedge fund managers who strategically make charitable donations to network with potential charitable foundation investors and gain their trust.

We also contribute to the literature on the value of political contributions in finance generally. Political donations are made as an expense of the shareholders but whether they are value-added expense is still debatable. Politically connected firms tend to receive more government contracts (Tahoun, 2014) and more funding when financially constrained (Claessens, Feijen, and Laeven, 2008, Faccio, Masulis, and McConnell, 2006). However, political contributions are shown to reflect an agency problem between managers and shareholders (Yu and Yu, 2011, Fulmer, Knill and Yu, 2012, Correia, 2014). Our finding that political contributions are associated with a higher presence of government clients for investment management firms

suggests that these expenses may be beneficial to investment advisor owners and firm but may hurt the retirees of the pension plans.

2. Data and Summary Statistics

2.1. Form ADV data

The Investment Advisers Act requires all advisors with greater than \$100 million in assets under management as well as certain advisors to private funds with greater than \$150 million in private fund assets to register with the SEC.⁶ The Act defines an investment advisor as any entity that receives compensation for managing securities portfolios or providing advice regarding individual securities. Advisors registered with SEC make up a broad population of business types within the investment management industry including: mutual fund managers, institutional asset managers, pension consultants, hedge fund managers, and retail-focused RIAs. These registered advisors must file Form ADV on at least an annual basis to disclose information about their advisory business including operational information and potential conflicts of interest. We obtain the complete set of Form ADV filings since the inception of electronic filing in 2001 through March 31, 2017 from the SEC via Freedom of Information Act (FOIA) request. To create an annual panel dataset from these filings, we only keep the “annual updating amendments” filings following Gurun et al. (2017).

Our key variables of interest are constructed using disclosures from Item 5 and Schedule A of Form ADV. In Item 5, advisors provide information about the operations of their advisory business. In particular, we focus on Item 5D.(1) which requires the advisor to disclose the types of clients for which they manage assets. Designated client types include: “individuals”, “high net

⁶ Prior to the implementation of the Dodd-Frank Act the cut off for registration was \$25 million in assets under management and advisors with less than 15 U.S. clients were not required to register, see Dimmock and Gerken (2012).

worth individuals”, “banking or thrift institutions”, “investment companies”, “business development companies”, “pooled investment vehicles (other than investment companies)”, “pension and profit sharing plans (but not the plan participants)”, “charitable organizations”, “corporations or other businesses not listed above”, “state or municipal government entities”, “other investment advisers”, “insurance companies”, and “other” entities.

During our sample period, advisors are required to select one of the following percentage band categories for each client type: none, up to 10%, 11-25%, 26-50%, 51-75%, 76-99%, and 100%. In our tests, we focus on the percentage of the advisor’s clients which are “State or municipal government entities”. To test for evidence of pay to play activities, we examine if advisors with a history of political contributions have more success obtaining government (e.g., public pension plan) clients. Because Form ADV reports the presence of client types within bands, we use band midpoints to approximate the composition of each advisor’s client base. If individual investors are listed as 51-75% of clients, for instance, we assign a value of 63%.

In our analyses, we also consider operational control variables from Form ADV which may influence an advisor’s presence of government clients. In particular, we control for the advisor’s assets under management (AUM) and the natural log of client accounts. We also account for potential conflicts of interest and the presence of other lines of business, i.e., if the advisor is related to a commercial bank, brokerage or insurance company. Lastly, we control past legal and regulatory issues as government clients may choose to avoid advisors with past legal issues. Variable definitions and construction are detailed in Appendix A.

2.2. *Owner and officer political contribution data*

In this study, we focus on contributions to state-level political candidates from 1995 to 2016, which gives us three prior election cycles to compute the main contribution variable. As mentioned in previously, we consider contributions to state-level candidates as opposed to federal because prior literature indicates that elected officials at the state-level are heavily involved in the selection of plan trustees.⁷ We also consider direct contributions and indirect contributions. Direct contributions are made directly to state-level candidates during the elections for state officials. Indirect contributions are made to a political action committee (PAC) of a political party. The parties are responsible for allocating these contributions among their state-level and federal candidates during their election campaign. It is probable that a portion of the contributions would go to the state-level candidates.

Data on direct contributions, i.e., contributions that go directly to state-level political candidates, are from the National Institute on Money on Politics⁸. This dataset aggregates contribution reports for state-level election campaigns collected from each state's public campaign finance reporting system. Even though reporting schedule requirements vary across states, all campaign finance data are publicly available for every candidate who runs for state-level political positions. We focus on individual donors in the banking/finance industries only. We also aggregate all contributions from each donor to each state-level candidate.

Data on indirect contributions, i.e., contributions that go to political parties' PAC are from Federal Election Committee's (FEC) database. Campaign finance law requires all registered PACs to report all parties that give them contributions over \$200 in each election cycle. We obtain

⁷ See Hochburg and Rauh (2013)

⁸ We thank Denis Barber from the National Institute on Money on Politics for helping us with getting the customized data.

political contributions from owners and officers of investment advisory firms from the “Contributions by individuals” files. We focus on individual contributions to political party PACs or super PACs. To do so, we merge this file to the “Committee master” file using the receiving committee ID and only keep the committees with committee type “X” (Party committees that have not yet been in existence for six months and received contributions from 50 people), “Y” (Party committees that have existed for at least six months and received contributions from 50 people), or “Z” (National party nonfederal accounts).

Finally, we match data on direct and indirect contributions with Form ADV data using a fuzzy match algorithm on donor name and the investment advisory firms’ owner and officer names. Schedule A of Form ADV requires advisors to list the names of all directors, executive officers, and direct owners of 5% or more of the firm. Each individual must list their ownership position and job title. We then hand-clean all matches to make sure the employer filed with the FEC is similar to the firm name from Form ADV. Following Cooper et al. (2010) and Correia (2014), we construct an indicator variable which is equal to one if any of the individuals listed on the advisor’s Schedule A have donated to a state government official or Political Action Committee (PAC) within the past three election cycles.⁹

2.3. *Investment advisor characteristics*

Table 1 presents the characteristics of investment advisory firms in our sample. Panel A presents data on advisors’ clienteles. We present statistics only for client categories available during the entire sample period. Further, since Item 5 includes the possibility that some clients are

⁹ Both of these studies use contributions during the last five years. We convert this to the past three election cycles because it is more relevant to the discussion of contributions during election campaigns.

double-counted, we also exclude pension and profit sharing plans since pension plan sponsors will also be counted as government or corporate clients, for example.

We find that the clientele types with the greatest means within the entire sample of SEC registered investment advisors are high net worth individuals and individuals. This indicates that most registered advisors tend to be retail-focused in nature. The average advisor's client base consists of 1.7% State or Municipal Governments, but there is significant variation (standard deviation of 7.8%) within the sample. This suggests that many firms either do not pursue or cannot obtain government clients, but that a subset of firms may specialize in serving these types of clients. Later in the paper we focus on subsamples of advisors with some presence of institutional clients.

[Insert Table 1 here]

Panel B presents summary statistics on other advisor characteristics including the percentage of firms whose owners and officers have donated to state and local officials or PACs during the past three election cycles. We find that *Donor* firms make up 11% of advisors in the sample. The mean advisor manages \$4.5 billion in assets, but this number is highly positively skewed as the median advisor manages \$210 million. This is consistent with the broader investment management literature (e.g., Berk and van Binsbergen, 2012) which finds that the bulk of delegated assets are managed by the largest firms in the industry.

In our main tests, we run concurrent analyses using the entire sample of investment advisory firms as well as the subsample of advisors which excludes the largest firms (bottom three quartiles). In Table 2, we partition the sample of investment advisory firms. Each year we rank advisors by assets under management. Column (1) presents mean characteristics for advisors in

the top quartile of the sample, while column (2) presents mean characteristics for advisors in the bottom three quartiles of the sample. In column (3), we present the differences in means as well as a t-statistics which test if the differences in means are statistically different from zero.¹⁰

[Insert Table 2 here]

While larger firms tend to have a greater percentage of government clients on average (4.12% versus 0.85%), large firms also exhibit more complexity. Column (3) reveals that larger advisors are significantly less likely to be stand-alone entities (independent) and are more likely to be related to other types of businesses operating in the financial services industry, such as commercial banks, brokerage firms, or insurance companies. To the extent that political donations seek to influence government officials and their appointees to steer business to firms, the presence of other business activities for a firm adds noise to whether the intended business at the firm resides within the investment management division or otherwise. Due to this issue, we concurrently run our main analyses with the entire sample of advisors and a subsample of smaller advisors which consists of the advisors in the bottom three quartiles as ranked by assets under management in each fiscal year.

3. Main Empirical Results

3.1. Panel regression results

The empirical analyses begin by examining relationship between the presence of state or municipal government clients at the investment advisor and past political donations made by

¹⁰ Standard errors are clustered on investment advisor.

owners and officers of the advisor. Specifically, in Table 3, we compute coefficient estimates using the following panel OLS regression model:

$$\%State \& Local \ Gov't \ Clients_{i,t} = \beta_0 + \beta_1 Donor_{i,t,t-5} + \beta X_{i,t-1} + YearFE + \varepsilon_{i,t} \quad (1)$$

Where $\%State \& Local \ Gov't \ Clients_{i,t}$ is the percentage of the advisor's clients which are state or municipal government entities reported by investment advisor i in year t and $Donor_{i,t,t-5}$ is an indicator variable which takes a value of one if any owners or officer of investment advisor i have donated to a state government official or a PAC over the prior three election cycles and zero otherwise. Each regression includes year fixed effects so that each advisor's clientele composition is compared to other advisors operating during the same fiscal year. Columns (2), (3), (5), and (6) add advisor control variables. Columns (1) – (3) present results for the entire population of SEC registered investment advisors and columns (4) – (6) present results for advisors in the bottom three quartiles of the sample as measured by AUM in each fiscal year.

[Insert Table 3 here]

For the entire sample in columns (1) – (3), the coefficient estimates on the *Donor* indicator variable are statistically significant at the 5% level or better. We observe very strong significance in column (1) (t-stat of 7.37), but the introduction of control variables in columns (2) and (3) indicates that much of the relationship results from advisor size as larger advisors (more AUM) tend to have a greater number of owners and officers listed on Schedule A and are thus more likely to have personnel who have donated to state or local government officials in the recent past.

Once we account for other determinants of government clients in columns (2) and (3), including advisor size, the coefficient estimates on the *Donor* indicator are statistically significant at the 5% level or better. Economically, we find that the client bases of donor advisors are made up of nearly 0.5 percentage points more government clients. This magnitude appears small on percentage basis. However, since the average advisor has greater than 78,000 client accounts, this suggests that political donations yield a materially large number of government clients on an absolute number of accounts basis. Furthermore, since public pension plan allocations tend to be large with regard to asset levels (in the tens to hundreds of millions of dollars), and investment managers typically charge clients on an asset under management basis, this suggests that political donations may have a large economic impact on an advisor's fee revenues.

Columns (4) – (6) present results for the subset of advisors in the bottom three quartiles as measured by assets of management during each fiscal year. Since these advisors are more likely to be stand-alone entities and are also less likely to be engaged in other financial services activities such as commercial banking, brokerage, or insurance we expect to find a less diluted relationship between the presence of government client and owners/officer political donations. In all three columns, we note an improvement in the relationship between government clients and officers' past donations relative to the entire sample. The coefficient estimates on the *Donor* indicator are statistically significant at the 1% level or better. We find that the introduction of controls, including advisor size, have a muted effect on the relationship relative to the results observed in the first three columns. Economically, in columns (5) and (6), we find that donor advisors obtain 0.60 percentage points more of their client base from government clients which is 20% larger in magnitude than the coefficient estimates for the full sample of advisors.

Overall, the results in Table 3 are consistent with evidence that relatively widespread quid pro quo pay to play activities exist in the investment management industry. However, a correlation between the presence of government clients and past political donations for investment advisors does not necessarily imply a causal relationship between the two. The balance of this paper aims to provide more convincing evidence for causality using time series (pre and post SEC pay to play rules) and cross-sectional tests.

4. Pre and Post SEC Pay to Play Rules

4.1. Background of SEC pay to play rules for registered investment advisors

On July 1, 2010, the SEC adopted a new antifraud rule, Rule 206(4)-5, under the Advisers Act designed to prevent investment advisors from obtaining business from government entities in return for political contributions or fund raising. – i.e., from participating in pay to play practices. The SEC modeled the rule on those adopted by the Municipal Securities Rulemaking Board, or MSRB, which in 1994 prohibited municipal securities dealers from participating in pay to play practices. Specifically, Rule 206(4)-5 prohibits the principal avenues for pay to play practices. Most importantly, the rule makes it unlawful for an advisor to receive compensation for providing advisory services to a government entity for a two-year period after the advisor or any of its associates make a political contribution to a public official of a government entity or a candidate for such office who is or will be in a position to influence the award of advisory business. The rule also covers contributions made by third party solicitors on behalf of investment advisors and government business obtained indirectly through pooled investment vehicles such a mutual funds, hedge funds, or private equity funds. Rule 206(4)-5 was made effective on September 13, 2010

and investment advisors were required to comply with the rule by March 14, 2011. Figure 1 provides a timeline of the rule including the dates of its proposal, adoption, and implementation.

[Insert Figure 1 here]

4.2. *Pre and post SEC rule tests and results*

If pay to play considerations drive the relationship that we observe between the presence of government clients and past political donations in Section 3, we expect to find that the enactment of rules directly prohibiting pay to play activities for advisors to weaken the relationship. To test if the relationship becomes significantly weaker post compliance with the rule, we estimate the following panel OLS regression model

$$\begin{aligned} \%State\ \& \ Local\ Gov't\ Clients_{i,t} = \beta_0 + \beta_1 Donor_{i,t,t-5} + \beta_2 Donor_{i,t,t-5} * Post2011 \\ & + \beta X_{i,t-1} + YearFE + \varepsilon_{i,t} \end{aligned} \quad (2)$$

The model is nearly identical to equation (1) but now includes an interaction term between the *Donor* indicator variable and *Post2011* which is a dummy variable that takes a value of one if the fiscal year is 2012 or later and zero otherwise. Observations for the 2010 and 2011 transition years are excluded from the analyses since the rule was adopted in 2010 and compliance was not required until March 2011. If pay to play activities contribute the observed relationship, we expect that β_2 will be negative and statistically significant, i.e., the prevalence of pay to play activities will significantly decline after the adoption of the SEC's rule.

Table 4 presents results from the estimation of equation (2). Columns (2) and (4) include the investment advisor control variables used in columns (3) of Table 3. Columns (1) and (2) present results using the entire sample of investment advisors and columns (3) and (4) restrict the sample to smaller advisors, i.e., those in the bottom three quartiles of sample as ranked by assets under management each fiscal year. As in Table 3, since smaller advisors engage in auxiliary financial services activities to a lesser extent, we expect to observe a purer relationship in our estimation of the model for these firms.

[Insert Table 4 here]

The results in Table 4 reveal a significant decline in the relationship between the presence of government clients and an advisor's officer and owner political donations post enactment of the SEC's pay to play rules. The coefficient estimates on the interaction terms are negative and statistically significant at the 10% level or better in all four columns. While the coefficients on the *Donor* variable are statistically significant at the 1% level or better in all columns indicating a strong relationship prior to 2010, the sum of the Donor and interaction term coefficients in each column are not statistically different from zero. The results indicate that the SEC's adoption of play to play rules weakened the relationship between the presence and government clients and advisors' past political donations considerably. As in Table 3, we note a much clearer relationship for smaller advisors in columns (3) and (4) where other business activities are less prevalent.

We next provide visual evidence to shed more light on why a decline in the relationship is observed. Figure 2 plots the time series means of the Donor indicator variable, as measured only over the most recent prior election cycle, for two subsets of advisors. The dashed line presents the

means of the Donor indicator variable for advisors with the greatest presence of government clients, i.e., advisors who check the 26-50%, 51-75%, 76-99%, and 100% boxes on Item 5. The solid line presents the Donor variable means for advisors who have no government clients.

[Insert Figure 2 here]

In the years prior to the adoption of the SEC's pay to play rule, Figure 2 shows a greater incidence of donor firms among the advisors with the greatest presence of government clients. In the typical year, advisors with high percentages of government clients are approximately twice as likely to have owner or officers donating to state government officials. Figure 2 further shows that post enactment of SEC's pay to play rules in 2011 that the fraction of donor firms for the advisors with highest percentages of government clients declines precipitously and approaches that of advisors with no government clients. The trend is consistent with a play to pay explanation for why we observe the relationship between the presence of government clients and advisor owners and officer donations to state government officials and PACs. Taken together, the results in Table 4 and Figure 2 help to support a causal interpretation for the main panel regression results in Table 3.

5. Additional Tests Supporting a Pay to Play Explanation

This section of the paper presents results from tests that further support a pay to play explanation for our main findings. We pursue several avenues. First, we show that the main results are only present when officers and owners likely involved in capital raising at the advisor make political donations. In particular, we find that the relationship is driven by advisors who have had the CEO, an owner/partner, or a marketing/sales executive make a past political donation.

Second, we examine if advisor geography is consistent with a pay to play explanation. Hochberg and Rauh (2013) find that public pension plans tend to bias toward making in-state private equity investments. The authors further find that local private equity investments by public pension plans are more prevalent in politically corrupt states and tend to underperform similar out-of-state investments. Consistent with Hochberg and Rauh's findings on the local bias of public pension plans, we show that within the general population of investment advisors, advisors headquartered in states with a significant population of public pension plans are significantly more likely to obtain government clients. We also find that pay to play activities appear to be most prevalent for advisors located in states with a high population of public pension plans and a history of political corruption.

Lastly, we explore subsamples of investment manager types. We find that our results are more pronounced for investment advisors who have significant institutional client bases (e.g., institutional separate account managers) and for advisors who indicate that they provide pension consulting services. These types of advisors are common service providers to public pension plans. On the contrary we find no relationship between the presence of government clients and past contributions for mutual fund managers and private fund managers. Arguably, these types of managers have the opportunity to attempt to obfuscate pay to play activities by having public pension plans invest through their funds as opposed to executing a direct advisory contract (e.g., a separate account) with firm.

5.1. Sources of contributions

Schedule A of Form ADV requires advisors to list the names of their direct owners and officers. Officers required to be listed on Schedule A include the Chief Executive Officer, Chief

Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, and directors and any other individuals with similar status or functions. Moreover, the advisor must disclose the names of any individuals who own 5% or more of the firm. In this section, we examine which individuals at the advisor make political contributions. If contributions are made with the intention of steering business to the advisor, it would be expected that contributions would likely be made by individuals close to the sales and marketing functions at the firm or by individuals with the greatest incentives to bring in (or maintain) new business to the firm. In particular, we focus on if contributions are made by owners/partners of the firm, the Chief Executive Officer, or sales/marketing officers. We flag these individuals using text search of job titles for key words and phrases.¹¹ Owners or partners are identified via the ownership codes disclosed in Schedule A.

We use this information to bifurcate our main *Donor* variable into two separate variables. *CEO/Owner/Sales Executive Donor* is an indicator variable equal to one if the Chief Executive Officer, an owner of the firm, or a marketing/sales executive at the firm have donated to a state government official or PAC over the prior three election cycles and zero otherwise. *Other Officer Donor* is an indicator variable equal to one if the advisor is flagged as a Donor firm due to a different type (other than CEO/Owner/Sales Executive) of officer donating to a state government official over the previous three election cycles. Since these variables are mutually exclusive, we introduce both into equation (1) in lieu of the original donor variable and re-estimate the coefficients for each variable to examine which type of officers' political contributions drive the main results. These results are presented in Table 5.

[Insert Table 5 here]

¹¹ For full details on the text searches of job titles, see Appendix A.

The coefficient estimates in Table 5 reveal that advisors whose donations originate from CEOs, owners, and sales/marketing executives are associated with a greater presence of state and local government clients, while advisors whose political donations are only from other types of officers are not. Column (1) presents regression results without control variables and finds positive and statistically significant coefficient estimates for both donor variables. However, once controls are introduced in columns (2) and (3) only the CEO/Owner/Sales Exec Donor variable survives, while donations from other types of officers are no longer significantly associated with a greater presence of government clients. Overall, the results are consistent with a pay to play explanation for the relationship between the presence of government clients and past political contributions from advisor personnel.

5.2. The geography of advisors, public pension plans, and pay to play activities

We next explore if investment advisor geography impacts the incidence of pay to play activities in manner consistent with prior literature. Hochberg and Rauh (2013) document that public pension plans tend to over-allocate to local private equity investments and that these investments tend to underperform similar out-of-state investments. Consistent with a pay to play explanation for over allocation the authors show that states with political climates characterized by more self-dealing invest a larger share of their portfolio in local investments. Based on the authors' findings, if our main results are driven by a pay to play explanation, we would expect to observe that our results are strongest in states that have a large population of public pension plans and a culture of political corruption.

To assess each state's historical corruption culture, we follow Hochberg and Rauh (2013) and obtain state-level governance measures from Glaeser and Saks (2006). Their study derives corruption levels from the Justice Department's "Report to Congress on the Activities and Operations of the Public Integrity Section," a listing of the number of federal, state and local public official convicted of a corruption-related crime by state. They divide these convictions by average state population from the 1999 and 2000 Census to obtain an estimate of the state corruption rate per capita.

We obtain data on the public pension plan population in each state from the U.S. Census Bureau's "Annual Survey of Public Pensions". The survey covers only defined benefit pensions that meet two criteria: (1) they are sponsored by a recognized unit of government as defined by the Census Bureau; and (2) their membership must be comprised of public employees compensated with public funds. In addition to state governments, the Census Bureau defines five types of local governments: county, municipal, township, school district, and special district. The census of Public Pensions is conducted every five years (years ending in '2' and '7'). We use state public pension population data from the most recent survey (2017) and apply it to the years in our sample as the population. Since the distribution of public pension plans by state has remained relatively steady over time, we believe that this approach is appropriate.

We use our state-level data on the public pension plan population and political corruption to construct two indicator variables. For each year in the sample period we rank observations by both variables independently. First, we create a variable an indicator variable, *High Public Pension State*, which is equal to one if the advisor is above the median value in that year as ranked by the advisor's state public pension plan population and zero otherwise. Next, we create a second indicator variable, *High Public Pension Plan and Corruption State*, which takes a value of one in

the advisor has an above median value in that year for both the advisor's state public pension plan population and the advisor's state's measure of political corruption.

Table 6 present the results of panel regressions similar to those estimated in our main analyses in Table 3 but now using the state-level indicator variables to restrict the sample in columns (1), (2), (4) and (5), and as interaction terms in columns (3) and (6).¹² Results in Columns (1) – (3) show that our main results are weakly stronger in states with high populations of public pension plans. The coefficient estimates in columns (1) and (2) show that the relationship between the presence of government clients and past political contributions in high public pension plans is stronger as the magnitude of the coefficient estimate on the Donor indicator variable is nearly two and half times larger in column (1), where the sample is restricted to observations in high public pension plan states. In column (3), where we analyze the entire sample, the positive and statistically significant coefficient (at the 10% level) on the interaction term signifies that the relationship is meaningfully stronger from a statistical standpoint in the states with larger populations of public pension plans.

[Insert Table 6 here]

In columns (3), (4), and (5) we further investigate the relationship between the presence of government clients and past political contributions by advisor personnel in states with both a large population of public pension plans and a history of political corruption. As in columns (1) and (2), in columns (4) and (5) we the restrict the sample using the *High Public Pension Plan and Corruption State* indicator variable. Economically, the coefficient estimate on the *Donor* indicator

¹² All regressions include advisor controls, year fixed effects, and standard errors are clustered on investment advisor.

variable in column (4) is eight times larger than the estimate in column (5) and is statistically significant at the 1% level. When we examine the pooled sample in column (6), our findings are confirmed as the coefficient on the interaction term between the *Donor* indicator and the *High Public Pension and Corruption State* indicator is statistically significant at the 1% level. This result confirms that the relationship between the presence of government clients and past contributions by advisor personnel is statistically stronger when the advisor is headquartered in a state with a large population of public pension plans and a history of political corruption. Overall, the results in Table (6) support a pay to play explanation for our main findings.

5.3. *Advisory firm type analyses*

The broader population of investment advisory firms consist of numerous subgroups. While certain firms focus on management of assets for individuals, others may specialize in managing separate accounts for institutional clients or managing private investment vehicles such as hedge funds or private equity funds. The particular relationship that we document, i.e., past political contributions being associated with a greater presence of direct state or municipal government clients is not likely to be equally prevalent for different subsets of various investment advisory firm types. For example, a retail RIA with no institutional business has little incentive to engage to pay to play activities because they may not offer services that interest government clients. On the other hand, institutional separate account managers or advisors that provide pension consulting services may have greater incentive to engage in pay to play activities since the services that they provide are of interest to public pension plans whose administrators can potentially be influenced via the political donation process. On the next hand, advisors that also manage investment companies (i.e., mutual funds and ETFs) or private funds (e.g., hedge funds or private

equity funds) could potentially complicate our documented relationship. The nature of the client composition disclosure on Form ADV does not require advisors to disclose the composition of the underlying investors in their funds. Because of this, it is possible for mutual fund and private fund managers to have government clients invested in their funds that we do not observe in our data. To the extent that fund managers engage in pay to play activities, they may push government clients into their funds as opposed to executing a direct investment advisory agreement in an attempt to obfuscate these activities from regulators.

Table 7 reports the results of regressions used in our main tests but now restricting the sample to investment advisors who serve different types of clients or who indicate that they provide pension consulting services on their Form ADV Item 5. In columns (1) and (2) we restrict the sample to advisors who disclose minimum thresholds of institutional clients. In particular, we require advisors in column (1) to have some institutional client presence, i.e., the sum of the four mutually exclusive institutional client types is greater than zero (Charities + Banks + Non-bank Corporate + Gov't > 0). In column (2), we raise this threshold to 25%. Consistent with our intuition on pay to play activities most benefitting firms that offer services of interest to public pension plans, we find that the results in columns (1) and (2) are more pronounced than the estimates in our baseline tables. In particular, in column (2), where the sample is restricted to advisors with a more than a quarter of their client base consisting of institutional clients, donor firms' client bases have 3 percentage points more government clients. Economically, this estimate is six times larger than the estimate in our baseline tests. In column (3), we document similar findings in the subsample of advisors who offer pension consulting services. When we restrict the sample to these firms, we find that the relationship between donations and the presence of government clients is

markedly improved. The coefficient estimate on the Donor indicator variable in column (3) is approximately twice that of our main tests.

[Insert Table 7 here]

Columns (4) restricts the sample to advisors who manage investment companies (e.g., mutual funds) in column (4) and advisors who manage private funds (e.g., hedge funds or private equity) in column (5). Consistent with the intuition that these types of managers may have an incentive to obfuscate pay to play activities by funneling government clients into their funds as opposed to executing a direct advisory agreements, we find that the subsamples of advisors who manage either public or private funds do not exhibit the pay to play relationship that we document in our main tests. In column (4), we note no relationship between the presence of government clients and donor advisors for firms who advise investment companies and in column (5) we observe a negative relationship between the presence of government clients and donor advisors for firms that manage private funds such as hedge funds or private equity funds. The latter result indicates that private fund advisors who have donated to state political candidates in the past have significantly fewer direct government clients. This is consistent with the interpretation that these advisors may push any clients obtained via pay to play activities into their funds.

Overall, our analyses of advisor subsamples support a pay to play explanation for the main result. Our findings that past donations yield a greater presence of government clients for firms focusing on institutional clients and pension consulting services is expected given that these types of advisors likely provide services that public pension plans seek. The negative relationship documented for the subsample of private fund advisors is interesting, and consistent with the

possibility that these firms cater to government clients in their funds as opposed to through direct separate account relationships.

5.4. Other client types and political contributions

Lastly, we explore how past political contributions are related to the presence of other mutually exclusive client types on Form ADV. If a pay to play relationship drives our main results, we expect to find little positive correlation between past donations and the presence of other types of clients on Form ADV. Table 8 presents the coefficient estimates from regressions similar to those our used in our main tests but now examining other client types on Form ADV as the dependent variables of interest. Column (1) examines the presence of individual clients, column (2) high net worth individuals, column (3) non-bank corporations, column (4) charitable organizations, column (5) banks, column (6) investment companies (e.g., mutual funds), and column (7) private funds.

The results in Table 8 are generally consistent with our expectations, with the exception of two client types. In column (4), we find that past donations are positively correlated with the presence of charitable organization clients at the 5% level. Economically, the magnitude of the coefficient estimate is much smaller than those documented in the main results in Table 3. In untabulated tests, we find that the presence of government clients is most correlated with the charitable organization clients relative to other client types. One possible explanation for the positive relationship is that advisors who engage in pay to play activities with their government clients may also engage in similar behavior with their non-profit clients. For example, advisor personnel may contribute sizable amounts to a charitable foundation in hopes of securing future business managing foundation assets. Related to this point, Agrawal et al. (2018) examine if hedge

fund managers' charitable contributions are strategically motivated to secure favorable inflows or outflows. The authors find that hedge fund managers charitable contributions appear to curb outflows after their funds suffer poor performance.

[Insert Table 8 here]

In column (7) we also document a very strong relationship between past political contributions and the presence of private fund clients, i.e., hedge fund and private equity fund managers are more likely to have donated to political candidates in the past relative to advisors focusing on other client types. This result is consistent with the findings of Hochberg and Rauh (2013) who document results consistent with pay to play behavior in the private equity sector. Overall, the results from Table 8 generally support a pay to play explanation and are consistent with findings from prior literature regarding charitable contributions of fund managers and pay to play type activities in the private fund industry.

6. Robustness Checks

6.1. Robustness tests of the main results

Finally, we conduct a battery of robustness tests on our main regression results. The first set of tests address our dependent variable of interest, since Form ADV clientele data are provided in percentage bands during our sample period. In columns (1) and (2) we employ limited dependent variable models in lieu of OLS. Column (1) uses an ordered logit model where each of the percentage bands are assigned a value of 0 – 6. For example, an advisor with 0% public clients is assigned a value of 0 and an advisor with 100% public clients is assigned a value of 6. Column (2) uses a Tobit model since the dependent variable of interest is bounded from below at 0%. Columns

(3) and (4) recalculate coefficients using the OLS model, but instead of using clientele band midpoints, we use band minimums and maximums. The results in three out of four columns yield statistically significant coefficients on the Donor variable at better than the 1% level. The results suggest that our choice of model and use of band midpoints for our dependent variable do not drive our main results.

In columns (5) – (8) we make small changes to our main independent variable. In columns (5) and (6) we recalculate the donor indicator variable using political donations over the past two and four election cycles respectively instead of the past three election cycles. In column (7), we use a continuous version of the variable. Instead of an indicator variable, we calculate the percentage of owners and officers at the advisor who have donated to a state official or PAC over the prior three elections cycles. Finally, column (8) employs a placebo test. We recalculate the Donor indicator using political donations to federal candidates as opposed to state candidates and PACs. Here, we would expect not to observe significant results since the United States federal employees' retirement system is primarily consolidated into two plans (the Thrift Savings Plan or TSP and FERS or the Federal Employees Retirement System) where there is little ability to engage in the activities we document in this study. The coefficient estimates in all four columns yield the expected results. In columns (5) – (7), we find that making small changes to the donor indicator does not appear to materially affect the main results. In column (8), we observe no statistical significance when we construct the Donor indicator variable using past federal donations as opposed to state politician donations.

Finally, in column (9), we address changes made to the population of registered investment advisors with the passage of Dodd-Frank in 2010. Prior to Dodd-Frank, advisors with greater than \$25 million in assets under management were required to register with the SEC. Dodd-Frank raised

this threshold to \$100 million. Also, prior to Dodd-Frank, many advisors to private funds (i.e., hedge funds and private equity funds) were exempt from registering if they had fewer than 15 clients (each fund counting as one client). Post Dodd-Frank, advisors to private funds were required to register with the SEC if they managed more the \$150 million in their private fund vehicles regardless of the number of funds they managed. To more directly address the differences in the advisor populations Pre and Post Dodd-Frank¹³, we restrict the sample to advisors with greater than \$100 million under management and more than 15 client accounts and retabulate coefficient estimates from column 3 of Table 3. The results are shown in column (9) and reveal that the coefficient estimate for the Donor indicator remains relatively unchanged when making these restrictions to our sample of advisors.

7. Conclusion

This paper investigates a particular form of local government support from political donors. Specifically, we study the market for public pension plan business and document a higher existence of government clients for investment advisory firms whose owners and officers have made recent political contributions to the state-level officials and PACs during election campaigns. We also offer evidence that this relation is causal using the adoption of Rule 206(4)-5 under Investment Advisers Act of 1940 by the SEC in 2011. As the rule made it more difficult for political contributors to establish clients from their supported candidates, we observe a sharp drop in the percentages of advisors with a substantial presence of government clients whose owners and officers donate to state officials. The relation between the presence of public clients and past owner and officer contributions also weakens in the post rule-implementation period.

¹³ The main tests address this issue with the use of year fixed effects.

To further provide evidence of pay to play activities as an explanation for our results, we implement several cross-sectional tests. First, the relation we document concentrates in cases in which political donations are made by individuals involved in capital raising, such as CEOs, owners/partners, and marketing/sales executives. Second, the result strengthens for investment advisors headquartered in states with more potential public clients and states with a history of political corruption. Lastly, our result is more pronounced for investment advisors who are more likely to pursue public pension clients, for example, advisors who have a large institutional client bases and advisors who disclose that they provide pension consulting services.

Our study contributes to asset management literature on the allocation of capital to investment management firms. We also present new findings relevant to the literature on the value of political contributions. Most importantly, our paper also provides valuable information for policy makers. In particular, we find that the SEC's rule on pay to play activities for investment advisors appears to have been successful in curbing the prevalence of this type of quid pro quo activity in the investment management industry. Our findings may offer a roadmap for the adoption of similar rules by other government agencies overseeing industries where political corruption is prevalent.

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Appendix A. Definition and Data Source of Variables

Variable Name	Data Source	Variable Definition and Construction
%State & Local Gov't Clients	Form ADV	Percentage of state and municipal government entity clients managed by the investment advisor. Calculated as the midpoint of the band disclosed for this client category Form ADV. Similarly, all other client categories use the midpoint of the disclosed percentage band.
Donor	Form ADV, National Institute on Money on Politics, Federal Election Committee	An indicator variable equal to one if any of the officers or direct owners listed on Schedule A of Form ADV have donated to a state-level politician or a PAC over the past three election cycles and zero otherwise.
Log(AUM)	Form ADV	Natural log of assets under management of the investment advisor, Item 5F.(2)(c).
Log(Accts)	Form ADV	Natural log of client accounts managed by the investment advisor, Item 5F.(2)(f).
Related Brokerage	Form ADV	Indicator variable equal to one if the investment advisor indicates that it is a broker-dealer or is affiliated with an entity that is a broker-dealer and zero otherwise, Items 6A.(1) and 7A.(1) .
Related Bank	Form ADV	Indicator variable equal to one if the investment advisor indicates that it is a commercial bank or trust company or is affiliated with an entity that is a commercial bank or trust company and zero otherwise, Items 6A.(7), 6A.(8), 7A.(8) and 7A.(9).
Related Insurance	Form ADV	Indicator variable equal to one if the investment advisor indicates that it operates as an insurance company or is affiliated with an entity that operates as an insurance company, Items 6A.(6) and 7A.(12).
Independent	Form ADV	Indicator variable equal to one if the advisor does not disclose any financial industry affiliates on Form ADV (i.e., does not check any boxes on Item 7) and zero otherwise.
Legal/Regulatory Issues	Form ADV	And indicator variable equal to one if the advisor discloses that it has past legal or regulatory violations (i.e., checks any boxes on Item 11) and zero otherwise.
CEO/Owner/Sales Executive Donor	Form ADV	An indicator variable equal to one if the advisor's CEO, an owner or partner in the firm, or a sales or marketing executive have donated to the state-level politician or PAC during the past three election cycles and zero otherwise. We use text search of key words and phrases within job titles to construct this variable.
Other Officer Donor	Form ADV	An indicator variable equal to one if the advisor is flagged as a Donor firm due to an officer other than those listed above donating to a state-level politician or PAC over the past three election cycles.
High PP State	U.S. Census Bureau's "Annual Survey of Public	An indicator variable equal to one if the advisor above median number of public pension plans located in its

Pensions”

headquarters state in a given fiscal year and zero otherwise. Headquarters states are obtained from Form ADV. Data on the number of public pension plans comes from the U.S. Census Bureau’s “Annual Survey of Public Pensions”. The survey covers only defined benefit pensions that meet two criteria: (1) they are sponsored by a recognized unit of government as defined by the Census Bureau; and (2) their membership must be comprised of public employees compensated with public funds. The census of Public Pensions is conducted every five years (years ending in ‘2’ and ‘7’). We use state public pension population data from the most recent survey (2017) and apply it to the years in our sample as the population.

High PP & Corruption
State

Glaeser and Saks (2006)
and U.S. Census Bureau’s
“Annual Survey of Public
Pensions”

An indicator variable equal to one if the advisor has above median value of corruption in its headquarters state and above median number of public pension plans located in its headquarters state in a given fiscal year and zero otherwise. Glaeser and Saks (2006) derive corruption levels from the Justice Department’s “Report to Congress on the Activities and Operations of the Public Integrity Section,” a listing of the number of federal, state and local public official convicted of a corruption-related crime by state. They divide these convictions by average state population from the 1999 and 2000 Census to obtain an estimate of the state corruption rate per capita.

Figure 1: Timeline of the SEC's Pay to Play Rule for Investment Advisors

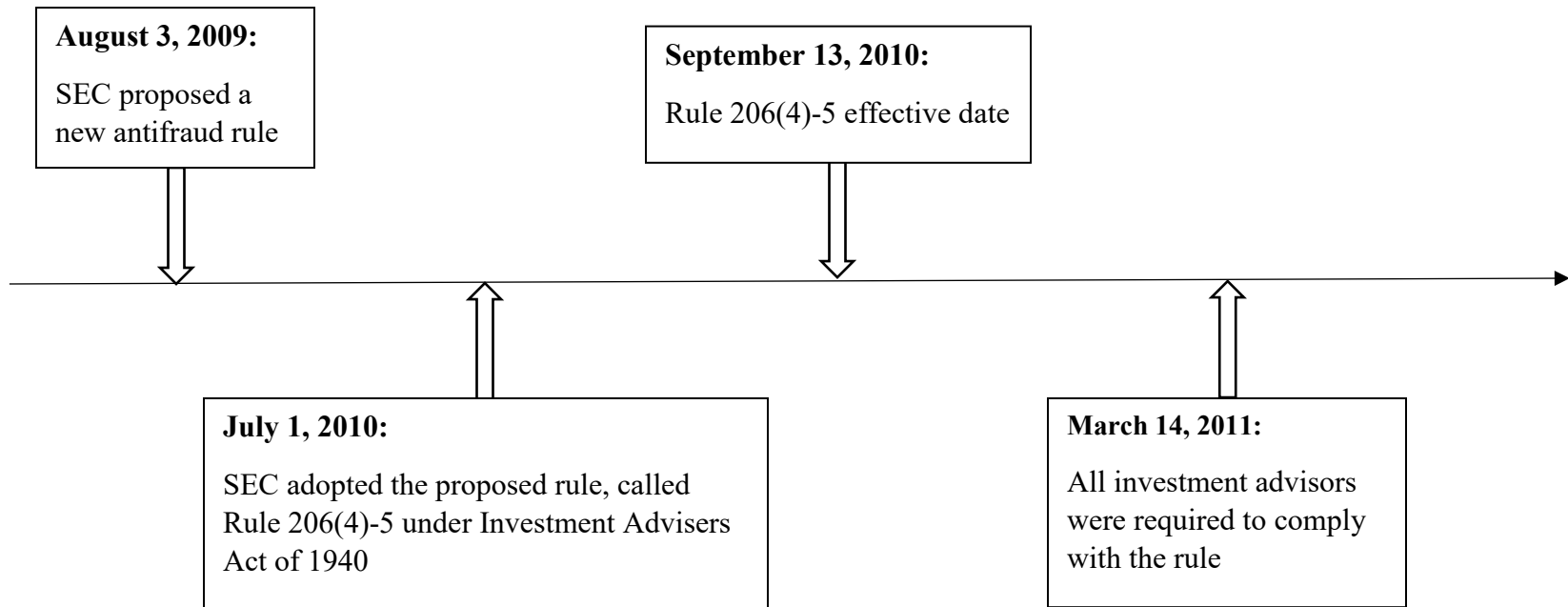


Figure 2: Time Series of Advisor Personnel Contributions to State or Local Government Officials: Advisors with High versus Low Percentages of State and Local Gov't Clients

This figure presents the time series of subsample means of the donor indicator variable for advisors with high percentages of state and local government clients and advisors with no state or local government clients. We define advisors with high percentages of state or local government clients as those with at least 25% of their client base consisting of government clients.

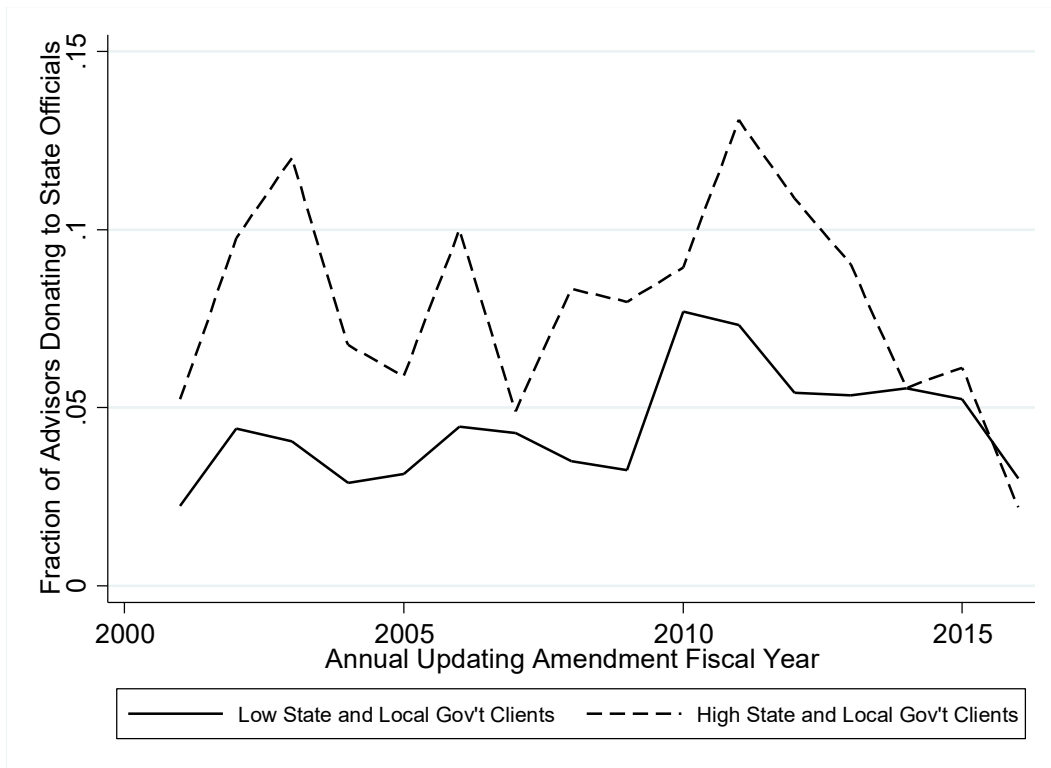


Table 1: Summary Statistics

This table presents summary statistics for registered investment advisors from 2001 to 2016. Panel A presents summary statistics for all mutually exclusive client types available during the entire sample period. Panel B presents summary statistics for other data disclosed on Form ADV as well as the Donor variable. Donor is an indicator variable equal to one if an owner or officer listed on Schedule A has contributed to a state of local government official or a PAC in the past three election cycles and zero otherwise. All variable definitions are contained in Appendix A.

Panel A: Clientele Data

VARIABLES	(1) n	(2) mean	(3) median	(4) stdev	(5) p(10)	(6) p(90)
State & Local Gov't	155,174	1.7%	0.0%	7.8%	0.0%	5.0%
Non-Bank Corporate	155,174	4.6%	0.0%	0.0%	0.0%	5.0%
Charitable Organizations	155,174	3.4%	0.0%	7.1%	0.0%	5.0%
Banks	155,174	0.9%	0.0%	6.1%	0.0%	0.0%
Individuals	155,174	26.6%	5.0%	31.4%	0.0%	87.5%
HNW Individuals	155,174	29.3%	18.0%	30.9%	0.0%	87.5%
Investment Companies	155,174	4.3%	0%	15.9%	0.0%	5.0%
Private Funds	155,174	10.0%	0.0%	24.8%	0.0%	38.0%
Other	155,174	2.0%	0.0%	10.0%	0.0%	0.0%

Panel B: Contributions and Other ADV Data

VARIABLES	(1) N	(2) mean	(3) median	(4) stdev	(5) p(10)	(6) p(90)
Donor	155,174	0.11	0	0.31	0	1
AUM (\$MM)	155,174	4,650	210	46,900	36	4,530
Number of Accts	155,174	78,450	127	8,979,663	3	1,201
Independent	155,174	0.44	0	0	0	1
Related Bank	155,174	0.17	0	0.38	0	1
Related Brokerage	155,174	0.26	0	0.44	0	1
Related Insurance	155,174	0.09	0	0.29	0	1
Legal or Regulatory Issues	155,174	0.15	0	0.36	0	1

Table 2: Mean Characteristics of Investment Advisors Sorted by Assets Under Management

This table reports sample means of investment advisor characteristics for annual observations sorted by lagged assets under management. High AUM advisors are investment advisors in the top quartile of the sample and Low AUM advisor are investment advisors in the bottom three quartiles as ranked by assets under management. Variable definitions are provided in Appendix A. Column (3) presents the differences in means between columns (2) and (1). Column (4) tests if the difference in means between observations in columns (2) and (1) is statistically different from zero. Standard errors are taken from univariate regressions and are clustered on investment advisor. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	Means			
	(1) High AUM Advisors	(2) Low AUM Advisors	(3) Difference (1) – (2)	(5) t-statistic
State & Local Gov't (%)	4.12%	0.85%	3.27%***	(20.36)
Donor	0.19	0.08	0.12***	(23.27)
AUM (\$MM)	17,900	215	17,685***	(-13.73)
Number of Accts	202,173	37,191	164,982*	(1.90)
Independent	0.22	0.51	-0.29***	(-42.52)
Related Bank	0.29	0.14	0.15***	(23.50)
Related Brokerage	0.47	0.20	0.27***	(34.38)
Related Insurance	0.12	0.09	0.03***	(8.89)
Legal or Regulatory Issues	0.26	0.11	0.15***	(23.90)
<i>N</i>	38,809	116,365		

Table 3: Panel Regressions of an Investment Advisor’s Gov’t Clients on Past Political Contributions of its Owners and Officers

This table reports coefficients from the following panel regression model of investment advisor i 's percentage of state and local government clients on advisor characteristics:

$$\%State \& Local \ Gov't \ Clients_{i,t} = \beta_0 + \beta_1 Donor_{i,t,t-5} + \beta X_{i,t-1} + YearFE + \varepsilon_{i,t}$$

The sample in columns (1), (2), and (3) consists of all SEC registered investment advisor operating between 2001 and 2016. Columns (4), (5), and (6) restricts the sample to investment advisors whose assets under management are in the bottom three quartiles of the sample as ranked on an annual basis. The key explanatory variable of interest is the Donor indicator variable. This variable is equal to one if any owner or officer listed on Schedule A of Form ADV has contributed to a state government official or a PAC in the past three election cycles. The dependent variable in all regressions is the advisor’s percentage of state or municipal government client taken from Item 5 of Form ADV. Regressions in columns (2), (3), (5), and (6) include advisor control variables (see Appendix A for details). Standard errors are clustered on investment advisor, and t-statistics are reported in parentheses. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	% State & Local Gov't Clients					
	All Advisors			Ex-Large Advisors		
	(1)	(2)	(3)	(4)	(5)	(6)
Donor	1.34*** (7.37)	0.48*** (2.63)	0.46** (2.50)	0.87*** (4.06)	0.60*** (2.88)	0.59*** (2.81)
Log(AUM)		0.77*** (22.12)	0.76*** (21.56)		0.42*** (11.74)	0.42*** (11.73)
Log(Accts)		-0.22*** (-9.69)	-0.22** (-9.46)		-0.28*** (-11.33)	-0.28** (-11.43)
Independent		0.20* (1.92)			-0.06 (-0.72)	
Related Bank			0.02 (0.16)			0.10 (0.82)
Related Brokerage			0.10 (0.73)			0.14 (1.09)
Related Insurance			0.03 (0.26)			0.24** (2.40)
Legal & Regulatory Issues		-0.12 (-0.88)	-0.22* (-1.66)		0.12 (1.06)	0.05 (0.44)
Year FEs	Yes	Yes	Yes	Yes	Yes	Yes
N	155,174	155,174	155,174	116,372	116,374	116,374
Adj. R-squared	0.004	0.040	0.040	0.002	0.015	0.015

Table 4: Investment Advisor Gov't Clients and Past Political Contributions Pre and Post Adoption of the SEC Pay to Play Rules

This table reports coefficients from the following panel regression model of investment advisor i 's percentage of state and local government clients on advisor characteristics:

$$\%State \& Local Gov't Clients_{i,t} = \beta_0 + \beta_1 Donor_{i,t,t-5} + \beta_2 Donor_{i,t,t-5} * Post2011 + \beta X_{i,t-1} + YearFE + \varepsilon_{i,t}$$

The sample in columns (1) and (2) consists of all SEC registered investment advisor operating between 2001 and 2016. Columns (3) and (4) restrict the sample to investment advisors whose assets under management are in the bottom three quartiles of the sample as ranked on an annual basis. The key explanatory variable of interest is the Donor indicator variable. This variable is equal to one if any owner or officer listed on Schedule A of Form ADV has contributed to a state government official or a PAC in the past three election cycles. This variable is interacted with an indicator variable (Post 2011) which take a value of one in years after 2011 and zero otherwise. The fiscal years 2010 and 2011 are omitted from the sample since these years represent the transition period for advisors to come into compliance with the SEC's pay to play rules. The dependent variable in all regressions is the advisor's percentage of state or municipal government client taken from Item 5 of Form ADV. Regressions in columns (2) and (4) include advisor control variables (see Appendix A for details). Standard errors are clustered on investment advisor, and t-statistics are reported in parentheses. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	% State and Local Gov't Clients			
	All Advisors		Ex-Large Advisors	
	(1)	(2)	(3)	(4)
Donor	1.67*** (6.07)	0.82*** (2.98)	1.36*** (3.81)	1.12*** (3.18)
Donor*Post 2011	-0.58* (-1.85)	-0.56* (-1.81)	-0.80** (-2.12)	-0.86** (-2.29)
Controls	No	Yes	No	Yes
Year FEs	Yes	Yes	Yes	Yes
N	133,962	133,962	100,459	100,459
Adj. R-squared	0.005	0.040	0.003	0.015

Table 5: Source of Political Donations

This table reports coefficients from panel regressions of investment advisor i 's percentage of state and local government clients on advisor characteristics. The sample consists of all SEC registered investment advisors operating between 2001 and 2016. In this table, we bifurcate the Donor variable. CEO/Owner/Sales Executive Donor is an indicator variable equal to one if the CEO, an owner, or an officer involved in marketing or sales at the firm has contributed to a state or local government official or a PAC in the past three election cycles. Other Officer Donor takes a value of one if an officer of the advisor has contributed to a state or local government official in the past three election cycles but that individual is not a CEO, owner or sales executive and zero otherwise. The dependent variable in all regressions is the advisor's percentage of state or municipal government client taken from Item 5 of Form ADV. Regressions in columns (2) and (3) include advisor control variables (see Appendix A for details). Standard errors are clustered on investment advisor, and t-statistics are reported in parentheses. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	% State and Local Gov't Clients		
	(1)	(2)	(3)
CEO/Owner/Sales Executive Donor	1.41*** (6.04)	0.61*** (2.65)	0.61*** (2.62)
Other Officer Donor	1.20*** (5.17)	0.24 (1.00)	0.19 (0.80)
Log(AUM)		0.77*** (22.12)	0.76*** (21.76)
Log(Accts)		-0.22*** (-9.68)	-0.22** (-9.47)
Independent		0.19* (1.88)	
Related Bank			0.03 (0.21)
Related Brokerage			0.10 (0.76)
Related Insurance			0.04 (0.36)
Legal & Regulatory Issues		-0.12 (-0.85)	-0.22* (-1.65)
Year FEs	Yes	Yes	Yes
N	155,174	155,174	155,174
Adj. R-squared	0.004	0.040	0.040

Table 6: Geography of Advisors and Pay to Play Activities

This table reports coefficients from the following panel regression model of investment advisor *i*'s percentage of state and local government clients on advisor characteristics. The key explanatory variable of interest is the Donor indicator variable. This variable is equal to one if any owner or officer listed on Schedule A of Form ADV has contributed to a state or local government official or a PAC in the past three election cycles and zero otherwise. The dependent variable in all regressions is the advisor's percentage of state or municipal government client taken from Item 5 of Form ADV. Columns (3) and (6) use the full sample of SEC registered investment advisors from 2001 to 2016. High Public Pension State takes a value of one if the advisor is above median (on an annual basis) based on its headquarters state's public pension plan population and zero otherwise. Column (1) restricts the sample to observations where High Public Pension State is equal to one and column (2) restricts the sample to observations where High Public Pension State is equal to zero. High PP & Corruption State is an indicator variable equal to one if the advisor is above median (on an annual basis) for sample based on its headquarters state's public pension population and its headquarters state's culture of political corruption as calculated in Glaeser and Saks (2006) and zero otherwise. Column (4) restricts the sample to observations where High PP & Corruption State is equal to one and column (5) restricts the sample to observations where High PP & Corruption State equal to zero. Regressions in all columns include advisor control variables (see Appendix A for details). Standard errors are clustered on investment advisor, and t-statistics are reported in parentheses. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	% State and Local Gov't Clients					
	High PP States (1)	Low PP States (2)	Full Sample (3)	High PP & Corruption States (4)	Non-High PP & Corruption States (5)	Full Sample (6)
Donor	0.69** (2.44)	0.29 (1.27)	0.17 (0.79)	1.53*** (3.14)	0.19 (1.03)	0.14 (0.81)
High Public Pension State			0.39*** (3.80)			
Donor*High PP State			0.62* (1.77)			
High PP & Corruption State						0.49*** (3.77)
Donor*High PP & Corruption State						1.47*** (2.88)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FEs	Yes	Yes	Yes	Yes	Yes	Yes
N	76,172	79,002	155,174	34,155	121,019	155,174
Adj. R-squared	0.046	0.035	0.041	0.048	0.036	0.042

Table 7: Types of Investment Advisory Firms and Pay to Play Activities

This table reports coefficients from regressions of investment advisor i 's percentage of state and local government clients on advisor characteristics. The key explanatory variable of interest is the Donor indicator variable. This variable is equal to one if any owner or officer listed on Schedule A of Form ADV has contributed to a state or local official or a PAC in the past three election cycles. The dependent variable in all regressions is the advisor's percentage of state or municipal government clients taken from Item 5 of Form ADV. Column (1) restricts the sample to advisors with some institutional client presence, i.e. Government + Non-bank Corporate + Banks + Charitable Organizations > 0%. Column (2) restricts the sample to advisors obtaining a substantial fraction of their client base from institutional accounts, i.e. Government + Non-bank Corporate + Banks + Charitable Organizations > 25%. Column (3) restricts the sample to advisors that disclose they provide pension consulting services. Column (4) restricts the sample to advisors who disclose that they manage investment companies on Form ADV. Column (5) restricts the sample to advisors who disclose that they manage pooled investment vehicles (other than investment companies) and charge performance-based fees. All regressions include advisor control variables (see Appendix A for details). Standard errors are clustered on investment advisor, and t-statistics are reported in parentheses. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	% State and Local Gov't Clients				
	(1) Advisors with >0% Inst. Clients	(2) Advisors with >25% Inst. Clients	(3) Advisors offering Pension Consulting	(4) Advisors to Mutual Funds	(5) Advisors to HFs/PE
Donor	0.86*** (3.12)	3.01*** (2.82)	0.92*** (2.68)	0.32 (0.97)	-0.52** (-2.45)
Controls	Yes	Yes	Yes	Yes	Yes
Year FEs	Yes	Yes	Yes	Yes	Yes
N	97,877	15,699	38,056	24,124	29,423
Adj. R-squared	0.086	0.017	0.044	0.046	0.091

Table 8: Other Mutually Exclusive Form ADV Client Types and Political Contributions

This table reports coefficients from the following panel regression model of investment advisor i 's percentage of certain client types on advisor characteristics:

$$\%Client\ Type_{i,t} = \beta_0 + \beta_1 Donor_{i,t,t-5} + \beta X_{i,t-1} + YearFE + \varepsilon_{i,t}$$

The key explanatory variable of interest is the Donor indicator variable. This variable is equal to one if any owner or officer listed on Schedule A of Form ADV has contributed to a state or local government official or a PAC in the past three election cycles. The dependent variables in the regressions are various mutually exclusive client types of the investment advisor taken from Item 5 of Form ADV. Each regression includes advisor control variables (see Appendix A for details). Standard errors are clustered on investment advisor, and t-statistics are reported in parentheses. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	Individuals (1)	HNW Individuals (2)	Non-Bank Corporate (3)	Charitable Organization (4)	Banks (5)	Investment Companies (6)	Private Funds (7)
Donor	-0.58 (-1.48)	-0.75 (-1.54)	-0.36** (-2.01)	0.30** (2.38)	-0.09 (-0.77)	-0.55* (-1.80)	1.87*** (4.19)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FEs	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	155,174	155,174	155,174	155,174	155,174	155,174	155,174
Adj. R-squared	0.455	0.207	0.031	0.037	0.017	0.121	0.218

Table 9: Robustness Checks of the Main Results

This table reports coefficients from regressions of investment advisor i 's percentage of state and local government clients on advisor characteristics. The key explanatory variable of interest is the Donor indicator variable. This variable is equal to one if any owner or officer listed on Schedule A of Form ADV has contributed to a state or local government official or a political action committee in the past three election cycles. The dependent variable in all regressions is the advisor's percentage of state or municipal government client taken from Item 5 of Form ADV. Columns (1) and (2) consider alternate model specifications since the percentage of clientele data on Form ADV take the form of limited dependent variables. Column (1) uses an ordered logit model and column (2) uses a Tobit model. Columns (3) and (4) use band maximums and minimums from Form ADV as opposed to midpoints to construct the dependent variable of interest. Columns (5) and (6) use officer political donations from the previous two and four cycles respectively instead the prior three cycles to construct the donor indicator variable. Column (7) changes the nature of the explanatory Donor variable. Instead of indicator variable, it represents the fraction of officers and owners on Form ADV that have contributed to state politicians or a PAC in the past three election cycles. Column (8) reconstructs the donor indicator variable using contributions to federal government officials as opposed to PACs and state government officials. Column (9) restricts the sample to advisors with at least \$100MM in assets under management and at least 15 client accounts. This is to account for differences in the SEC investment advisor populations pre and post Dodd-Frank. All regressions include advisor control variables (see Appendix A for details). Standard errors are clustered on investment advisor, and t-statistics are reported in parentheses. ***, ** and * indicate significance at the 1%, 5% or 10% levels.

VARIABLES	% State and Local Gov't Clients								
	(1) Ordered Logit Model	(2) Tobit Model	(3) Gov't Band Maximum	(4) Gov't Band Minimum	(5) Donor Past 2 Cycles	(6) Donor Past 4 Cycles	(7) % Officers Donors	(8) Federal Donor	(9) Balanced Sample
Donor	0.16*** (3.01)	3.30*** (3.79)	0.63*** (2.63)	0.25 (1.60)	0.34* (1.70)	0.45** (2.34)	1.02** (1.96)	-0.08 (-0.31)	0.56** (2.25)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FEs	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	155,174	155,174	155,174	155,174	155,174	155,174	155,174	155,174	79,439
Adj. R-squared	N/A	N/A	0.057	0.192	0.040	0.040	0.040	0.039	0.075
Pseudo R-squared	0.154	0.071	N/A	N/A	N/A	N/A	N/A	N/A	N/A