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CORPORATE & FINANCIAL WEEKLY DIGEST

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SEC Adopts "Pay to Play" Rule for Investment Advisers

On July 1, the Securities and Exchange Commission adopted Rule 206(4)-5 under the Investment Advisers Act of 1940 to protect public pension plans and other government investors by deterring advisers from participating in "pay to play" practices. The new rule applies to investment advisers that are registered (or required to be registered) with the SEC or are exempt from registration under Section 203(b)(3) of the Advisers Act, including investment advisers to any "covered investment pool" in which a "government entity" (including public pension plans and other government investors) invests or is solicited to invest. Most, if not all, advisers that provide discretionary management with respect to public pension fund assets would fall under the scope of the new rule. "Covered investment pools" include entities that would be investment companies but for the exceptions provided by Sections 3(c)(1), 3(c)(7) or 3(c)(11) of the Investment Company Act of 1940, and any registered investment company that is an investment option under a government plan or program.

The new SEC rule has three key elements:

- It prohibits an investment adviser from providing investment advisory services for compensation to a government entity within two years after the investment adviser or any of its "covered associates" has made a contribution to an official of the government entity that is in a position to influence the selection of the investment adviser for its advisory services. This prohibition does not apply to certain de minimis contributions made by a covered associate who is a natural person (limited in the aggregate to $150 or $350 per election per candidate depending upon the circumstances).
- It prohibits an investment adviser or any of its covered associates from directly or indirectly paying any person to solicit a government entity for investment advisory services on its behalf, including soliciting investments to a covered investment pool advised by the investment adviser. This prohibition on paying third party marketers does not apply to "regulated persons," such as registered investment advisers that have met certain preconditions and registered brokers who are subject to similar prohibitions on "pay to play" by the self-regulatory organization overseeing such broker.
- It prohibits an investment adviser or any of its covered associates from coordinating or soliciting any person or political action committee to make any (1) contribution to an official of a government entity to which the investment adviser is providing or seeking to provide investment advisory services, or (2) payment to a political party of a state or

locality where the investment adviser is providing or seeking to provide investment advisory services to a government entity.

The SEC also adopted amendments to the books and records maintenance obligations in Rule 204-2 under the Advisers Act to require registered investment advisers that provide investment advisory services to government entities to make and keep additional records related to political contributions made by such advisers and their covered associates.

Rule 206(4)-5 and the recordkeeping requirements in the amendment to Rule 204-2 become effective 60 days after their publication in the Federal Register, and compliance will generally be required within six months of the effective date. However, the SEC has allowed one year for compliance with the prohibition on paying third-party marketers who do not meet the new requirements and for all of the requirements (under both Rule 206(4)-5 and Rule 204-2) for advisers to registered investment companies that are covered investment pools.

To read the SEC's press release on Rule 206(4)-5 click here.
To read the Adopting Release click here.
Click here for more information on the Proposing Release in the July 24, 2009, edition of *Corporate and Financial Weekly Digest*.

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