Client Alert

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CURRENT ISSUES RELATED TO OUR CLIENTS JULY 6, 2010

SEC Adopts New Measures to Curtail “Pay to Play” Practices by Investment Advisers

On June 30, 2010, the Securities and Exchange Commission (“SEC”) unanimously adopted new measures intended to prevent “pay to play” practices by investment advisers seeking to manage funds for state and local governments. The adopted rule aims to prevent investment advisers from making campaign contributions and related payments to elected officials in order to influence the awarding of lucrative contracts for the management of public pension plan assets and similar government investment accounts. The new rule will be become effective 60 days after publication in the Federal Register and generally will have to be complied with six months after that.

The SEC’s new adviser rule is modeled from the Municipal Securities Rulemaking Board’s Rule G-37 for broker-dealers, and has three key elements:

- It prohibits an investment adviser from providing advisory services for compensation — either directly or through a pooled investment vehicle — for two years, if the adviser or certain of its executives or employees make a political contribution to an elected official who is in a position to influence the selection of the adviser.
- It prohibits an advisory firm and certain executives and employees from soliciting or coordinating campaign contributions from others — a practice referred to as “bundling” — for an elected official who is in a position to influence the selection of the adviser. It also prohibits solicitation and coordination of payments to political parties in the state or locality where the adviser is seeking business.
- It prohibits an adviser from paying a third party, such as a solicitor or placement agent, to solicit a government client on behalf of the investment adviser, unless that third party is an SEC-registered investment adviser or broker-dealer subject to similar pay to play restrictions.

However, unlike Rule G-37, the new advisers rule provides a *de minimis* exception that allows advisers to avoid the two-year ban on receiving compensation for services if they contribute $350 or less to an elected official for whom they are eligible to vote, or $150 to any elected official, regardless of voting eligibility.

In defending the adoption of this new rule, SEC chairman Mary Shapiro noted that “pay to play distorts municipal investment priorities as well as the process by which investment managers are selected. It can mean that public plans and their beneficiaries receive sub-par adviser performance at a premium price.”

If you would like to discuss any of the issues discussed in this Client Alert, please contact any attorney in our Investment Management Group or visit us online at chapman.com.

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