

SEC ADOPTS NEW MEASURES TO CURTAIL PAY TO PLAY PRACTICES BY INVESTMENT ADVISERS

The Securities and Exchange Commission today voted unanimously to approve new rules to significantly curtail the corrupting influence of “pay to play” practices by investment advisers.

Pay to play is the practice of 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 rule adopted by the SEC today includes prohibitions intended to capture not only direct political contributions by investment advisers, but also other ways that advisers may engage in pay to play arrangements.

“The selection of investment advisers to manage public plans should be based on the best interests of the plans and their beneficiaries, not kickbacks and favors,” said SEC Chairman Mary L. Schapiro. “These new rules will help level the playing field, allowing advisers of all sizes to compete for government contracts based on investment skill and quality of service.” The new SEC rule 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.

The new rule becomes effective 60 days after its publication in the Federal Register. Compliance with the rule’s provisions generally will be required within six months of the effective date. Compliance with the third-party ban and those provisions applicable to advisers to registered investment companies subject to the rule will be required one year after the effective date.

FACT SHEET

Across the country, state and local governments manage money as part of many important public programs. Such programs include public pension plans that pay retirement benefits to government employees, retirement plans in which teachers and other government employees can

invest money for their retirement, and plans that allow families to invest money for college (commonly known as “529 plans”). The assets overseen by these governments are substantial. Public pension plans alone hold more than \$2.6 trillion of assets and represent one-third of all U.S. pension assets. 529 plans today hold approximately \$100 billion in assets.

THE ROLE OF AN INVESTMENT ADVISER

To help manage this money, state and local governments often hire outside investment advisers. These investment advisers may directly manage the money in the pension funds or government programs for these state and local governments.

In some cases, these advisers may provide advice to the governments about which investments they should make, or which investment options they should make available as choices to workers investing for retirement or families investing for college. Additionally, the advisers may manage the mutual funds or other investments in which employees’ or families’ money is invested.

In return for their advice, the investment advisers typically charge the governments fees that come out of the assets of the pension funds for which the advice is provided. If the advisers manage mutual funds or other investments that are options in a plan, the advisers receive fees from the money in those investments.

SELECTING AN INVESTMENT ADVISER

The investment advisers are often selected by one or more trustees who are either themselves elected officials, or are appointed by elected officials. While such a selection process is common, the fairness of the selection process can be undermined in two ways.

On the one hand, the process can be undermined when advisers seeking to do business with state and local governments make political contributions to elected officials or candidates, hoping to influence the selection process. On the other hand, elected officials or their associates may ask advisers for political contributions, or otherwise foster a perception that only advisers who make contributions will be considered for selection. Hence the term: “pay to play.”

In recent years, the SEC has charged investment advisers with engaging in pay to play practices. Investment advisers who engage in such practices compromise their obligations to put their clients’ interests first. Pay to play practices distort the process by which investment advisers are selected and can harm the pension, retirement or 529 plans, which may receive inferior advisory services and pay higher fees. Pay to play practices also create an uneven playing field among investment advisers, and may hurt smaller advisers who cannot afford the required contributions.

PROHIBITIONS OF THE PAY TO PLAY RULE

Advisers and government officials engaging in pay to play practices may try to hide the true purpose of contributions or payments. The SEC today adopted a rule that includes prohibitions intended to capture not only direct political contributions by advisers, but other ways advisers may engage in pay to play arrangements.

RESTRICTING POLITICAL CONTRIBUTIONS

Under the new rule, an investment adviser who makes a political contribution to an elected official in a position to influence the selection of the adviser would be barred for two years from providing advisory services for compensation, either directly or through a fund.

The rule applies to the investment adviser as well as certain executives and employees of the adviser. Additionally, the rule applies to political incumbents as well as to candidates for a position that can influence the selection of an adviser.

There is a *de minimis* provision that permits an executive or employee to make contributions of up to \$350 per election per candidate if the contributor is entitled to vote for the candidate, and up to \$150 per election per candidate if the contributor is *not* entitled to vote for the candidate.

BANNING SOLICITATION OF CONTRIBUTIONS

The pay to play rule prohibits an adviser and certain of its executives and employees from asking another person or political action committee (PAC) to:

- 1) Make a contribution to an elected official (or candidate for the official's position) who can influence the selection of the adviser.
- 2) Make a payment to a political party of the state or locality where the adviser is seeking to provide advisory services to the government.

BANNING CERTAIN THIRD-PARTY SOLICITORS

The pay to play rule also prohibits an adviser and certain of its executives and employees 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.

RESTRICTING INDIRECT CONTRIBUTIONS AND SOLICITATIONS

Finally, the pay to play rule would prohibit an adviser and certain of its executives and employees from engaging in pay to play conduct indirectly, such as by directing or funding contributions through third parties such as spouses, lawyers or companies affiliated with the adviser, if that conduct would violate the rule if the adviser did it directly. This provision prevents advisers from circumventing the rule by directing or funding contributions through third parties.