

July 2, 2010

## SEC Adopts Pay-to-Play Rules

On June 30, 2010, the Securities and Exchange Commission (the "SEC") formally adopted Rule 206(4)-5 (the "Pay-to-Play Rule") under the Investment Advisers Act of 1940, as amended (the "Act"). The Pay-to-Play Rule is primarily designed to prohibit investment advisers from making political contributions to influence their selection as investment advisers for government investment accounts such as public pension plans. The Pay-to-Play Rule also imposes significant new regulatory requirements on investment advisers.

**Two-Year Time Out.** Subject to certain exceptions (described below), an investment adviser is prohibited from receiving compensation for providing advice to a government entity within two years after it or a covered associate makes a contribution to an official of that government entity. The Pay-to-Play Rule reaches contributions to elected officials who have legal authority to hire the adviser, but also extends to officials who can influence the hiring of the adviser, such as persons with appointment authority. The Pay-to-Play Rule does not ban or limit political contributions but instead imposes a two-year time out on receiving compensation for conducting advisory business with a government entity.

### Exceptions to Two-Year Time Out:

**De Minimis Exceptions.** Individuals can make aggregate contributions of up to \$350, per election, to an elected official or candidate for whom the individual is entitled to vote, and up to \$150, per election, to an elected official or candidate for whom the individual is not entitled to vote. These *de minimis* exceptions are available only for contributions by individual covered associates and not the investment adviser itself.

**Returned Contributions.** An investment adviser has an exception for inadvertent political contributions made by a covered associate to an official for whom that covered associate is not entitled to vote. This exception is only available for contributions that, in the aggregate, do not exceed \$350 to any one official per election, that are discovered within four months of the date of the contribution, and that are returned within 60 days after discovery of the contribution.

**Placement Agents and Solicitors.** Neither an investment adviser nor any of its covered associates can provide or agree to provide, directly or indirectly, payment to any person to solicit government clients for investment advisory services on its behalf. This prohibition does not apply (i) to any of the adviser's employees, general partners, managing members or executive officers (but a contribution by any of these persons may trigger the two-year time out described above), or (ii) if the third party solicitor is a regulated person that is subject to prohibitions against engaging in pay-to-play practices.

**Coordination Prohibition.** An investment adviser and its covered associates are also prohibited from coordinating, or asking any person or political action committee to make (i) any contribution to an official of a government entity to which the adviser is providing or seeking to provide investment advisory services, or (ii) any payment to a political party of the state or locality where the adviser is providing or seeking to provide investment advisory services to a government entity.

**Applicability and Effective Date.** The Pay-to-Play Rule applies to investment advisers registered with the SEC under the Act as well as covered associates of such advisers. Covered associates includes (i) any general partner, managing member or executive officer, or other individual with a similar status or function, (ii) any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee, and (iii) any political action committee controlled by the investment adviser or by any person described in (i) or (ii) above. The Pay-to-Play Rule is designed broadly to apply to those individuals whose position with an investment adviser is more likely to incentivize them to obtain or retain clients for the investment adviser and, therefore, more likely to engage in pay to play practices. The Pay-to-Play Rule becomes effective sixty days after its publication in the Federal Register and most investment advisers will be required to comply with the rule's provisions within six months after such date.

**Recordkeeping Requirements.** In conjunction with the adoption of the Pay-to-Play Rule, the SEC also adopted amendments to Rule 204-2 under the Act, imposing new recordkeeping requirements on investment advisers that have government clients or that provide investment advisory services to investment pools in which government entities invest. Advisers are generally required to make and keep records including (i) the names, titles and business and residence address of all covered associates, (ii) all government entities to which the investment adviser provides or has provided investment advisory services in the past five years, but not prior to the effective date of the rule, (iii) all direct and indirect contributions made by the investment adviser or any of its covered associates to an official of a government entity or payments to a political party of a state or political subdivision thereof, or to a political action committee, and (iv) the name and business of each regulated person to which the investment adviser, directly or indirectly, agrees to provide payment to solicit a government entity for investment advisory services on its behalf.

For additional information regarding the Pay-to-Play Rule or the new recordkeeping requirements, please contact one of the attorneys listed below:

[Taylor H. Wilson](#)

214.651.5615

[taylor.wilson@haynesboone.com](mailto:taylor.wilson@haynesboone.com)

[Vicki Martin-Odette](#)

214.651.5674

[vicki.martin-odette@haynesboone.com](mailto:vicki.martin-odette@haynesboone.com)

[Richard M. Fijolek](#)

214.651.5570

[rick.fijolek@haynesboone.com](mailto:rick.fijolek@haynesboone.com)

[Evan K. Hall](#)

214.651.5831

[evan.hall@haynesboone.com](mailto:evan.hall@haynesboone.com)

[Rick A. Werner](#)

212.659.4974

[rick.werner@haynesboone.com](mailto:rick.werner@haynesboone.com)

[Christina Markell-Balleza](#)

214.651.5486

[christina.markell-balleza@haynesboone.com](mailto:christina.markell-balleza@haynesboone.com)

[Kit Addleman](#)

214.651.5783

[kit.addleman@haynesboone.com](mailto:kit.addleman@haynesboone.com)

[David Siegal](#)

212.659.4995

[david.siegal@haynesboone.com](mailto:david.siegal@haynesboone.com)