The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 25484

September 14, 2011

SEC Provides No-Action Relief on Pay-on-Play Rule; Call to Discuss Relief Scheduled for Thursday, Sept. 15th At 2 P.M.

URGENT/ACTION REQUESTED

[25484]

September 14, 2011

TO: SEC RULES MEMBERS No. 113-11
COMPLIANCE MEMBERS No. 39-11
OPERATIONS MEMBERS No. 21-11
SMALL FUNDS MEMBERS No. 59-11
BROKER/DEALER ADVISORY COMMITTEE No. 57-11
INVESTMENT ADVISER MEMBERS No. 19-11
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 53-11 RE: SEC PROVIDES NO-ACTION RELIEF ON PAY-ON-PLAY RULE; CALL TO DISCUSS RELIEF SCHEDULED FOR THURSDAY, SEPT. 15TH AT 2 P.M.

As you may know, ICI has been working with the SEC staff for approximately a year to address concerns with the SEC's new pay-to-play rule imposing upon investment advisers an obligation to identify government entity shareholders who hold mutual fund shares through omnibus accounts. We are pleased to announce that the SEC staff has provided the Institute no-action relief that addresses these concerns. [1] Copies of the ICI's request for relief and the SEC's no-action letter are attached. The SEC's letter is brief summarized below. Please note that the attached letters differ slightly from the versions circulated to members on September 12.

The Institute has scheduled a call for Thursday, September 15th from 2-3 p.m. (Eastern) to discuss this relief with members. To participate in the call, please email Gwen Kelly (gwen.kelly@ici.org) no later than the close of business on Wednesday, September 14th.

The Need for Relief

Rule 204-2(a)(18)(i)(B) under the Investment Advisers Act requires all investment advisers to maintain a list of all government entities that are or were an investor in any covered investment pool to which the investment adviser provides or has provided investment advisory services. Because many of these government accounts are held in omnibus positions on the fund's books and records, and because the fund and its adviser would not have information on the shareholders in these accounts, the rule requires fund advisers to obtain shareholder information from the omnibus accountholders. However, because the omnibus accountholders receiving these requests have no legal obligation to provide such information to the funds requesting it, funds have largely been unable to obtain the records necessary to comply with this recordkeeping requirement. As a result, there was expected to be widespread non-compliance with the rule by mutual fund advisers through no fault of their own.

The SEC's No-Action Relief

To address the concern with the lack of transparency in omnibus accounts and the potential for widespread non-compliance, the staff of the SEC has issued no-action relief that permits advisers to satisfy the recordkeeping requirement of Rule 204-2(a)(18)(i)(B) through an alternative means that does not require advisers to pierce their omnibus accounts or seek information from their omnibus accountholders in order to comply with the rule. In particular, an adviser may satisfy its recordkeeping requirements under Rule 204-2(a)(18)(i)(B) if it makes and keeps a list or other record that includes:

- Each government entity that invests in a Covered Investment Pool where the account of such government entity can reasonably be identified as being held in the name of or for the benefit of such government entity on the records of the Covered Investment Pool or its transfer agent;
- Each government entity, the account of which was identified as that of a government entity – at or around the time of the initial investment – to the adviser or one of its client servicing employees, [2] regulated persons or covered associates; [3]
- Each government entity that sponsors or establishes a 529 Plan and has selected a specific Covered Investment Pool as an option to be offered by such 529 Plan; and
- Each government entity that has been solicited to invest in a Covered Investment Pool either (i) by a covered associate or regulated person of the adviser; or (ii) by an intermediary or affiliate of the Covered Investment Pool if a covered associate, regulated person, or client servicing employee of the adviser participated in or was involved in such solicitation, regardless of whether such government entity invested in the Covered Investment Pool.

This relief will impose upon an adviser that relies on it the duty to create a system to track the solicitation activities of its covered associates or regulated persons involving a government entity, as well as solicitation activities undertaken to assist an intermediary. In addition, an adviser relying upon the relief will need to create a system to ensure that its covered associates, regulated persons and client servicing employees notify such adviser when they have become aware of the identity of a government entity account. Unlike information on omnibus account shareholders, both of these sets of information are within the adviser's control. Although not addressed in the no-action letter, the SEC staff has assured us that advisers will have a reasonable period of time to develop and implement these systems. Even so, we recommend that advisers begin creating the required records

as soon as possible.

We would very much like to thank ICI members who worked with us on obtaining this relief and who assisted us by providing information to support our efforts with the SEC.

Heather L. Traeger
Associate Counsel Tamara K. Salmon
Senior Associate Counsel
Attachment

endnotes

[1] The SEC no-action letter is available at http://www.sec.gov/divisions/investment/noaction/2011/ici091211-204.htm.

[2] For purposes of this relief, a "client servicing employee" would be a person who provides, on behalf of the adviser or the Covered Investment Pool, specialized client services to a government entity that invests in a Covered Investment Pool. Employees of the Covered Investment Pool or adviser who have incidental contact with a variety of shareholders or who service a variety of clients as part of their normal course of business – without being assigned specific responsibility to service a particular accountholder (e.g., call center representatives) – would not be considered "client servicing employees" for purposes of this relief. To the extent that the Covered Investment Pool or its adviser subcontracts its client servicing responsibilities, an adviser seeking to rely on this relief would obtain this information from its subcontractor.

[3] Among other ways, an account may be identified to a covered associate, regulated person or client servicing employee of an adviser if: (i) the plan's sponsor, agents, or participants disclose this information to such adviser's covered associate, regulated person, or client servicing employee; (ii) such adviser's covered associate, regulated person, or client servicing employee becomes aware that an affiliate of the Covered Investment Pool is providing services to such plan or government entity; or (iii) a third-party distributor directly informs such adviser's covered associate, regulated person or client servicing employee.
