The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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SEC PROPOSES ""PAY TO PLAY"" RULES FOR INVESTMENT ADVISERS

1 Securities and Exchange Commission Release No. I-A-1812 (August 4, 1999). [11166] August 6, 1999 TO: COMPLIANCE ADVISORY COMMITTEE No. 32-99 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 15-99 INVESTMENT ADVISER MEMBERS No. 12-99 SEC RULES MEMBERS No. 48-99 RE: SEC PROPOSES "PAY TO PLAY" RULES FOR INVESTMENT ADVISERS _____ The Securities and Exchange Commission has proposed for comment two rules under the Investment Advisers Act (the "Act") that are designed to address "pay to play" practices in the investment adviser industry.1 [The term "pay to play" refers to using political contributions and other similar payments to officials to influence the award of public contracts.] The first of these proposed rules, Rule 206(4)-5, would prohibit an investment adviser from providing advisory services for compensation to a government client for two years after the adviser or any of its partners, executive officers, or solicitors make a contribution to certain elected officials or candidates. The second rule proposal would amend Rule 204-2 to require an adviser with government clients to maintain certain records relating to those political contributions covered by the first rule. Comments on the proposed rules are due to the Commission by November 1, 1999. A copy of the Commission's proposal, which is summarized below, is attached. PROPOSED RULE 206(4)-5, PROHIBITION ON "PAY TO PLAY" PRACTICES Under proposed Rule 206(4)-5, which is modeled after MSRB Rule G-37, it would be a fraudulent, deceptive, or manipulative act for an investment adviser to provide advisory services for compensation to a governmental entity within two years after the adviser, any of its partners, executive officers, or solicitors made a contribution to an elected official who could influence the selection of the adviser. The rule would also make it unlawful for an adviser to solicit contributions (through a PAC or otherwise) for an official of a government client while providing or seeking to provide the government client advisory services. This rule would apply to all advisers registered with the Commission as well as to certain exempt advisers. Contributions of $250 or less to elected officials or candidates for whom the person making the contribution can vote would be exempt from the rule. As used in the rule, the term "executive officer" would include the adviser's president, vice presidents in charge of a business unit or division of the adviser, and other officers or persons who perform a policy-making function for the adviser. The rule would extend to indirect acts that, if done directly, would violate the rule. Finally, the rule would permit the Commission, upon application, to exempt advisers from the rule's prohibitions when imposition of the prohibitions is inconsistent with the rule's intended purpose or when it is triggered by inadvertent contributions. PROPOSED AMENDMENTS TO RULE 204-2 RELATING TO RECORDKEEPING The Commission's proposal would also revise Rule 204-2 under the Act, relating to recordkeeping, to require a registered adviser that has government clients to make and keep certain records of contributions made by the adviser,

its partners, executive officers, and solicitors. These records would be confidential and only reviewed by the Commission staff in the course of an adviser examination. As proposed, the rule would require an adviser to make and keep a list of its partners, executive officers and solicitors; the states in which the adviser has, or is seeking, government clients; the identify of those clients; and the contributions made. Tamara K. Reed Associate Counsel
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