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A Win for Both Fund Advisers and the SEC

In October 2010, ICI began to work with staff at the Securities and Exchange Commission (SEC) to obtain no-action relief from a recordkeeping requirement of the "pay-to-play" rule, which the SEC adopted in July 2010. SEC staff recently granted that no-action relief, a positive development both for advisers to mutual funds and the SEC's staff.

Naturally, funds remain subject to the rule's prohibition on pay-to-play activities, which aim to eliminate the connection between state and local political contributions and the awarding of government investment advisory business. The no-action relief, however, addressed what was shaping up to be a serious recordkeeping challenge for funds, one that would have resulted in widespread industry violation of the rule.

How so? The pay-to-play rule sets up several detailed reporting and recordkeeping requirements for fund advisers. Prior to the no-action relief, one of those requirements imposed an obligation on fund advisers to obtain government-account information that resided with intermediaries such as brokers, bank trust departments, insurance companies, and others that hold omnibus accounts on the fund's books and records. And yet, these intermediaries are not legally obligated to provide such information to fund advisers. So, even with advisers' best efforts to get the required information, it would have been very difficult—if not impossible—for them to comply fully with the recordkeeping requirements of the pay-to-play rule.

The no-action relief solves this dilemma by requiring an adviser to a fund to maintain a list that includes the following:

- government entities that maintain an account in their name on the fund's books and records;
- 529 plans that are invested in the fund; and
- government entities that have been solicited by a covered associate, regulated person, or client servicing employee of the adviser.

The last item is not required of other advisers subject to the rule—only mutual fund advisers. Still, the no-action relief is a clear improvement because the only government entities that advisers are required to include on their lists are those that hold accounts directly with the funds. So these entities are known to the funds, enabling fund advisers to satisfy the rule's recordkeeping requirements by maintaining information that is within the adviser's control and possession.

The no-action relief is also a win for the SEC staff because, by requiring advisers to maintain a list of their government solicitation activities, it will provide them greater access to information to determine whether any pay-to-play conduct has occurred.
