

SEC Amends Pay-to-Play Rule

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On June 22, 2011, the Securities and Exchange Commission (“SEC”) released amendments to Rule 206(4)-5 (the “Rule”) under the Investment Advisers Act of 1940 (the “Advisers Act”), which places restrictions on political contributions by an investment advisor or its covered associates, and prohibits the engagement by an investment advisor of unregulated third party solicitors to solicit government entity clients on its behalf.

As initially adopted, investment advisors subject to the Rule included investment advisors registered with the SEC, as well as advisors operating under the exemption from registration provided by Section 203(b)(3) of the Advisers Act (the former “private adviser” exemption, which was repealed by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)). In order to harmonize the Rule with the Dodd-Frank Act, the SEC has extended the application of the Rule to include any advisor that is exempt from registration by reason of the exemptions provided by:

1. Section 203(b)(3) of the Advisers Act, as amended by the Dodd-Frank Act (the “foreign private adviser” exemption for non-U.S. managers with limited U.S. activities),
2. Section 203(l) of the Advisers Act (the “venture capital fund adviser” exemption for managers whose only clients are qualifying venture capital funds), or
3. Section 203(m) of the Advisers Act (the “private fund adviser” exemption for managers whose sole clients are private funds, and who manage assets of less than \$150 million in the aggregate).

In addition, the SEC amended the provisions of the Rule relating to the use of third party solicitors by an investment advisor. The Rule prohibits covered advisors from engaging any third party to solicit government entities on behalf of the adviser, unless such third party is a “regulated person” and is subject to rules governing pay-to-play practices that are determined by the SEC to be:

1. at least as stringent as the Rule and
2. consistent with the objectives of the Rule.¹ “Regulated persons” were initially defined to include SEC registered investment advisors, as well as registered broker-dealers that are members of FINRA.

The amendments expand the definition of “regulated persons” to include a “municipal advisor,” defined as a person registered as such pursuant to Section 15B of the Securities Exchange Act of 1934 and subject to the rules of the Municipal Securities Rulemaking Board (“MSRB”). This expansion is intended to harmonize the Rule with the provisions of Section 975 of the Dodd-Frank Act, which require registration as a municipal advisor by persons that provide certain advisory services to municipal entities or who solicit municipal entities for advisory services offered by an unaffiliated third party investment advisor.²

The effective date the amendments to the Rule will be 60 days following the date of their publication in the Federal Register. The deadline by which investment advisors must comply with the prohibitions relating to the use of third party solicitors, as amended, has been extended to June 13, 2012.

¹ Investment advisors should note that final pay-to-play rules have not yet been adopted by either FINRA or the MSRB, and as such no determination as to whether such rules meet the requirements of Rule 206(4)-5 has been made by the SEC at this time. Approval of either a registered broker/dealer or a registered municipal advisor to act as a third party solicitor of government entity clients on behalf of a

covered investment advisor will be subject to the SEC's approval of such rules when and as adopted.

2 The final amendment represents a departure from the SEC's earlier proposal to require that permissible third party solicitors be limited solely to registered municipal advisors, based on the SEC's recognition of the fact that an investment advisor may engage an affiliated registered broker-dealer or an affiliated registered investment advisor to solicit advisory business, which arrangement would not otherwise cause such affiliated solicitor to fall within the statutory definition of a municipal advisor.

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