

Republican State Parties Challenge SEC's Pay-to-Play Rule

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On August 7, 2014, the New York Republican State Committee and Tennessee Republican Party (the "Plaintiffs") filed a civil suit against the Securities and Exchange Commission (the "SEC") seeking to overturn Rule 206(4)-5 under the Investment Advisers Act of 1940 (the "Advisers Act"), commonly referred to as the SEC's "pay-to-play" rule (the "Rule").

Rule 206(4)-5 was approved by the SEC in 2010 as a means to curb perceived abuses resulting from investment advisers making political contributions in order to influence government officials involved in selecting investment advisers to manage public pension fund assets. Under the Rule, investment advisers are prohibited from providing investment advisory services for compensation to a government entity for a two-year period after any covered associate of the adviser makes an impermissible contribution to an official or candidate for an office that has or would have the ability to influence the selection of an investment adviser by such government entity, as well as placing restrictions on activities of an adviser to any government entities from soliciting or coordinating contributions from others. The Rule applies to any investment adviser that is registered (or required to be registered) with the SEC, as well as to certain advisers that operate under an exemption from registration available under the Advisers Act.

In their complaint, the Plaintiffs argue, amongst other grounds for relief, that (i) Congress has delegated authority over campaign contributions exclusively to the Federal Election Commission under the Federal Election Campaign Act of 1970, and thus the SEC is preempted from regulation of this area, and (ii) by forcing investment advisers to choose between exercising their right to make contributions to their preferred candidates and retaining the ability to engage in their professional activities, the Rule creates an impermissible restraint in violation of the First Amendment.

This suit follows a recent SEC settlement in which TL Ventures, an investment adviser to venture capital funds, agreed to pay substantial disgorgement fees in order to settle allegations that it violated the Rule when a covered associate made campaign contributions to mayoral and gubernatorial candidates. The suit also follows the Supreme Court's recent *McCutcheon* decision, which is cited prominently in the Plaintiff's complaint, which overturned, on First Amendment grounds, rules placing aggregate limits on federal campaign contributions.

We will continue to monitor and provide further updates on this matter as it progresses.

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