# SEC Approves Pay-to-Play Restrictions (Rule 206(4)-5)

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On Wednesday June 30, 2010, members of the Securities and Exchange Commission voted unanimously to approve new Rule 206(4)-5 (the "Rule") adopted under the Investment Advisers Act of 1940 (the "Advisers Act"). The Rule is aimed at curbing so-called pay-to-play abuses resulting from investment advisors making political contributions in order to influence persons involved in the selection of investment advisors to manage public pension fund assets.

The Rule, the final text of which has not yet been published, will prohibit investment advisors from providing advisory services for compensation, either directly or indirectly through a pooled investment vehicle, to any governmental entity (which includes federal, state or local government, administrative agencies, public pension plans and collective government funds) within two years of the investment advisor or its executives and/or certain other employees ("covered associates") making a contribution (subject to certain de minimus exceptions, generally limited to contributions of $350 or less for elections that the contributor is entitled to vote in and $150 or less for elections in which the contributor has no right to vote) to an official of such governmental entity.

In addition, the Rule will prohibit advisory firms and their covered associates from soliciting political contributions from others on behalf of an applicable official. Based on the proposed version of the Rule circulated for public comment by the SEC, officials covered by the Rule will include any elected official or candidate for elected office (including a successfully elected but not yet in office candidate) who can directly or indirectly influence the selection of an investment advisor for such governmental entity. Covered associates of an advisor are expected to be broadly defined, and include general partners, managing members and executive officers or people holding similar status and who are involved in (or who supervise others involved in) the client advisory or client solicitation functions of the investment advisor, and will also include anyone making a contribution indirectly on behalf of the investment advisor.

In a departure from the prior version proposed rule circulated for public comment, the Rule is not expected to include a ban on investment advisors compensating any third-party solicitor to obtain governmental entities as advisory clients, provided, however, that any such solicitor must be registered with the SEC and/or the Financial Industry Regulatory Authority (as an investment advisor or broker-dealer) and thus independently subject to pay-to-play restrictions.

It is important to note that the Rule is expected to cover both federally registered investment advisors, as well as any investment advisor that is exempt from registration by virtue of the exemption provided by Section 2.3(b)(3) of the Advisers Act (for advisors with fewer than fifteen clients, relied on by many advisers to hedge funds and private equity funds), although it remains to be seen how this will interact with changes to the investment advisor exemption anticipated in connection with current Congressional reform proposals.

The Rule will become effective sixty days following its publication in the Federal Register. Advisors will be required to comply with the provisions of the Rule within six months of such effective date (with the exception of the restrictions relating to use of placement agents, compliance with which will be required within one year following the effective date). Foley Hoag will continue to monitor the status of the Rule and provide more specific guidance to our clients following its publication.

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