



The New SEC Pay-To-Play Rules

Compliance Reporter's Ask An Attorney column allows readers to pose questions—anonously—to regulatory specialists on dealing with new rules and other compliance matters. If you would like to submit a question, answer a query or become a member of our panel of experts, contact Ben Maiden, managing editor, at bmaiden@iineews.com.

How should investment advisers be preparing to comply with the new federal anti-pay-to-play regulations?

The Securities and Exchange Commission's recently-adopted rules governing political contributions by investment advisers and their employees become operational March 14. In order to be ready and to avoid unnecessary risks, IAs must begin designing and implementing the necessary processes and policies now.

The crux of the SEC new rules is as follows: if an IA or one of its "covered associates" makes a direct or indirect non-*de minimis* political contribution to a state or municipal officer or candidate who can now or, if elected, will be able to influence the award of a contract for advisory services, then the IA may not receive compensation for such services for the next two years. Covered associates include the IA's solicitors, supervisors of the solicitors and other executive officers.

Comprehensive Compliance Plan

In order to comply with the SEC's far-reaching limitation on political activity and with the separate pay-to-play restrictions imposed by many states and localities, IAs must adopt certain policies and procedures. These would include, at a minimum:

- A comprehensive analysis of what employees qualify as covered associates.
- A pre-clearance policy applicable to all political contributions made by covered associates.
- A recordkeeping system to locate, verify and retain the required information.
- A reminder/follow-up mechanism to ensure that employees are following the policies and procedures.
- A training regimen for covered associates and other employees.
- A procedure to pre-clear new employees and employees from other areas of a multi-faceted company transferring into the investment adviser.

Contribution Pre-Clearance Process

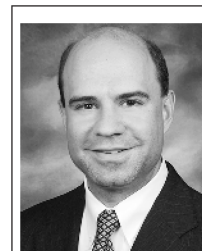
A particularly important part of a company's pay-to-play compliance efforts falls outside of the SEC rules. Since the rules provide for exceptions for *de minimis* contributions by natural

persons (\$350 if the individual can vote for the recipient; \$150 if not), it is imperative that the firm also be aware of any state or local pay-to-play laws. For example, if the focus is solely on the SEC rules and the firm permits a covered associate living in New Jersey to contribute \$350 to a gubernatorial candidate, such a contribution may put the firm in violation of the state's pay-to-play \$300 contribution limit. Special reporting in New Jersey also may be required.

Another aspect of a comprehensive pre-clearance policy that an investment adviser must keep in mind is the fact that the state and local pay-to-play laws often apply to individuals not covered by the SEC rules. For example, Connecticut's broad pay-to-play contribution ban applies to, among other persons, a firm's board of directors. Such directors may or may not be covered by the SEC rules, depending on their functions and other factors.

Procedures For New Employees

Like Municipal Securities Rulemaking Board Rule G-37, on which they are modeled, the new SEC rules include provisions that apply the pay-to-play ban to employees who become covered associates—before they become covered associates. Therefore, new employees (or employees promoted or otherwise transferred into positions falling within the definition of covered associates) must not have made prohibited contributions before they became covered associates. This means that an investment adviser must perform extensive due diligence with respect to hiring new employees or promoting or transferring employees from other divisions or jobs. This due diligence must include analysis of contributions made by the new/promoted employee in the previous two years if the employee will be soliciting municipal business. The look-back period for other new or promoted employees is still a substantial six months before they start employment in their covered associate position.



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