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NEWSLETTER

Pay-to-Play Spotlight: Proper Planning and Implementation Necessary to Comply with New SEC Pay-to-Play Rule

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As the March 14, 2011, operational date draws near, it is imperative for investment advisers to prepare for the advent of the Securities and Exchange Commission's (SEC's) new pay-to-play rule. The rule severely curtails the state, local and even federal political activities of investment advisers who work with state and local pension funds, 529 plans or otherwise provide state and local governments with advisory services. The rule, importantly, also extends to many employees of these advisors. The SEC's rule is complex, especially when combined with pre-existing and new state and local pay-to-play laws around the country, and when taking into account the ban on indirect contributions and on soliciting and coordinating contributions. Thus, careful planning and implementation are necessary to avoid a compliance nightmare.

Compliance with the SEC's pay-to-play rule begins with the identification of those employees covered by the rule and the adoption of wholesale policies designed to avoid political contributions that will cost the adviser business or, worse, just compensation for services rendered. Moreover, corporate policies will need to address the recruitment of new employees and the promotion or transfer of employees into covered positions with the investment adviser from within or from related entities, for the new rule looks back as much as two years with respect to new covered employees.

At the same time a company considers these issues, it also must determine how it will treat any federal, state or local political action committees (PACs) that it may sponsor or in which it may participate.

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Succinctly, will the PAC operate in a fashion that is compliant with the SEC's rule or not? Informing this determination should be the Municipal Securities Rulemaking Board's (MSRB's) recent guidance on dealer-affiliated PACs under MSRB's pay-to-play Rule G-37 (*see* "SEC Approves Guidance with Respect to Dealer-Affiliated PACs" from the November 2010 issue of *Election Law News*. If the PAC of a parent or related entity will operate as usual, without regard to the SEC's rule, then the adviser will need to develop the necessary firewalls and accompanying policies.

Next, the financial services entity must decide how it will approach contributions made by covered employees and, if applicable, a related PAC. Among other considerations, will all state and local contributions be banned by company policy, limited to *de minimis* amounts, or simply be subject to a pre-clearance process? Such a determination must take into account the many state and local pay-to-play laws which, among other things, may cover additional persons at the company, such as directors, and may have look-back periods of more than two years.

Finally, in brief, investment advisers soon must roll out education and training programs to ensure that their employees know the broad scope of the rule, understand whether they are covered, understand the scope of any firewalls, understand and comply with the chosen compliance process (ban, limit, pre-clearance), and know the identity of the persons in legal, compliance, government relations or other departments who can help them if they have questions. The firm must monitor the impact of this SEC-mandated chilling of First Amendment rights on the firm's culture and be willing to adjust as necessary, while still observing the rule.