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Legal

REGULATORY ENFORCEMENT ON PAY-TO-PLAY RULE

On June 30, 2010, the Securities and Exchange Commission (SEC) adopted Rule 206(4)-5 of the Investment Advisers Act (the "Act") pursuant to which investment advisers are prohibited from providing their services for compensation to a government client for two years following the donation of a campaign contribution by the firm. Now four years later, the SEC has settled its first case against an advisory firm under the statute colloquially known as the "Pay-to-Play" rule.

Business From Two Public Pension Funds

The case involved two defendant firms that, although affiliated, were charged under different sections of the Act. According to the SEC, a Philadelphia-area investment advisory firm continued to receive advisory fees from Pennsylvania's state retirement system and Philadelphia's pension plan even after a $2,500 campaign contribution was made to a Philadelphia mayoral candidate and a $2,000 campaign contribution was made to the governor of Pennsylvania. The contributions were funneled by way of an associate of the firm.

Influence Over Board Selections

In Philadelphia, the mayor appoints three out of the nine members of the Philadelphia Board of Pensions and Retirement and, therefore, has an influence over the selection of outside investment advisers. Similarly, Pennsylvania's governor appoints six of the eleven-member state retirement system. After the contributions were made in 2011, rather than refrain from providing compensatory services during the two-year cooling-off period, the firm continued to receive compensation from the funds in exchange for providing advisory services.

Strict Liability for Violations

According to a statement released by Andrew Ceresney, director of the SEC Enforcement Division: "We will use all available enforcement tools to ensure that public pension funds are protected from any potential corrupting influences. As we have done with broker-dealers, we will hold investment advisers strictly liable for pay-to-play violations."

Public Pension Fund Investments

Public pension funds are increasingly turning to alternative funds as vehicles for investing government-held retirement funds. As noted by LeeAnn Ghazil Gaunt, chief of the SEC Enforcement Division's Municipal Securities and Public Pensions Unit: "Public pension funds are increasingly investing in alternative investment vehicles such as hedge funds and private equity funds. When dealing with public pension fund clients, advisers to those kinds of investment vehicles should be mindful of the restrictions that can arise from political contributions."

Firms Claimed Exemption From Registration

Both the defendant firm and its affiliated firm were also charged with violating Section 203(a) of the Act pertaining to registration because the exemption provisions they had relied on were subsequently repealed. Since the two firms share employees, associates and, occasionally, the same facilities, they are deemed to overlapping operations sufficient to be regarded functionally as one firm.

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