

Genova, Burns & Vernoia

NEWS ALERT

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SEC to Propose New Pay to Play Restrictions: What Might Be Covered?

The Securities and Exchange Commission ("SEC") plans to reconsider a rule it last considered in 1999 to curb political contributions by investment advisers seeking to manage the investment of state pension funds. The new proposal comes in the wake of continuing investigations by New York Attorney General Andrew Cuomo ("NYAG") concerning investments by New York's largest pension fund under former State Comptroller Alan Hevesi. These investigations have resulted in a "Public Pension Fund Reform Code of Conduct," issued by the NYAG, which restricts campaign contributions by investment firms and related parties as a condition of maintaining eligibility to accept, manage or retain investments from or to provide investment management services to public pension funds. The Cuomo Code is national in scope; it is not limited to government pension funds in New York. The NYAG has made firm acceptance of this Code of Conduct a condition for resolving allegations.

As in its 1999 proposal, the SEC may again look to Municipal Securities Rulemaking Board ("MSRB") Rule G-37 as a model. In brief, G-37 bans broker-dealers and municipal finance professionals from engaging in the municipal securities business for two years after soliciting or making a contribution to an official of a governmental issuer. G-37 is distinctive as the product of a self-regulatory organization and not merely an imposition by an agency of government.

In 1999, the SEC proposed but ultimately failed to adopt a similar rule to ban investment advisory firms from providing paid advisory services to a government entity for two years after the firm (or its partners, executive officers, or political action committee) made or solicited a contribution to an official of that government entity directly or indirectly responsible for the use of an investment adviser (including candidates for such office). As in G-37, contributions up to \$250 per election made to officials for whom the contributor was entitled to vote would not trigger the ban. Since the 1999 SEC proposal, some states, notably New Jersey and Connecticut, have stepped into the breach by implementing pay to play restrictions on investment managers.

The New Jersey rules, also modeled after G-37, are similar to the 1999 SEC proposal. Both (i) impose a two year ban on the award of business following a covered contribution; (ii) reach the making and solicitation of contributions, as well as "indirect" violations; and (iii) include a de minimis exception for certain contributions of \$250 or less. The

New Jersey rules have a broader reach. For example, the New Jersey ban extends beyond partners, executives, solicitors, and PACs to also cover contributions made or solicited by the investment management firm's parent company, controlling persons or entities, various employees defined as "investment management professionals", and third party solicitors. The New Jersey ban also covers a broader range of contribution recipients, including candidates for state and local office, and political parties, regardless whether the recipient has a role in choosing investment advisers for the state. New Jersey also requires extensive periodic reporting, a feature absent from the 1999 SEC proposal.

Connecticut's statute reaches an even broader group of contributors. These individuals, defined as principals of an investment services firm, include directors, individuals with an ownership interest, senior executives, employees with managerial or discretionary responsibilities with respect to investment services, and their spouses and dependent children. Investment services are broadly defined as investment legal, banking or advisory services, underwriting services, financial advisory services and brokerage firm services. Likewise following the G-37 structure, the Connecticut State Treasurer is barred from issuing any contract to any firm which provides investment services if a principal of that firm has made or solicited a contribution to a candidate for State Treasurer. The ban covers the full term of office as State Treasurer following the contribution and also the remainder of the prior term in the case of an incumbent Treasurer seeking reelection. There is no exception for small contributions.

Will the SEC draw on these models or opt for a new approach? Regardless of how strict it may be, will the new pay-to-play restrictions bring about national uniformity or stimulate further local innovation? A new proposal is expected soon.

Maria Bernido assisted in the preparation of this alert.

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