

CLIENT UPDATE

PROPOSED “PAY TO PLAY” RULE ERECTS HURDLES TO INVESTMENT FUNDS’ CAPITAL RAISING EFFORTS

September 4, 2009 -- Managers of private equity and hedge funds investments from public institutions such as state pension plans would face substantial hurdles under a rule proposed by the Securities and Exchange Commission intended to curtail the corrupting influence of “pay to play” practices.

The rule would prohibit the fund’s covered associates from making any political contributions to officials in a position to influence the investment decisions of the public institution. Separately, the rule would bar a fund’s investment adviser, regardless of whether it had made any prohibited contribution, from engaging any placement agent to solicit the public institution. Proposed Investment Advisers Act Rule 203(4)-5 would:

- Cover all investment advisers to pooled investment vehicles in which a public institution invests, whether or not the adviser is registered under of the Advisers Act;
- Cover any state or local government-controlled fund, any state-directed 529 college savings plan, state pension funds or any other investment program or plan sponsored or established by a government entity (a “public institution”);
- Impose a two-year “time out” ban on an investment advisor from receiving compensation for providing advisory services if such advisor or any of its covered associates (including the adviser’s general partners, managing member, executive officers, or other individuals with a similar status or function) directly or indirectly makes a political contribution to an elected official in a position to influence the selection of the adviser. Any employee of the adviser who solicits government entity clients for the investment adviser would also be a covered associate. Although not receiving compensation, the adviser would nonetheless be required to continue to render fiduciary advisory services to the government entity investor; and
- Prohibit investment advisers from hiring placement agents to solicit investment involving public institutions.

Investment advisers would be required to adopt detailed and comprehensive compliance policies relating to political contributions from each of its employees and covered associates that conform to the increased restrictions imposed by the proposed rule. Investment advisers will have to monitor prospective employees to ensure they are not “hiring a ban” since the proposed rule includes a “look-back” component that would attribute contributions made by a covered associate to investment advisers that employ that person within two years after the date of the contribution.

In addition, investment advisers subject to the proposed rule would be required to maintain records, regarding their political contributions and payments and those of their covered associates, which would be available to the SEC as part of the adviser-examination process.

The proposed rule would ban investment advisers from utilizing placement agents and other third parties from soliciting capital on behalf of investment advisers from public pension plans and other public institutions that invest in investment funds. Thus if adopted in its present form the proposed rule has the potential to inhibit the ability of many investment advisers who do not have an in-house placement staff from raising capital from public institutions

The proposed rule is currently subject to the 60-day public comment period. Public Comments must be submitted to the SEC on or before October 6, 2009. Morrison Cohen LLP will continue to monitor developments relating to the proposed rule and the potential impacts on investments advisers and their investment funds. If you have any questions relating to the proposed rule, please feel free to contact your primary contact at Morrison Cohen LLP.

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