(2) Officials of a Government Entity

The rule's two-year time out is triggered by a contribution to an "official" of a "government entity."[138] An official includes an incumbent, candidate or successful candidate for elective office of a government entity if the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser or has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser.[139] Government entities include all state and local governments, their agencies and instrumentalities, and all public pension plans and other collective government funds, including participant-directed plans such as 403(b), 457, and 529 plans.[140]

The two-year time out is thus triggered by contributions, not only to elected officials who have legal authority to hire the adviser, but also to elected officials (such as persons with appointment authority) who can influence the hiring of the adviser. We have not modified this approach from our proposal.[141] As we noted in the Proposing Release, a person appointed by an elected official is likely to be subject to that official's

---

138 Rule 206(4)-5(a)(1) makes it unlawful for covered investment advisers to provide investment advisory services for compensation to a government entity within two years after a contribution to an *official* of the *government entity* is made by the investment adviser or any of its covered associates.

139 Rule 206(4)-5(f)(6). For purposes of the rule, we would not interpret the definition of "official" as covering an individual who is also a "covered associate" of the adviser. Accordingly, under the rule, a covered associate who is an incumbent or candidate for office is not limited to contributing the *de minimis* amount to his or her own campaign. The MSRB takes a similar view with respect to its rule G-37. MSRB, *Questions and Answers Concerning Political Contributions and Prohibitions on Municipal Securities Business: Rule G-37,* MSRB rule G-37 Interpretive Notice, *available at* http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G37-Frequently-Asked-Questions.aspx ("MSRB Rule G-37 Q&A"), Question II.10 (May 24, 1994).

140 Rule 206(4)-5(f)(5).

141 *See* Proposing Release, at section II.A.3(a)(2).

influences and recommendations.[142] It is the scope of authority of the particular *office* of an official, not the influence actually exercised by the individual, that would determine whether the individual has influence over the awarding of an investment advisory contract under the definition.[143] We are adopting these provisions as proposed.[144]

Some commenters asserted that the rule should be more specific as to which public officials to whom a contribution is made would trigger application of the rule in order to reduce uncertainty and compliance burdens.[145] But state and municipal statutes vary substantially with respect to whom they entrust with the management of public

---

142 *Id.*

143 As such, executive officers or legislators whose official position gives them the authority to influence the hiring of an investment adviser generally would be "government officials" under the rule. For example, a state may have a pension fund whose board of directors, which has authority to hire an investment adviser, is constituted, at least in part, by appointees of the governor and members of the state legislature. *See, e.g.*, The Commonwealth of Pennsylvania Public School Employees' Retirement Board, *Statement of Organization, By-Laws and Other Procedures* (rev. Jun. 11, 2009), art. II, sec. 2.1, *available at* http://www.psers.state.pa.us/org/board/policies/201001_bylaws.pdf (noting that the board shall be composed of, *inter alia*, two persons appointed by the Pennsylvania State Governor, two Pennsylvania state senators and two members of the Pennsylvania state house of representatives). In such circumstances, the governor and the members of the state legislature serving on the board would be officials of the government entity. Conversely, a public official who is tasked with performing an audit of the selection process but has no influence over hiring outcomes would not be an official of a government entity for purposes of the rule.

144 These definitions and their application are substantively the same as those in MSRB rule G-37. *See* MSRB rule G-37(g)(ii) and (g)(vi).

145 *See, e.g.*, IAA Letter; NSCP Letter; Comment Letter of T. Rowe Price Associates, Inc. (Oct. 6, 2009) ("T. Rowe Letter"); MFA Letter; Davis Polk Letter. For a discussion of the potential costs involved in identifying officials to whom contributions could trigger the rule's prohibitions, see section IV of this Release (presenting our cost-benefit analysis). Another commenter suggested that advisers should be able to rely on certifications from candidates and officials regarding whether their office would render them an "official" for purposes of the rule—*i.e.*, identifying the range, if any, of public investment vehicles over which the relevant office directly or indirectly influences the selection of investment advisers or appoints individuals who do). Caplin & Drysdale Letter. We are concerned that such a safe harbor would undercut the purposes of the rule, not least because officials will be incentivized to offer such certifications liberally (and will presumably sometimes do so inappropriately) to encourage contributions.

funds, and any effort we make in a rule of general application to identify specific officials who are in a position to influence the selection of an adviser would certainly be over-inclusive in some circumstances and under-inclusive in others.[146] Others urged that triggering contributions should be limited to contributions to officials directly responsible for the selection of advisers.[147] Excluding from the application of the rule contributions to those who are in a position to *indirectly* influence the selection of an investment adviser could simply lead officials to re-structure their relationships to avoid application of the rule to advisers that may contribute to those officials.

Two commenters argued that the rule should not cover contributions to candidates for federal office,[148] while another contended that it should.[149] Under our rule, as proposed, a candidate for federal office could be an "official" under the rule not because of the office he or she is running for, but as a result of an office he or she currently holds.[150] So long as an official has influence over the hiring of investment advisers as a function of his or her current office, contributions by an adviser could have the same effect, regardless to which of the official's campaigns the adviser contributes. For that

---

146 Like us, the MSRB does not specify which officials have the authority to influence the granting of government business for purposes of its rule G-37. *See* MSRB, *Campaign for Federal Office*, MSRB Rule G-37 Interpretive Notice (May 31, 1995), *available at* http://msrb.org/msrb1/rules/interpg37.htm ("The Board does not make determinations concerning whether a particular individual meets the definition of "official of an issuer.").

147 *See, e.g.*, IAA Letter; NASP Letter; NY City Bar Letter; Davis Polk Letter.

148 *See, e.g.*, NSCP Letter; Dechert Letter.

149 Fund Democracy/Consumer Federation Letter.

150 As a result, if a state or municipal official were, for example, a candidate for the U.S. Senate, House of Representatives, or presidency, an adviser's contributions to that official would be covered by the rule. MSRB rule G-37's time out provision is also triggered by contributions to state and local officials running for federal office. *See* MSRB Rule G-37 Q&A, Questions IV.2-3.

reason, we are not persuaded that an incumbent state or local official should be excluded from the definition solely because he or she is running for federal office.[151]

(3) Contributions

The rule's time out provisions are triggered by *contributions* made by an adviser or any of its covered associates.[152] A contribution is defined to include a gift, subscription, loan, advance, deposit of money, or anything of value made for the purpose of influencing an election for a federal, state or local office, including any payments for debts incurred in such an election.[153] It also includes transition or inaugural expenses incurred by a successful candidate for state or local office.[154] The definition is the same as we proposed and as the one used in MSRB rule G-37.[155]

---

151 Under certain circumstances, a state or municipal official running for federal office could remove herself from being an "official" for purposes of rule 206(4)-5 by eliminating her ability to influence the outcome of the hiring of an investment adviser. This might occur, for example, if she were to: (i) formally withdraw from participation in or influencing adviser hiring decisions; (ii) be leaving office, so that he or she could not participate in subsequent decision-making; and (iii) have held direct influence over the adviser hiring process (as opposed to, for example, having designated an appointee with such influence who would remain in a position to influence such hiring).

152 Rule 206(4)-5(a)(1) makes it unlawful for covered investment advisers to provide investment advisory services for compensation to a government entity within two years after a *contribution* to an official of the government entity is made by the investment adviser or any of its covered associates. As suggested above, we are concerned that contributions may be used "as the cover for what is much like a bribe: a payment that accrues to the private advantage of the official and is intended to induce him to exercise his discretion in the donor's favor, potentially at the expense of the polity he serves." *Blount*, 61 F.3d at 942 (describing the Commission's approval of MSRB rule G-37 as based on a wish to curtail this function).

153 Rule 206(4)-5(f)(1).

154 MSRB rule G-37 also covers payment of transition or inaugural expenses as contributions for purposes of its time out provision. *See* MSRB Rule G-37 Q&A, Question II.6. However, under neither rule does a contribution include the transition or inaugural expenses of a successful candidate for *federal* office. Contributions to political parties are not specifically covered by the definition and thus would not trigger the rule's two-year time out unless they are a means to do indirectly what the rule prohibits if done directly (for example, the contributions are earmarked or known to be provided for the benefit of a particular political official). We also note that "contributions" are not intended to include independent "expenditures," as that term is defined in 2 U.S.C. 431 &

We received requests that we clarify the application of the rule to some common circumstances that may arise in the course of an adviser's relationship with a government client.[156] We would not consider a donation of time by an individual to be a contribution, provided the adviser has not solicited the individual's efforts and the adviser's resources, such as office space and telephones, are not used.[157] Similarly, we would not consider a charitable donation made by an investment adviser to an organization that qualifies for an exemption from federal taxation under the Internal Revenue Code,[158] or its equivalent in a foreign jurisdiction, at the request of an official of a government entity to be a contribution for purposes of rule 206(4)-5.[159]

441b (the federal statutory provisions limiting contributions and expenditures by national banks, corporations, or labor organizations invalidated by *Citizens United v. Federal Election Commission*, 130 S. Ct. 876 (2010) (holding that corporate funding of independent political broadcasts in candidate elections cannot be limited under the First Amendment)). Indeed, it is our intent that, under the rule, advisers and their covered associates "are not in any way restricted from engaging in the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events." *Blount*, 61 F.3d at 948.

155 MSRB rule G-37(g)(i).

156 *See, e.g.*, Caplin & Drysdale Letter; Callcott Letter I (volunteer activities); NASP Letter (charitable contributions); Sutherland Letter; IAA Letter (entertainment expenses and conference expenses). We address entertainment and conference expenses in section II.B.2(c) of this Release (which discusses the prohibition on soliciting or coordinating contributions from others).

157 *See* Proposing Release, at n.91. A covered associate's donation of his or her time generally would not be viewed as a contribution if such volunteering were to occur during non-work hours, if the covered associate were using vacation time, or if the adviser is not otherwise paying the employee's salary (*e.g.*, an unpaid leave of absence). *But see* rule 206(4)-5(d) (prohibiting an adviser from doing indirectly what the rule would prohibit if done directly). The MSRB deals similarly with this issue. *See* MSRB Rule G-37 Q&A, Question II.19.

158 Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. 501(c)(3)) contains a list of charitable organizations that are exempt from federal income taxation.

159 The MSRB deals similarly with this issue. *See* MSRB Rule G-37 Q&A, Question II.18. *But see* rule 206(4)-5(d) (prohibiting an adviser from doing indirectly what the rule would prohibit if done directly).

The few commenters that addressed the definition of "contribution" generally urged us to adopt a narrower version. Some, for example, recommended that contributions be expressly limited to political contributions and more explicitly exclude expenditures not clearly made for the purpose of influencing an election.[160] We are not narrowing our definition. We are instead adopting our definition as proposed due to our concern that "contributions" may also take the form of payment of election-related debts and transition or inaugural expenses. Further, our definition of "contribution" already requires that the payment be made for the purpose of influencing an election for a federal, state or local office.[161] We believe that the scope of our proposed definition is appropriate in light of the conduct we are seeking to address.

Commenters were divided as to whether contributions to PACs or local political parties should trigger the two-year time out.[162] Such contributions were not explicitly covered by the proposed rule and do not necessarily trigger the two-year time out in MSRB rule G-37.[163] In some cases, such contributions may effectively operate as a

---

160 *See, e.g.*, National Organizations Letter; NASP Letter.

161 Rule 206(4)-5(f)(1).

162 *See, e.g.*, CalPERS Letter; NSCP Letter (should not apply to contributions to PACs or state or local parties, unless a particular candidate directly solicits contributions for those entities); Comment Letter of James J. Reilly (Aug. 24, 2009) ("Reilly Letter") (contributions to political parties should be included because in state and local elections contributions to political parties may effectively amount to contributions to an individual candidate); SIFMA Letter.

163 *See, e.g.*, MSRB, *Payments to Non-Political Accounts of Political Organizations*, MSRB rule G-37 Interpretive Letter (Sept. 25, 2007), *available at* http://msrb.org/msrb1/rules/interpg37.htm (explaining that not all payments to political organizations that, in turn, make contributions to officials trigger Rule G-37's time out). With regard to solicitations from a PAC or a political party with no indication of how the collected funds will be disbursed, advisers should inquire how any funds received from the adviser or its covered associates would be used. For example, if the PAC or political party is soliciting funds for the purpose of supporting a limited number of government officials, then, depending upon the facts and circumstances, contributions to the PAC or payments to the political party might well result in the same prohibition on compensation

funnel to the campaigns of the government officials.[164] In other cases, however, they may fund general party political activities or the campaigns of other candidates.[165] Therefore, we have decided not to explicitly include all such contributions among those that trigger the time out, although they may violate the provision of the rule, discussed below, which prohibits an adviser or any of its covered persons from indirect actions that would result in a violation of the rule if done directly.[166]

The MSRB rule G-37 definition of "contribution" has, in our view, proved to be workable. The types of contributions relevant to money managers and elected officials are unlikely to be different than those made to influence the awarding of municipal securities business by broker-dealers. On balance, we believe that the MSRB's definition of "contribution," which we mirrored in our proposal, achieves the goals of this rulemaking. Therefore, we are adopting the definition as proposed.

(4) Covered Associates

Contributions made to influence the selection process are typically made not by the firm itself, but by officers and employees of the firm who have a direct economic stake in the business relationship with the government client.[167] Accordingly, under the

---

for providing investment advisory services to a government entity as would a contribution made directly to the official. Our approach is consistent with the MSRB's. *See* MSRB Rule G-37 Q&A, Question III.5.

164 *See, e.g.*, Reilly Letter.

165 *See, e.g.*, Caplin & Drysdale Letter (explaining that "leadership PACs," for example, are commonly established by officeholders to donate to other candidates and issues).

166 *See* section II.B.2(d) of this Release. For the MSRB's approach to this issue, see MSRB Rule G-37 Q&A, Question III.4. *But see* rule 206(4)-5(d) (noting that the rule's definition of "official" of a government entity includes any election committee for that person).

167 Proposing Release, at section II.A.3(a)(4). Based on enforcement actions, we believe that such persons are more likely to have an economic incentive to make contributions to influence the advisory firm's selection. *See id*.

rule, contributions by each of these persons, which the rule defines as "covered associates," trigger the two-year time out.[168] A "covered associate" of an investment adviser is defined as: (i) any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) any political action committee controlled by the investment adviser or by any of its covered associates.[169]

Owners. Contributions by sole proprietors are contributions by the adviser itself.[170] If the adviser is a partnership, the rule covers contributions by the adviser's general partners.[171] If the adviser is a limited liability company, the rule covers contributions made by managing members.[172] A contribution by an owner that is a limited partner or non-managing member (of a limited liability company) is not covered, however, unless the limited partner or non-managing member is also an executive officer or solicitor (or person who supervises a solicitor) covered by the rule, or unless the contribution is an indirect contribution by the adviser, executive officer, solicitor, or supervisor.[173] Similarly, if the adviser is a corporation, shareholder contributions are not covered unless the shareholder is also an executive officer or solicitor covered by the

---

168 Rule 206(4)-5(a)(1).

169 Rule 206(4)-5(f)(2).

170 We note, however, that a sole proprietor may, in a personal capacity, avail herself or himself of the *de minimis* exceptions described in section II.B.2(a)(6) of this Release.

171 Rule 206(4)-5(f)(2)(i).

172 *Id.*

173 *See* rule 206(4)-5(a)(1), (d) and (f)(2)(i)-(ii).

rule, or unless the contribution is an indirect contribution by the adviser, executive officer, solicitor, or supervisor.[174]

Executive Officers. Contributions by an executive officer of an investment adviser trigger the two-year time out.[175] Executive officers include: (i) the president; (ii) any vice president in charge of a principal business unit, division or function (such as sales, administration or finance); (iii) any other officer of the investment adviser who performs a policy-making function; or (iv) any other person who performs similar policy-making functions for the investment adviser.[176] Whether a person is an executive officer depends on his or her function, not title; for example, an officer who is the chief executive of an advisory firm but whose title does not include "president" is nonetheless an executive officer for purposes of the rule.

The definition reflects changes we have made from our proposal that are designed to clarify the rule and to tailor it to apply to those officers of an investment adviser whose position in the organization is more likely to incentivize them to obtain or retain clients for the investment adviser (and, therefore, to engage in pay to play practices) while still achieving our objectives. We have clarified that "other executive officers" under the rule—*i.e.*, those other than the president and vice presidents in charge of principal business units or functions—include only those officers or other persons who perform a policy-making function for the investment adviser.[177] This limitation, which was

---

174 *Id.*

175 The definition of "covered associate" includes, among others, any executive officer or other individual with a similar status or function. Rule 206(4)-5(f)(2)(i).

176 Rule 206(4)-5(f)(4).

177 Rule 206(4)-2(f)(4). This modification also aligns the definition more closely with the definition of "executive officer" in our other rules. *See, e.g.,* rule 205-3(d)(4) under the Advisers Act [17 CFR 275.205-3(d)(4)] (defining executive officer for purposes of

recommended by commenters,[178] excludes persons who enjoy certain titles as a formal matter but do not engage in the kinds of activities that we believe should trigger the prohibitions in the rule.[179] We have also modified the definition to remove the limitation that the officer, as part of his or her regular duties, performs or supervises any person who performs advisory services for the adviser, or solicits or supervises any person who solicits for the adviser. We agree with the commenter who asserted that ". . . all of the adviser's executive officers should be included because the nature of their status alone

---

determinations of who is a qualified client exempting an adviser from the prohibition on entering into, performing, renewing or extending an investment advisory contract that provides for compensation on the basis of a share of the capital gains upon, or the capital appreciation of, the funds, or any portion of the funds, under the Advisers Act) and rule 3c-5(a)(3) [17 CFR 270.3c-5(a)(3)] under the Investment Company Act of 1940 [15 U.S.C. 80a] ("Investment Company Act") (defining executive officer for purposes of determinations of the number of beneficial owners of a company excluded from the definition of "investment company" by section 3(c)(1) of the Investment Company Act, and whether the outstanding securities of a company excluded from the definition of "investment company" by section 3(c)(7) of the Investment Company Act are owned exclusively by qualified purchasers, as defined in that Act). It also more closely aligns the definition to the MSRB approach. *See* MSRB rule G-37(g)(v).

178 *See, e.g.*, Sutherland Letter.

179 Several commenters urged us expressly to exclude from the definition the CEO, officers and employees of a parent company. *See, e.g.*, SIFMA Letter; ICI Letter; MFA Letter; Skadden Letter. Depending on facts and circumstances, there may be instances in which a supervisor of an adviser's covered associate (who, for example, engages in solicitation of government entity clients for the adviser) formally resides at a parent company, but whose contributions should trigger the two-year time out because they raise the same conflict of interest issues that we are concerned about, irrespective of that person's location or title. In other words, whether a person is a covered associate ultimately depends on the activities of the individual and not his or her title. We recently considered a similar issue in a report addressing whether MSRB rule G-37 could include contributions by employees of parent companies as triggering that rule's time out provision, see *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: JP Morgan Securities, Inc.*, Exchange Act Release No. 61734 (Mar. 18, 2010), *available at* http://www.sec.gov/litigation/investreport/34-61734.htm ("This Report serves to remind the financial community that placing an executive who supervises the activities of a broker, dealer or municipal securities dealer outside of the corporate governance structure of such broker, dealer or municipal securities dealer does not prevent the application of MSRB Rule G-37 to that individual's conduct."). The MSRB also takes the view that it is an individual's activities and not his or her title that may render his or her contributions a trigger for that rule's time out provision. *See* MSRB Rule G-37 Q&A, Question IV.18.

creates a strong incentive to engage in pay to play practices."[180] Even if these senior officers are not directly involved in advisory or solicitation activities, as part of senior management, their success within the advisory firm is likely to be tied to the firm's success in obtaining clients.[181]

Employees who Solicit Government Clients. Contributions by any employee who solicits a government entity for the adviser would trigger the two-year time out.[182] An employee need not be primarily engaged in solicitation activities to be a "covered associate" under the rule.[183] We are also including persons who supervise employees who solicit government entities because we believe these persons are strongly incentivized to engage in pay to play activities to obtain government entity clients.[184] We

---

180 *See* Fund Democracy Letter.

181 Commenters also suggested that our definition exclude vice presidents in charge of business units, divisions or functions whose function is unrelated to investment advisory or solicitation activities. *See, e.g.*, IAA Letter. For the reasons described above, we do not believe such an exclusion is appropriate.

182 We are not adopting the suggestion of several commenters that we treat third-party solicitors the same way as employees. *See, e.g.*, 3PM Letter; Triton Pacific Letter; Comment Letter of Arrow Partners, Inc. Partner Ken Rogers (Sept. 2, 2009) ("Arrow Letter"). We explained in the Proposing Release that we determined not to propose this approach out of concern for the difficulties that advisers may have when monitoring the activities of their third-party solicitors. *See* Proposing Release, at nn.135 and accompanying text. Commenters did not persuade us that these concerns can reasonably be expected to be overcome. Therefore, whereas contributions by covered associates of the adviser trigger the two-year compensation time out, an adviser is prohibited from hiring third parties to solicit government business on its behalf unless the third party is a "regulated person." *See* section II.B.2(b) of this Release. Our approach is similar to MSRB's rule G-38, which restricts third-party solicitation activities differently from the two-year time out. *See* MSRB rule G-38.

183 The MSRB also takes the approach that an associated person need not be "primarily engaged" in activities that would make his or her contributions trigger rule G-37's time out provision, particularly where he or she engages in soliciting business. *See* MSRB Rule G-37 Q&A, Question IV.8.

184 Rule 206(4)-5(f)(2)(ii). The proposed rule would only have applied to *senior officers* who supervise employee solicitors. *See* proposed rule 206(4)-5(f)(4)(ii). MSRB rule G-37 also applies to supervisors of persons who solicit relevant business from government entities. *See* MSRB Rule G-37 Q&A, Question IV.14.

have revised this aspect of the definition to include *all* supervisors of those solicitors that solicit government entities because we believe the incentives to engage in pay to play exist for all such supervisors, not just those that have a certain level of seniority.

Rule 206(4)-5 defines "solicit" to mean, with respect to investment advisory services, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser.[185] Commenters asked us to provide further guidance on what we mean by "solicit."[186] The determination of whether a particular communication is a solicitation is dependent upon the specific facts and circumstances relating to such communication. As a general proposition any communication made under circumstances reasonably calculated to obtain or retain an advisory client would be considered a solicitation unless the circumstances otherwise indicate that the communication does not have the purpose of obtaining or retaining an advisory client. For example, if a government official asks an employee of an advisory firm whether the adviser has pension fund advisory capabilities, such employee generally would not be viewed as having solicited advisory business if he or she provides a limited affirmative response, together with either providing the government official with contact information for a covered associate of the adviser or informing the government official that advisory personnel who handle government advisory business will contact him or her. [187]

---

185 Rule 206(4)-5(f)(10)(i). We are adopting this definition as proposed.

186 *See, e.g.*, Skadden Letter.

187 Similarly, if a government official is discussing governmental asset management issues with an employee of an adviser, the employee generally would not be viewed as having solicited business if he or she provides a limited communication to the government official that such alternative may be appropriate, together with either providing the government official with contact information for a covered associate or informing the

Political Action Committees. A covered associate includes a political action committee controlled by the investment adviser or by any of its covered associates.[188] Under the rule, we would regard an adviser or its covered associate to have "control" over a political action committee if the adviser or its covered associate has the ability to direct or cause the direction of the governance or operations of the PAC.[189]

Two commenters asserted that we should narrow the definition of "covered associate" with respect to political action committees.[190] Specifically, they asserted that the definition should only include PACs controlled by the adviser and not those controlled by other covered associates, which could be a separate legal entity over which

---

government official that advisory personnel who handle asset management for government clients will contact him or her. In these examples, however, if the adviser's employee receives compensation such as a finder's or referral fee for such business or if the employee engages in other activities that could be deemed a solicitation with respect to such business, the employee generally would be viewed as having solicited the advisory business. Our interpretation of what it means to "solicit" government business is consistent with the MSRB's. *See* MSRB, *Interpretive Notice on the Definition of Solicitation under Rules G-37 and G-38* (June 8, 2006), *available at* http://msrb.org/msrb1/rules/notg38.htm.

188 Rule 206(4)-5(f)(2)(iii) (which we are adopting as proposed). One commenter suggested that we define a "political action committee," or PAC, as any organization required to register as a political committee under federal, state or local law. Caplin & Drysdale Letter. But we have not included this definition of PAC because we do not believe a definition linked to the registration status of a political committee would serve our purpose of deterring evasion of the rule as registration requirements vary among election laws. We note, however, that we would construe the term PAC to include (but not necessarily be limited to) those political committees generally referred to as PACs, such as separate segregated funds or non-connected committees within the meaning of the Federal Election Campaign Act, or any state or local law equivalent. *See* Federal Election Commission, Quick Answers to PAC Questions, *available at* http://www.fec.gov/ans/answers_pac.shtml#pac. Determination of whether an entity is a PAC covered by our rule would not, in our view, turn on whether the PAC was, or was required to be, registered under relevant law.

189 One commenter suggested a similar interpretation of "control." Caplin & Drysdale Letter. For the MSRB's approach to this definition, see MSRB Rule G-37 Q&A, Question IV.24.

190 SIFMA Letter; Sutherland Letter.

the adviser may have little influence.[191] We are not adopting this suggestion. As we discussed in the Proposing Release, PACs are often used to make political contributions.[192] The recommended changes would permit an executive of the adviser or another covered person of the adviser to use a PAC he or she controls to evade the rule. Even where the adviser itself does not control such PACs directly, we are concerned about their use to evade our rule where they are controlled by covered associates (whose positions in the organization, as we note above, are more likely to incentivize them to obtain or retain clients for the investment adviser).[193]

Other Persons. Several commenters urged that our definitions be broadened to encompass other persons whose contributions should trigger the two-year time out.[194] One urged that in some cases all employees should be covered associates because of the likelihood they could directly benefit from engaging in pay to play.[195] Another urged that the definition of covered associate include affiliates of the adviser that solicit government business on the adviser's behalf, any director of the adviser, and any significant owner of the adviser.[196] These suggestions would expand the rule to a range of persons that could

---

191 *Id.*

192 Proposing Release, at n.101.

193 Advisers are responsible for supervising their supervised persons, including their covered associates. We have the authority to seek sanctions where an investment adviser, or an associated person, has failed reasonably to supervise, with a view to preventing violations of the federal securities laws or rules, a person who is subject to the adviser's (or its associated person's) supervision and who commits such violations. Sections 203(e)(6) and 203(f) of the Advisers Act [15 U.S.C. 80b-3(e)(6) and (f)].

194 *See, e.g.,* Fund Democracy/Consumer Federation Letter; DiNapoli Letter (suggesting the rule also cover contributions from family members); Ounavarra Letter.

195 Ounavarra Letter.

196 Fund Democracy/Consumer Federation Letter.

engage in pay to play activities.[197] In our judgment, however, contributions from these types of persons are less likely to involve pay to play unless the contributions were made by these persons for the purpose of avoiding application of the rule, which could result in the adviser's violation of a separate provision of the rule.[198] We do not believe that the incremental benefits of capturing conduct of other individuals less likely to engage in pay to play based on the record before us today outweigh the additional burden such an expansion would impose.[199] Thus, we are not expanding the definition as these commenters have suggested.

Other commenters urged us to narrow our definition of "covered associate" to include fewer persons.[200] For example, one commenter recommended that the definition of "covered associate" expressly exclude all "support personnel."[201] Another suggested that we limit the definition to those who solicit government clients with a "major purpose" of obtaining that government client.[202] Expressly excluding all "support personnel" is unnecessary because, in almost all cases, such persons would not be

---

197 *See, e.g.*, *supra* note 179 (discussing why we have chosen not to limit the definition of "executive officer" in other ways as suggested by some commenters).

198 *See* Rule 206(4)-5(d). We also note that the MSRB takes a similar approach. *See, e.g.*, MSRB Rule G-37 Q&A, Question IV.9 (noting that the universe of those whose contributions above the *de minimis* level *per se* trigger the two-year time out is limited and does not include their consultants, lawyers or spouses). The MSRB also leaves contributions by affiliates and personnel beyond those identified as triggering the two-year time out to be addressed by a provision prohibiting municipal securities dealers from doing indirectly what they are prohibited from doing directly under rule G-37. *See* MSRB Rule G-37(d).

199 In this instance, as in others, we are sensitive to First Amendment concerns that further expansion of the scope of covered associates could broaden the rule's scope beyond what is necessary to accomplish its purposes.

200 *See, e.g.*, T. Rowe Price Letter; NSCP Letter; Skadden Letter.

201 T. Rowe Price Letter.

202 Skadden Letter.

"covered associates," as that term is defined in the rule. We have not limited the definition to those who solicit government clients with a "major purpose" of obtaining that government client because we believe that our rule's definition of "solicit," as discussed above, adequately takes into account the purpose of the communication and adding an additional element of intent may exclude employees who have an incentive to engage in pay to play practices.

(5) "Look Back"

The rule attributes to an adviser contributions made by a person within two years (or, in some cases, six months) of becoming a covered associate of that adviser.[203] In other words, when an employee becomes a covered associate, the adviser must "look back" in time to that employee's contributions to determine whether the time out applies to the adviser.[204] If, for example, the contribution were made more than two years (or, pursuant to the exception described below for non-solicitors, six months) prior to the employee becoming a covered associate, the time out has run; if the contribution was made less than two years (or six months) from the time the person becomes a covered associate, the rule prohibits the adviser that hires or promotes the contributing covered associate from receiving compensation for providing advisory services from the hiring or

---

203 Rule 206(4)-5(a)(1). The "look back" applies to any person who becomes a covered associate, including a current employee who has been transferred or promoted to a position covered by the rule. A person becomes a covered associate for purposes of the rule's look-back provision at the time he or she is hired or promoted to a position that meets the definition of "covered associate" in rule 206(4)-5(f)(2). For a discussion of the definition of "covered associate," see section II.B.2(a)(4) of this Release.

204 Rule 206(4)-5(a)(1) (including among those covered associates whose contributions can trigger the two-year time out a person who becomes a covered associate within two years after the contribution is made); Rule 206(4)-5(b)(2) (excepting from the two-year look back those contributions made by a natural person more than six months prior to becoming a covered associate of the investment adviser unless such person, after becoming a covered associate, solicits clients on behalf of the investment adviser).

promotion date until the two-year period has run.[205] The look-back provision, which is similar to that in MSRB rule G-37, is designed to prevent advisers from circumventing the rule by influencing the selection process by hiring persons who have made political contributions.[206]

We received many comments on our proposed look-back provision,[207] which would have applied the two-year look back with respect to all contributions of new covered associates.[208] One commenter asserted that such a provision is necessary to prevent advisers from circumventing the prohibitions on pay to play.[209] Most commenters, however, argued that the rule should not contain a look-back provision or should contain a shorter one because it could prevent advisers from hiring qualified

---

205 In no case would the prohibition imposed by the rule be longer than two years from the date the covered associate makes a covered contribution. If, for example, a covered associate becomes employed by an investment adviser (and engages in solicitation activity for it) one year and six months after making a contribution, the new employer would be subject to the proposed rule's prohibition for the remaining six months of the two-year period. We also note that the rule's exemptive process may be available in instances where an adviser believes application of the look-back provision would yield an unintended result. Rule 206(4)-5(e). For a discussion of the rule's exemptive provision, see section II.B.2(f) of this Release.

206 Similarly, to prevent advisers from channeling contributions through departing employees, advisers must "look forward" with respect to covered associates who cease to qualify as covered associates or leave the firm. The covered associate's employer at the time of the contribution would be subject to the proposed rule's prohibition for the entire two-year period, regardless of whether the covered associate remains a covered associate or remains employed by the adviser. Thus, dismissing a covered associate would not relieve the adviser from the two-year time out. MSRB rule G-37 also includes a "look-forward provision." *See* MSRB Rule G-37 Q&A, Question IV.17 (". . . any contributions by [an] associated person [who leaves the dealer's employ] (other than those that qualify for the *de minimis* exception under Rule G-37(b)) will subject the dealer to the rule's ban on municipal securities business for two years from the date of the contribution").

207 *See, e.g.*, Fund Democracy/Consumer Federation Letter; ICI Letter; Davis Polk Letter; NY City Bar Letter; Fidelity Letter; Wells Fargo Letter; MFA Letter; IAA Letter; NASP Letter; American Bankers Letter; Comment Letter of Seward & Kissel LLP (Oct. 6. 2009) ("Seward & Kissel Letter"); Park Hill Letter; Dechert Letter; Skadden Letter.

208 *See* Proposing Release, at section II.A.3(a)(5).

209 Fund Democracy/Consumer Federation Letter.

individuals who have made unrelated political contributions,[210] or it could be disruptive to public pension plans seeking to hire qualified managers.[211] While some urged that we eliminate the look-back provision altogether,[212] most asked us to shorten the period to three to six months.[213] Others suggested alternative approaches to the look back, including adopting a higher contribution threshold to trigger the look-back provision[214] or permitting advisers to hire and promote persons to be covered associates who have made prohibited contributions, but not permitting them to solicit government clients or otherwise create firewalls between them and government clients.[215]

Upon consideration of the comments, we believe that applying the full two-year look back to all new covered associates may be unnecessary to achieve the goals of the rulemaking. We are adopting a suggestion offered by several commenters to shorten the look-back period with respect to certain new covered associates whose contributions are less likely to be involved in pay to play.[216] Under an exception to the rule, the two-year

---

210 *See, e.g.*, ICI Letter; Davis Polk Letter; NY City Bar Letter; Fidelity Letter; Wells Fargo Letter; MFA Letter.

211 *See, e.g.*, Comment Letter of Connecticut Treasurer Denise L. Nappier (Sept. 10, 2009) ("CT Treasurer Letter"); CalPERS Letter.

212 *See, e.g.*, IAA Letter; ICI Letter; Wells Fargo Letter; NASP Letter; American Bankers Letter; MFA Letter; Seward & Kissel Letter.

213 *See, e.g.*, ICI Letter (three-month look back); IAA Letter (six-month look back); Park Hill Letter (six-month look back); Wells Fargo Letter (six-month look back); Davis Polk Letter (six-month look back); Dechert Letter (six-month look back); MFA Letter (six-month look back).

214 *See, e.g.*, Wells Fargo Letter; NSCP Letter.

215 *See, e.g.*, Comment Letter of Strategic Capital Partners (Oct. 1, 2009) ("Strategic Capital Letter"); Comment Letter of B. Jack Miller (Oct. 3, 2009); Comment Letter of RP Realty Partners, LLC Chief Financial Officer Jerry Gold (Oct. 2, 2009); SIFMA Letter.

216 *See, e.g.*, MFA Letter; Fidelity Letter; Dechert Letter; Wells Fargo Letter; Skadden Letter. The MSRB shortened the look-back period under MSRB rule G-37 to six months for certain municipal finance professionals in response to similar industry concerns about the impact on hiring. *See* MSRB, *Amendments Filed to Rule G-37 Concerning the*

time out is not triggered by a contribution made by a natural person more than six months prior to becoming a covered associate, unless he or she, after becoming a covered associate, solicits clients.[217] As a result, the two-year look back applies only to covered associates who solicit for the investment adviser.[218]

The potential link between obtaining advisory business and contributions made by an individual prior to his or her becoming a covered associate that is uninvolved in solicitation activities is likely more attenuated and therefore, in our judgment, should be subject to a shorter look back. We have modeled this shortened look-back period[219] on the MSRB's six-month look back for certain personnel, which it implemented as a result of feedback it received from dealers that indicated the two-year look back was negatively affecting in-firm transfers and promotions and "preclud[ing] them from hiring individuals

---

Exemption Process and the Definition of Municipal Finance Professional (Sept. 26, 2002), *available at* http://www.msrb.org/msrb1/archive/g%2D37902notice.htm.

217 Rule 206(4)-5(b)(2). An adviser is subject to the two-year time out regardless of whether it is "aware" of the political contributions. Thus, statements by prospective employees regarding whether they have made relevant contributions are insufficient to inoculate the adviser, as some commenters urged (*see, e.g.*, IAA Letter; ICI Letter; NSCP Letter; Caplin & Drysdale Letter), to ensure that investment advisers are not encouraged to relax their efforts to promote compliance with the rule's prohibitions. Nonetheless, advisers who advise or are considering advising any government entity should consider requiring full disclosure of any relevant political contributions from covered associates or potential covered associates to ensure compliance with rule 206(4)-5. Advisers are required to request similar reports about securities holdings by Advisers Act rule 204A-1(b)(1)(ii) [17 CFR 275.204A-1(b)(1)(ii)], which requires each of a firm's "access persons" to submit an initial "holdings report" of securities he or she beneficially owns at the time he or she becomes an access person, even though the securities would likely have been acquired in transactions prior to becoming an access person. For a discussion of an adviser's recordkeeping obligations with regard to records of contributions by a new covered associate during that new covered associate's look-back period, see *infra* note 428.

218 *See* rule 206(4)-5(f)(2) (defining covered associate of an investment adviser as: (i) any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee).

219 *See* rule 206(4)-5(b)(2).

who had made contributions, even though the contributions (which may have been relatively small) were made at a time when the individuals had no reason to be familiar with Rule G-37."[220] This approach balances commenters' concerns about the implications for their hiring decisions with the need to protect against individuals marketing to prospective investment adviser employers their connections to, or influence over, government entities those advisers might be seeking as clients.[221]

(6) Exceptions for De Minimis Contributions

Rule 206(4)-5 permits individuals to make aggregate contributions without triggering the two-year time out of up to $350, per election, to an elected official or candidate for whom the individual is entitled to vote,[222] and up to $150, per election, to

---

220 MSRB, *Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Amendments to Rules G-37, on Political Contributions and Prohibitions on Municipal Securities Business, G-8, on Books and Records, Revisions to Form G-37/G-38 and the Withdrawal of Certain Rule G-37 Questions and Answers*, Exchange Act Release No. 47609 (April 1, 2003) [67 FR 17122 (Apr. 8, 2003)]. *See also* MSRB, *Self-Regulatory Organizations; Order Granting Approval of a Proposed Rule Change and Amendment No. 1 Thereto by the Municipal Securities Rulemaking Board Relating to Amendments to Rules G-37, on Political Contributions and Prohibitions on Municipal Securities Business, G-8, on Books and Records, Revisions to Form G-37/G-38 and the Withdrawal of Certain Rule G-37 Questions and Answers*, Exchange Act Release No. 47814 (May 8, 2003) [68 FR 25917 (May 14, 2003)] (Commission order approving amendments to MSRB rule G-37); MSRB rule G-37(b)(iii).

221 We are not adopting the suggestion of commenters to exclude from the look-back provision contributions made before a merger or acquisition by an adviser by not attributing the contributions of the acquired adviser to the acquiring adviser. *See, e.g.*, Dechert Letter; ICI Letter. We believe that an acquisition of another adviser could raise identical concerns where the acquired adviser has made political contributions designed to benefit the acquiring adviser. Rule 206(4)-5 is not intended to prevent mergers in the investment advisory industry or, once a merger is consummated, to hinder the surviving adviser's government advisory business unless the merger was an attempt to circumvent rule 206(4)-5. Thus, the adviser may wish to seek an exemption from the ban on receiving compensation pursuant to rule 206(4)-5(a) from the Commission. The MSRB takes the same approach to this issue. *See* MSRB Rule G-37 Q&A, Question II.16.

222 For purposes of rule 206(4)-5, a person would be "entitled to vote" for an official if the person's principal residence is in the locality in which the official seeks election. For example, if a government official is a state governor running for re-election, any covered

an elected official or candidate for whom the individual is not entitled to vote.[223] These *de minimis* exceptions are available only for contributions by individual covered associates, not the investment adviser itself.[224] Under both exceptions, primary and general elections would be considered separate elections.[225]

We proposed a $250 *de minimis* exception for contributions to candidates for whom a covered associate is entitled to vote,[226] which reflects the current *de minimis* exception in MSRB rule G-37.[227] Many commenters urged us to increase the *de minimis* amount (either to a larger number or by indexing it to inflation), arguing that a

---

associate of an adviser who resides in that state may make a *de minimis* contribution to the official without causing a ban on that adviser being compensated for providing advisory services for that government entity. In the example of a government official running for President, any covered associate in the country can contribute the *de minimis* amount to the official's Presidential campaign. The MSRB has issued a similar interpretation of what it means to be "entitled to vote" for purposes of MSRB rule G-37. *See MSRB Reports*, Vol. 16. No. 1 (January 1996) at 31-34.

223 *See* Rule 206(4)-5(b)(1) (excepting "*de minimis*" contributions to "officials" (*see supra* note 139 and accompanying text) from the rule's two-year time out provision).

224 *Id.* Under the rule, each covered associate, taken separately, would be subject to the *de minimis* exceptions. In other words, the limit applies per covered associate and is not an aggregate limit for all of an adviser's covered associates. *But see supra* note 170 (pointing out that a sole proprietor may, in a personal capacity, avail herself or himself of the *de minimis* exceptions even though his or her contributions are otherwise considered contributions of the adviser itself).

225 Accordingly, a covered person of an investment adviser could, without triggering the prohibitions of the rule, contribute up to the limit in both the primary election campaign and the general election campaign of each official for whom the person making the contribution would be entitled to vote. The MSRB takes the same approach of excepting from rule G-37's time out trigger contributions up to the rule's *de minimis* amount for *each* election (including a primary and general election). *See* MSRB Rule G-37 Q&A, Question II.8. *See also In the Matter of Pryor, McClendon, Counts & Co., Inc., et al.*, Exchange Act Release No. 48095 (June 26, 2003) (noting that contributions must be limited to MSRB rule G-37's *de minimis* amount *before* the primary, with the same *de minimis* amount allowed *after* the primary for the general election).

226 *See* Proposing Release, at section II.A.3(a)(6).

227 *See* MSRB rule G-37(b)(i).