

The logo for HedgeOp Compliance, featuring a blue swoosh that curves over the text "HEDGEOP COMPLIANCE".

HEDGEOP COMPLIANCE

The 2010 Excellence in Compliance Seminar Series
Topic: New Advisers Act “Pay to Play” Rule
Rule 206(4)-5

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Agenda

- Introduction to HedgeOp
- What is covered by the new Advisers Act Rule 206(4)-5?
 - Prohibitions
 - Application to Pooled Investment Vehicles
 - What Public Officials and Political Candidates Are Covered?
 - What Government Entities are Covered by the Rule?
 - What is Considered a Contribution?
 - De Minimis Exceptions
- Who is a Covered Associate?
- Look Back Provision on Contributions by Covered Associates
- What are the record keeping requirements related to the new Rule?
- What practical procedures are firms employing to address Advisers Act Rule 206(4)-5?
- When is the new Rule effective?
- ² Q&A

Introduction to HedgeOp

- HedgeOp was founded in 2001.
- HedgeOp provides ongoing, pro-active compliance support of varying levels to about 40 different investment advisers with over \$75B in AUM.
- HedgeOp also provides project-based compliance support services and due diligence research and reporting services.
- HedgeOp offers a patented compliance workflow, monitoring and reporting software application – ComplianceTrak (which includes a platform for electronic filing, and automated review, of personal securities transactions)
- HedgeOp has a staff of 40 professionals working in offices in NYC and Boston.

Advisers Act Rule 206(4)-5 - Prohibitions

- ***BIG ISSUE/POSSIBLE 2 YEAR BAN ON COMPENSATION*** -- Rule makes it unlawful for an adviser to receive compensation for providing advisory services to a government entity for a 2 year period after the adviser or any of its “covered associates” makes a political contribution to a public official of a government entity or candidate for such office who is or will be in a position to influence the award of advisory business
 - NOTE – Rule has a provision that advisers and covered associates cannot indirectly violate the prohibitions of the Rule (e.g., by flowing contributions through other entities). Rule does not prohibit general contributions to PACs or political parties (as opposed to individual officials or candidates) – but cannot do so in order to circumvent the Rule.

Advisers Act Rule 206(4)-5 - Prohibitions

- Rule prohibits advisers paying third parties to solicit government entities for advisory business unless such third parties are “regulated persons”:
 - SEC-registered broker-dealers that are members of registered national securities association that has a pay to play rule
 - SEC-registered investment advisers that are subject to Advisers Act Rule 206(4)-5
 - NOTE – such an RIA will also be deemed a supervised person of the paying firm.

Advisers Act Rule 206(4)-5 - Prohibitions

- Rule makes it unlawful for an adviser (or any of its covered associates) to solicit any person or political action committee to make or to coordinate: (a) contributions to an official of a government entity to which the investment adviser is seeking to provide investment advisory services; or (b) payments to a political party of a state or locality where the investment adviser is providing or seeking to provide investment advisory services to a government entity.
 - *The coordination of contributions or payments is known as “bundling”*

Advisers Act Rule 206(4)-5 – Application to Pooled Investment Vehicles

- Rule provides that investment advisers to “covered investment pools” in which a government entity invests or is solicited to invest will be treated as if the advisers were providing or seeking to provide investment advisory services directly to the government entity.
 - “Covered investment pools” include registered investment companies that are an investment option of a government entity’s plan or program, and unregistered 3(c)(1), 3(c)(7) or 3(c)(11) investment vehicles such as hedge funds, private equity funds, venture capital funds and collective investment trusts.

Adviser Act Rule 206(4)-5 – What Public Officials and/or Candidates are Covered by the Prohibitions?

- An “official” includes any person (including any election committee for the person) who was, at the time of the contribution, 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 the investment adviser.
 - Includes the legal authority to hire AND appointment authority that can influence the hiring.
 - NOTE – “OFFICIAL” COULD INCLUDE CANDIDATES FOR FEDERAL OFFICE IF THE CANDIDATE PRESENTLY HOLDS STATE OR LOCAL OFFICE (IF THEY HAVE DIRECT OR INDIRECT CONTROL OR INFLUENCE IN HIRING OF AN INVESTMENT ADVISER).

Adviser Act Rule 206(4)-5 – What Government Entities are Covered by the Prohibitions?

- “Government entities” include all state and local governments, their agencies, authorities and instrumentalities, all state general funds, public pension plans and other collective government funds, including participant-directed plans such as 403(b), 414(j), 457 and 529 plans, and officers, agents or employees of the state or local government, agency, authority or instrumentality, acting in their official capacity
 - ONLY APPLICABLE TO STATE AND LOCAL GOVERNMENTS AND AGENCIES – NOT FEDERAL GOVERNMENT OR FEDERAL AGENCIES

Advisers Act Rule 206(4)-5 – What is Considered a Contribution?

- A “contribution” includes 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 payment for debts incurred in an election
- Also includes transition or inaugural expenses incurred by a successful candidate for state or local office (NOT FEDERAL)
- DOES NOT include the donation of time by an individual covered associate, provided that the adviser has not solicited the individual’s efforts AND the adviser’s resources (such as office space and telephones) are NOT used

Advisers Act Rule 206(4)-5 – De Minimis Exceptions

- 2 year “time out” on receiving advisory compensation is NOT triggered for contributions of:
 - \$350 (in the aggregate) per election to an elected official or candidate IF THE INDIVIDUAL MAKING THE CONTRIBUTION IS ENTITLED TO VOTE IN THE ELECTION
 - No Circumvention: e.g., not allowed to make 4 separate \$100 contributions to one official or candidate in one election
 - \$150 (in the aggregate) per election to an elected official or candidate IF THE INDIVIDUAL MAKING THE CONTRIBUTION IS NOT ENTITLED TO VOTE IN THE ELECTION
 - DE MINIMIS EXCEPTIONS ARE ONLY AVAILABLE FOR INDIVIDUAL COVERED ASSOCIATES – NOT THE INVESTMENT ADVISER

Advisers Act Rule 206(4)-5 – Definition of Covered Associate

- “Covered Associates” of an investment adviser are:
 - Any GP, managing member or executive officer, or other individual with a similar status or function;
 - Any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and
 - Any political action committee controlled by the investment adviser or by any of its covered associates.

Advisers Act Rule 206(4)-5 – Look Back Provision

- IMPORTANT NOTE – Rule attributes to an adviser any contributions made by a covered associate:
 - Within 6 months of becoming a covered associate of the adviser in the case of any covered associate not performing any solicitation of clients on behalf of the adviser (regardless of whether covered associate was an employee during that 6 month period); or
 - Within 2 years of becoming a covered associate with respect to covered associates that solicit clients on behalf of the advisers (regardless of whether the covered associate was an employee during that 2 year period).

Advisers Act Rule 206(4)-5 – Recordkeeping Requirements

- As part of the adoption of Rule 206(4)-5, the Advisers Act Recordkeeping Rule (Rule 204-2) was amended to require SEC-registered investment advisers which have government entity clients or government entity investors in any covered investment pool to which the investment adviser provides or has provided investment advisory services, to keep the following:
 - The names, titles, and business and residence addresses of all covered associates of the investment adviser
 - A list of all government entities to which the investment adviser provides or has provided investment advisory services, or which are or were investors in any covered investment pool to which the adviser provides or has provided investment advisory services (as applicable) over the past 5 years;
 - NOT prior to effective date of the Rule

Advisers Act Rule 206(4)-5 – Recordkeeping Requirements

- All direct or indirect contributions made by the investment adviser or any of its covered associates to an official of a government entity, or payments to a political party of a state or political subdivision thereof, or to a political action committee;
 - Does not include contributions to federal officials or candidates unless they presently hold state or local office
- Regardless of whether the adviser currently has any governmental clients, must maintain a list of the names and business addresses of each regulated person to whom the investment adviser provides or agrees to provide, directly or indirectly, payment to solicit a government entity for investment advisory services on its behalf.

Advisers Act Rule 206(4)-5 – Practical Procedures to Address

- What Are We Seeing?
 - Pre-Clearance Requirement Procedure
 - Either:
 - ALL political contributions
 - Political contributions in excess of \$350 or \$150 (as applicable)
 - Reporting Requirement Procedure
 - Reporting form for new employees that are covered associates
 - Including those under the De Minimis Exceptions and contributions and payments to PACs and political parties
 - Use of reporting tools:
 - HedgeOp will have relevant electronic pre-clearance and reporting tools available in Compliance ELF by March 1, 2011

Advisers Act Rule 206(4)-5 – Effective Date

- March 14, 2011
 - Except:
 - As of September 13, 2011 – investment advisers may no longer use third parties to solicit government business unless in accordance with the Rule.
 - As of September 13, 2011 – investment advisers to registered investment companies that are covered investment_pools must comply with the Rule and with the recordkeeping rule with respect to such registered investment companies.

Questions & Answers

Thank you for your interest.

If you would like to see a demo of ComplianceTrak or ELF or have any further questions, please email us at: info@hedgeop.com.

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