Chapman and Cutler LLP

Chapman Client Alert

August 31, 2016 Current Issues Relevant to Our Clients

SEC Approves New FINRA "Pay-to-Play" Rules

The Securities and Exchange Commission (*"SEC"*) recently approved new Financial Industry Regulatory Authority, Inc. (*"FINRA"*) pay-to-play rules to regulate activities of FINRA member firms that engage in distribution or solicitation activities with government entities on behalf of investment advisers. The rules were adopted as last proposed by FINRA in December 2015. FINRA's initial proposal is described in our Client Alert available here and the revised December 2015 proposal is described in our Client Alert available here. The SEC order approving the rules, as proposed, is available here.

Why is FINRA Adopting Pay-to-Play Rules?

In July 2010 the SEC adopted Rule 206(4)-5 under the Investment Advisers Act of 1940 (the *"Advisers Act"*) addressing pay-to-play practices by investment advisers. The Advisers Act rule generally prohibits an investment adviser from providing advisory services for compensation to a government entity for two years after the adviser or any of its covered associates make a contribution to an official of the entity absent an available exemption. The Advisers Act rule also prohibits advisers from providing direct or indirect payments to any person who solicits a government entity for investment advisory services on behalf of an adviser unless the soliciting person is a "regulated person." FINRA member firms are included in the definition of "regulated person" as long as (1) FINRA rules exist that prohibit member firms from engaging in distribution or solicitation activities if political contributions have been made by the member firm (or its covered associates) to officials of a government entity to which the member firm directs its distribution or solicitation activities and (2) the SEC finds such rules to impose equivalent or more stringent restrictions on member firms than the Advisers Act rule. Current FINRA rules do not include a pay-to-play prohibition that meets this requirement. As a result, FINRA needed to adopt its own rule to enable member firms to continue to engage in government entity solicitation activities in order for investment advisers to rely on the Advisers Act rule.

What's Next?

In addition to approving the FINRA rules as proposed, the SEC also indicated that it will issue orders finding that the new FINRA and Municipal Securities Rulemaking Board (*"MSRB"*) pay-to-play rules impose "substantially equivalent or more stringent restrictions" than the SEC's as required by Advisers Act Rule 206(4)-5. We will provide another Client Alert detailing the final rules and applicable compliance dates once FINRA publishes an effective date by which member firms should modify their compliance programs to align with the rules. FINRA has noted that the rules' prohibitions would not be trigged by contributions made prior to the effective date, although the Advisers Act rule would apply to any member firm which is an investment adviser covered under that rule. Firms should review existing policies and practices relating to distribution and solicitation activities with government entities on behalf of investment advisers in light of the new FINRA rules.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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