HEDGE FUND ALERT

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AUGUST 1999

SEC PROPOSES NEW RULE TO CURB "PAY TO PLAY" POLITICAL CONTRIBUTION PRACTICES BY REGISTERED AND UNREGISTERED INVESTMENT ADVISERS

The Securities and Exchange Commission (SEC) has proposed the adoption of a new rule designed to curb "pay to practices by investment advisers. The term "pay to play" in this context refers to the practice of making political contributions to government officials with the expectation of influencing the award of investment advisory contracts to manage government employee benefit plans or other government accounts.

The new rule would prohibit an investment adviser from providing investment advisory services for compensation to any state or local government entity (including a benefit plan for state or local employees) for two years after the adviser, or any of its partners, executive officers or solicitors, makes a contribution to any state treasurer, comptroller or other elected official who can influence the selection of an adviser to provide investment advisory services to the government entity. The proposed rule would also apply to contributions to candidates for these positions. The rule covers not only direct contributions but also solicitation activities, contributions made through political action committees, contributions made through "gatekeepers" and other forms of indirect attempts to arrange for third party contributions that the adviser and its principals would be prohibited by the rule from making directly.

The proposed rule would apply not only to registered advisers but to *all* investment advisers, other than certain small advisers. For example, any adviser that manages more than $25 million of client accounts, but that is exempt from SEC registration because it has fewer than 15 clients, would be subject to the new rule. In addition, the proposed rule explicitly provides that an adviser to a hedge fund or other "private investment company" is considered to be providing "investment advisory services" to any government entity that is an investor in the private investment company.

The proposed rule includes a *de minimis* exception for contributions of not more than $250 per candidate, per election, but only if the contribution is made by a person eligible to vote for the candidate.

In addition to the substantive prohibitions, the SEC proposals also include related record-keeping requirements. These would be applicable only to SEC-registered advisers.

The proposed rule, which was announced on August 4, 1999, is described in detail in a release published by the SEC on August 10, 1999. The deadline for comments on the proposal is November 1, 1999. The SEC release (Release No. IA-1812) has been posted, and any electronically submitted comment letters will be posted, on the SEC's Internet web site (http://www.sec.gov).

IF YOU HAVE ANY QUESTIONS CONCERNING THIS RULE PROPOSAL OR WOULD LIKE MORE INFORMATION ON OUR INVESTMENT MANAGEMENT PRACTICE, PLEASE CONTACT:

DAVID M. BILLINGS
PHONE: (212) 872-8030
E-MAIL: DBILLINGS@AKINGUMP.COM

CATHERINE M. DONOVAN
PHONE: (212) 872-1033
E-MAIL: CDONOVAN@AKINGUMP.COM

ELIOT D. RAFFKIND
PHONE: (214) 969-4667
E-MAIL: ERAFFKIND@AKINGUMP.COM

EDWARD D. SOPHER
PHONE: (212) 872-1026
E-MAIL: ESOPHER@AKINGUMP.COM

STEPHEN M. VINE
PHONE: (212) 872-1030
E-MAIL: SVINE@AKINGUMP.COM

AKIN, GUMP, STRAUSS, HAUER & FELD, L.L.P.
ATTORNEYS AT LAW

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