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July 28, 2010

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Political Contributions by Certain Investment Advisers*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission), entitled "Political Contributions by Certain Investment Advisers" (RIN: 3235-AK39). We received the rule on July 1, 2010. It was published in the *Federal Register* as a final rule on July 14, 2010. 75 Fed. Reg. 41,018. The rule is effective on September 13, 2010.

The final rule and rule amendments address "pay to play" practices in investment advising. Specifically, the final rule prohibits an investment adviser from providing advisory services for compensation to a government client for 2 years after the adviser or certain of its executives or employees make a contribution to certain elected officials or candidates. The rule also prohibits an adviser from providing or agreeing to provide, directly or indirectly, payment to any third party for a solicitation of advisory business from any government entity on behalf of such adviser, unless such third parties are registered broker-dealers or registered investment advisers. In addition, the rule prevents an adviser from soliciting from others, or coordinating, contributions to certain elected officials or candidates or payments to political parties where the adviser is providing or seeking government business. The Commission is also adopting rule amendments that require a

registered adviser to maintain certain records of the political contributions made by the adviser or certain of its executives or employees.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review of the procedural steps taken indicates that the Commission complied with the applicable requirements.

If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer
Managing Associate General Counsel

Enclosure

cc: Florence E. Harmon
Deputy Secretary
Securities and Exchange Commission

ENCLOSURE

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
"POLITICAL CONTRIBUTIONS BY
CERTAIN INVESTMENT ADVISERS"
(RIN: 3235-AK39)

(i) Cost-benefit analysis

The Commission evaluated the costs and benefits of the final rule. With regard to benefits, the Commission stated that, overall, the rule is intended to address "pay to play" relationships that interfere with the legitimate process by which advisers are chosen based on the merits rather than on their contributions to political officials. The Commission noted that the potential for fraud to invade the various, intertwined relationships created by "pay to play" arrangements is without question. In addition, by leveling the playing field among advisers competing for state and local government business, the Commission expects the final rule will help minimize or eliminate manipulation of the market for advisory services provided to state and local governments.

With regard to costs, the Commission recognized that an adviser with government clients will incur costs to monitor contributions and to establish procedures to comply with the final rule. The initial and ongoing compliance costs imposed by the final rule will vary significantly among firms. The Commission estimates that to establish and implement adequate compliance procedures, the final rule would impose initial compliance costs of approximately $2,352 per smaller firm, $29,407 per medium firm, and $58,813 per larger firm. The Commission also estimates that the final rule would impose annual, ongoing compliance expenses of approximately $2,940 per smaller firm, $117,625 per medium firm, and $235,250 per larger firm. In addition, the Commission estimates that to comply with provisions of this rule, advisers will incur an aggregate cost of approximately $200,246 per year and the non-labor cost burden to be $20,080,000.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607, and 609

The Commission prepared a Final Regulatory Flexibility Analysis under the Act. The analysis included discussions of the need for and objectives of the rule; significant issues raised by public comment; small entities affected by the rule; projected reporting, recordkeeping, and other compliance requirements; and significant alternatives.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to the Act.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

On August 3, 2009, the Commission published a proposed rule. 74 Fed. Reg. 39,840 (Aug. 7, 2009). In response to the proposal, the Commission received approximately 250 comment letters, many of which were from advisers, third-party solicitors, placements agents, and their representatives. The Commission responded to the comments in the final rule.

Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520

The Commission determined that this final rule contains information collection requirements under the Act, which it submitted to the Office of Management and Budget (OMB) for review.

Statutory authorization for the rule

The Commission states that it is adopting new rule 206(4)-5 and amending rule 206(4)–3 of the Advisers Act pursuant to the authority in sections 206(4) and 211(a) of the Investment Advisers Act of 1940 (15 U.S.C. §§ 80b-6(4), 80b–11(a). The Commission states that it is amending rule 204–2 of the Advisers Act pursuant to sections 204 and 211(a) of the Advisers Act (15 U.S.C. §§ 80b–4, 80b–11(a)).

Securities Exchange Act of 1934, 15 U.S.C. §§ 78c(f), 78w(a)

The Commission analyzed the final rule to determine if it will promote efficiency, competition, and capital formation, and that any burden imposed by this rule on competition is necessary or appropriate.

Executive Order No. 12,866 (Regulatory Planning and Review)

As an independent regulatory agency, the Commission is not subject to the review requirements of the Order.

Executive Order No. 13,132 (Federalism)

As an independent regulatory agency, the Commission is not subject to the review requirements of the Order.