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SEC Issues Fine in Pay-to-Play Rule and Registration Requirement Violation Case

On June 20, 2014, the Securities and Exchange Commission (SEC) censured and fined investment adviser TL Ventures Inc. for violating the SEC's pay-to-play rule, Rule 206(4)-5 (the Rule), and failing to properly register under the Investment Advisers Act of 1940 (the Advisers Act). In addition to being censured, TL Ventures was ordered to (1) cease and desist violating the Rule and the registration requirement of the Advisers Act and (2) pay disgorgement penalties in the amount of $256,697, prejudgment interest in the amount of $3,197, and a civil penalty in the amount of $35,000. The order and the SEC's press release can be found here: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542119853#.U6mVmNJOWJA.

The Rule prohibits, among other things, an investment adviser from receiving compensation for advisory services provided to a government client (including through a pooled investment vehicle) for two years following a campaign contribution from the adviser or its covered associates to a candidate for, or holder of, an office with the authority to influence the selection of an adviser for such client or to appoint an individual with such authority (Covered Official), subject to certain exceptions for *de minimis* contributions.

The SEC found that a covered associate of TL Ventures made campaign contributions to two Covered Officials — a $2,500 contribution to a candidate for the mayor of Philadelphia and a $2,000 contribution to the governor of Pennsylvania. As a result of their appointment powers, the mayor is a covered official of the Philadelphia Retirement Board, and the governor is a covered official of the Pennsylvania State Employees' Retirement System. Each system is an investor in at least one fund managed by TL Ventures. Accordingly, by continuing to receive compensation attributable to managing these investments, the SEC found that TL Ventures violated the Rule. This finding comes despite the fact that TL Ventures submitted an application for a waiver to the SEC on September 17, 2013, arguing in part that, since the contributions in question occurred almost 10 years after the systems' original commitments were made, they could not have influenced the investment decisions.

Additionally, the SEC determined that TL Ventures and its affiliate, Penn Mezzanine Partners Management, L.P., were operationally integrated and, accordingly, should have been registered as a single adviser under the Advisers Act since the exemptions upon which they relied are not available when the two are viewed as a single adviser.[1] In finding that the two entities were operationally integrated, the SEC noted, among other factors, that the two entities (1) were under common control with each other; (2) had several overlapping employees and associated persons; (3) had significantly overlapping operations without any policies and procedures designed to keep them separate; and (4) did not have adequate information security policies or procedures in place to protect investment advisory information disclosure to the other.

Please contact us with any questions.

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1 TL Ventures claimed it was exempt from registration because it solely advised one or more venture capital funds, and Penn Mezzanine Partners Management, L.P. claimed it was exempt from registration because it acted solely as an adviser to private funds and had regulatory assets under management in the U.S. of less than $150 million.