JONES DAY

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October 5, 2009

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-18-09

Dear Ms. Murphy:

We are writing in response to your request for comments on proposed rule 206(4)-5 (the "Proposed Rule") under the Investment Advisers Act of 1940 (the "Advisers Act"). The Proposed Rule would implement restrictions on investment advisers' political contributions and their use of placement agents in soliciting investment advisory business from governmental clients. We regularly represent investment advisers in connection with the formation of commingled investment vehicles (principally private equity funds), many of which have governmental as well as non-governmental investors.

While we support the efforts of the Securities and Exchange Commission (the "Commission") to address "pay-to-play" practices in this area, we believe that the Proposed Rule goes too far in several respects. We believe that the ban on the use of placement agents ignores the important and legitimate role of placement agents in the marketing of interests in commingled funds. We also believe that the proposed penalty for failure to comply with the Proposed Rule–a two-year "time out" on the collection of fees–is inappropriate in the context of an ongoing investment advisory relationship.

I. Ban on Use of Third-Party Placement Agents

We regularly work with placement agents who have been hired by our investment adviser clients to assist with the private offering of interests in their commingled investment funds. These offerings normally take at least six months and as long as three years to complete and require extensive ongoing work by the placement agent. Placement agents conduct background reviews of the sponsoring investment advisers and their track records, they assist sponsors in the preparation of offering documents, they advise sponsors on market terms for the offered interests and they participate in negotiations between sponsors and prospective investors. For emerging managers unfamiliar with the requirements of institutional investors, placement agents may also help their clients develop due diligence, underwriting and asset management procedures, reporting and accounting systems and other back-office management systems.

In much the same way that an underwriter must invest significant time and effort in preparing an issuer for an initial public offering, placement agents must vet and develop investment advisers to meet the requirements and expectations of institutional investors. This is particularly true of emerging investment advisers who rely to a much greater degree on the services of third party placement agents than do more established advisers. While the Proposed Rule may not have a significant impact on established investment advisers that have existing institutional investor relationships and in-house investor relations staff, emerging sponsors (often small businesses or minority owned groups) will likely find it much more difficult to obtain governmental (or other institutional) investment without the services of a placement agent.

Although a few governmental pension investors, including the New York Common Retirement Fund ("NYCRF"), have recently modified their codes of conduct to ban the use of placement agents in connection with their investments with investment advisers, we believe that this is an over-reaction to recent scandals, and that eventually such bans will be modified to allow placement agents to participate in these transactions where appropriate.

We also believe that many of the "pay-to-play" problems that have arisen in the context of private commingled investment funds are attributable to payments made to informal "finders" or other solicitors who are not, but perhaps should be, registered broker-dealers under the Securities and Exchange Act of 1934 (the "Exchange Act"). As an alternative to a complete ban on the use of third-party placement agents, we suggest that investment advisers be permitted to retain only placement agents registered as broker-dealers under the Exchange Act. The Commission could then police the political contributions of these placement agents through its regulatory powers under the Exchange Act.

You requested comment on an alternative approach based on your 1999 proposal to make investment advisers liable for the actions of their placement agents. Although this approach would be preferable to an outright ban, we believe it would be unfair to punish a sponsor for the actions of its placement agent. If this approach were adopted, a sponsor should be entitled to rely on a representation from the placement agent as to its compliance with the contribution limits set forth in the Proposed Rule. However, in our view the best approach would be to hold the placement agents accountable for their own actions by imposing penalties (or a fee rebate) on them, rather than on the sponsors. Such an approach, together with the requirement that investment advisers retain only registered broker-dealers as placement agents, would allow the Commission to impose "pay-to-play" limitations on placement agents directly, without impeding the legitimate role of placement agents in the market for investment advisory services.[1]

[1] *C.F.* Rule 206(4)-3 of the Advisers Act, which bans the payment of cash compensation for client solicitations unless certain requirements are met.

II. Two-Year "Time Out"

The Proposed Rule, including the "time out" penalty, is modeled on rules G-38 and G-37 of the Municipal Securities Rulemaking Board ("MSRB"), which you credit with having reduced "pay-to-play" practices in the municipal securities market. However, there are significant differences between the municipal securities markets and the market for investment advisory services. Most significantly, the municipal securities market involves short-term engagements and frequent bidding for new business on a periodic basis. Investment advisory services, on the other hand, are generally marketed under advisory contracts or fund investment commitments, with the investment adviser and its clients entering into a long-term relationship. Most private equity funds involve a 3-to 5-year investment commitment, with an overall fund life of 10 years or longer. Thus, while imposing a two-year time out on a municipal securities underwriter means that the underwriter will have to forego fee opportunities by sitting on the sidelines for two years, the impact on an investment adviser will likely be much more onerous.

As a practical matter, we believe that in the context of a commingled fund, an investment adviser subject to a "time out" will be required to continue to provide the advisory services without compensation. You suggest that the sponsor could redeem the interest of the affected governmental investor. However, it may not be in the best interest of the investor to be redeemed, and the sponsor may not have the right to redeem the investor against its will. Moreover, even if the investor does agree to the redemption of its interest, the fund may hold illiquid investments, and any forced sale of those investments could disadvantage the other investors in the fund.

Notably, the recent changes adopted by NYCRF to its code of conduct do not require a breaching investment adviser to a private equity fund to continue to work without compensation. Rather, in that case it gives NYCRF the right to cease making capital contributions, while retaining its existing interest in the fund and continuing to pay the investment adviser to manage those investments.[2]

You also note the difficulties in seeking to rebate performance fees in the context of a private equity fund, where the performance fee depends upon final cash distributions. Although, as you suggest, it would be possible (with the agreement of the affected investor) to deem a portion of those performance fees to have been earned pro rata over the holding period for a given investment (or over the term of the fund, in the case of a portfolio-based performance fee), we question whether that is a fair or appropriate way to implement the proposed penalty. We also question the fairness and parity between such a penalty in this context, which would deprive an investment adviser of sharing in potentially significant amounts of profit actually earned by it

[2] *See* New York State Common Retirement Fund Placement Agent Disclosure Policies and Procedures of the Office of the State Comptroller adopted July 24, 2007, as modified on April 21, 2009 (available at http://www.osc.state.ny.us/pension/placementagntdiscl.pdf).

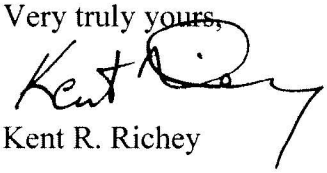
(potentially running into the millions of dollars), in comparison to the MSRB rules, which merely require an underwriter to sit on the sidelines for two years.

As an alternative to the proposed "time out" penalty, we believe that a limitation on political contributions, combined with the Commission's ability to impose penalties and other enforcement powers, should be sufficient to ensure compliance. At most, the two-year time out should apply only to the creation of new investment advisory contracts/commingled funds and should not affect the obligations of the parties under existing advisory contracts or commingled funds.

In closing, we urge the Commission to consider alternatives to the proposed ban on the use of private placement agents and the proposed two-year "time out" as a penalty for rule violations. The ban on the use of private placement agents will make it more difficult for smaller, less well-established advisers and non-US advisers to gain access to governmental investors, and may lead them to exclude such investors from their fundraising activities altogether. Also, the two-year "time out" penalty is, in our view, ill-suited to the long-term nature of investment advisory services, imposes too harsh a penalty on advisers, may adversely affect governmental and other investors in commingled funds and may ultimately discourage advisers from accepting governmental investment.

We appreciate having the opportunity to comment on the Proposed Rule; and we hope that the Commission will consider these comments before adopting any final rule.

Very truly yours,



Kent R. Richey