Cornell University
Cornell Law School

William A. Jacobson, Esq.
Associate Clinical Professor
Director, Securities Law Clinic
G57 Myron Taylor Hall
Ithaca, New York 14853
t. 607.254.8270
f. 607.255.3269
waj24@cornell.edu

October 6, 2009

Via Electronic Filing

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Release No. IA 2910; File No. S7-18-09 (Political Contributions by Certain Investment Advisers)

Dear Ms. Murphy:

The Cornell Securities Law Clinic (the "Clinic") welcomes the opportunity to comment on the proposed new rule under the Investment Advisers Act of 1940 (the "Proposed Rule"). The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and public education as to investment fraud in the largely rural "Southern Tier" region of upstate New York. For more information, please see http://securities.lawschool.cornell.edu.

To protect public pension plans from the consequences of pay-to-play practices, the Securities and Exchange Commission (the "Commission") seeks to prohibit an investment adviser from receiving compensation for providing advisory services to a government client for two years after the adviser or any of its covered associates makes a contribution to certain officials of the government entity. In addition, the Proposed Rule would prohibit an adviser from providing or agreeing to provide, directly or indirectly, payment to a third party for solicitation of government advisory business on behalf of such adviser. Lastly, the Proposed Rule would prohibit an adviser from soliciting from others, or coordinating, contributions to certain government officials or candidates, or payments to political parties where the adviser is providing or seeking government business.

The Clinic generally supports the Proposed Rule, with certain modifications as discussed below. The management of public pension funds affects millions of present and future state and municipal retirees who rely on the funds for their pensions and who do not play a role in selecting their pension fund management. While keeping in mind the goal of protecting public pension funds from the consequences of pay-to-play practices, it is important to ensure that public pension funds obtain and retain the best management available.

1. The Clinic Supports Extending Application of the Rule to State and Other Exempt Investment Advisers

The Commission asks whether the scope of the application of the Proposed Rule is appropriate. The Proposed Rule would apply to any investment adviser registered with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Investment Advisers Act. The Proposed Rule would not apply to most small advisers that are registered with the state securities authorities, and certain other advisers that are exempt from registration with the Commission. The Clinic believes that the Proposed Rule should apply to state-registered advisers so that the rule will affect all investment advisers equally. For the same reason, the Proposed Rule should apply to advisers that are exempt from registration in reliance on section 203(b)(3) of the Investment Advisers Act. For example, the Commission could extend the scope of the Proposed Rule to apply to advisers exempt from registration pursuant to any or all of the Investment Advisers Act sections that cover intrastate advisers, advisers with only insurance company clients, investment advisers that are charitable organizations, advisers whose plans are described in section 414(e) of the Internal Revenue Code of 1986 or certain persons associated with such plans, and certain commodity trading advisers.

2. The Clinic Generally Supports the Scope of the Two-Year Time Out

A. The Clinic Supports the Two-Year Time Out

The Commission asks whether two years is an appropriate length for the time out for contributors. The two-year time out would prohibit investment advisers from providing advice for compensation to a government entity within two years after a contribution to an official of the government entity has been made by the investment adviser or any of its covered associates. The two-year ban would likely deter investment advisers from engaging in pay-to-play activities. Thus, the Clinic supports the two-year time out.

B. The Clinic Supports the Proposed Rule's Approach to the Prohibition on Compensation

The Commission asks whether the Proposed Rule's approach to the prohibition on compensation after an investment adviser or one of its covered associates makes a contribution is appropriate. Investment advisers that make contributions covered by the Proposed Rule would not be prohibited from providing advisory services to a government client, even after triggering the two-year time out. Instead, an adviser would be prohibited from receiving compensation for providing advisory services to the government client during the time out. This approach is intended to avoid requiring an adviser to abandon a government client after the adviser or any of its covered associates makes a political contribution covered by the Proposed Rule. Although there may be other approaches, to the extent that an adviser or one of its covered associates makes a prohibited contribution, the Proposed Rule's approach, which allows the adviser to continue providing services without compensation, appears to be the least disruptive approach concerning the operations of the government client.

C. The Clinic Suggests Changes to the *De Minimus* Exception

The Commission asks whether the scope of the exception for *de minimus* contributions is appropriate. The *de minimus* exception would permit each covered associate who is an individual to make aggregate contributions of $250 or less, per election, to an official or candidate without triggering the Proposed Rule's two-year time out if the person making the contribution is entitled to vote for the official or candidate. Although contributions of $250 or less are typically made without the intent or ability to influence the selection process for investment advisers and thus do not involve the conflicts of interest that the Proposed Rule is designed to prevent, the Commission should adjust the Proposed Rule's *de minimus* exception for inflation.

Additionally, the *de minimus* exception should be extended to contributions made to officials for whom an investment adviser or its covered associate is not entitled to vote. We agree that contributions made to candidates in this context raise concerns equal to or greater than situations where the investment adviser or covered associate is entitled to vote. The *de minimus* amount would equal the inflated amount assigned to the original exception.

3. <u>The Clinic Generally Supports the Prohibition on Using Third-Party Solicitors</u>

The Clinic supports the prohibition on investment advisers using third-party solicitors to obtain government business, subject to narrowing the scope of the prohibition. This aspect of the Proposed Rule is important given that third-party solicitors have played a central role in each of the enforcement actions against investment advisors that the Commission has brought in the past several years involving pay-to-play schemes.[1] Because "actors in this field are presumably shrewd enough to structure their relations rather indirectly,"[2] it is important that the Proposed Rule prohibits investment advisers from doing indirectly what they are prohibited from doing directly.

A. Disclosure Requirements Alone Would Not Be Adequate

The Commission asks whether there is a different approach that would be effective at eliminating circumvention of the rule through the use of third parties.[3] The California Public Employees' Retirement System, for example, doesn't ban placement agents, but instead requires full disclosure by investment advisers of their use of placement agents and the fees paid to them.[4]

---

1 Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 2910, 74 Fed. Reg. 39,840, at 39,852 (Aug. 7, 2009) [hereinafter Proposing Release].

2 *Blount v. Securities and Exchange Comm'n*, 61 F.3d 938, 945 (D.C. Cir. 1995) (upholding a similar rule on pay-to-play practices in the municipal securities markets).

3 Proposing Release, *supra* note 1, at 39,853.

4 Press Release, CalPERS, CalPERS Adopts Placement Agent Policy – Requires Disclosure of Agents, Fees (May 1, 2009), *available at*

However, the Clinic believes that disclosure alone would not eliminate circumvention of the Proposed Rule. For example, after concluding that required disclosure was neither adequate to prevent circumvention nor consistently being made, the Municipal Securities Rulemaking Board (the "MSRB") amended its own rules on pay-to-play practices in the municipal securities markets to impose a complete ban on the use of third-party consultants to solicit government clients.[5] Moreover, where there are only some states or localities with disclosure requirements rather than industry-wide requirements, investment advisers can circumvent the rule by pursuing government business in other states or localities.

B. Third-Party Commitments Not to Contribute Would Not Prevent Circumvention of the Rule

The Commission also asks whether it should consider narrowing the prohibition to accommodate government solicitation activities by third parties if such third parties commit not to contribute to officials of any government entity from which any adviser that hires them is seeking business.[6] The Clinic believes that requiring investment advisers to obtain such commitments from their placement agents presents two problems: First, as commenters to the Commission's 1999 rule proposal argued, this creates significant compliance challenges because the solicitors are not, according to the commenters, controlled by the advisers. This is one reason why the current Rule Proposal does *not* subject advisers using third-party solicitors to the two-year time out. Second, investment advisers could potentially avoid this requirement by identifying and obtaining commitments from certain third-party solicitors while not identifying others. In New York, for example, the manager of the New York City Pension Funds failed to identify in a due diligence questionnaire certain individuals as placement agents although it identified others.[7] Because investment advisers should be prohibited from doing indirectly what they cannot do directly, investment advisors should not be left to regulate themselves in this regard.

C. The Commission Should Reconsider the Scope of the Ban on Third-Party Solicitors

The Commission further asks whether the Proposed Rule could disproportionately impact the ability of smaller and less established investment advisers to compete in the market to provide advisory services to government clients.[8] While the Clinic generally supports the prohibition on using third-party solicitors, it also believes that the scope of the prohibition may

---

http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2009/may/adopts-placement-agent-policy.xml.

5 MSRB rule G-38(a).

6 Proposing Release, *supra* note 1, at 39,853–54.

7 Office of the New York City Comptroller, Thompson Moves to Ban Placement Agents, Asks State AG to Investigate Quadrangle Transaction (Apr. 22, 2009), http://www.comptroller.nyc.gov/press/2009_releases/pr09-04-095.shtm.

8 Proposing Release, *supra* note 1, at 39,853–54.

disproportionately affect smaller and less established investment advisers. Because the management of public pension funds affects millions of present and future state and municipal retirees who rely on the funds for their pensions and who do not play a role in selecting their pension fund management, it is important to ensure that public pension funds obtain and retain the best management available.

The proposed ban on using third parties to solicit government business is not limited to contributions made by third parties. The Proposed Rule broadly defines "solicit" to include direct or indirect communications for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser. By contrast, the two-year time out discussed above is only triggered by "contributions" made by an investment adviser or any of its covered associates. This means that a smaller investment adviser without the internal resources to obtain government business cannot use a solicitor to communicate with a government official for this purpose. On the other hand, a larger firm could use its internal resources to make such communications, so long as the firm did not make a contribution. Many commenters have already argued that the prohibition is unfair because small and less established investment adviser firms cannot secure government business without the internal resources available to larger firms.

Therefore, the Clinic suggests that the Commission reconsider the scope of the prohibition on using third-party solicitors by narrowing the definition of "solicit" such that it is more closely aligned with the "contributions" triggering the two-year time out. The Commission could do this by deleting part (i) from the definition of "solicit," namely, the prohibition on communications made by third parties for the purpose of obtaining government business. The definition of "solicit" would therefore only apply to communications for the purpose of obtaining or arranging *contributions*. In this way, smaller and less established investment advisers would not be excluded from competing for government business so long as they do not use third-party solicitors to indirectly make contributions to certain government officials.

3. The Clinic Supports the Restrictions on Soliciting and Coordinating Contributions and Payments

The Clinic supports the proposed restriction on investment advisers from soliciting from others, or coordinating, contributions to certain government officials or candidates, or payments to political parties where the adviser is providing or seeking government business. The Clinic believes that this proposal would close an important gap in which contributions might be made indirectly to government officials for the purpose of influencing their choice of investment advisers.

Conclusion

The Clinic greatly appreciates the opportunity to comment on the Proposed Rule. The Clinic generally supports the Proposed Rule because it provides greater protection of public pension plans from the consequences of pay-to-play practices. However, the Clinic suggests that the Commission extend the application of the Proposed Rule to state and other exempt investment advisers, and adjust the *de minimus* exception for inflation and have it also apply to contributions to officials for whom a covered associate is not entitled to vote. The Commission should also reconsider the scope of the prohibition on using third-party solicitors given that this ultimately affects public pension plan beneficiaries. While keeping in mind the goal of protecting public pension funds from the consequences of pay-to-play practices, it is also important that public pension funds obtain and retain the best management available.

Respectfully submitted,

William A. Jacobson, Esq.
Associate Clinical Professor of Law
Director, Cornell Securities Law Clinic

Josephine Djekovic
Cornell Law School, Class of 2010

Stuart Lott
Cornell Law School, Class of 2011