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October 6, 2009

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

RE: File Number S7-18-09: Comments to Proposed Rule 206(4)-5

Dear Ms. Murphy:

We are pleased to submit these comments regarding Proposed Rule 206(4)-5 on behalf of the eleven (11) investment advisers listed at the end of this letter ("the Commenters"). These investment advisers vary widely in their structure and business models but share the concerns described herein -- common concerns we believe will exist in many sectors of the investment adviser industry.

In particular, we appreciate and support the Commission's efforts to eliminate any vestiges of actual, or even the appearance of, pay-to-play in the investment adviser industry. We also recognize the role that Municipal Securities Rulemaking Board ("MSRB") Rules G-37 and G-38 have played in the municipal securities industry. However, modeling Proposed Rule 206(4)-5 on the MSRB rules results in numerous unintended consequences stemming from the significant differences between the municipal securities and the investment adviser industries.

This letter describes these unintended consequences in greater detail and proposes solutions to make the Proposed Rule more workable.

I. TWO YEAR BAN

A. Scope of the Ban

Proposed Rule 206(4)-5 makes it unlawful for an investment adviser to receive compensation for advisory services provided to a government entity within two years after the adviser or any covered associate makes a political contribution to an official of the government entity. The Commission states that the rationale for this rule is to "capture not only direct political contributions by advisers, but also other ways that advisers may engage in pay-to-play arrangements."[1]

1. Relevant Differences in the Nature of the Businesses Regulated Under Rule G-37 and the Proposed Rule

MSRB Rule G-37 regulates broker-dealers that contract with the government to underwrite the issuance of municipal securities. Rather than establishing a long term legally binding relationship, the broker-dealer's relationship with the government is generally transaction-based, consisting of individual contracts involving the underwriting of specific municipal securities. Once the particular security is purchased by the broker-dealer, its obligations to the government issuer are generally over. While the dealer may seek additional business from the government, each underwriting agreement is an independent contract for the purchase of the bonds in question. In those situations, barring a broker-dealer from business with the government for two-years because of a political contribution stops the dealer and the government from doing business with each other during that time. There is no doubt that this is a serious business hardship for the broker-dealer. However, as is normally the case when two parties are barred from doing business with each other, the ban works both ways: the government does not pay for services and the broker is not obligated to do any work for the government. The MSRB ban does not affect contracts that are entered into prior to the contribution.

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[1] Political Contributions by Certain Investment Advisers, 74 Fed. Reg. 39840, at 39844 (proposed August 7, 2009) (to be codified at 17 C.F.R. pt. 275). It is important to note that many of the pay-to-play cases cited by the Commission involved bribery and kickback schemes where the making of political contributions played little or no part. This is not surprising given that political contributions are reported, often subject to limits, and generally cannot be used for the personal expenses of the candidate, making them less than the ideal vehicle for personal enrichment. Therefore, while prophylactic rules serve an important purpose, it should not be presumed that there is a connection between a political contribution and a later action taken by a government official, either as a general proposition or in a specific case. This is particularly important when considering a rule that reaches back and presumes the intent of the contribution based on the contributor's affiliation with an investment adviser that only came into being as much as two years after the contribution was made.

In contrast, the investment adviser's relationship with an investor, such as the government, is of a longer duration (sometimes lasting decades), throughout which a strict fiduciary duty is owed to the investor. Whether the investment adviser is a general partner in a fund, with the government and other investors participating as limited partners, manages an investment fund with wide participation, including funds invested by the government, provides separate account services directly to the government, or manages an investment fund that is one of several options offered by the government to employees as a place to invest their savings or retirement accounts, the relationship between the investment adviser and an investor is not based on a single transaction but, rather, is ongoing and generally governed by a contract which creates fiduciary obligations and duties. The investors, whether governmental or private, expect and are owed the advice, skill, and professional services of the investment adviser for as long as called for in the contract or as required by the fiduciary obligations of the adviser.

If the proposed ban is triggered, the effect will be to disrupt an ongoing relationship governed by contract and professional standards applicable to investment advisers. The Commission notes that this objection was raised in response to a similar proposal the Commission put out in 1999, and responds that even though municipal underwritings involved separate contracts, "underwriting relationships are often long-standing." Therefore, according to the Commission, "the rule's time outs may have similar effects" on broker-dealers and investment advisers.[2] While it is true that neither the broker-dealer nor the investment adviser will be able to enter into new contracts with the government entity if the ban is imposed, the significance of the difference between the two industries should not be understated. In fact, it is recognized in the Proposed Rule itself. Unlike Rule G-37, the Commission's proposed rule doesn't actually ban the provision of services; rather it prohibits the investment adviser accepting compensation for services. Moreover, although there may be some small pockets in the municipal securities industry that involve ongoing relationships (such as remarketing and distribution of 529 college tuition savings programs), an overwhelming majority of the business consists of transaction based underwriting.

As the Commission notes, because of the fiduciary duty owed by an investment adviser, "[a]n adviser subject to the prohibition would likely, at a minimum, be obligated to provide (uncompensated) advisory services for a reasonable period of time."[3] Thus, rather than forcing the immediate termination of the provision of services, the Proposed Rule, when coupled with the adviser's

[2] 74 Fed. Reg. at 39846 n. 67.

[3] Id. at 39847.

fiduciary obligations, will force the adviser to continue to provide its services without the agreed-upon compensation. In fact, according to the Commission, the adviser is not only prohibited from making a profit from the service, but is also prohibited from recouping costs.[4] Thus, the adviser would not only be penalized by losing any profit but would have to provide services at a loss.[5]

The Commission does say that it does not believe the government official (who may have been the recipient of the prohibited contribution) can slow-walk replacing the investment adviser so as to obtain up to two years of free financial services. Rather, the Commission believes that that the adviser's fiduciary obligations "do not require it to provide uncompensated advice indefinitely...."[6] However, neither the language of the Proposed Rule nor the realities of the investment adviser industry, provide any assurance that an investment adviser would not be forced to provide free services for the entire two years.

Indeed, in addition to its fiduciary obligation, the governing contract in many cases requires an investment adviser to continue providing its services with or without the agreed compensation.[7] For example, in a closed-end fund (such as a private equity fund), the contract that sets forth the duties and obligations of the investment adviser and the conditions under which investors participate in the fund may not allow an investment adviser to require a government entity to withdraw from the fund.[8] Moreover, the contract may prohibit the government investor from withdrawing even if it wanted to do so. The only way a government investor may be permitted to withdraw is if it sells its interest to a third party, often at a discount. In the case of a private equity fund where no efficient market exists for interests, it may have to sell out at a substantial loss.

Even if the government investor were willing and able to withdraw from the fund, such withdrawal could cause substantial hardship to the fund or even result in the collapse of the fund, especially given that government entities tend to be larger

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[4] Id. at 39858.

[5] An adviser managing $100 million for a public employee pension plan for a fee of fifty basis points annually would therefore be penalized a minimum of $500,000 per annum.

[6] 74 Fed. Reg. at 39847, n. 79.

[7] One commenter has an investment contract which does not allow the investment adviser to terminate the contract prior to seven years.

[8] There may be a provision that permits the adviser to require an investor to withdraw from the fund if staying in the fund violates applicable law. However, a contribution under the Proposed Rule is not a violation.

investors in the fund.[9] At the very least, the co-investors in the fund could be harmed when a government entity pulls out its significant investment.[10] Indeed, the investment adviser may not be able to find another investor to replace the government entity. Moreover, the other investors, who may have been drawn to the fund because of the investment adviser, will be forced to decide (if they have withdrawal rights) whether they want to be invested in a fund that will be required to operate with an investment adviser that is not being fully compensated as agreed, and a government partner not paying its share of the costs. In fact, the other participants who will still be required to have a portion of their investment go towards their share of the services of the adviser may accuse the government of getting preferential treatment at the expense of the other investors. Regardless of what the investors decide, the fund will not be the same fund in which they originally invested.

Thus, in reality, what is referred to as the two year "cooling off" period will result in the adviser suffering a real and substantial financial loss and being left in a financial position far worse than it was in prior to undertaking the service. For the adviser, this is the equivalent of a real and potentially large civil penalty being assessed. Moreover, the Commission is clear that this is not an unavoidable

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[9] For example, the withdrawal of a government investor from a private equity fund, which calls down capital on an as-needed basis over time, might require changing the documents which established the plan, and would likely result in the investment profile of the fund changing (e.g., either engaging in fewer deals or making smaller investments). In fact, when the government investor withdraws, the other investors would likely find that the percentage of their ownership of the fund increases, which could potentially require them to consolidate their investment in the fund. The increased ownership percentage could also have adverse consequences for limited partnerships affiliated with Bank Holding Companies which typically are allowed to hold no more than 24.99% of a fund (unless they are Financial Holding Companies and meet certain other conditions).

Finally, the general partner in a private equity fund is paid a carried interest (i.e., performance fee) when a deal is sold - usually 20% of net profits. This creates an incentive, or at least the appearance of an incentive, for the manager undergoing a two-year compensation ban to delay selling an investment that is otherwise "ripe" until the ban is over. While this may violate the manager's fiduciary duty to the fund, the incentive will be real. Moreover, even if the manager does not take the ban into consideration, investors in the fund might grow concerned and lose faith in its operation because the inventive is exists. This obviously puts the fund at additional risk.

[10] Certain institutional investors in collective investment vehicles have internal investment limits or guidelines that may require such investor to redeem its interest in the investment vehicle if such investor's percentage ownership exceeded its initial investment amount or exceeded some specified amount as a result of a decrease in the assets of the vehicle, including asset decreases resulting from large redemptions from other investors, or if the composition of the other investors changed. However, the redemption of a governmental entity that owned a large percentage of the interest of a collective investment vehicle will likewise increase the ownership percentage of the remaining investors and may result in one or more of the remaining investors being deemed to "control" the vehicle or require the consolidation of the vehicles' assets on the investors' financial statements under certain circumstances.

consequence of the application of the rules, but is intended to act as a financial sanction against the investment adviser. The Commission notes that there are situations where the "the MSRB has provided additional flexibility" and allowed a firm to receive compensation throughout the time the ban is in effect.[11] However, the Commission rejects this approach "because it would undermine the deterrent effect of having a two-year time out."[12]

To the contrary, the automatic sanction that results from the Proposed Rule adds a layer of liability above and beyond the liability that investment advisers already face. For example, investors can already sue advisers for negligence or breach of fiduciary duty. The Proposed Rule adds to this the specter of an automatic two-year ban on compensation resulting from even inadvertent contributions to covered officials. The undue burden is exacerbated by the fact that if an investment adviser unwittingly accepts compensation in light of such ban, it may result in having to disclose the violation in the Form ADV, which in turn could have a serious impact on an investment adviser's ability to do business with any institutional investor.

If adopted as is, the Proposed Rule will also affect contracts where the connection between the investment adviser and the government, let alone the actual recipient of the contribution, is far more tenuous. For example, the Proposed Rule's two-year ban applies to a publicly offered fund that is offered as an option in a government plan, even if the government plan selects the fund as part of a platform established by a third-party broker-dealer. In these cases, the investment adviser would not know which government plan offers its fund as an option, but rather the third-party establishing the platform would have that knowledge. In addition, the Proposed Rule, as currently worded, may cover sub-advisers, who provide discrete services to the investment adviser regarding the fund. These sub-advisers play a secondary role in the business, and may not even have any contact with government officials.

2. The Rule Should be Modified to Reflect the Unique Nature of the Investment Advisory Business

As described, the practical effect of the Proposed Rule will be to force the investment adviser to provide its services without receiving the agreed upon compensation for up to two years and potentially lead to a number of adverse consequences that go far beyond a "two year time out." By unilaterally modifying ongoing contracts, the Proposed Rule would affect the adviser's relationship with

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[11] 74 Fed. Reg. at 39858.

[12] Id. at n.189.

investors, even though most, if not all of them, will have had no connection to the contribution that caused the rule to be invoked. It will also adversely impact the investment adviser's overall business. What may be most problematic is that the "all or nothing" approach to the sanction fails to differentiate between contributions that clearly fall within the core conduct being addressed and those that are far removed from the problems being addressed.

The issues raised by the impact of the Proposed Rule on the investment advisers and the third party investors are neither trivial nor easily ignored.[13] However, this does not mean that the Commission should abandon its effort to promulgate a regulation intended to address pay-to-play.

Given the harshness and automatic nature of the penalty imposed on investment advisers, and the effect it may have on co-investors, the Commission should begin by adapting the framework provided by Rule G-37, recognizing that it was written to govern the transitory (and constantly renewing) relationship between dealers and governmental entities offering municipal bonds. At the same time, the rule adopted for investment advisers should be modified to reasonably reflect the realities of the industry and avoid unduly harming the vast majority of investment advisers who operate in good faith in compliance with their legal and fiduciary duties. Indeed, the exceptions and exemptions to the Proposed Rule should be strengthened and tailored to accommodate the significant interests involved, while ensuring the efforts to end pay-to-play practices are strengthened. As described below, the Commission should not only provide the opportunity to seek an exemption, but it should also clarify and broaden the exceptions to the rule proposed.[14]

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[13] The fact that the Proposed Rule requires the investment adviser to provide free services and could interfere with the adviser's relationship with third-parties puts it outside the D.C. Circuit's analysis in Blount v. SEC, 61 F. 3d 938 (DC Cir, 1995), cert. denied 517 U.S. 1119 (1996), where the court rejected a First Amendment challenge to Rule G-37. The court in Blount explicitly found rule G-37 to be "closely drawn" because it:

> "constrains relations only between the two potential parties to a quid pro quo: the underwriters and their municipal finance employees on the one hand, and officials who might influence the award of negotiated municipal bond underwriting contracts on the other. Even then, the rule restricts a narrow range of their activities for a relatively short period of time. The underwriter is barred from engaging in business with the particular issuer for only two years after it makes a contribution.... "(Footnote omitted.)

Thus, Blount cannot be read to suggest that the court would have reached the same result had Rule G-37 required the dealer-broker to continue underwriting municipal bonds, but without taking a fee, or effectively changed contracts the dealer-broker had with third-parties.

[14] There are significant differences between exceptions and exemptions to the rule. With the Proposed Rule, an investment adviser must apply for an exemption and may have to wait weeks or months for a

It is with this goal in mind that we offer the following recommendations.

3. Recommendations

i. Provide for a More Tailored Remedy

As drafted, the Proposed Rule recognizes only one sanction, which is to prohibit the investment adviser for being compensated for two years, but also contains several exceptions to the Proposed Rule's coverage and provides for a way to get an exemption from the penalty. For the most part, however, the process leaves the state or local government entity that is contracting with the adviser out of the equation.[15] Nevertheless, the government investor is a central actor in the events. First, a government official who is running for election presumably accepted the political contribution that triggers the operation of the rule. In addition, the government investor is the entity that can force the investment adviser to provide services without compensation, or it can lose the services of the investment adviser, forgo an investment opportunity or decide to pull out of an investment fund. But, as has been discussed, the actions that trigger the ban can range from a contribution made under circumstances where there is no doubt that it was unrelated to either the investment adviser's or government entity's business, to contributions where the motives of both the covered associate and the government officer can be questioned. Therefore, the government investor may consider the impact of the sanction to be unjustified and disproportionate to the violation, or may think the matter serious enough that it wishes to pursue other sanctions with the officer or adviser.

Given this wide range of potential fact patterns, involving the government investor in the process only makes sense.

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response. In the financial world, this may mean the difference between obtaining or losing the business. On the other hand, once the investment adviser determines that it fits within the exception, it may proceed. Of course, if the Commission believes the adviser does not qualify for the exception, it can notify the investment adviser and apply the two year ban.

[15] The Commission states that the Proposed Rule "would have no effect on State laws, codes of ethics or other rules governing the activities of State and municipal officials or employees of public pension plans over whom we have no jurisdiction." 74 Fed. Reg. at 39845-39846. Regardless of the strength of the obvious counter-arguments to this assertion, it would appear that offering the fiduciaries of public pension plans the ability to grant an exemption would, at the very least, help ensure that government entities retain some input into a process that will change their relationship with the investment adviser.

Recommendation: The Proposed Rule should be modified to provide for the following:

(a) Permit the investment adviser to notify the government investor of contributions within 10 days of discovery;

(b) Permit the government investor to make a formal decision (e.g., by a majority vote of the trustees of a pension fund (without the participation of the official who received the contribution) to continue to compensate and do business with the investment adviser; [16]

(c) Require the investment adviser to notify SEC of the above process, where the SEC could, upon its discretion, disallow it, such as when the contribution is egregious or repetitive; and

(d) if the investment adviser does not avail itself of the above process, it must abide by the two-year ban on compensated advisory services.

Alternative Recommendation: Alternatively, the Commission could provide for a mechanism that allows the Investment Management Division to directly fashion a remedy befitting the particular contribution. For example, as a threshold matter, the alternative procedure could be made available only if the investment adviser notifies the Commission of a covered contribution within 10 days of its discovery. If the investment adviser meets this initial threshold, it could then submit a request to the Commission's staff explaining the mitigating factors and asking to be considered for a discretionary remedy ranging from a warning letter to instituting the full two-year ban.

The Commission could utilize factors similar to the ones currently proposed for deciding whether an exemption is warranted pursuant to Proposed Rule 206(4)-5(e), focusing on whether the violation was inadvertent, the compliance procedures that were in place, how quickly the contribution was discovered, whether a refund was obtained, and the amount of compensation in question. If the Commission decided it was warranted, it could offer the investment adviser an agreement with a remedy appropriate to the facts. These could include a shorter prohibition period, a

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[16] Facts that could be considered relevant include, but are not limited to: 1) Size of the contribution; 2) Timing of the contribution; 3) Status of the contributor when he or she made the contribution; 4) Whether this was an isolated incident; 5) Actual involvement of the contributor in soliciting the business; 6) Actual involvement of the recipient agency official in awarding the business to the investment adviser; 7) Likely affect of two year ban (e.g., will it likely result in the investment adviser stopping services or working without compensation); 8) Harm to government employee pension plan and its beneficiaries, third party investors, investment adviser and general public, if ban is implemented.

financial payment or other appropriate remedy. Of course, if an adviser fails to use this alternative procedure, then the full two-year ban would apply.

Please note, however, that for this alternative to be workable, the Proposed Rule should clearly state that this tailored remedy will not have to be reported by an investment adviser in its Form ADV unless there is a knowing and willful violation. This is because of the disproportional effect that a Form ADV disclosure has on an investment adviser's ability to do business with other institutional investors—it would exponentially magnify the penalty for innocent and inadvertent breaches of the Proposed Rule. This should also be the case for Forms BD and Forms TA (that an affiliated broker-dealer or transfer agent may have to file, respectively). Moreover, given the routine nature of this procedure and the administrative nature of the remedy, this process should be administered by the Division of Investment Management staff, and should not have to go to the Commissioners.

ii. Clarify the Application of the Rule to Sub-Advisers

The Commission's proposal applies the two year ban to an investment adviser accepting compensation for services provided to an investment pool if a political contribution was made by one of the adviser's covered associates to a covered government official.[17] This is intended to cover situations where a contribution is made to a government official who directs public funds to a pooled investment product (other than a mutual fund) managed by the adviser, chooses an investment adviser to be an adviser to a government sponsored plan or chooses an adviser's pooled investment fund as an investment option in a government sponsored plan, even if the adviser is not chosen to advise the plan.[18] However, the Commission asks whether there may be sub-advisory arrangements in which a sub-adviser would not know or be able to influence whether, or which, government entities are being solicited for a covered investment pool.[19]

Recommendation: The Commission should make clear that sub-advisers are not covered by the rule. Generally, sub-advisers work under a contractual relationship which places them in a subordinate role to the investment adviser, by providing discrete and limited services to the adviser. Thus, a sub-adviser is not in the same position as the investment adviser, and will generally lack the same level of knowledge and ability to influence the government's decisions regarding the

[17] "Investment pools may include, but are not limited to: mutual funds, hedge funds, private equity funds, and venture capital funds." 74 Fed. Reg. at 39856.

[18] Id. at 39855-39856.

[19] Id. at 39858.

investment pool. Indeed, they generally have no contact with the governmental investor whatsoever. Excluding sub-advisers will help keep the rule narrowly tailored and limits some of the effect of the overbreadth that appears in other areas of coverage. This is important because, as the Commission recognizes, the rule is limiting the ability of people to engage in protected political speech. Moreover, to the extent there is a concern about sub-advisers being used as surrogates to make contributions, the Proposed Rule provides that the investment adviser cannot do indirectly what it cannot do directly.[20]

B. Covered Associates

The Proposed Rule provides that the term "covered associate" includes, among others, an investment adviser's employee who solicits investment advisory business from a governmental entity. "Solicit" is defined in relevant part as a direct or indirect communication for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser.[21] Political contributions made by any covered associate will trigger the two-year ban on compensated business and look-back provisions.

1. Covered Associates Should be Limited to Those Who Communicate with a Government Entity for the Major Purpose of Obtaining Government Investment Advisory Business

The Proposed Rule has the effect of treating as covered associates even those employees whose communications regarding investment advisory service business are merely incidental to a communication with a government entity regarding other issues or the provision of other substantive services. Lawyers, accountants, engineers, actuaries or insurance professionals who provide substantive and valuable services to the investment adviser may become covered associates merely because they happen to communicate with a government entity regarding advisory services as part of providing such services to the adviser. In such cases, the communication could be viewed as having the ultimate effect of helping to obtain the investment advisory business.

The Proposed Rule does not recognize any difference in degree in the type of communications that typically take place between firms and prospective clients or investors, and does not create any exceptions for a communication such as those

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[20] Proposed Rule 206(4)-5(d).

[21] Proposed Rule 206(4)-5(f)(2) and (10).

made by employees who provide substantive services. Such communications are principally made for reasons other than soliciting particular investment advisory business, but rather are part of the substantive services provided by the employee to the adviser. In addition, the Proposed Rule does not recognize that employees making such incidental communications have little or no direct financial incentive to engage in pay-to-play practices.

As another example, under the modern business structure, a sales force may sell not only one product line, but many. Indeed, it would not be unusual for one person to be responsible for selling numerous products ranging from banking services, insurance services, or in some cases (where a company is very diversified) even manufacturing or energy products. For instance, it is not unusual for a life insurance agent to be able to sell hundreds of different products. Moreover, in the course of an employee's communication with a government official about one product line, the official could express an interest in the company's advisory services capabilities, resulting in a referral. An employee may also provide a government entity with relevant information (such as a brochure) and contact information for the investment adviser.

Over-regulating these individuals on any one product could unduly hamper the sales force's ability to legitimately sell all of the corporation's products. Under the literal reading of the Proposed Rule, however, all of these communications could trigger covered associate status for a non-advisory employee of an entity that happens to be registered as an investment adviser. This is beyond the intent of the Rule. In such cases, the employee making the communication is far removed from the corporation's advisory services business unit, and thus would have little incentive to engage in the kind of behavior the rule is designed to protect against, pay-to-play.

Similarly, the Proposed Rule's definition arguably could cover all client relations personnel of an adviser who provide day-to-day support to institutional clients. Under the Proposed Rule, the only way to have any certainty that the foregoing types of employees are not treated as covered associates would be to severely restrict their communications with government entities, which in turn would have a negative effect upon the appropriate provision of services to government entities.

Recommendation: Change Definition of "Solicit"

In order to mitigate these problems, we suggest that the Commission modify the definition of "solicit" to provide that only a communication made by an investment adviser's employee to a government entity that is made with a "major" purpose of obtaining, retaining, or referring a government entity for investment advisory business would be treated as a solicitation, as opposed to a communication where a discussion of investment advisory services is merely incidental to the provision of services or communication regarding other business or existing advisory business.

The "major purpose" standard would be effective and equitable because it would not dilute the effect of the Proposed Rule in combating pay-to-play, yet it would avoid triggering covered associate status for employees such as those described above who have little or no stake in attempting to obtain investment advisory business from a government entity.

The MSRB recognized the problem of incidental communications when it issued a 2006 interpretation under Rules G-37 and G-38.[22] That interpretation provides examples of circumstances under which a communication would normally be considered incidental to the provision of other services and would not be considered made for the purpose of obtaining or retaining municipal securities business. For example, the interpretation provides that exempt communications might include communications made by non-affiliated professionals such as lawyers, engineers, accountants, and other professionals in the scope of their professional duties, and that limited promotional communications, such as providing a brochure in response to a request, or providing details of a municipal securities product line, are normally not considered solicitations. Such communications, as noted above, are only incidental to the other services provided.

2. Employees of Affiliates Should Not be Treated as Covered Associates

The Commission states that the term "covered associates" would not cover employees of affiliates who solicit investment advisory services from a government entity, but requests comments on whether such employees of affiliates should be included.[23]

As a practical matter, affiliated employees' communications concerning investment advisory business are usually incidental to an unrelated provision of other goods or services to the government entity as described above. As a result, such employees are even further removed from the investment adviser and the economic incentive to engage in pay-to-play.

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[22] MSRB Interpretive Notice on the Definition of Solicitation Under Rules G-37 and G-38 (June 8, 2006).

[23] 74 Fed. Reg. at 39849.

Recommendation: Do not include in the term "covered associates" employees of affiliates.

3. Executive Officers

The Proposed Rule provides that an adviser's "covered associates" include certain "executive officers." Executive officers are defined as the president; any vice-president in charge of a principal business unit, division or function; and any other executive officer of the investment adviser who in connection with his or her regular duties performs, or supervises any person who performs, investment advisory services for the adviser, or solicits or supervises any person who solicits for the investment adviser, including with respect to investors for a covered investment pool, or who supervises, directly or indirectly, any of the aforementioned persons.[24]

i. The Definition of Executive Officer Should be Clarified or Narrowed

The definition of "executive officer" is vague and overbroad. The proposed definition of "executive officer" includes executive officers who provide advisory services to, or solicit advisory services from, any client, whether government or private, and their supervisors. Given that the term "executive officer" is defined using the term "executive officer," it is unclear as to what level of seniority one has to be in order to be subject to the rule. Moreover, this places an undue burden on advisory firms by including executives who provide advisory services to, or solicit such business from, any investor, not only government entities. This is contrary to the Commission's statement that the definition is narrowly tailored to include only those persons who are likely to have an economic incentive to influence the firm's selection by a governmental entity.[25]

Failing to accurately identify covered executive officers can result in a ban on compensated business for two years. Thus, the stakes are high and the need for clarity and certainty even more important.

Recommendation: We suggest rules that are in accord with the business practice of investment advisers. We suggest the appropriate level of seniority should include the senior officers who are on the investment adviser's executive or management committees or have an equivalent position. These persons would be, essentially, the officers who have ultimate responsibility for running the investment adviser on a day-to-day basis. This is consistent with the definition of MFP in Rule

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[24] Proposed Rule 206(4)-5(f)(4).

[25] 74 Fed. Reg. at 39849.

G-37, which includes an associated person who is a member of the broker, dealer, or municipal securities dealer executive or management committee or similar officials.[26]

Clarifying the Proposed Rule in this way would be consistent with the Proposed Rule's stated purpose as well. Given that the Proposed Rule does not limit the definition of executive officer to those working with a government entity, it is apparently attempting to reach executives who have an interest in the well-being of the investment adviser as a whole, as opposed to only those executives with dealings regarding government entities. By covering these senior executive or management committee members, the Proposed Rule would be covering individuals whose interests are firm-wide.

Alternatively, the Proposed Rule should be modified to include only those executive officers who perform advisory services for, or solicit advisory services from, a government entity. Limiting the applicability of the term executive officer in this manner would provide the needed nexus between the executive officer's activities and an adviser's business with government entities.

ii. The Definition of Supervisory Executive Officer Should be Limited to Those Who Supervise Advisory Business with a Governmental Entity

It does not serve the purpose of the Proposed Rule for all supervisors to be covered regardless of whether they have any control or interest in government advisory services business or an economic incentive to engage in pay-to-play. The Proposed Rule as currently drafted covers all supervisors without distinguishing between those who supervise an employee regarding, or have some connection with, covered government advisory business, and those who do not.

Recommendation: Limit the rule to those executives who directly supervise employees regarding their covered government advisory business. Please note that this is consistent with Rule G-37, which limits supervisory MFP status to those municipal securities principals or municipal securities sales principals who directly supervise MFPs, and supervisors up the chain from there.[27]

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[26] MSRB Rule G-37(g)(iv)(E).

[27] MSRB Rule G-37(g)(iv)(C).

iii. The Proposed Rule Should Clarify that the Chain of Covered Supervisors Ends with the CEO of the Investment Adviser

Under the Proposed Rule, executive officers include any executive who directly or indirectly supervises any person described above. The definition should be revised as indicated in the Commission's justifications, which provide that the chain of supervisors in an investment adviser would extend up through anyone in the manager's chain of supervision up to and including the president of the investment adviser.[28] This would ensure that the chain of supervisors ends with the CEO of the investment adviser and does not extend to other companies (for example, the parent company of the investment adviser).

Recommendation: Incorporate the Commission's example into the rule.

C. The Look-Back Rule Should be Modified

1. The Look-Back Should be Tailored to the Type of Covered Associate Involved in the Contribution

The Commission's desire to prevent people from doing indirectly what they cannot do directly is understandable, and there is always the possibility that someone intent on getting around the rules will use a surrogate to make a contribution. However, there should be some reasonable line drawn to separate that which is capable of being imagined but unlikely to happen, from realistic concerns regarding efforts to subvert the law. Given that the Proposed Rule already makes it a violation for an investment adviser to do indirectly what he or she cannot do directly[29], there is no need for a "belt and suspenders" approach to the rule. Given the serious nature of the sanctions, a tailored rule will be more effective and a greater deterrent, as it will be more likely be seen as connected to the problem identified, as opposed to a "speed trap" designed to be indiscriminate in who it ensnares.

Recommendations: In order to tailor the rule to address the specific problems identified, we recommend the Commission start with the approach used in MSRB Rule G-37 for two situations, modified as noted, and adopt a provision for individuals new to the industry:

i. If an individual becomes a covered associate for soliciting covered advisory business, then the two year look-back should only cover

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[28] 74 Fed. Reg. 39849.

[29] Proposed Rule 206(4)-5(d).

contributions made to an official of the government entity that the individual solicits for business. See MSRB Rule G-37(b)(ii). Similarly, for covered associates who perform investment advisory services, the two year look-back should only apply to contributions made to those government officials who have authority over the funds for which the covered associate performs the advisory services.

ii. For supervisors, executives and members of a management committee, the look-back should apply only to contributions made during the period beginning six months prior to becoming a covered associate. See MSRB Rule G-37(b)(iii).

iii. If an individual who was never previously involved in the investment adviser industry is hired as a covered associate, the look-back should only apply to contributions within the six-month period prior to the person becoming a covered associate that were made to a government official whom the covered associate solicits for business, or for which the covered associate performs investment advisory services, within one year of making the contribution. [30]

2. Automatic Look-Back Exception for New Hires

Determining with any certainty whether, in fact, an applicant for a covered associate position made a prior contribution that would fall under the Proposed Rule is very difficult, if not impossible. While there is widespread reporting of political contributions, there is no practical way for an investment adviser to do a comprehensive search for every political contribution made by a prospective hire.

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[30] The blanket application of the rule to someone who made a political contribution prior to becoming a covered associate or even starting work for an investment adviser who was selected by the government is perhaps the furthest removed from the Commission's goals. For example, it is highly unlikely that a $500 contribution made by a woman while she is a student or a practicing trial attorney at a law firm the year before she is hired to be a covered associate made her political contribution in an effort to influence the selection of the investment firm by the government. The same is true of a woman returning from two years of military service overseas who, a year before returning home, sends three $100 political contributions to a state assemblyman who was supportive of veterans, and then obtains a job that qualifies her as a covered associate upon her discharge from the military. Nevertheless, under the Proposed Rule if the recipient has any authority over the selection of the investment adviser and the contributor is hired, the firm will find itself barred from receiving compensation for one year (or two years from the date of the contribution), even if the investment firm had no knowledge of the prior contribution. If the investment firm does learn of the contribution prior to hiring the contributor, there is little practical choice other than to not hire her. It is hard to imagine the governmental interest strong enough to justify effectively banning those women from acquiring those jobs solely on the basis of those political contributions.

The online availability of state and local contributor information varies widely, and the states do not use a standardized method to capture, sort or report contributor data. Therefore, even if an investment adviser was willing to search the available databases for each state in which it did business, it would quickly find that many states do not provide a way to do an adequate search. Therefore, regardless of who the look-back provision covers, its application makes the employer's ability to carry on business totally dependent on the memory and honesty of a job applicant who may or may not know that admitting to a lawful political contribution made long before applying for the job will disqualify him from further consideration. In light of this, the Commission should provide for an exemption for an employer who makes a good faith effort to determine if a prohibited contribution was made.

Recommendation: We recommend that the Commission modify the Proposed Rule to provide for an exemption for a prohibited contribution made before an individual is hired and becomes a covered associate if the investment adviser:

a. obtains a written statement from the individual prior to their being hired stating that he or she has not made a prohibited contribution;
b. notifies the Commission of the prohibited contribution within 10 days of discovering it, and
c. prohibits the covered associate from soliciting business from the covered official for two years from the date of the contribution is discovered.

D. The Exceptions and Exemptions in the Proposed Rule Should be Modified to Make Them More Useful for the Commission and the Regulated Community

1. The De Minimis Exception

The Proposed Rule contains a de minimis exception[31] providing that the prohibition does not apply to a contribution by a covered associate if it is made to a person for whom the covered associate could vote and the contributions do not exceed $250 in the aggregate to any one official per election. In addition, if the covered associate is not eligible to vote for the recipient of the contribution, the investment adviser may still be entitled to an exception to the prohibition if 1) the investment adviser discovered the contribution within four months of it being made, 2) a refund of the contribution is obtained within 60 days of when it was discovered by the investment adviser, and 3) the contribution did not exceed $250. While the

[31] Proposed Rule 206(4)–5(b)(1)

exception is automatic, an investment adviser may only use it twice during a 12 month period, and only once for any one covered associate.

These exceptions are based on Rule G-37. Since the time they were promulgated, the contribution limits for what an individual can give to a federal candidate have more than doubled, going from $1,000 per election to $2,400 per election.[32] Likewise, many state contribution limits have changed. As the value of a contribution is, in part, measured relative to those surrounding it, the limits should be raised to reflect the higher contribution limits.

Recommendation: While there are a number of possible approaches, one reasonable approach would be to increase the amount of the contribution subject to the latter automatic exception to $1,000. In particular, if a covered associate cannot vote for the candidate, the Proposed Rule provides an automatic exception if a $250 contribution is discovered within four months and refunded within 60 days of discovery. This limit could be raised to $1,000 and the related time periods can be proportionally reduced to one month for discovery, and refund within 15 days.

Also, an investment adviser should be permitted to use the automatic exemption more than twice per year, depending on the number of covered associates it has. In particular, the more covered associates one has the higher the likelihood that one of them may inadvertently make a contribution. So we recommend that an investment adviser be allowed to have two automatic exemptions for its first 100 covered associates and then be allowed one additional exemption for each additional 100 covered associates.

2. The Discretionary Exemption

Proposed Rule 206(4)-5(e) provides an avenue by which an investment adviser may seek from the SEC a discretionary exemption. Upon application by the investment adviser, the Commission will consider a variety of factors, including but not limited to, the sufficiency of the investment adviser's compliance procedures, whether the investment adviser had knowledge of contribution before it was made, and the remedial steps, if any, the investment adviser took after discovering the contribution.[33]

The Commenters support the Commission's recognition that the application of the rules and the imposition of sanctions should be tempered by the exercise of

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[32] Moreover, the federal limits have been indexed for inflation and rise every election cycle.

[33] Proposed Rule 206(4)-5(e).

discretion, where warranted. In this way, the Commission can distinguish between an inadvertent violation which the investment adviser acted quickly to correct, and actions that reflect a disregard for the intent of the Proposed Rule.[34] Making this exemption available where warranted will encourage voluntary compliance and the adoption of best practices by investment advisers. Moreover, procedures should be developed to encourage a timely response to a request for an extension, as delays can cost the investment adviser business and prevent government pension plans from engaging the investment managers of their choosing.

This exemption process should also be made available for the third party placement agent ban.

Recommendation: The Commenters urge the Commission to make clear that the discretionary exemption is available for any situation that meets the stated criteria, including appropriate cases involving contributions made when the contributor is a covered associate, and will not be limited to cases involving the look-back provision. In addition, the Commission should amend the rule to provide that: (1) once a written request for an exemption is submitted the Commission has 45 days to respond, and (2) the two-year ban is tolled during the pendency of the exemption process, where the investment adviser may continue to provide services to the government for which the investment adviser is fully compensated (and the two-year ban would start if the exemption is denied). This allows the exemption process to have some level of predictability irrespective of the outcome.

E. Clarify Definition of a Covered Governmental Official

The Proposed Rule defines a government "Official" as a person who is an incumbent or candidate for an elective office which 1) is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser; or 2) has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity.[35]

Recommendation: The Commission should clarify that the analysis required by this section of the Proposed Rule is limited to the formal scope of authority of the

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[34] Putting aside the question of one's civic duty, the reality is that some people see no reason to report an illegal contribution if the enforcement process does not make some effort to distinguish between the person who comes forward as soon as they find out about the contribution and the person who decides to wait and take the chance that the contribution will never be discovered.

[35] Proposed Rule 206(4)–5(f)(6)

office in question. In this way, everyone will know the standard by which their actions will be judged. The MSRB has taken the same position when interpreting Rule G-37.[36]

Also, the Commission should exclude (i) state officials running for federal offices, and (ii) state officials (e.g., governors) who can appoint members of the board of trustees of a public employee pension plan but do not participate in the plan's decision-making.

F. Covered Investment Pools

The Proposed Rule's two-year ban does not apply to an investment adviser providing services to a publicly-offered registered investment pool in which the government invests. The Commission correctly finds that the danger of a contribution by the investment adviser being for the purpose of influencing the government in making that investment is remote, especially considering that the adviser may not even know that the government entity has made an investment.[37]

Recommendation: For the same reason, the Commission should not apply the Proposed Rule to a publicly offered, registered investment pool that is selected as an option in a government plan. For example, if an investment pool is made available as an option in a government plan through a platform established by a third party broker-dealer, the investment adviser would not have any knowledge of that government entity. More importantly, if an investment adviser is forced to not charge a fee to the investors who are part of such government plan, it would result in an impermissible preferred dividend to that investor. Thus, publicly offered, registered investment pools should be entirely exempt from the Proposed Rule's two-year ban.[38]

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[36] See MSRB Notice 2008-12 (March 4, 2008).

[37] 74 Fed. Reg. 39857.

[38] This change would also help address the use of circular and overlapping definitions in the Proposed Rule, which could cause confusion regarding the investment of state funds in certain publicly offered mutual funds as part of a 529, plan, 403(b) plan or a 457 plan. The definition of "covered investment pool" includes a mutual fund if it "is an investment or an investment option of a plan or program of a government entity." At the same time, "government entity" is defined, in part, as a "plan, program, or pool of assets sponsored or established by the State." Proposed Rule 206(4)-5(f)(3) and (5). A "plan or program of a government entity" is defined to mean any "investment program or plan sponsored or established by a government entity," including but not limited to 529 plans, 403(b) plans and 457 plans, "or any similar program." Proposed Rule 206(4)-5(f)(8). The reference to both an "investment" and "investment option" in defining "covered investment pool," and the circular and overlapping definitions noted above, could raise questions regarding the ban's application to certain

II. THIRD PARTY PLACEMENT AGENT BAN

Subject to certain exceptions, the Proposed Rule would prohibit an investment adviser or its covered associates from paying any third party for soliciting investment advisory business from a governmental entity. Exempt from the ban are a general partner, managing member or Executive Officer or employee of the investment adviser, and a "related person" of the investment adviser. "Related person" includes any person directly or indirectly controlling, controlled by, or under common control with the investment adviser. If the related person is a company, the Proposed Rule would include employees of the company.[39]

A. Registered Broker-Dealers and Others Providing Substantive Services to the Investment Adviser or Investment Pool Should be Exempt from the Ban

As written, the placement agent ban applies to any third party making a communication to solicit investment advisory business on behalf of the adviser. The rule applies without discrimination, regardless of whether the third party is providing substantive services or is merely hired for his or her relationship with a government official. This undermines the well-established system in the investment adviser business in which certain third parties, such as broker-dealers, have always provided valuable and substantive services to the adviser that also benefit public employee pension plans.

Such services include conducting research on investments; identifying current portfolio exposure, investment strategy and due diligence requirements of potential investors; advising the investment adviser on fundraising strategy; and matching potential investors to appropriate products. Typical communications by such broker-dealers are not attempts to establish business based on relationships or influence, but rather are substantive communications related to the services described above, or other services. Indeed, registered investment pools routinely pay third party broker-dealers to gain access to the broker-dealer's platform and all the accompanying substantive services, such as record-keeping and due diligence, and not necessarily for soliciting governmental entity investors. Moreover, investment pools sometimes pay such third party broker-dealers a flat fee, thus making it impractical to determine what portion of that fee is related to the government investor.

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publicly offered mutual funds, which the Commission's explanation suggests are excluded. Id. at 39857 n. 185.

[39] Proposed Rule 206(4)-5(a)(2)(i) and (f)(9).

Besides the services provided by a registered broker-dealer, other professionals also provide substantive services to investment advisers, such as legal, accounting, and engineering services, due diligence services, banking services, actuarial services, insurance services, financial advisory services, and marketing services (such as providing a brochure or creating promotional materials). Please note that the payment for many third party services is typically not tied to whether a particular solicitation is successful. These individuals usually are only communicating with a government entity incidental to the provision of these substantive services to investment advisers, as discussed above in our comment regarding the definition of the term "solicit."

Recommendation: Rather than effectively prevent investment advisers from obtaining such services from third party broker-dealers and other professionals providing substantive services to the investment adviser, the Proposed Rule should be modified to exclude them from the ban.

This suggestion is consistent with the purpose of the Proposed Rule. In explaining the proposed placement agent ban, the Commission states that it is concerned that adopting a pay-to-play rule as applied to investment advisers would lead to the kinds of behaviors that lead the MSRB to impose a complete ban on the use of consultants and other third party solicitors pursuant to Rule G-38.[40] The same concern that the MSRB had in the case of unregistered solicitors and consultants does not apply to registered broker-dealers and providers of substantive services.

Indeed, broker-dealers and their registered representatives are licensed and regulated by the Commission and the Financial Industry Regulatory Authority ("FINRA"). The Commission and FINRA could directly impose and enforce restrictions on such broker-dealers. This was not the case under Rule G-38, under which third party consultants were for the most part unregistered and unregulated.

Moreover, professionals who provide substantive services to investment advisers typically are licensed and subject to strict regulation by state or federal entities. Connecticut, for example, has recognized this, and provided a similar exemption for payments to such professionals in its finder's fee statute. <u>See</u> Connecticut General Statutes § 3-131. Changing the definition of "solicit" as we suggest above would mitigate the problem of the placement agent ban applying to such professionals providing substantive services.

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[40] 74 Fed. Reg. at 39852.

For the same reasons, investment advisers should not be effectively prevented from using the services of non-affiliated registered investment advisers.

B. Allow for Case-by-Case Determination of Whether Independent Contractors may be Eligible for the Exemption for Related Persons

The Proposed Rule provides that any "related person" is exempt from the placement agent ban, and if the related person is a company, the exemption applies to employees of that company. However, of the types of companies that will be subject to the Proposed Rule, life insurance affiliates are unique in that they often work through insurance agents who are independent contractors.

Life insurance independent contractors may sell hundreds of products and services, some of which may be investment advisory services. These contractors are subject to rigorous requirements and licensing from both state and federal regulatory agencies. In addition, to the extent they sell interests in a covered investment pool, they must be registered representatives of an affiliated broker-dealer. As registered representatives, these agents are under direct control of the affiliated broker-dealer and under common control with the investment adviser. However, given that the Proposed Rule only refers to "employees" of related companies, these insurance agents could technically be banned from soliciting government entities.

This distinction based on employment status is artificial. There is no substantive difference between independent contractors who are controlled by an affiliated broker-dealer and those employed by that broker-dealer.

Recommendation: To address this problem, we suggest eliminating the following language in the Proposed Rule: "or, if the related person is a company, an employee of that related person." [41]

III. RECORDKEEPING REQUIREMENT

The Proposed Rule requires an investment adviser to keep records of, among other things, all government entities for which the investment adviser or any of its covered associates is "providing or seeking to provide" investment advisory services or are "investors or are solicited to invest" in a covered investment pool.

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[41] Proposed Rule 206(4)-5(a)(2)(i)(A).

A. Investment Advisers Should not be Required to Keep Records of Government Entities Being Solicited

This recordkeeping requirement imposes an impractical and unworkable burden on investment advisers to keep records of government entities that are being solicited for covered advisory services. This problem is compounded by the broad definition under the Proposed Rule as to when one is deemed to be soliciting a government entity. Thus, an investment adviser may have to track every instance of a covered associate leaving a brochure with a government entity describing the firm's investment advisory capabilities, making an introduction, answering a government official's question, or other brief discussion with a government entity regarding advisory services.

At the same time, having records of the government entities that are being solicited does not further the more efficient enforcement or implementation of the Proposed Rule. Indeed, knowing which government entities are being solicited is to a large degree irrelevant under the Proposed Rule in that the rule does not prohibit an investment adviser from soliciting covered business if a political contribution is made, but rather prohibits the investment adviser from receiving compensation for advisory services. The only way such solicitation activity could be relevant is in determining who qualifies as a covered associate. However, there is a separate requirement to keep records of covered associates so it does not add to that part of the rule either.

Recommendation: The Proposed Rule should eliminate the part of this recordkeeping requirement that covers government entities being solicited for covered business.

B. Investment Advisers Should not be Required to Keep Records of Government Entities Investing in Publicly Offered Investment Pools

The Proposed Rule exempts from the two-year ban on political contributions government entities investing in publicly-offered registered investment pools, where the pool is not otherwise offered as an option in a government plan, such as a § 403(b) retirement plan.[42] In justifying this exemption, the Commission states that an adviser may not even be aware that a government entity has invested in such publicly-offered pools and create substantial compliance challenges, thus warranting the exemption from the two-year ban.[43]

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[42] Proposed Rule 206(4)-5(f)(3).

[43] 74 Fed. Reg. at 39857.

The recordkeeping requirement, however, does not have a similar exemption for publicly-offered pools. If it is unreasonable to expect a publicly-offered investment pool to track government investors for purposes of the two-year ban, it should also be unreasonable to expect such tracking for recordkeeping purposes.

Recommendation: Exempt from the recordkeeping requirement publicly-offered registered investment pools, where the pool is not otherwise offered as an option in a government plan.

Where the Commission modifies the coverage of the two-year ban, it should also modify the recordkeeping requirements to ensure that the reporting and ban are co-extensive.

IV. TRANSITION PERIOD RULE

The Commission indicates that the prohibitions and recordkeeping requirements in the Proposed Rule would arise from political contributions made on or after the effective date of adoption. The Commission appears to be contemplating implementing a transition period of at least ninety days, and requests comments on whether a longer period is justified.[44]

Regardless of whether the Proposed Rule takes effect immediately or within ninety days or even six months of its adoption, the Proposed Rule is very likely going to take effect during the busy campaign fund-raising season related to the 2010 elections. In fact, it is likely that in many cases, individuals who will be treated as covered associates have already committed to fund-raise and work for campaigns, while many others may have pledged to make campaign contributions. In addition, it will take several months for companies to design and build systems to comply with the recordkeeping requirements alone, not to mention the tracking and monitoring systems that must be developed and implemented. All of this significantly increases the likelihood that an investment adviser will inadvertently trigger the ban while educating its employees and implementing compliance procedures.

Recommendation: The effective date of the Proposed Rule should be a date after the conclusion of the 2010 elections.

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[44] Id. at 39860.

Please call us with any questions.

Respectfully submitted,

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Comments on File Number S7-18-09:
Securities and Exchange Commission Proposed Rule 206(4)-5

Summary of Proposed Recommendations

- **Two Year Ban**

  - The two year ban on compensated investment advisory services should be modified to include alternative remedial procedures which allow for the investment advisor to seek a waiver from the relevant government investor or, in the alternative, the Commission should establish a procedure to allow the Investment Management Division to fashion a remedy tailored to the specific factual situation. See Section I, A, 3, i (page 8).

  - The Commission should clarify that the ban does not apply to sub advisers. See Section I, A, 3, ii (page 10).

- **Covered Associates**

  - The definition of "solicit" should be modified to include only those communications that are made with a "major" purpose of obtaining, retaining, or referring government investment advisory business (as opposed to incidental communications about advisory services). See Section I, B, 1 (page 11).

  - Employees of affiliates should be exempt from treatment as covered associates. See Section I, B, 2 (page 13).

  - The definition of "executive officer" should include only those on the investment adviser's executive or management committee, or, alternatively, should include only those executive officers who perform advisory services for, or solicit advisory services from, government entities. See Section I, B, 3, i (page 14).

  - The definition of "supervisory executive officers" should be clarified to either include only those who directly supervise employees regarding their covered government advisory business. See Section I, B, 3, ii (page 15).

  - The Proposed Rule should be clarified to provide that the chain of covered supervisory executive officers extends no further than the CEO or president of the investment adviser, and does not extend to a parent company. See Section I, B, 3, iii (page 16).

- **Look-Back Rule**

    - If an individual becomes a covered associate for soliciting covered advisory business, the two year look-back should only cover contributions made to an official of the government entity that the individual solicits for business. For covered associates who perform investment advisory services, the two year look-back should only apply to contributions made to those government officials who have authority over the funds for which the covered associate performs the advisory services. See Section I, C, 1, i (page 16).

    - For supervisors, executives and members of a management committee, the look-back should apply only to contributions made during the period beginning six months prior to becoming a covered associate. See Section I, C, 1, ii (page 17).

    - In the case of an individual who was never previously involved in the investment adviser industry, the look-back rule should only apply to contributions within the six-month period prior to the person becoming a covered associate that were made to a government official whom the associate solicits for business within one year of making the contributions. See Section I, C, 1, iii (page 17).

    - The Commission should provide an exemption for a contribution made before an individual is hired if the investment adviser obtains (prior to hiring the individual) a written statement from the individual that no prohibited contributions were made; notifies the Commission of the prohibited contribution within 10 days of discovery; and prohibits the covered associate from soliciting business from the official for two years after discovery. See Section I, C, 2 (page 17).

- **Exemptions and Exceptions**

    - The de minimis exception for a contribution made by a covered associate to a person for whom the associate is entitled to vote should be raised to $1,000. See Section I, D, 1 (page 18).

    - The discretionary exemption should be made available for any situation that meets the stated criteria. In addition, the discretionary exemption process should be amended to provide that once a written request for an exemption is submitted, the Commission has 45 days in which to respond, and the two-year ban is tolled while the application is pending. See Section I, D, 2 (page 19).

- **<u>Covered Government Official</u>**

    - The Commission should clarify that the analysis of whether a government official is covered under this provision is limited to the formal scope of authority of the office in question. <u>See</u> Section I, E (page 20).

- **<u>Covered Investment Pools</u>**

    - The Proposed Rule should not apply to a publicly-offered registered investment pool that is selected as an option in a government plan. <u>See</u> Section I, F (page 21).

- **<u>Third Party Placement Agent Ban</u>**

    - Third party registered broker-dealers, investment advisers, and others providing substantive services to the investment adviser should be exempt from the ban. <u>See</u> Section II, A (page 22).

    - Independent contractors who are under the actual control of an investment adviser's affiliate should be exempt from the ban. <u>See</u> Section II, B (page 24).

- **<u>Recordkeeping</u>**

    - Publicly-offered registered investment pools that are not offered as an option in a government plan should be exempt from the recordkeeping requirement, consistent with the Proposed Rule's exemption of such pools from the two-year ban. <u>See</u> Section III, A (page 25).

    - If the Proposed Rule is modified to exclude publicly-offered registered investment pools that are offered as an option in a government plan, the recordkeeping requirement should be modified to exempt such pools. <u>See</u> Section III, B (page 25).

- **<u>Transition Rule</u>**

    - To allow enough time for investment advisers to build compliance systems and to develop compliance procedures, and to avoid inadvertent violations while such systems and procedures are being implemented, the effective date of the Proposed Rule should be at some point after the 2010 elections. <u>See</u> Section IV (page 26).