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October 6, 2009

VIA ELECTRONIC MAIL

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

**Re: File No. S7-18-09; Release IA-2910**
**Political Contributions by Certain Investment Advisers**

Dear Ms. Murphy:

This letter is submitted on behalf of certain clients of Sutherland Asbill & Brennan LLP ("Clients") in response to the publication of *Political Contributions by Certain Investment Advisers* (the "Proposing Release") issued by the U.S. Securities and Exchange Commission ("SEC").[1] The Proposing Release requests comment on proposed rule 206(4)-5 ("Rule") under the Investment Advisers Act of 1940, as amended ("Advisers Act"). The Clients appreciate the opportunity to comment on the proposed Rule.

Among other things, the Rule would prohibit investment advisers from providing advisory services for compensation to a government entity for two years after an adviser or certain of its executives or employees make a contribution to certain elected officials or candidates. The Rule also would prohibit advisers from providing or agreeing to provide payment to third party solicitors for solicitation of advisory business from any government entity on behalf of the advisers. In addition, the Rule would prevent advisers from soliciting or coordinating contributions from others to certain elected officials or candidates or payments to political parties where the adviser is providing or seeking government business. Finally, the Rule would prohibit investment advisers from doing indirectly what they are prohibited by the Rule from doing directly. While the Clients support the SEC's attempt to rid the investment management industry of the harms associated with pay to play activity, they have significant concerns with a number of the proposed Rule's provisions. The Clients urge the SEC to refine these provisions in order to alleviate such concerns while effectuating the underlying purposes of the proposal, as discussed below.

[1] The Proposing Release was published in Investment Advisers Act Release No. IA-2910 (Aug. 3, 2009), *reprinted in* 74 Fed. Reg. 39840 (Aug. 7, 2009).

This letter first discusses certain open-ended provisions of the proposed Rule and the challenges such provisions would create for investment advisers that are part of a large financial services complex. There is a significant risk such investment advisers would not know which practices and arrangements would fall within the Rule's prohibitions. The Clients believe that the Rule could have a chilling effect on certain salutary practices that have long been viewed as being consistent with the Advisers Act. In addition, the Rule could foster inconsistent interpretations and varied compliance strategies in the investment management industry.

Second, this letter questions the rationale of the Rule's proposed ban on the use of third party solicitors to obtain investment advisory business from government entities. An activity (*i.e.*, use of a third party solicitor to solicit advisory business) that typically contributes to market efficiency by permitting companies to focus on their core competencies and is permissible under the Advisers Act as long as certain conditions are satisfied, should not be characterized as being fraudulent simply because the target of such solicitation activity is a government entity.

Third, this letter raises concerns with respect to the Rule's proposal to treat investment advisers to covered investment pools "as if" they have a direct investment advisory relationship with government entities investing in such pools. Such a result is inconsistent with the current state of the law and rule 203(b)(3)-1 under the Advisers Act, and would unfairly encumber investment advisers with a conflict of interest between government entity investors in such pools and non-government entity investors in the pools. Finally, this letter discusses a number of miscellaneous provisions of the proposed Rule that are impractical or otherwise should be revised to reflect a proper balance of the competing interests the SEC is seeking to reconcile.

## I. Uncertainty about Scope and Application of the Rule

Our Clients' primary concern is that the scope and extent of the proposed Rule are unclear and ambiguous. As currently proposed, the proposed Rule would not permit investment advisers to have a reasonable degree of certainty as to which activities and relationships are prohibited under the Rule. The following discussion illustrates the types of questions that are left unanswered by the proposed Rule and the Proposing Release.

### *A. Activities of Affiliates*

Our Clients are concerned about the scope of proposed Rule 206(4)-5(d), which would make it unlawful for any investment adviser or any of an adviser's covered associates "to do anything indirectly which, if done directly, would result in a violation of this section." In an attempt to provide guidance as to the parameters of acceptable activity, the Proposing Release provides a number of examples of impermissible indirect activity.[2] While the Clients applaud

[2] For instance, the Proposing Release provides that "[c]ontributions by non-executive employees (other than those who solicit government entity clients) would not trigger the rule's prohibitions, unless the adviser or any of its covered associates used the person to indirectly make a contribution. This could occur, for example, if a firm paid a non-executive employee a bonus **with the understanding** that the bonus would be used by the employee to make a political contribution that, if made by the firm, would trigger the rule's prohibition." (text accompanying n.105.)

the SEC's statement in the Proposing Release that "[w]e are not proposing that contributions by 'related persons' and their employees would trigger the two-year time out," the limitless scope of the language in proposed Rule 206(4)-5(d), combined with the ability of SEC Staff to interpret the language in an enforcement context, will have a number of important repercussions:

- SEC Staff will have tremendous leeway to characterize activities engaged in by a related person of an investment adviser as being an "indirect" activity attributable to the investment adviser -- this is particularly troublesome for large financial entities engaged in various activities and industries, some of which are wholly unrelated to investment management;

- There is little that an investment adviser could do to refute such a characterization by the SEC Staff as doing so requires an investment adviser to "prove a negative" (*i.e.* that the related person of an investment adviser was not acting at the instruction or direction of the investment adviser);

- Investment advisers would not know which activities the SEC Staff would consider to be impermissible "indirect" activity except through enforcement actions (*i.e.*, not until *after* certain behavior has been undertaken, perhaps for a long period of time);

- The open-ended nature of the language in proposed Rule 206(4)-5(d) creates uncertainty as to which activities and arrangements of affiliates of an investment adviser fall within the Rule's prohibitions. For instance, the lack of clarity as to when a "contribution" by an affiliate or efforts by an affiliate to coordinate or to solicit any person or political action committee to make any "contribution" or "payment" would be imputed to an investment adviser would have a chilling effect on legitimate political contributions made by large financial services companies. Since investment advisers would not know, until after the fact, when a practice will be deemed to constitute impermissible "indirect" activity, they would be forced to act cautiously and seek to limit and prohibit related persons (including affiliated companies) from making "contributions" or "payments," or coordinating or soliciting any person or political action committee to make "contributions" or "payments."

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(Emphasis added.) Footnote 150 provides that "[t]his provision would prohibit, for example, an adviser's solicitation of a payment to the political party of the state in which the adviser was seeking to provide advisory services to a government entity of the state, but would not preclude that adviser from soliciting a payment to a local political party, unless the adviser was doing so as a means to do indirectly what the adviser could not do directly under the proposed rule (for example, if the adviser was soliciting the payment **as a means to funnel payments** to an official of the government entity from which the adviser was seeking business)." (Emphasis added.) Similarly, footnote 154 states that "[w]e note that a direct contribution to a political party by an adviser or its covered associates would not trigger the two-year time out provision of the proposed rule . . . . unless the contribution was a means for the adviser to do indirectly what the proposed rule would prohibit if done directly (for example, if the contribution was earmarked **or known** to be provided for the benefit of a particular government official)." (Emphasis added.)

Due to the uncertain scope and reach of Rule 206(4)-5(d), but giving consideration to the prophylactic nature of the proposed Rule, it is appropriate for the SEC to explicitly incorporate a knowledge and support requirement into this rule so that it would be violated only if an investment adviser has direct knowledge of, and takes measures to aid and support, activities undertaken by its affiliates. Such a standard would merely make explicit what is implicit in the examples provided by the SEC in the Proposing Release (see footnote two above).[3] This approach is in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Advisers Act. If an adviser does not know or aide or support the activities undertaken by its affiliates, then it cannot fairly be said to be doing indirectly what it cannot do directly. Such an approach would also foster understanding of the Rule requirements and compliance with its provisions. Moreover, such an approach would create an incentive (by creating certainty as to the parameters of the Rule) for investment advisers to "wall" themselves off from the activities of affiliates that might otherwise trigger a violation of the Rule. Investment advisers would thus be able to actively manage their risk of being deemed to violate Rule 206(4)-5(d). Should the SEC decide not to incorporate a knowledge and support provision into Rule 206(4)-5(d), the Clients strongly encourage the SEC to provide more guidance as to when activities of affiliates of investment advisers would be attributable to the investment adviser, taking into account the concerns that advisers in large financial organizations have with respect to the scope and reach of this provision.

*B. Officers, Directors and Employees of Multiple Companies*

One concern of the Clients closely related to the point discussed above stems from circumstances in which officers, directors or employees of investment advisers also serve as officers, directors or employees of affiliated companies. This practice is common in large financial organizations. The Clients are concerned that the SEC might attribute to investment advisers the "contributions" made by an affiliate or efforts by such affiliate to coordinate or solicit any person or political action committee to make any "contribution" or "payment" simply because the two companies share one or more officers, directors or employees. The Clients request the SEC to confirm that so long as any such officers, directors or employees do not play a role in determining, shaping or directing any "contributions" or efforts to coordinate or to solicit any person or political action committee to make any "contribution" or "payment" on the part of the affiliate, then such activity would not be imputed to the investment adviser. The role (or lack thereof) of the officers, directors or employees could be established by creating and maintaining records, such as board or meeting minutes, setting forth which individuals were present and played a role in determining, shaping or directing any "contributions" or efforts to coordinate or to solicit any person or political action committee to make any "contribution" or "payment" on the part of the affiliate.

The Clients believe that this approach also is in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the

[3] Implicit within the examples illustrated by the SEC in the Proposing Release (outlined in footnote two) of indirect, impermissible activities is the notion that the adviser "knew," "understood," intended to circumvent a restriction, or . expected to benefit from a contribution.

Advisers Act. They also believe that such an approach would foster understanding of the requirements under the Rule and compliance with its provisions. If advisers understand where the bounds of permissible behavior lie, then they could mitigate their risks of violating Rule 206(4)-5(d) by ensuring that their officers, directors or employees do not determine, shape or direct any "contributions" or efforts to coordinate or to solicit any person or political action committee to make any "contribution" or "payment" on the part of an affiliate. By limiting the roles that their officers, directors or employees play when acting on behalf of affiliates, advisers would be able to take active steps to avoid being in a position of potentially violating Rule 206(4)-5(d). Since such steps would effectively remove advisers' associated persons from any decision-making role with respect to the "contribution," coordination or solicitation activities of its affiliates, such activities should not be attributable to the advisers.

### C. *Pay to Play Activity Versus Marketing and Distribution Arrangements in the Ordinary Course*

The Proposing Release asserts that "an investment adviser subject to our proposed rule that manages a registered investment company would be prohibited from compensating a third party to solicit an investment by a government entity in the fund." The Clients wish to understand the scope of this statement. On its face, this language suggests that any payment by an adviser to a broker-dealer registered with the SEC under the Securities Exchange Act of 1934, as amended, for solicitation of a government entity, would be illegal. This statement is inconsistent with the current state of the law. Accordingly, the Clients request clarification of the intent and scope of this language.

The Proposing Release also states that pay to play activities "may be effectuated, for example, through revenue sharing arrangements." In this regard, the Proposing Release does distinguish pay to play activities that may be effectuated through revenue sharing arrangements from marketing and distribution arrangements "in the ordinary course of business through compensated third parties, such as registered broker-dealers." The Clients conclude from this statement that revenue sharing arrangements involving a registered investment company in which a government entity invests is not inherently prohibited pay to play activity - and to conclude otherwise would ascribe to the proposed Rule consequences far beyond those indicated by the SEC. The basis, however, upon which the SEC distinguishes revenue sharing arrangements that constitute pay to play activities from acceptable marketing and distribution arrangements established in the ordinary course of business is not clear. Accordingly, the Clients request clarification of this distinction.

Specifically, the Clients submit that revenue sharing arrangements should not be considered to involve impermissible pay to play activity. In fact, such arrangements have been explicitly recognized by the SEC in a number of contexts.[4] The Clients request that the SEC

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[4] *See, e.g.*, Proposed Rule: Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Exchange Act Release No. 34-49148 (Feb. 9, 2004), *reprinted in* 69 Fed. Reg. 6,438 (Feb. 10, 2004).

clarify its statements concerning revenue sharing arrangements in the Proposing Release in a manner that is sensitive to long-standing industry practices that have been designed based on prior SEC guidance concerning such arrangements. In this respect, the Clients strongly believe the proposed Rule should not serve as a vehicle to restrict or limit ordinary revenue sharing arrangements that have long existed in the investment management industry. Such payments are typically made in consideration of the value or efficiencies realized by advisers that have no connection to any pay to play scheme. Our Clients are concerned that counter-inferences may be suggested unless a clearer delineation of permissible revenue sharing arrangements versus arrangements intended to be prohibited by the Rule is set forth.

*D. Executive Officers*

The definition of "covered associate" in the Proposing Release would include, among other things, executive officers. The definition of "executive officers" in turn would include the president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), or any other executive officer of the investment adviser who, in each case, in connection with his or her regular duties:

(i) Performs, or supervises any person who performs, investment advisory services for the investment adviser;
(ii) Solicits, or supervises any person who solicits, for the investment adviser, including with respect to investors for a covered investment pool; or
(iii) Supervises, directly or indirectly, any person described in (i) or (ii).[5]

The definition of executive officer is too broad and vague.[6] The term "executive officer" should be revised to include "the president or any officer in charge of a principal business unit, division or function if any such individual in connection with his or her regular duties makes or determines policy for the investment adviser with respect to government entities <u>and</u> (i) performs, or supervises any person who performs, investment advisory services to government entities for the investment adviser; (ii) solicits, or supervises any person who solicits government entities, for the investment adviser, including with respect to investors for a covered investment pool; or (iii) supervises, directly or indirectly, any person described in (i) or (ii)."

This revised definition of "executive officer" would achieve the SEC's goal of eliminating pay to play activities while also ensuring that the Rule is "narrowly tailored" to meet

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[5] As currently drafted, it is unclear whether (i), (ii) and (iii) modify the entire first part of the definition or merely the language coming after the word "or" (*i.e.*, just the phrase "or any other executive officer of the investment adviser who, in each case, in connection with his or her regular duties").

[6] According to the Proposing Release, the SEC "drafted the proposed rule so that its prohibitions are triggered by political contributions by persons who, in the context of an advisory firm, are likely to have an economic incentive to make contributions to influence the advisory firm's selection and the categories of executives and employees of an adviser that we have seen, most typically, to make political contributions and payments in pay to play situations" (*see* discussion following n.105). However, there is no data provided to support the SEC's assertions.

this goal. First, the Clients note that requiring any "executive officer" to make or determine policy for the adviser with respect to government entities is consistent with rule 205-3 under the Advisers Act, upon which the proposed definition of "executive officer" is based.[7] Second, the revised definition is necessary to ensure it does not capture individuals who do not play a material role with respect to an adviser's government entity clients and should not be subject to the proposed Rule's limitations. Third, the revised definition will promote understanding of the Rule and more consistent compliance strategies since advisers will interpret the bounds of acceptable behavior in a more consistent fashion. Fourth, the revised term "executive officer" will be broad enough to ensure that there is no reduction in the level of investor protection[8] as compared to the SEC's proposed definition. Finally, to be fairly considered an "executive officer" of a company under the Rule, an individual ought to, as part of his or her regular duties, make or determine policy for the investment adviser with respect to government entities and play a material role in seeking advisory business from, or providing advisory services to, government entities, or overseeing either of these two activities.

*E. The Meaning of "Control" of PACs*

The Rule would define the term "covered associate" of an investment adviser to include, among other things, "[a]ny political action committee controlled by the investment adviser or by any person described in paragraphs (f)(2)(i) and (f)(2)(ii) of this section." The Proposing Release does not contain a definition of "control." The Clients presume that the SEC would look to the definition of control in Section 202(a)(12) of the Advisers Act, which defines the term "control" to mean "the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company." Similarly, we note that Form ADV defines "control" to mean "the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise." The manner in which the SEC defines when a political action committee is "controlled" by an investment adviser or its personnel is very important in the context of an investment adviser that is part of a large financial services complex. It is fairly common for such complexes to maintain one or more "enterprise-wide" political action committees. The Clients, which are part of such complexes, are concerned that contributions by such enterprise-wide political action committees would be attributed to the investment adviser. Based on either of the two definitions above, there should be no such attribution unless the adviser actually exercises a controlling influence over, or directs, the management or policies of, an enterprise-wide political action committee. Under this approach, mere contributions by an investment adviser or any of its associated persons to an enterprise-wide political action committee would not cause such committee to be deemed to be controlled by the adviser (and therefore a covered associate of the adviser).

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[7] *See* footnote 103 of the Proposing Release.

[8] The Clients seek confirmation that the term "executive officer" does not include individuals who are officers of a parent, subsidiary or affiliate of an investment adviser but not of the investment adviser itself.

*F. Two-Tiered Products and Services*

The Clients seek clarification of how the proposed Rule would operate in the context of two-tiered investment products and advisory services, including fund-of-funds, manager-of-manager programs, adviser/sub-adviser relationships and variable insurance products. In particular, the SEC should confirm that the practices (*e.g.*, making "contributions" or "payments," or coordinating or soliciting any person or political action committee to make "contributions" or "payments") of a top-tier investment adviser should not be imputed to the bottom-tier investment adviser, or vice-versa, unless an investment adviser knows about and takes measures to aid and support practices undertaken by the other tier's investment adviser. The Clients believe that such an approach is in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Advisers Act. In this respect, if an adviser does not know of or actively support the activities undertaken by the adviser at the other tier, then it should not be responsible for the other investment adviser's practices merely because it has a contractual arrangement with such other adviser or the issuer. Should the SEC decide not to incorporate a knowledge and support provision into Rule 206(4)-5(d), the Clients strongly encourage the SEC to provide more guidance as to when activities of top-tier advisers could be attributed to bottom-tier advisers in multi-tier investment products and advisory services and vice versa, taking into account the practical difficulties in knowing and monitoring the activities undertaken by other investment advisers.

*G. Large Financial Complexes*

Much of the concern expressed above regarding the scope of the definitions and other provisions of the proposed Rule stem from the "default" assumptions embedded in the proposed Rule language. These assumptions (*e.g.*, the definition of "executive officer") will result in the two year time out and other Rule provisions being triggered by contributions by individuals who play no role with respect to the advisory services provided to a government entity. The Clients fully support the goals sought to be achieved by the SEC but not an approach that casts such a wide net as to bring within the Rule individuals who have no involvement with the practices the SEC is seeking to terminate. In this respect, it is important to recognize the difficulties and hardships that the proposed Rule will impose on large financial complexes that contain one or more investment advisers. In such complexes, it is common for multiple companies and multiple units or divisions of such companies to engage in various contribution, payment and solicitation activities. As noted above, these companies sometimes share common officers or directors. The large of number of companies in such complexes and the large number of business relationships and interactions such companies have with government entities means that it is *inevitable* that contribution, payment or solicitation activity will be conducted by a company within the complex with respect to a government entity that an investment adviser in the complex is seeking to obtain as a client. After all, an adviser in such a complex may have hundreds of affiliates, some of which have relationships with the same government entities the adviser is seeking to obtain as advisory clients. The Clients are greatly concerned that the optics of such a situation will result in a de-facto regulatory presumption that such activity involves a pay to play

violation. Accordingly, the Clients seek, in addition to the specific refinements discussed above, confirmation from the SEC that the merits of each situation will be closely scrutinized so that no presumption follows from the activities conducted by affiliates of an investment adviser.

## II. The Proposed Ban on Third Party Solicitors

When the SEC adopted rule 206(4)-3 under the Advisers Act it wrote the following:

> On the other hand, a few commentators contended that the payment of cash referral fees involves unacceptable conflicts of interest and should not be permitted under any circumstances. Although referral fee arrangements pose conflict of interest problems, the Commission is not persuaded that such arrangements are necessarily fraudulent and therefore should be prohibited. Rather, the Commission is of the view that, with appropriate regulatory safeguards, the payment of cash referral fees can be permitted consistent with the protection of investors, and that an outright prohibition of such fees would unnecessarily restrict the ability of investment advisers to make their services known to potential clients.[9]

For over thirty years, rule 206(4)-3 has permitted investment advisers to pay solicitors for their services so long as a number of regulatory safeguards are satisfied. Based primarily on a concern that "adoption of a rule addressing pay to play practices by advisers would lead to a similar use of consultants or solicitors by investment advisers to circumvent the rule," the SEC now proposes to prohibit investment advisers from using third party solicitors to obtain government clients. This proposed ban on the use of third party solicitors would mean that activity (*i.e.*, paying third party solicitors for their solicitation activities) which is perfectly legal (and, in fact, expressly authorized by the SEC) if conducted with most types of clients would be fraudulent if conducted with this category of clients. Thus, activity which is perfectly legal would become fraudulent based solely on the identity of the person that is solicited.

While the Clients recognize that the proposed ban on the use of third party solicitors is based on the MSRB's experience with rules G-37 and G-38, adherence to the MSRB's rulemaking decisions is neither desired nor justified. The MSRB is a self-regulatory organization that has limited jurisdiction over entities involved in the sale and distribution of municipal securities. It does not have to consider the impacts of its rules on the distribution of other types of securities or how its rules impact the non-municipal securities activities of firms. In this respect, because of the regulatory regime governing broker-dealers, many broker-dealers limit their activities to certain markets, such as municipal securities. This is because expanding their activities to additional markets subjects broker-dealers to additional regulation (*e.g.*, FINRA rules) and requires additional regulatory approvals (*see, e.g.*, NASD Membership and Registration Rule 1017). In contrast, investment advisers do not have to file an application and undergo an extensive review process every time they enter new markets, roll out new advisory

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[9] Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Advisers Act Release No. IA-688 at sentence preceding n.7 (July 12, 1979).

products, service new types of clients or make any other "material change in business operations."

Unlike the MSRB, the SEC is responsible for regulating all of the activities of an investment adviser registered (or required to register) with it. In addition, most investment advisers that service government entities also advise other types of clients. It would be quite unusual for all of these advisers to enter into with solicitation arrangements with third party solicitors with respect to a variety of different types of clients but not enter into such arrangements with respect to other types of (government entity) clients; unlike the regulatory regime for broker-dealers, there is nothing in the Advisers Act that supports having different rules for different types of securities markets.

More importantly, unlike rules G-37 and G-38, the proposed Rule would be an anti-fraud rule adopted under Section 206(4) of the Advisers Act, meaning any violation of the Rule is a violation of the anti-fraud provisions of the Advisers Act. It is difficult to understand why application of the anti-fraud provisions of the Advisers Act should depend on the identity of the person being solicited (as this individual is a passive actor and separated from the activity the SEC seeks to categorize as fraud). Given the SEC's promulgation of rule 206(4)-3 and the language cited above from the release adopting that rule, advisers will find the SEC's rationale for the proposed ban on use of third party investment advisers difficult to reconcile and understand. After all, if the proposed Rule is adopted, both permissible and prohibited third party solicitation activity would involve the same activity and functions, the same types and amounts of compensation and the same disclosures and other safeguards. However, the repercussions of engaging in prohibited solicitation activity under the proposed Rule can be very significant in light of the stigma and business repercussions associated with a finding that an investment adviser has violated a rule adopted under Section 206(4) of the Advisers Act.[10]

The Clients also note that the SEC's concern about investment advisers circumventing the Rule is adequately addressed by section (d) of the proposed Rule. Where investment advisers utilize third party solicitors to circumvent the Rule, section (d) would permit the SEC to bring an enforcement action to stop any pay to play activity. The SEC has not shown that it would be unable to prevent advisers from circumventing the Rule through third party solicitors. Instead, the SEC merely states, as support for its proposed ban on the use of third party solicitors, that "[i]n 2005, after concluding that the required disclosure was neither adequate to prevent circumvention of rule G-37, nor consistently being made, the MSRB (with the Commission's approval) amended rule G-38 to impose a complete ban on the use of third party consultants to solicit government clients."

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[10] The Clients also note that MSRB rule G-37 relates to a transactional practice (*i.e.*, underwriting activity) that the SEC acknowledges in the Proposing Release is "episodic." Advisers' business relationships with government entities often are ongoing and long-term and thus the two-year time out is more harsh a consequence for investment advisers. While underwriting relationships may be longstanding, they often do not last as long as investment advisory relationships – and they typically are not as deep; managing one or more underwritings for an issuer does not involve the same sort of relationship as managing pension fund assets on an ongoing, discretionary basis.

The Clients note that rule 206(4)-3 under the Advisers Act has a number of regulatory safeguards that are not present in rule G-38, including the obligation to have the solicitor, at the time of solicitation activity, provide the client with a current copy of the investment adviser's written disclosure statement and a written solicitor disclosure document. This latter document discloses, among other things, the nature of the relationship, including any affiliation, between the solicitor and the investment adviser, that the solicitor will be compensated for its solicitation services by the adviser, the terms of the compensation arrangement, including a description of the compensation paid or to be paid to the solicitor and the amount, if any, for the cost of obtaining his account the client will be charged in addition to the advisory fee, and the differential, if any, among clients with respect to the amount or level of advisory fees charged by the investment adviser if such differential is attributable to the existence of any arrangement pursuant to which the investment adviser has agreed to compensate the solicitor for soliciting clients for, or referring clients to, the adviser. In addition, the investment adviser must receive from the client, prior to, or at the time of, entering into any written or oral investment advisory contract with such client, a signed and dated acknowledgment of receipt of the investment adviser's written disclosure statement and the solicitor's written disclosure document. The Clients believe that these safeguards in rule 206(4)-3, which are not present in rule G-38, refute the rationale provided for the ban on third party solicitors.

The SEC can effectively monitor and police advisers that seek to circumvent the proposed Rule, and the MSRB's experience with rule G-38 does not support any contrary assumption. The Clients urge the SEC to consider the significant business ramifications to investment advisers and the compliance challenges they will face if the proposed ban on the use of third party solicitors is adopted, and to base the proposed Rule on evidence and experience involving third party solicitors.[11]

If the ban on third party solicitors is adopted, then the SEC should clarify that the mere payment of fees by one investment adviser (or an affiliate) to other investment advisers in a "co-advisory arrangement" or to other parties in other arrangements does not mean that the payment is for solicitation services. For instance, in advisory arrangements where clients are served by two or more investment advisers, it is common for client fees to be paid to a single adviser, which then pays (or an affiliate pays) the fees owed under the client agreement to all of the other investment advisers. Such "paymaster arrangements" exist for the convenience of clients, who are spared from having to separately pay each investment adviser. Similarly, sometimes investment advisers provide investment advisory services to government entities that hire a third party, such as a pension consultant, to provide independent advice to the government entity. It is not uncommon for the government entities to *request the investment adviser (or an affiliate) to serve as a paymaster* and to receive a single payment from the government entity and to pass on part of such payment (*i.e.*, the fee owed by the government entity to the pension consultant for the services provided by the pension consultant to the government entity) to the pension consultant. In other words, sometimes government entities prefer to make a single payment to

[11] The Clients are concerned that the proposed Rule may be an attempt to address the activities of unregulated solicitors, finders and placement agents, an issue that may be better addressed by requiring such entities to register and comply with the federal securities laws.

the investment adviser (which keeps its advisory fees from the government entity and passes on the fees owed by the government entity to the pension consultant) or an affiliate instead of making two, separate payments to the investment adviser and the pension consultant (or other third party). In such cases, the investment adviser (or affiliate) is acting in a clerical and ministerial fashion and is simply following the instructions of the government entity in paying the money it owes to the pension consultant (or other third party) pursuant to an agreement between the government entity and the pension consultant (or third party) with respect to which the investment adviser has no involvement.

The Clients are concerned about the appearances created by such paymaster arrangements since they involve sending a payment to a pension consultant (or other third party) with respect to advisory services provided to a government entity. The Clients note that the Proposing Release states that payments to pension consultant could be a prohibited payment for services "if those services are intended to obtain government clients." In the situations described above, the payments are not for services intended to obtain government clients. In addition, footnote 145 of the Proposing Release observes that the proposed Rule would not prohibit "government entities from retaining 'pension consultants' (or other third-parties) and paying them to recommend particular investment advisers for the management of public funds." The Clients seek confirmation that serving as a paymaster at the request of a government entity or other investment adviser would come within the quoted language in footnote 145 even though the investment adviser (or affiliate) is making a payment to a pension consultant or other third party (at the government entity's request).

## III. Pooled Investment Vehicles

Section (c) of the proposed Rule states that "an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity." The Clients submit that such an approach is at odds with rule 203(b)(3)-1 under the Advisers Act and the decision of the D.C. Circuit Court of Appeals in *Phillip Goldstein v. SEC*,[12] which stated, among other things, that "[t]he adviser owes fiduciary duties only to the fund, not to the fund's investors." It is inconsistent with rule 203(b)(3)-1 and the *Goldstein* decision to "treat" advisers to a covered investment pool "as though" they were providing investment advice directly to the investors in such pool. Such a stance is at odds with the treatment of investors in pooled investment vehicles under rule 203(b)(3)-1 and the D.C. Circuit Court opinion. Section (c) of the Rule is both impractical[13] and

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[12] *Phillip Goldstein v. SEC*, 371 U.S. App. D.C. 358, 366 (D.C. Cir. 2006).

[13] The proposed Rule seems to suggest that while advisers to covered investment pools in which a government entity invests would need to act as if they were providing investment advisory services directly to the government entity, they would not treat non-government entities in the same fashion. Thus, under the proposed Rule, investment advisers to covered investment pools would treat certain investors in the pool (*i.e.*, government entities) as though they were direct clients of the advisers but not others. Under this framework, the proposed Rule would require investment advisers to treat some investors in the pool differently than other investors in the pool, thus creating a conflict of interest on the part of investment advisers. The Clients believe that such a framework is contrary to the

contrary to the state of the law -- under which only the investment pool and not the individual investors in the pool are treated as clients of the investment adviser -- and should therefore be deleted.

## IV. Miscellaneous

### *A. Business and Entertainment Activity*

It is not uncommon for companies, including investment advisers and their affiliates, to entertain potential and current clients (*e.g.*, lunch, dinner, ticket to a local sporting event), make gifts to clients around the holiday season or to recognize special personal events such as birthdays, weddings, anniversaries *etc*, to make charitable contributions on behalf of clients, to host client appreciation events or to organize or sponsor a conference at which a government official is invited to speak at or attend.[14] The Clients submit that such business activities, which have long been part of the American business landscape, should not be deemed to fall within the definitions of "contribution" or otherwise fall under the proposed Rule merely because the individual being entertained, receiving a gift, being credited with a charitable contribution, attending a client appreciation event or speaking or attending a conference is a government official. In this respect, the Clients note that the proposed definition of "contribution" would mean any gift, subscription, loan, advance, or deposit of money or anything of value made for:

(i) The purpose of influencing any election for federal, state or local office;
(ii) Payment of debt incurred in connection with any such election; or
(iii) Transition or inaugural expenses of the successful candidate for state or local office.

Putting (ii) and (iii) aside, since they relate to very particular types of contributions that are not likely to be implicated by common business entertainment, gifts, charitable contributions, client appreciation events, or conference slots, we note that (i) contains an intent element - the contribution must be made for the purpose of influencing any election for federal, state or local office in order to be a "contribution" under the proposed Rule. Any contribution that is not made for such purpose is not a "contribution" for purposes of the Rule. The Clients thus seek confirmation that business entertainment, gifts, charitable contributions, client appreciation events or conference slots will not be deemed to be a "contribution" under the Rule unless the business entertainment, gift, charitable contribution, client appreciation event or conference slot is so frequent or excessive as to raise questions of propriety.[15] Such a standard properly balances

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protection of investors and the purposes fairly intended by the policy and provisions of the Advisers Act and fundamental notions of fairness and equity. In addition, the proposed Rule might potentially create a conflict with the requirements of rule 206(4)-8(a)(2) under the Advisers Act.

[14] *See* footnote 95 of the Proposing Release and related text.

[15] This standard is taken from the rules governing business entertainment for broker-dealers. *See, e.g.*, NASD Conduct Rule 2830; NASD Interpretive Letter to Henry H. Hopkins and Sarah McCafferty, T. Rowe Price Investment Services, Inc., catalogued under NASD Rule 3060 (June 10, 1999).

the business needs of investment advisers with the pay to play concerns of the SEC without disturbing long-standing compliance structures that many advisers have established to comply with state and local ethics rules governing business entertainment provided to government officials. The Clients also reiterate their concern that the business entertainment and related activities carried out by affiliates of an adviser in a large financial complex should not be attributed to the investment adviser itself unless the standards discussed in sections I.A and I.B above, as applicable, are satisfied.

*B. First Amendment Concerns*

The proposed Rule would effectively place substantial restrictions on the ability of investment advisers and their covered associates to make contributions to officials of government entities. The Clients believe that the Rule's provisions are too restrictive in a number of respects:

- The proposed $250 de-minimis exception is the same amount as was adopted by the MSRB in 1994. This amount, which fails to take inflation into consideration, is unreasonably low.

- The de-minimis exception in (b)(1) of the proposed Rule is available only if the covered associate is entitled to vote for the government official at the time of the contribution. If a contribution is less than the "de-minimis" amount then, by definition, the contribution is not large enough to influence the recipient and does not involve pay-to-play activity, making additional conditions unnecessary.

- The two year "look back" is too long.

- The $250 amount under the proposed exception for returned contributions is unnecessary. There is no need to have a de-minimis amount at all under this exception. If the contribution is returned as is required under the exception, then there is no harm as both the contributor and contributee are placed in the same position they would have been in had no contribution been made.

The proposed Rule's limitations are not drawn with sufficient precision to match the SEC's interests in prohibiting pay to play activities and would unnecessarily restrict the ability of investment advisers and their covered associates from contributing to candidates for government office. In order to avoid substantial limitations on the associational and expressive activities of investment advisers and their covered associates, the Clients urge that: the $250 amount should be substantially raised; the requirement in the de-minimis exception that the covered associate be entitled to vote for the government official should be eliminated; the two year "look back" period should be reduced to one year; and the $250 amount under the proposed exception for returned contributions should be eliminated.

*C. The Exception from the Ban on the Use of Third Party Solicitors*

Proposed Rule 206(4)-5(a)(2)(i)(A) would exclude from the ban on the use of third party solicitors, persons who are "related persons" of the investment adviser. The SEC proposes to define "related persons" as "any person, directly or indirectly, controlling or controlled by the investment adviser, and any person that is under common control with the investment adviser." Proposed Rule 206(4)-5(a)(2)(i)(B) would exclude from the ban on the use of third party solicitors, any executive officer, general partner, managing member (or, in each case, a person with a similar status or function), or employee of the investment adviser. It would appear that all of the individuals in proposed Rule 206(4)-5(a)(2)(i)(B) would, necessarily, also fall within Rule 206(4)-5(a)(2)(i)(A).[16] The Clients do not understand the distinction made by the SEC between these two provisions and request clarification.

## IV. Conclusion

As noted above, the Clients support the goals underlying the proposed Rule and recognize the challenge in crafting the Rule so that it is reaches all of the activity sought to be eliminated without also prohibiting activity which is harmless. This is a particularly difficult task in the context of an investment adviser that is part of a large financial complex where the activities of certain associated persons, affiliates or other related persons of an investment adviser may seem, on their face, to involve pay to play activity, but which, in fact, are completely harmless. The Clients hope the SEC will recognize these challenges and the difficulties that the proposed Rule language presents for advisers that are part of such complexes. The Clients strongly believe that the broad and sweeping provisions of the proposed Rule will result in confusion and uncertainty on the part of such advisers as to what activity is permitted, differing compliance strategies, a reduction in salutary business practices that superficially resemble pay to play activities and a host of unintended consequences. The Clients believe it is in the interest of investor protection for the SEC to be sensitive to these concerns and to craft a rule that acknowledges the practical challenges presented when an adviser is part of a large financial complex and incorporates the standards discussed herein.

Respectfully submitted,

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BY: CLIFFORD E. KIRSCH

[16] The Clients also note that footnote 140 of the Proposing Release states in part: "More specifically, we do not include any of the following within the prohibition on payments for solicitation of government clients: executive officers, general partners, managing members (or, in each case, persons with similar status or function), employees, *or "related persons"* of the investment adviser. Proposed rule 206(4)-5(a)(2)(i). We make this distinction because *related person* solicitors are subject to an adviser's (or its affiliates') control and thus should not present the compliance challenges that advisers pointed to with respect to third party solicitors." (Emphasis added).