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Via e-mail to: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

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

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "Committee" or "we") of the Section of Business Law (the "Section") of the American Bar Association (the "ABA"), in response to the request for comments by the U.S. Securities and Exchange Commission (the "Commission") in its August 3, 2009 proposing release referenced above (the "Proposing Release"). In the Proposing Release, the Commission has proposed Rule 206(4)-5 under the Investment Advisers Act of 1940 (the "Advisers Act"). The Rule would prohibit so-called "pay to play" practices and is similar to a 1999 Commission proposal (the "1999 Proposal"). [1]

The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section, nor does it necessarily reflect the views of all members of the Committee.

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[1] See Release No. IA-1812 (File No. S7-19-99 (August 4, 1999).

Overview

The Committee supports the Commission's opposition to "pay to play" practices. Political contributions by an investment adviser to government officials in an effort to influence the award of public pension plan advisory contracts are unethical and compromise the adviser's fiduciary responsibility. We also believe that these practices are inconsistent with the fiduciary obligations and the anti-fraud provisions under the Advisers Act.

Although we strongly oppose pay to play practices, we believe that the Commission's efforts should seek to prohibit these practices without having the unintended consequence of affecting or prohibiting conduct not related to pay to play practices. In addition, any sanctions imposed for violations should be commensurate with the nature of such violations. We are concerned, therefore, that in certain respects the Commission's proposal is overly restrictive and the sanctions are overly harsh. We believe that the Commission can achieve its important goals with a more appropriately tailored regulatory structure. With these policy goals in mind, we offer the following recommendations, which are discussed in greater detail below:

- *Adopt a more tailored regulatory model.* Pay to play prohibitions should be incorporated into an investment adviser's code of ethics requirements. The Commission should suggest an appropriate range of sanctions based on the nature and character of the actual wrongdoing. The sanctions could, for example, range from fines for an individual who makes inappropriate contributions to the imposition of a two-year time out penalty for an adviser that has engaged in egregious violations of the prohibition. In this regard, an adviser's actions under its code of ethics would be subject to Commission oversight through the Commission's examination and enforcement programs.

- *Tailor "covered associate" definition to policy goals.* We suggest that the Commission consider adopting a "municipal financial professional" ("MFP")/non-MFP executive officer type distinction similar to that contained in MSRB Rule G-37. The Commission should consider limiting the application of the proposed Rule to individuals who actually participate in or supervise the solicitation of business from government entities. Alternatively, the Rule could exclude from its prohibitions individuals and supervisors responsible for products and services that are not marketed to government entities.

- *Withdraw the proposed ban on third-party intermediaries.* A total ban is unnecessary. Among other things, if solicitors offer interests in pooled investment accounts, they are brokers subject to registration with the Commission and would be required to be members of FINRA. The Commission also has adequate authority to regulate the conduct of solicitors of clients for separate-account investment advisory management. Advisers who use such solicitors should supplement their codes of ethics to cover monitoring of third-party solicitors as well as covered associates.

Regulatory Model and Sanctions

Proposed Rule 206(4)-5 would prohibit investment advisers from providing advice for compensation to a government entity within two years after a contribution to an official of the government entity has been made by the investment adviser or by any of its covered associates. The Commission states in the Proposing Release that it has "proposed that the time out be two years long because the duration needs to be sufficiently long to have a deterrent effect." The Commission has requested comment on whether two years is an appropriate length of time.

The Commission's proposal for advisers is modeled after the rules for municipal dealers (MSRB Rules G-37 and G-38). Municipal securities dealers, however, have a fundamentally different type of business relationship with public entities than investment advisers do with public pension plans. The underwriting transactions in which municipal securities dealers are involved are periodic and transactional in nature, whereas an investment adviser's business relationship with a public pension plan is ongoing and may be long-term. For municipal dealers, a ban on obtaining new business is not difficult to implement or harsh to impose following the completion of the underwriting transaction. This situation contrast sharply with an investment adviser's relationship with a pension plan, where the Commission's proposal for a termination of the adviser's money management services would interfere with a possibly beneficial continuing business relationship and lead to potential transition issues for the public pension plan.

Similar to the concerns we pointed out in connection with the 1999 Proposal, the proposed Rule would impose a single remedy – a two-year time out – on all violations, regardless of the circumstances of the violation: whether the violation was calculated or inadvertent, or directly linked to the advisory activity or remote. The imposition of a restriction on receiving fees for two years would likely have the draconian effect of terminating the subject advisory relationship, and would constitute an overly harsh punishment in all but the most egregious cases. As proposed, the two-year time out could apply to inadvertent and minor violations. Consider, for example, the situation where a covered associate makes a $100 political contribution to an official for whom the covered associate is not entitled to vote – without any intent to obtain government business. If the adviser does not discover this minor violation within four months, the adviser will either be subject to the two-year time out or face an uncertain and expensive exemptive process. Although some remedy may be appropriate in this situation, the remedies prescribed are non-scaled and could have unnecessarily harsh effects.

Code of Ethics Alternative

We recommend that the Commission adopt a more tailored regulatory approach to achieving the Commission's important goals. We believe the Commission should require the incorporation of pay to play prohibitions into an adviser's code of ethics, which constitutes a component of an adviser's present compliance responsibilities.

Rule 206(4)-7 under the Adviser's Act requires an investment adviser to adopt and implement a compliance program. Among other things, Rule 206(4)-7 requires an adviser to adopt a code of ethics to prohibit improper personal trading activities of advisory personnel. This Rule could easily be amended to include pay to play prohibitions. As with other code of ethics violations, an adviser would be responsible for appropriately sanctioning individuals who seek to obtain government business through political contributions. In this regard, the Commission should suggest an appropriate range of possible sanctions based on the actual nature and character of the actual wrongdoing. This range of sanctions could include fines for individuals who make inappropriate contributions to the imposition of two-year time out for an adviser that has engaged in egregious violations of the prohibition.

An adviser's actions under Rule 206(4)-7 would be subject to Commission oversight through the Commission's examination and enforcement programs. If the Commission thought it necessary, the Rule could also include a pre-clearance requirement before a covered associate or an adviser's political action committee could make a contribution to an official. The adviser's compliance program would be subject to the Commission's books and records requirements.

Tailored Sanctions to Policy Goals

If the Commission determines not to adopt the code of ethics approach, we recommend that the penalty provisions of proposed Rule 206(4)-5 be revised to make them more appropriate to the nature and character of the violation. As we recommended in response to the 1999 Proposal, the Rule could provide for alternative sanctions that would be imposed in appropriate situations. These include the following:

(a) Prohibiting an investment adviser from competing for new business from the particular government client for two years after the adviser or any of its covered persons makes a prohibited contribution,
(b) Prohibiting a person from sharing in commission or fee income from the particular government client for two years after that person has made a prohibited contribution and
(c) Requiring investment advisers to report any violations to the Commission, together with any sanctions which have been imposed or other actions taken.

The Commission also could suggest similar sanctions for the suggested code of ethics approach.

Covered Associates

Overly Broad Definition Relative to Policy Goals

As proposed, the political contribution limits and prohibitions in Rule 206(4)-5 would apply to any "covered associate" of an adviser. "Covered associate" in turn is defined broadly to include not only employees who solicit a government entity, but also any general partner, managing member or executive officer of the adviser, or any other individual with a similar status or function, regardless of whether such person has any contact with or involvement in government entity business. "Executive officer," in turn is defined very broadly to include not only any officer who supervises (directly or indirectly) anyone who solicits any investor (whether or not a government entity) for an investment pool, but also "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: Performs, or supervises any person who performs, investment advisory services for the investment adviser". We believe the scope of these definitions is unnecessarily broad and could lead a court to conclude that the Rule was not narrowly tailored to advance a compelling governmental interest, as required by *Blount v. SEC,* 61 F.3d 938, 947-48 (D.C. Cir. 1995), *cert. denied,* 116 S. Ct. 1351 (1996).

By contrast, MSRB Rule G-37, on which the proposed Rule 206(4)-5 is otherwise primarily patterned, only applies to MFPs who are directly responsible for municipal finance activities, and Rule G-37 explicitly recognizes a group of "non-MFP executive officers" who direct principal business units or functions of the municipal securities dealer but who are not MFPs because they are not directly involved in the municipal securities business. Under the MSRB scheme, only MFPs are subject to contribution limits and prohibitions, while non-MFP executive officers are subject only to public disclosure of their political contributions.

In other words, the Commission's proposed Rule captures a broad group of executives (heads of principal functions or business units not directly engaged in governmental business) who would not be captured (and in fact are explicitly excluded) by MSRB Rule G-37. The Commission's Proposing Release does not offer any explanation why it does not recognize a similar category of "non-MFP executive officers" or why the MSRB's differentiation between different types of executive officers has been ineffective in preventing corruption and the appearance of corruption. In the absence of such an explanation, we question whether the proposed Rule is sufficiently narrowly tailored to achieve a compelling governmental interest.

Moreover, we believe the Commission's definition of "covered associate" is overbroad in other ways. As discussed above, "covered associate" is defined in terms of "investment advisory services" provided by the adviser. But this definition provides no limiting principle – all the activities of an investment adviser are, in some way, "investment advisory activities." The Commission provides no convincing explanation why it should be concerned that, for example, partners involved in trading (or executive officers who supervise trading), or partners or executive officers responsible for managing portfolios or offering advisory services not marketed to government entities, should be covered by the proposed Rule. As the Proposing Release recognizes, municipal securities dealers typically offer services to government entities through a defined and limited business unit, and it is only that business unit that is primarily affected by MSRB Rule G-37.

By contrast, the proposed Rule would apply to the entire business of any adviser that solicits any investment advisory business of any kind from any government entity, no matter how separate the other product or service offerings of the adviser are from the governmental business. Again, it is difficult to square the breadth of this coverage – much broader than the coverage of Rule G-37 – with the constitutional requirement that any rule touching on First Amendment interests be narrowly tailored to achieve a compelling governmental interest.

Tailor Definition to Policy Goals

The Commission could limit the proposed Rule 206(4)-5 in several ways to address the concerns we have noted:

(i) At a minimum, the MFP/non-MFP executive officer distinction contained in MSRB Rule G-37 should be adopted.
(ii) The Commission should consider allowing investment advisers to organize a business unit devoted to governmental entities, and apply the proposed Rule to that business unit, in a way that would parallel MSRB Rule G-37.
(iii) The Commission should consider limiting the proposed Rule to individuals who actually participate in or supervise the solicitation of business from government entities, or the Rule could exclude from the prohibitions individuals and supervisors responsible for products and services that are not marketed to government entities.

Third-Party Intermediaries

Whatever the Commission's final determination with respect to the application of the proposed Rule on investment advisers and their covered associates, we believe the Commission's proposal goes too far in its proposed absolute ban on the use of third-party solicitors. The absolute ban would have a crippling effect on many small- and medium-sized money managers that cannot afford an in-house staff dedicated to the public markets. Third-party solicitors should be allowed to do business subject to the same kinds of restrictions as investment advisers and their covered associates.

In addition, the Commission's cost-benefit analysis does not take into account the fact that an absolute ban on use of third-party solicitors will discriminate unfairly against solicitors engaged in legitimate activities and against small- and medium-sized advisers. This unsubstantiated bias will also tend to deprive public plans of a wider choice of investment advisory services.

Appropriate Substantive Regulations

If solicitors are offering interests in pooled investment accounts, they are brokers subject to registration with the Commission and would be required to be members of FINRA. The Commission has the authority to regulate their conduct directly by rules under the Securities Exchange Act of 1934.

The Commission also has adequate authority to regulate the conduct of solicitors of clients for separate-account investment advisory management, even if those solicitors are not registered with the Commission. Investment advisers who use such solicitors should, in our view, be required to supplement their codes of ethics to cover monitoring of third-party solicitors as well as covered associates. Advisers could be held accountable for misconduct by their third-party solicitors if they know or could reasonably have known of such misconduct, just as FINRA holds broker-dealers responsible for the performance of outsourced activities.

In addition, many states deem solicitors for advisers to be advisers or investment adviser representatives subject to registration.

Appropriate Disclosure Requirements

The disclosure requirements of Rule 206(4)-3 could be expanded to include express disclosures relating to policies on pay to play.

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The Committee appreciates the opportunity to comment on the Proposing Release and respectfully requests that the Commission consider the comments and recommendations set forth above. Members of the Committee are available to discuss them should the Commission or the staff so desire.

Respectfully submitted,

/s/ Jeffrey W. Rubin
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