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October 22, 2009

VIA ELECTRONIC TRANSMISSION

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

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

Dear Ms. Murphy:

We respectfully submit this letter in response to a request by the Securities and Exchange Commission ("SEC" or "Commission") for comments regarding proposed rule 206(4)-5 ("Proposed Rule" or "Rule") under the Investment Advisers Act of 1940, as amended ("Advisers Act"), relating to "pay-to-play" practices by investment advisers.[1]

Dechert LLP is an international law firm with a wide-ranging financial services practice that serves clients in the United States and worldwide. Our clients include investment advisers, investment company complexes, private funds, fund administrators, broker-dealers, pension plans, insurance companies, commercial and investment banks, thrift institutions and third-party intermediaries, including placement agents and solicitors, many of whom would be affected by the Proposed Rule. In developing these comments, we have drawn on our extensive experience in the financial services industry. Although we have discussed the matters addressed in the Proposed Rule with some of our clients, the comments that follow reflect our own views and not necessarily those of our clients. We very much appreciate the opportunity to submit comments on the Proposed Rule.

The Proposed Rule would address pay-to-play practices as they relate to investment advisers that provide advisory services to a "government entity," as defined in the Proposed Rule. The Proposed Rule generally would prohibit an adviser from: (i) providing advisory services for compensation to a government entity for a two-year period after the adviser, or a "covered associate" of the adviser, makes a political contribution to certain elected officials or candidates for public office ("two-year time

[1] *See Proposed Rule: Political Contributions by Certain Investment Advisers*, Rel. No. IA-2910 (Aug. 3, 2009) ("Proposing Release").

out");[2] (ii) providing or agreeing to provide, directly or indirectly, payment to any third party for the solicitation of government advisory business;[3] and (iii) soliciting from others, or coordinating, (a) contributions to certain elected officials or candidates or (b) payments to certain political parties where the adviser is providing, or seeking to provide, advisory services to a government entity. The Commission is also proposing amendments to Rule 204-2 under the Advisers Act ("Recordkeeping Rule") that would require registered investment advisers to maintain certain records, including with respect to political contributions made by the adviser or its covered associates.

Although we strongly support the Commission's goal of implementing measures to prevent pay-to-play abuses by investment advisers, we believe that the Proposed Rule would have severe, unintended and adverse consequences.

I. Analogy to the Municipal Securities Industry and Reliance on MSRB Rules G-37 and G-38 is Inappropriate

As an initial matter, we submit that the Commission's analogy to the municipal securities industry and reliance on Municipal Securities Rulemaking Board ("MSRB") Rules G-37 and G-38 is inappropriate. First, investment advisers are fiduciaries[4] that owe their clients a duty to act in good faith, with reasonable care and diligence, and with full and fair disclosure of all material facts. Second, as part of an investment adviser's fiduciary duties, an adviser generally provides ongoing advisory services to its clients. Third, an investment adviser generally is selected to provide advisory services to a government entity through requests for proposals or a similar search process, which mitigates the potential for pay-to-play practices. Conversely, municipal securities underwriters are not fiduciaries. They generally provide services to government entities on a transaction-by-transaction basis involving the underwriting of specific municipal securities. Once the particular municipal security offering is finished, the municipal securities underwriter's obligation to the government entity is generally over. In addition, municipal securities underwriters are often selected through a negotiated underwriting process.

Whereas a municipal securities underwriter subject to MSRB Rule G-37's ban is prohibited from providing further services to a government entity in connection with future transactions, an investment adviser subject to the two-year time out in the Proposed Rule could cause substantial harm to a government entity by disruption of

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2 As discussed below, we believe that the two-year time out would effectively bar an investment adviser and its covered associates from participating meaningfully in the political process through political contributions.

3 As proposed, this prohibition would apply regardless of whether the intermediary, itself or on behalf of an investment adviser, has made political contributions that would be prohibited for advisers and their covered associates under the Proposed Rule.

4 *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

the adviser's *ongoing and continuous* investment program for the government entity. The Commission recognizes the disparate result by prohibiting an adviser's receipt of compensation, rather than subjecting the adviser to an absolute prohibition on rendering advisory services. The Commission also notes that an adviser, consistent with its fiduciary duties, must render uncompensated advisory services for a reasonable period of time after an impermissible political contribution.[5]

The Commission should consider the differences between underwriting municipal securities and providing advisory services when determining whether to (i) adopt the Proposed Rules in their current form, or (ii) rely on MSRB Rules and interpretations when interpreting whatever rules are ultimately adopted.

II. The Commission Should Reconsider the Proposed Rule's Ban on the Use of Third-Party Intermediaries

To bar advisers from using third-party intermediaries would limit government entities' access to valuable services provided by these intermediaries, prevent many advisers from entering into or continuing the business of providing advisory services to a government entity and, ultimately, reduce the breadth of investment options and capable investment advisers available to government entities. While there have been instances of improper behavior by third-party intermediaries in securing mandates for investment advisers or investors for private funds, legitimate placement agents and solicitors provide *bona fide* and invaluable services to persons and entities seeking investment advisory services.[6] Those services include, among other things, (i) systematic and continuous due diligence, (ii) comprehensive analysis and evaluation of the adviser's performance and investment strategy, including research on its investments; portfolio exposure and investment strategy and (iii) matching potential investors to appropriate products or advisory services. In particular, placement agents provide a crucial role in capital formation for private funds. In addition, third-party intermediaries provide valuable services to investment advisers by counseling them regarding marketing strategies, compliance concerns, the level of due diligence and other related requirements of potential investors.

The Proposed Rule's ban on the use of the third-party intermediaries would (i) favor and increase the advantage already enjoyed by large, highly-capitalized and well established advisers, and (ii) work to the detriment of smaller and/or newer advisers (including new entrants in the market) who might be able to offer superior services or

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5 Furthermore, as noted below, *see infra* section V, an adviser to a private fund subject to the two-year time out is presented with limited options during the time-out period, specifically with regard to the adviser's ability to redeem the government entity's shares.

6 In addition, the Proposed Rule would severely harm legitimate solicitors and placement agents and, to the extent a sub-set of such businesses specialize in the particular needs of government entities, could put a number of legitimate solicitors and placement agents out of business.

products to government entities.[7] If the Commission determines to adopt the Proposed Rule's ban on the use of third-party intermediaries, in order for an investment adviser to successfully market its products or services to a government entity, it would either need to already have specialized marketing personnel on staff (or available to it through an affiliate) or hire knowledgable personnel to provide such marketing services on its behalf to government entities. However, specialized, small or less-established fund advisers are generally without the means to hire dedicated marketing personnel and/or establish an affiliated broker-dealer to solicit investors.[8] Moreover, even if an adviser has, or could (or desired to) establish a broker-dealer affiliate, it would still need to hire employees that are knowledgeable about the sale of its products or services to governmental entities in order to be effective in their activities with respect to government entities. By using third-party placement agents to market private funds, investment advisers can concentrate on the things they are best equipped to do (*i.e.*, implementing investment programs and investment strategies).

The Proposed Rule's ban on the use of third party intermediaries likely would also materially harm government entities, including state and municipal pension plans (as well as the beneficiaries of such plans) that may not have the resources to (i) explore the universe of appropriate investment advisers or their pooled investment vehicles and (ii) conduct necessary due diligence on such advisers or vehicles. Third-party placement agents and solicitors that solicit government entities on behalf of investment advisers often possess information critical to the effective evaluation of, for example, emerging markets or other specialized markets or investment strategies. Thus, government entities often rely on third-party intermediaries, even when they may have in-house capability to evaluate investment advisers or their pooled investment products. Where a government entity does not enjoy the benefits of experienced in-house investment professionals, the government entity might (i) find it necessary to hire its own consultant[9] (perhaps at the expense of the relevant pension

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7 For example, less well-known advisers often can gain entré with government entities only when introduced by an established third-party intermediary. Moreover, winning a mandate from a government entity often provides necessary capital and assets to support the ongoing viability of a new or less established advisory firm that may employ innovative strategies or have new investment ideas.

8 Third-party placement agents used by fund advisers are generally broker-dealers registered with, and regulated by, the Commission and the Financial Industry Regulatory Authority ("FINRA"). Hiring dedicated marketing personnel could subject a fund adviser and its employees to registration requirements under the Securities Exchange Act of 1934, as amended ("1934 Act"). By removing the ability to continue using a third-party placement agent, the Proposed Rule would require fund advisers to (i) create an affiliated broker-dealer or (ii) register as a broker-dealer, in order to effectively distribute interests in its private funds. Initial costs to form a new broker-dealer (or register an existing adviser as a dual-registrant) could exceed $100,000, with significant on-going costs and compliance obligations associated with maintaining a registered broker-dealer.

9 Currently, third-party solicitors and placement agents perform many of the same services as investment consultants but, unlike consultants, are compensated by the adviser (or fund) rather than

plan) or (ii) risk not being in a position to make the best possible decisions about investments or, in some circumstances, being unable to invest in certain investment opportunities. As with investment advisers, the greatest harm will likely be to the smaller pension plans or government entities that may lack sufficient resources to perform their own search or to hire a consulting firm to assist them.[10]

A. Narrowly-Tailored Alternative to the Prohibition on Payments to Third Parties that Solicit Government Entities

According to the Proposing Release, the Commission has proposed the prohibition on payments to third-party intermediaries that solicit government entities because of (i) the Commission's concern that investment advisers would circumvent the two-year time out provision of the Proposed Rule through the use of third-party intermediaries, such as placement agents and solicitors and (ii) the "apparent difficulties for advisers to monitor the activities of their third-party solicitors."[11]

Furthermore, we note that Section 206 of the Advisers Act already contains broad anti-fraud provisions that have been interpreted to, among other things, restrict an investment adviser's ability to compensate third-parties that solicit prospective investors or clients on behalf of the adviser. For example, Rule 206(4)-3 under the Advisers Act ("Cash Solicitation Rule") sets forth conditions necessary for a registered investment adviser to pay a cash referral fee to a third-party solicitor.[12]

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the government entity, with full disclosure of the nature of such compensation and any conflicts. Because third-party solicitors and placement agents are compensated by the adviser or fund (and, in our experience, seldom pass such compensation on to the government entity in the form of higher fees), returns for the government entity are not diminished as compared to circumstances where identical investments were sourced by the government entity's own consultant. While we recognize that certain abuses (*e.g.*, instances in which a solicitor or placement agent has engaged in illegal kickbacks and bribes) are not adequately addressed through disclosure alone, we believe that alternatives exist (and have made some suggestions in that regard below) that should mitigate the potential that decisions made by a government entity will be influenced by pay-to-play practices, while preserving the use of third party intermediaries.

10 We believe that, given the large number of advisers and government entities, it is unlikely that (i) smaller government entities will have access or knowledge of smaller or newer advisers that may be suited to their investment needs or (ii) smaller or newer advisers will be aware of which government entities are seeking services that the adviser can provide.

11 *See* Proposing Release, at 46 (discussing the concerns raised by industry participants in response to a similar proposal proposed in 1999, which would have triggered a "time out" for an adviser upon an improper contribution by a third-party solicitor).

12 Prior to the adoption of the Cash Solicitation Rule, the SEC considered a rule prohibiting, without exception, cash referral fees to compensate third parties that solicit prospective clients on behalf of an investment adviser. *See Proposed Rule: Requirements Governing Payments of Cash Referral Fees*, Rel. No. IA-615 (Feb. 2, 1978). In adopting the Cash Solicitation Rule, the SEC determined "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

Among other things, the Cash Solicitation Rule requires that an investment adviser pay any cash referral fee pursuant to a written agreement to which the adviser is a party.[13] In addition, the adviser is required to (i) "make[] a *bona fide* effort to ascertain whether the [third-party] solicitor has complied with the agreement" and (ii) "ha[ve] a reasonable basis for believing that the [third-party] solicitor has" complied with such agreement. And, lastly, except with respect to impersonal advisory services, a third-party solicitor must provide a separate written disclosure document containing certain information, including the terms of such arrangement and a description of the compensation paid or to be paid to the solicitor.[14]

We believe that, as the Commission did in 1979 when it adopted the Cash Solicitation Rule, rather than an outright ban on the use of third-party solicitors, the Commission should recognize that "an outright prohibition . . . would unnecessarily restrict the ability of investment advisers to make their services known to potential clients."[15] Likewise, an alternative framework, similar to the Cash Solicitation Rule, should be able to address concerns that an adviser would seek to circumvent the Proposed Rule through third-party solicitors or placement agents. This alternative framework, implemented through amendments to the Cash Solicitation Rule and/or the Proposed Rule, as detailed below, would better address pay-to-play concerns while allowing advisers to benefit from the use of third-party intermediaries.[16]

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unnecessarily restrict the ability of investment advisers to make their services known to potential clients." *See Final Rule: Requirements Governing Payments of Cash Referral Fees by Investment Advisers*, Rel. No. IA-688 (July 12, 1979) (emphasis added). This comment letter focuses on those portions of the Cash Solicitation Rule that apply to third-party solicitors.

13 The Cash Solicitation Rule generally requires the written agreement with a third-party solicitor to: (i) describe the solicitor's activities and its compensation for such activities; (ii) contain an undertaking by the solicitor to perform such activities in a manner consistent with the adviser's instructions and the Advisers Act and the rules thereunder; and (iii) require that the solicitor, at the time of the solicitation, to provide any prospective client with a copy of the adviser's Form ADV Part II ("brochure") and a separate written document containing certain disclosures. Prior to or at the time of entering into an advisory agreement with the client, a registered investment adviser must receive a signed and dated acknowledgment that the client has received the adviser's brochure and the separate written disclosure document.

14 When an adviser uses a solicitor, it must also describe the solicitation arrangements in response to Item 13.B of its Form ADV, Part II.

15 *See Final Rule: Requirements Governing Payments of Cash Referral Fees by Investment Advisers*, Rel. No. IA-688 (July 12, 1979), *supra* note 12.

16 Recently, the staff of the SEC's Division of Investment Management confirmed that the Cash Solicitation Rule "generally does not apply to a registered investment adviser's cash payment to a person solely to compensate that person for soliciting investors or prospective investors for, or referring investors or prospective investors to, an investment pool managed by the adviser." *See Mayer Brown LLP* (pub. avail. July 15, 2008, as corrected July 28, 2008) ("Mayer Brown Letter"). However, the SEC staff cautioned that Section 206 may require the soliciting/referring person "to disclose to the investor or prospective investor material facts relating to conflicts of interest." *Id.*

Because we believe that an outright ban on the use of third-party intermediaries is unduly burdensome and not commensurate with the protections that might be afforded by such a ban, we offer below a more tailored alternative that would mitigate the unintended and detrimental effects of the Proposed Rule while providing appropriate protections against the dangers the Proposed Rule is intended to address. We also address below other interpretive and implementation issues raised by the Proposed Rule, along with suggestions for improvements to the Proposed Rule.

1. Placement Agents

We recommend that the Commission revise the Proposed Rule to allow payments to third-party placement agents in connection with the solicitation of government entities, provided that: (i) the placement agent is registered with, and regulated by, the Commission and FINRA;[17] (ii) any payments to a placement agent by a fund or adviser are made pursuant to a written agreement to which the fund or the adviser is a party, which written agreement must: (a) include a covenant that the placement agent or its covered associates will not make any contribution that is inconsistent with the Proposed Rule; (b) require that the placement agent provide, and the adviser to retain, a list of all political contributions by the placement agent and its covered associates during the previous two years; and (c) prohibit a fund or an adviser from compensating the placement agent if the placement agent or its covered associates have made an improper contribution during the previous two years;[18] and (iii) the adviser (a) makes a bona fide effort to ascertain whether the placement agent has complied with the agreement and (b) has a reasonable basis for believing that the placement agent has complied with specified limitations. Finally, we believe that such a rule should require that the adviser have a reasonable belief that compensation

17 We believe that the federal securities laws and FINRA rules currently provide an additional layer of protection against improper contributions to government officials or candidates to influence the selection of an investment adviser. *See, e.g.,* Rule 10b-5 under the 1934 Act (prohibiting any person, directly or indirectly, from "engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person"); FINRA Rule 2010 ("A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.")

18 We also believe that, because of the consequences of the Mayer Brown Letter, *supra* note 16, other material aspects of the Cash Solicitation Rule, as discussed above, should be incorporated into our alternative framework with respect to fund advisers and placement agents, including the requirement that the written agreement: (i) describe the placement agent's activities and its compensation for such activities; (ii) contain an undertaking by the placement agent to perform such activities in a manner consistent with the adviser's instructions and the Advisers Act and the rules thereunder; and (iii) require that the placement agent, at the time of the solicitation, provide to the prospective investor a copy of the adviser's brochure, as applicable, and a separate written document containing certain disclosures. Prior to or at the time of entering into a subscription agreement with the investor, a fund's adviser must receive a signed and dated acknowledgment that the investor has received the adviser's brochure, as applicable, and the separate written disclosure document.

arrangements have been appropriately disclosed to those persons who are authorized to make an investment decision on behalf of the government entity.

2. Solicitors

We believe that, with certain modifications, the Cash Solicitation Rule can achieve its principal purpose – addressing potential conflicts of interest – with respect to the solicitation by third parties of government entities on behalf of registered investment advisers. Specifically, we propose that the Cash Solicitation Rule be amended to (i) require that the written agreement currently required by the Cash Solicitation Rule include a covenant that the solicitor or its covered associates will not make any contribution that is inconsistent with the Proposed Rule; (ii) require that the solicitor provide, and the registered investment adviser retain, a list of all political contributions by the solicitor and its covered associates during the previous two years; and (iii) prohibit a registered adviser from compensating the solicitor where the solicitor or its covered associates have made an improper contribution during the previous two years. Finally, we believe that the Commission should make clear that the Cash Solicitation Rule requires that, in this context, the adviser have a reasonable belief that compensation arrangements have been appropriately disclosed to those persons who are authorized to make an investment decision on behalf of the government entity. Furthermore, under our proposal, if a registered investment adviser knew, or reasonably should have known, of any improper contribution by a third-party solicitor, such investment adviser would be prohibited from receiving compensation from a government entity.

B. Required Compliance Policies and Procedures

Pursuant to Rule 206(4)-7, registered advisers must "[a]dopt and implement policies and procedures reasonably designed to prevent violations . . . of the [Advisers] Act and the rules [thereunder]."[19] Although Rule 206(4)-7 does not apply to unregistered advisers, we recommend that any private fund and its adviser and any registered adviser to separately managed accounts that wishes to employ a third-party placement agent or solicitor be required to implement compliance policies and procedures that are sufficiently comprehensive to mitigate the potential for improper contributions by a placement agent or solicitor. For example, advisers that wish to employ a third-party placement agent or solicitor could be required to enter into an agreement with the placement agent or solicitor that requires the *placement agent or solicitor* to (i) provide a list of all political contributions by it or its covered associates during the two years prior to execution of the required agreement; (ii) provide a quarterly report containing political contributions for the prior quarter; and (iii) obtain pre-approval from the manager before making any political contributions and/or soliciting a

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19 *See* Rule 206(4)-7 under the Advisers Act. Thus, registered advisers would be obligated to adopt procedures reasonably designed to prevent violations of the Proposed Rule if it is adopted.

particular government entity.[20] Furthermore, if this approach is adopted, the adopting release should make clear that, in circumstances where the adviser knew, or reasonably should have known, of any improper political contribution made by a third-party placement agent or solicitor, the adviser would be viewed has having made such contribution directly and, therefore, would be subject to any applicable time out.

We believe that the benefits of maintaining advisers' (and government entities') ability to make use of the knowledge, skills and services of third-party placement agents and solicitors is worth preserving. Many advisers would welcome the freedom to continue to use solicitors or placement agents, when properly supervised and monitored by the adviser, with the understanding that a time out would result if the adviser knows, or reasonably should have known, about any improper contribution by a third-party solicitor or placement agent. Advisers or private funds that believe that it would be too difficult for them to adequately monitor the activities of their third-party solicitors or placement agents (or otherwise comply with the suggested proposal described above) would be free to choose not to engage third-party intermediaries.

III. The Proposed Rule's Definition of "Executive Officer" is Unduly Broad and Opaque

We believe that the definition of "executive officer" is unduly broad and that the Commission should provide further clarification as to which individuals within an organization are "executive officers." Given the draconian consequences of failing to comply with the Proposed Rule, advisers should be provided greater certainty as to the personnel whose political activities must be closely monitored and circumscribed. Moreover, because the Proposed Rule limits the ability of covered associates to participate fully in the political process, the class of persons subject to the Proposed Rule should be drawn in the narrowest manner possible. We believe that covered associates should include only those persons who have a cognizable incentive to make improper contributions.[21]

As currently drafted, the Proposed Rule provides a circular definition of "executive officer," by defining an "executive officer" as "the adviser's president and any vice president in charge of a principal business unit, division, or function (such as sales, administration, or finance) *or any other executive officer* who, in each case, in

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20 We note that Rule 204A-1 under the Advisers Act, which requires that an investment adviser establish, maintain and enforce a written code of ethics, imposes a similar framework with respect to the personal securities transactions and holdings of access persons, as well as the pre-approval of the direct or indirect acquisition by an access person of any security issued in an initial public offering or limited offering. Some advisers may choose to include in their codes of ethics provisions addressing improper contributions.

21 For example, persons whose primary duties include, or whose compensation is directly based upon the success of, marketing or sales activities as well as the five most highly compensated persons in the firm and the supervisors of such persons.

connection with his or her regular duties: (i) performs investment advisory services (or supervises someone who performs them) for an adviser; (ii) solicits (or supervises someone who solicits) for an adviser, including with respect to investors for a covered investment pool; or (iii) supervises, directly or indirectly, executive officers described in (i) or (ii)."[22] Thus, an investment adviser must determine whether an officer is an "executive officer" without the benefit of bright line guidance.[23]

In addition, the Commission should clarify the meaning of "any other executive officer who, in each case, in connection with his or her regular duties ...." We note that Rule 205-3 under the Advisers Act defines "executive officer" to mean "the president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), *any other officer who performs a policy-making function, or any other person who performs similar policy-making functions, for the investment adviser*."[24] It is unclear whether, under the Proposed Rule, "any other executive officer who, in each case, in connection with his or her regular duties ..." is intended to refer to officers with a policy-making function with the additional requirements of subparts (i), (ii) or (iii).[25] Absent clarity, a number of individuals, particularly in the context of a large, consolidated investment adviser, could be included within the definition of "executive officer." Thus, as a general matter, we request further clarification, in the rule itself or through any adopting release, regarding which additional personnel the Commission has intended to capture within "executive officer."

IV. The Two-Year "Look Back" Period is Unduly Excessive

We believe that the "look-back" period associated with the two-year time out is unduly excessive and should be reduced to alleviate the burdens associated with, for example, business combinations (*e.g.*, merger transactions or lift outs) involving investment advisers. In such instances, a single contribution by a covered associate

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22 Emphasis added. *See* Proposed Rule 206(4)-5(f)(4).

23 Similar difficulties arise when determining whether a particular action constitutes a "contribution" for purposes of the Proposed Rule. A number of jurisdictions already maintain laws, rules and regulations surrounding political contributions, not all of which are uniform. Absent clarifying guidance, advisers would be required to parse numerous legal requirements to determine whether or not a particular activity constituted a contribution. The expense and difficulty of doing so could cause advisers to adopt a wholesale ban on political activity by covered associates.

24 We note that the SEC's 1999 proposal used a definition of "executive officer" identical to Rule 205-3 under the Advisers Act.

25 We note that the definition of "executive officer" as contained in various other federal securities laws include within their definition "...any other officer who performs a policy-making function, or any person who performs similar policy-making functions..." *See, e.g.,* Rule 501(f) under the Securities Act of 1933, as amended; Rule 16a-1(f) under the 1934 Act; Rule 3c-5(a)(3) under the Investment Company Act of 1940, as amended ("1940 Act").

could taint the surviving firm. Similarly, the prohibition unnecessarily and adversely interferes with an adviser's judgment in connection with decisions affecting hiring, promotions or changes in job title, function, or responsibilities of its personnel, as well as solicitation activities of individuals. The Proposed Rule fails to appreciate the difficulties of monitoring and screening individuals prior to hiring or promoting them or in connection with business combinations.

Accordingly, we suggest that the Proposed Rule should contain a look-back period of six months (i) with respect to improper contributions by individual covered associates or PACs that are controlled by individual covered associates, as opposed to the adviser itself, and (ii) which does not apply to a covered associate's activities prior to, and not otherwise in anticipation of, employment by the adviser.[26] We believe that a look-back period of six months addresses the Commission's concerns while affording advisers limited relief to mitigate the operational difficulties of complying with the Proposed Rule.

V. The Proposed Rule Should Not Prevent "Cost Based" Reimbursement for Services Rendered by Investment Advisers

We note that the Proposed Rule's two-year time out would prohibit an investment adviser from providing advisory services "for compensation" to a government entity after certain political contributions are made by the adviser or its covered associates. As the SEC has noted, in certain situations an adviser's fiduciary duties may obligate that adviser to continue to provide, at a minimum, "uncompensated" advisory services to a government entity for a reasonable period of time during the time-out period.[27] Prohibiting an adviser from recouping its costs presents certain regulatory challenges and may harm other clients or investors in an adviser's pooled vehicles.[28]

In the context of registered investment companies, an impermissible contribution subjecting an adviser to the two-year time out may present very difficult legal issues because of restrictions under the 1940 Act, particularly Section 18(f) of the 1940

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[26] Although, as discussed above, we do not believe that the SEC's analogy to the municipal securities industry and reliance on MSRB Rules G-37 and G-38 is appropriate, we note that MSRB Rule G-37 provides relief to certain "municipal finance professionals" by limiting the look-back period to six months. *See* MSRB Rule G-37(b)(ii)(iii). Additionally, we believe that an adviser should be allowed to reasonably rely on the representations of a covered associate.

[27] In theory, an adviser would be under a fiduciary duty to continue to provide "uncompensated" advisory services at least until (i) a new adviser is selected; (ii) the government entity redeems it shares; or (iii) the two year time-out period ends and the adviser can again receive compensation for its services, which ever comes first.

[28] For example, it is not clear if the prohibition on compensation would limit an adviser's ability to use soft dollars, in a manner consistent with the Section 28(e) safe harbor, attributable to trades in an account or pooled fund in which the government entity has an interest. If so, an adviser might be required to alter its trading strategies in a manner that could harm other clients or investors.

Act.[29] Since an adviser subject to the two-year time out could be required to continue to provide advisory services to a government entity without compensation, coupled with the requirements of Section 18(f) of the 1940 Act, an adviser in such circumstance is left with very few options. For example, the adviser could achieve the result of providing services to the government entity without compensation by waiving its advisory fee or that portion of its total advisory fees that is attributable to shares held by the government entity. Of course, in order not to create a senior security in violation of the 1940 Act, the reduction in the advisory fees charged by the adviser to the fund would unfairly benefit shareholders that are not government entities.

In addition, as the Commission states in the Proposing Release, an adviser of a private fund that is subject to the two-year time out is presented with limited options during the time-out period, specifically with regard to the adviser's ability to redeem the government entity's shares.[30] For example, the private fund may have limitations on redemptions or be illiquid and redeeming the government entity's interest could cause financial harm to the other investors in the private fund.

In light of these concerns, we believe that the term "compensation" should be revised such that an adviser subject to the two-year time out may be reimbursed for the expenses or costs of providing advisory services to a government entity during the time-out period. We believe that removing the profit element would serve as a reasonable deterrent without unduly harming an adviser or its other clients and investors in its pooled vehicles.

VI. Exceptions To The Two-Year Time Out – *De Minimis* and Certain Returned Contributions

The Proposed Rule contains a *de minimis* exception that permits contributions of $250 or less, per election, by persons entitled to vote in such election. As noted in the Proposing Release, the amount of the exception is identical to the *de minimis* exception contained in MSRB Rule G-37, which has not been increased to account for inflation since the adoption of MSRB Rule G-37 in 1994. We submit that the *de minimis* exception should be increased to allow meaningful participation in the political process by covered associates.

Furthermore, we believe that the Proposed Rule's other exception – for certain returned contributions – fails to consider the legitimate interests a covered associate may have in an official or candidate for whom such covered associate is not entitled to vote. For example, to the extent a covered associate owns property in a jurisdiction where such covered associate does not reside, the Proposed Rule would prevent all

[29] Section 18(f) of the 1940 Act generally prohibits a fund from selling any class of senior securities.

[30] *See* Proposing Release, at 68.

contributions to officials or candidates in such jurisdiction. Moreover, in many metropolitan cities, such as New York, San Francisco or Washington, D.C., it is not uncommon for individuals to commute from the surrounding areas. Therefore, all *de minimis* contributions should be allowed under the Proposed Rule, without regard to voter eligibility.

Finally, because of the draconian effects of the two year time out and the potential that a rogue or disgruntled employee could irreparably damage a firm through improper contributions, we believe that an exception should be made available where: (i) the adviser has in place (and enforces) policies and procedures that are reasonably designed to prevent violations of the Proposed Rule; and (ii) the adviser was unaware of the improper contribution (despite reasonable efforts to be made aware of all relevant contributions)[31] or the adviser was aware of the contribution and appropriately sanctioned the personnel responsible for the improper contribution.

VII. Recordkeeping Requirement Should Be Narrowed

The proposed amendments to the Recordkeeping Rule would add to an already substantial amount of materials that registered advisers must maintain pursuant to the existing Recordkeeping Rule. In addition, because records of contributions made by the adviser and its covered associates, as required by the proposed amendments to the Recordkeeping Rules, are not created during the ordinary course of an adviser's business, advisers would need to implement costly and complex policies and procedures to regularly establish and subsequently maintain such records. Such extensive recordkeeping would impose a significant burden on advisers and require that they intrude on the private political activities of their employees.[32] In addition, analysis of state and local lobbying, contribution and procurements laws is so complicated and multi-dimensional that advisers likely would be required to employ experts in these matters in order to accurately establish and maintain required records.

We believe that the Commission should consider narrowing the requirements of the proposed amendments to the Recordkeeping Rule which, as drafted, would impose substantial burden and compliance costs for a large number of advisers that do not engage in pay-to-play practices and desire only to comply with the Proposed Rule. The Commission should consider whether the burden and cost of each proposed recordkeeping requirement (*e.g.*, the requirement that advisers keep an ongoing, continuously updated list of prospective government clients for which the adviser "is

[31] For example, where an employee fails to make required contribution reports in contravention of an adviser policy requiring that political contributions be reported.

[32] Employees whose political views may diverge from their colleagues or managers may feel uncomfortable reporting contributions and many people view the privacy of the voting booth as properly extending to other political activities. As a result, the recordkeeping requirements in the Proposed Rule will have a further chilling effect on political activity by adviser personnel.

seeking to provide" advisory services, which serves little purpose in determining whether pay-to-play abuses occurred in connection with current clients) outweighs its potential benefit of deterring and uncovering pay-to-play arrangements.

VIII. Other Clarifications/Technical Concerns

A. Application to Unaffiliated Distributors of Registered Funds

The Commission should clarify that the Proposed Rule's prohibition on payments to unaffiliated third-parties is not applicable to situations involving registered investment companies that enter into distribution arrangements with unaffiliated distributors. To avoid circumstances where a third-party distributor is used to evade the Proposed Rule, the Commission should note, in the adopting release (if any) that such action would violate the prohibition on indirect actions, which if done directly, would violate the Proposed Rule.

B. Application to an Unrelated Adviser to a Pooled Product or an Adviser to Providing Sub-Advisory Services

The Proposed Rule's two-year time out should not apply to situations where an independent investment adviser, with full discretionary authority over all or a portion of a government entity's assets, directs an investment on behalf of such government entity into a "covered investment pool" or separate or sleeve account managed by an unrelated adviser in accordance with the independent adviser's investment program (*e.g.*, fund of funds or manager of managers arrangements, where, in accordance with an adviser's investment program, the adviser has selected certain underlying funds or managers as part of an asset allocation strategy or otherwise).

We believe that a sub-adviser or an adviser to an underlying fund should not, in these circumstances, be viewed as directly or indirectly, soliciting an investment or mandate from the government entity and, therefore, should not be subject to the two-year time out if the such adviser or its covered associates make an improper contribution to a government entity. We submit that, in such situations, the abuses that the Proposed Rule is intended to eliminate are not implicated if no government official instructs the independent investment adviser as to the selection of investment vehicles or sub-advisers that will be employed by the adviser to manage the assets of the government entity.[33]

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[33] In such circumstances, or where it otherwise appears that the arrangement has been structured to evade the proper application of the Proposed Rule, the "further prohibition" set forth in paragraph (d) of the Proposed Rule would apply.

C. Retention of Pension Consultants by Government Entities

The Proposing Release states that that the "[P]roposed [R]ule 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."[34] We believe that the ability of government entities to retain consultants is important; but that the expense associated with doing so may be prohibitive and, at a minimum, would (all other things being equal) reduce returns when paid out of the government entity's account. In addition, we are aware of circumstances where a third-party consultant or solicitor is selected (and compensation is negotiated) by a client (*e.g.*, the government entity) but the fee paid to consultant or solicitor is actually paid by the adviser who earns the mandate, rather than by the government entity.

Even if the Commission determines to adopt the Proposed Rule's prohibition on traditional third-party solicitors and placement agents, we believe that arrangements where the third party intermediary is selected and retained by the government entity, rather than the adviser, should be permissible under the Proposed Rule, even if it is understood that the intermediary ultimately will be compensated by the adviser that earns the government mandate. This suggested change to the Proposed Rule would not eliminate the two-year time out if the adviser actually made a prohibited political contribution. As a result, advisers who have made prohibited political contributions would be unlikely to compete for, or accept, a mandate for which the adviser would be uncompensated for the initial two years. Thus, the dangers that the Proposed Rule is intended to eliminate are not likely to be present in these circumstances.

D. Application of the Defined Term "Solicit" to Certain Personnel and Third-Party Service Providers[35]

The Commission should clarify that the definition of "solicit" for purposes of the Proposed Rule does not include situations in which a third party, such as an administrator or custodian, is responsible for the delivery of ordinary-course communications (*e.g.*, mailing periodic statements or reports) to clients and/or shareholders. We believe that the delivery of such communications by such third parties, in the ordinary course of business, are not solicitation activities and the

[34] *See* Proposing Release, at footnote 145. The SEC should clarify that such payments could be made through a client-directed brokerage arrangement, in addition to direct cash payments; provided that the government entity has affirmatively directed the adviser to use the designated broker to satisfy these obligations. In the absence of such a direction, the adviser's exercise of discretion to "reward" a broker or other third-party through directing a government entity's (or other client's) commissions would be inconsistent with the soft dollar safe harbor established by Section 28(e) of the 1934 Act and, likely, would violate the adviser's duties and/or applicable law.

[35] This section discusses the term "solicit" as it relates to investment advisory services. *See* Proposed Rule 206(4)-5(f)(10)(i).

Proposed Rule should be revised to explicitly exclude such ordinary-course communications from the definition of "solicit."

In addition, we believe that the Commission should make clear that the term "solicit" does not include employees of an investment adviser who provide operational due diligence or other services, when such actions are not primarily for the purpose of obtaining or retaining a client. For example, a chief compliance officer that provides information to – or speaks with – representatives of a government entity regarding the adviser's compliance program in this context should not be an "employee who solicits a government entity for the investment adviser," and thus not a covered associate.

E. Application to Covered Associates Running for Office

The Commission should clarify that the two-year time out does not apply to contributions made by a covered associate to his own campaign or the campaign of an immediate family member when running for or holding state or local office. Absent this change, if such covered associate remains associated with an investment adviser, the person's employer could be subject to the two-year time out.[36] We submit that, in such situations, the Proposed Rule serves no practical purpose (as such persons would, naturally, be inclined to favor the adviser regardless of whether their campaign was self-funded or whether contributions were made by a spouse, parent or child) but improperly and significantly limits the ability of such persons to seek and hold public office.

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If the Commission or its staff wishes to discuss the matters mentioned in this letter, please contact Jane A. Kanter at 202.261.3302, Michael L. Sherman at 202.261.3449, Kenneth R. Earley at 617.728.7139, or Brenden P. Carroll at 202.261.3458.

Very truly yours,

Jane A. Kanter

Jane A. Kanter

[36] Many state and local offices do not require a full time commitment (or provide full time pay) and those who would wish to seek or hold state or local office may need or want to continue outside employment.