The Blackstone Group

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September 14, 2009

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549- 1090

Attention: Elizabeth M. Murphy, Secretary

Re: File Number S7-19-09 – Proposed Rule to Address "Pay-to-Play" Practices by Investment Advisers

Ladies and Gentlemen:

I am writing you on the draft rule that the SEC has put out for comment, which would prohibit political contributions to certain state and local officials by certain investment advisors. Prohibiting such political contributions is a wise and prudent idea, and one I endorse unequivocally. However, the proposed rule also bans placement agents from representing clients before state and local pension funds and this is a bad idea with many deleterious consequences.

I thought it might be useful for the SEC to have the perspective on the central role placement agents played in starting Blackstone. That experience would suggest that banning placement agents across the board, even those who are appropriately regulated and where there is appropriate disclosure of their activities, would be a terrible mistake for virtually all constituencies involved. These constituencies include pensioners, managers of pension funds, and managers of investment funds.

Blackstone is now the largest independent alternative asset manager in the world. It would be normal to assume that we always were large and successful. This is far from the case. When my partner Pete Peterson and I started the business in 1985, there were literally just the two of us and one personal assistant. We had only $400,000 of capital. We had agreed to start a corporate advisory business first and then go into the private equity business as soon as we were able.

We started raising private equity money in 1986, about one year after we incorporated our business. Pete made a trip to Singapore but was unsuccessful in raising any money. He also made another trip to Japan, which also resulted in no funds being raised.

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Starting in late 1986, like most start up investment funds, we had completed a private placement memorandum and contacted our top prospects to see if they wanted to invest with us. We sent out approximately 500 letters and copies of our offering memorandum. We were quite surprised to learn that there was virtually no response from the potential investors. Bear in mind that we were not neophytes in the financial world. Pete had been Chairman and CEO of Lehman Brothers and Secretary of Commerce in the Nixon Administration and I had headed the Mergers and Acquisitions Department at Lehman Brothers.

We had an exceptionally difficult time figuring out whom we should even be contacting at each institution. In many cases we just mailed the offering memorandum blindly to the institution itself. As a result of our initial mailing and a few visits to those potential investors who were willing to see us, we obtained a $100 million commitment from Prudential Insurance, a $50 million commitment from Metropolitan Life Insurance, and a $25 million commitment from New York Life Insurance. Although this does not sound like the worst possible outcome, each of the commitments was made contingent on our raising a substantially larger pool of capital inasmuch as no investor wanted to be more than 10% of the total fund. Since we had already contacted virtually everyone else we knew, our fundraising efforts were about to fail.

Faced with this disappointing outcome, we then hired Bankers Trust and First Boston (renamed CS First Boston in 1988), the latter of which had at the time, and still has, a leading placement agent business. They took us on as clients to help us raise the balance of the fund. As a result of their relationships, many more institutional sources of capital were willing to sit down with us and listen to our plans. We eventually raised approximately $850 million and started our business.

Let me give some personal examples of the utility of a placement agent to both pension funds, as well as to the investment managers who are seeking to raise funds. One example from our first fundraising involves General Motors Pension Corporation, which at the time was the largest corporate pension fund in the United States. Pete and I had been turned down three times by the General Motors Pension Fund as part of raising our first fund. However, after we had hired CS First Boston, which had a long, close, and trusting relationship with General Motors, they met with us again the fourth time. With the assurance of CS First Boston about our integrity and general corporate finance background, CS First Boston convinced General Motors to give us a commitment of $100 million. It is now 24 years later and the General Motors Pension Fund has participated in each of our private equity funds and we have been one of the best performing funds in their entire portfolio, helping to ensure the benefits are available for both their union and non-union employees.

CS First Boston also arranged introductions for us with major Japanese companies as potential investors. In 1987, as you will recall, Japan was quite strong financially and had surplus funds. Unfortunately, Pete and I knew virtually no one at most of these Japanese financial institutions who might have been potential investors in our private equity fund. Private equity was a new asset class at that time and so it became doubly difficult to get commitments from them. CS First Boston had an office in Tokyo and was very close to several of the major institutions there. Again, as a result of CS First Boston's efforts, we obtained a $100 million commitment from Nikko Securities and ended up being the largest gatherer of private equity funds in Japan for a first fund as a result of other institutions CS First Boston and Bankers Trust knew there.

Without the assistance of CS First Boston and Bankers Trust, I can assure you that our fundraising efforts for our first private equity fund would have utterly failed, Blackstone would have been a very different firm today and may not even have survived at all.

In 1993, when we were raising our second private equity fund, we tried to approach state pension funds which, as a group, were not prepared to invest in private equity when we were raising our first fund. The largest state fund was CalPERS, the California State Pension Fund. We contacted them directly, filled out the lengthy form which their consultant used to screen potential private equity fund managers, and found that we had been rejected by the consultant. In order to find out why this occurred, we hired a small placement agent firm to represent us. The firm, which had a long relationship with CalPERS, learned that the consultant had inaccurately evaluated our responses to their questionnaire. It arranged for us to meet with the Chairman of CalPERS and the Trustee principally responsible for CalPERS's investments. As a result of the meeting, CalPERS reevaluated Blackstone as a potential investment and joined the many other state pension funds who had committed to our second private equity fund. We were one of the first major investments by CalPERS in the private equity area. This was a direct result of our using a placement agent firm with very significant experience in the private equity investing field, and who had enormous credibility with virtually all of the major investors among state pension funds in this asset class. We still remain one of CalPERS's largest single investments and they have subsequently invested with us in all of our private equity funds as well as in other alternative investment areas. Today we are without question one of their top performing managers and in June of this year CalPERS actually raised its target commitment to private equity to 14 percent of assets from 10 percent. Without the help of this firm in getting us the opportunity to present our credentials directly to the important decision-makers, neither we nor CalPERS would have built this relationship.

I mentioned that ours have been among the highest performing funds. Since $39 out of every $100 invested with us comes from state and local pensions funds, these high returns have protected, and added to, the stability of the nation's pension fund system. The indirect beneficiaries are the police, firefighters, teachers, and state and local municipal workers whose pensions are now more secure given the high returns that we have provided over the years. None of these favorable results for these constituencies involved would have been achieved without the initial use of placement agents by us in our first two funds.

Blackstone has achieved a scale and reputation that means we no longer need placement agents to help us get in the door. We do, however, continue to selectively use placement agents and have achieved similar positive results. We have hired only the highest quality people and organizations. We believe that the firms we have used have the relevant expertise to assist institutions in getting to know our people and our investment process in order to facilitate a good match between an investment manager like us and investors looking to hire top quality managers.

I am well aware that there have been a few bad apples, particularly in New York State and New Mexico, which have brought the placement agent issue to the fore. No one has any sympathy with unlicensed influence-peddling political fixers. They should be eliminated for the good of everyone in the business. But there are ways of doing this without banning an entire industry.

No system is perfect. Recently, there have been reports of a few high profile baseball players using illegal steroids to unfairly enhance their performance. Their illegal and unethical behavior has unquestionably challenged professional baseball and yet no one is suggesting banning baseball. Eliminating placement agents as a group because there were a few bad actors who have tarnished the industry is analogous to eliminating Major League Baseball because several of its players behaved illegally.

I have been in finance for approximately 40 years. I have seen the legitimate need for seekers of capital to hire intermediaries - typically investment bankers - to find capital for them through large institutional and individual pools of capital. This is what a Silicon Valley high tech firm does when it hires an investment bank to get it ready for an IPO. It is what a Fortune 50 company does when it wants to place $500 million of 10 year senior notes. The asset management industry has a similar type of need and is no differently situated than any other seeker of capital. To eliminate intermediaries for state and local pension funds is just as illogical as preventing Morgan Stanley or Goldman Sachs from inviting Fidelity or Vanguard to a road show presentation for an IPO or a senior note offering.

Next, to go forward with the proposal to ban placement agents would hinder the ability of new firms of all types, including those owned by women and minorities, as well as small and medium-sized private equity firms, to start and expand their businesses. It would chill entrepreneurial opportunity in this area, which is part of what historically has helped create jobs in America and build its tax base. The proposed ban would also make it more difficult for state and municipal pension funds to identify the most appropriate managers since, by and large, they largely lack a staff of sufficient size to evaluate every worthy opportunity.

Blackstone started a placement agency business, Park Hill, several years ago. Park Hill has been quite successful in raising money for the newer and medium-sized managers I've just described. However, I am not writing this letter on behalf of our firm's interests in continuing our own placement business. I am writing this letter so that you understand clearly the role of placement agents in helping to start new firms like Blackstone. In our case, we have evolved into the largest firm of its kind in the world with consequent benefits to various constituencies. These include the beneficiaries of pension funds, the pension funds themselves, the federal government and other state and local governments which receive multi billion dollar tax payments, and the nearly one million people who work in our portfolio companies. This would not have happened without professional placement agents providing qualified entrepreneurs the opportunity to be introduced to sources of capital.

We at Blackstone bear tremendous responsibility for safeguarding and growing the retirement incomes of the men and women whose pensions are invested with us and each and every investment decision we make is undertaken with that responsibility weighing heavily on our minds. For that reason, I wholeheartedly support efforts to rid the industry of bad actors and endorse reforms that curtail pay-to-play, require registration, supervision and disclosure. Those reforms, however, can be achieved without taking the drastic step of eliminating the function of legitimate placement agents, which would have the unintended consequence of unfairly disadvantaging firms just starting out.

Sincerely,

Stephen A. Schwarzman