September 18, 2009

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

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

Dear Ms. Murphy:

We appreciate the opportunity to comment on the Securities and Exchange Commission's proposed new Rule 206(4)-5 under the Investment Advisers Act of 1940 (the "Advisers Act") regarding the use of political contributions by certain investment advisers to obtain investment advisory business from the governments of states and municipalities, a practice known as "pay to play." Monument Group, Inc. ("Monument Group") is an independent broker-dealer registered with the Commission and a member of FINRA, and our primary business is helping investment advisers that manage private investment funds raise capital from institutional investors.

Monument Group agrees wholeheartedly with the Commission's statement in the Release that "pay to play practices undermine the fairness of the selection process when advisers seeking to do business with the governments of states and municipalities make political contributions to elected officials or candidates, hoping to influence the selection process."[1] However, we are deeply concerned about the draconian nature of subparagraph (a)(2)(i) of proposed Rule 206(4)-5, which would ban firms such as ours from intermediating between our clients and public pension plans. For the following reasons, we believe that this provision of the proposed rule is an unnecessary and inappropriate response to the recent pay to play scandals and that the costs of this ban will far outweigh its benefits:

- SEC-registered and FINRA member placement agents, such as Monument Group, provide significant value to private fund investment advisers and to institutional investors, including public pension plans, by promoting private investment funds as an asset class and improving the efficiency of the capital raising market for private investment funds, which benefits all of the stakeholders that gain from the economic stimulus of private capital. We believe that the proposed ban on the solicitation of government entities by SEC-registered and FINRA member placement agents would create significant collateral harm, not just to the placement agents themselves and the private fund investment advisers that retain them to raise capital, but to many other stakeholders, including public pension plans and the millions of individual pension plan beneficiaries, and to the

[1] See Political Contributions by Certain Investment Advisers, 74 Fed. Reg. at 39841(August 7, 2009), Release No. IA-2910 (August 3, 2009) (the "Release").

economy in general. In short, the proposed ban would have a significantly adverse effect on efficient capital formation and thus the overall economy with little, if any, identified benefits.

- One of the principal concerns cited by the Commission in proposing the ban on the use of third parties to solicit investment advisory business from government entities is the "apparent difficulties for advisers to monitor the activities of their third-party solicitors."[2] We believe that the proposed rule does not logically follow from this concern, and that the concern itself is unsubstantiated, because investment advisers can exert control over third-party solicitors through their contracts of engagement, in the same way that they can be responsible for employees and other covered associates, and in the same way that any principal is responsible for the acts of its agent.

- We particularly take issue with certain assumptions that have been cited in the Release as the justification for the proposed ban on third party solicitors. Specifically, the Release states that the ban is based on the experience with Rules G-37 and G-38 adopted by the Municipal Securities Rulemaking Board ("MSRB").[3] We believe that MSRB Rule G-38 is not analogous to the proposed rule. Rule G-38 permits a broker-dealer that is unaffiliated with an issuer to market that issuer's securities to a public pension plan or any other investor. Proposed Rule 206(4)-5(a)(2)(i) prevents this and seeks to entirely disintermediate the process between the issuer of a security and the ultimate investor.

- As a FINRA member broker-dealer, we are required to conduct our business in a manner that is consistent with "high standards of commercial honor and just and equitable principles of trade"[4] as well as comply with anti-fraud and record keeping rules.[5] The proposed ban is unfair to compliant, regulated placement agents, like Monument Group, who would be excluded from this portion of the capital market despite the compliance costs we have incurred under existing rules. We believe the proposed ban is unnecessary given that existing securities laws and SEC and FINRA rules can already be used to bring actions against those who engage in pay to play practices. In addition, we believe that the proposed ban is inconsistent with the public policy behind the Advisers Act, namely that of full disclosure, rather than the prohibition of specific transactions.[6] Any measures

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[2] Release, 74 Fed. Reg. at 39852.

[3] Release, 74 Fed. Reg. at 39851, 39852.

[4] FINRA Rule 2010.

[5] FINRA Rules 2020 and 440.

[6] The Advisers Act was "Enacted by Congress to 'substitute a philosophy of full disclosure for the philosophy of caveat emptor' in the investment advisory profession." See *SEC v. Capital Gains Research Bureau, Inc.*, 375 US 180, 186 (1963).

ultimately adopted by the Commission to address pay to play abuses should bolster and be consistent with existing SEC and FINRA regulations and other relevant federal laws that already prohibit fraudulent practices such as pay to play.

- As discussed below, there are significant alternatives that would accomplish the Commission's objective of curtailing pay to play practices while minimizing the impact on small entities, such as independent SEC-registered placement agents and emerging private fund investment advisers who rely on them to assist with capital formation projects. We believe that our proposed alternatives would be even more effective at curtailing pay to play practices than the proposed ban on the use of third party solicitors.

- We estimate that the annual direct effect of this ban would far exceed $100 million per year, making this a "major" rule in terms of its effect on the economy. This negative financial impact would consist of placement agents' lost revenues[7] as well as a reduction in investment returns for public pension plans and their beneficiaries resulting from pension plans' reduced access to high quality, placement agent-vetted private investment funds in which to invest plan assets.

For these reasons, which are discussed in more detail below, we respectfully urge the Commission to eliminate or substantially modify sub-paragraph (a)(2)(i) of proposed Rule 206(4)-5.

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[7] See table and related discussion, pp. 17-18, below.

<u>Contents</u>

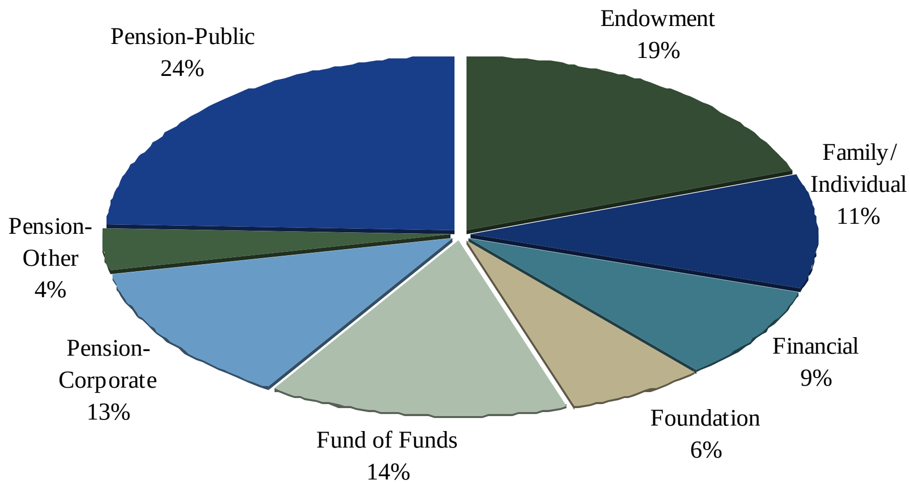
1. Introduction to Monument Group

Monument Group is an SEC-registered broker-dealer and FINRA member, based in Boston, Massachusetts, that has been engaged in business as a placement agent for over 15 years. The firm is independently owned and currently employs a total of 20 employees with 12 FINRA licensed registered representatives who, collectively, have over 200 years of experience in the investment business with an average of approximately 17 years. The business and educational credentials of the firm's principals and employees are those of investment professionals - CFAs, MBAs, investment analysts and consultants. The primary business of our firm is helping investment advisers that manage private investment funds, such as private equity, venture capital, real estate and energy funds, raise capital from institutional investors.

The help we provide to investment advisers includes: (i) providing advice on building a compelling investment case to prospective investors; (ii) preparing presentation and offering materials as well as detailed due diligence information; (iii) identifying and targeting potential investors (including public pension plans) based on our knowledge of their investment allocations, preferences and anticipated investment activity levels; (iv) introducing private investment funds managed by our investment adviser clients to investors; (v) arranging roadshows of investor meetings; (vi) coordinating follow-up meetings between investment advisers and investors; (vii) coordinating investors' due diligence requests; intermediating in terms negotiations; and (viii) providing post-closing updates to clients and to investors.

Since Monument Group's inception, we have helped 27 investment advisers, managing a total of 56 private investment funds to raise over $67 billion of capital from institutional investors diversified by type and geography. Since 1998, investors have made over three thousand distinct commitments to private investment funds managed by Monument Group's investment adviser clients, and 24% of the capital Monument Group has helped its investment adviser clients raise from U.S. investors has come from public pension plans, as shown in the chart below.

Monument Group U.S. Limited Partner Capital Raised by Source Since 1998



Since 2002, we have made close to ten thousand specific introductions between our client investment advisers and institutional investors. We have marketed our clients' private investment funds to public pension plans on over 900 occasions.

We are not a political fixer, and none of our staff has ever held elected public office. Not once in any of the hundreds of interactions with public pension plans over 15 years has Monument Group been involved directly, or indirectly, in a single pay to play incident. In fact, the need to pay to play has never been suggested or even hinted to us by any of our investment adviser clients or any official at a public pension plan.

Far from being seen by investment advisers or public pension plan officials as a possible conduit for illicit campaign contributions, we believe that Monument Group is viewed as a firewall against such practices. We maintain the highest standards of professional integrity and ethics. In this regard, we have had policies in place for many years that regulate and monitor the professional and investment conduct of our employees in order to ensure compliance with regulatory standards. Of particular relevance is our internal, firm-wide policy that expressly prohibits any of our principals or employees from making any political contributions to any state or municipal government official of more than $250 per year, regardless of an employee's or principal's entitlement to vote for such government official. In addition to its moral offensiveness, any form of corruption harms those, like us, who play by the rules. We vigorously support any measures that will achieve a reduction in corrupt activity. As a result, we are substantially in favor of the spirit of proposed Rule 206(4)-5 other than the proposed ban on third party solicitors.

2. <u>The Value of Registered Placement Agents to Investment Advisers, Institutional Investors and Public Pension Plans</u>

We believe that there are a number of stakeholders within the private investment fund landscape that would be harmed by the proposed ban on the use of placement agents in Rule 206(4)-5(a)(2)(i), as discussed below.

(a) <u>Investment Advisers</u>

Engaging a placement agent is a classic outsourcing activity of investment advisers for which there is a clear need. Banning investment advisers from being able to utilize registered placement agents to solicit public pension plans would unnecessarily preclude investment advisers from reaping the many benefits that flow from outsourcing the capital raising function. The primary considerations in outsourcing the capital raising function, which are discussed below, highlight the significant value created by placement agents for investment advisers. We believe that the unique, experience-based services provided by a placement agent would be difficult, if not impossible, for an investment adviser to internally replicate.

Capital raising workload is substantial – Capital raising by investment advisers of private investment funds requires a substantial amount of time and energy that is disproportionately borne by senior professionals. This can seriously diminish and distract their focus from running their core business of making, monitoring and exiting investments profitably for the benefit of public pension plans and other institutional investors. Capital raising can dominate a year or more of a fund manager’s time.

Examples of time-consuming activity during a private fund capital raising are:

- many weeks spent on preparation of due diligence and marketing materials including the articulation of strategy, analysis of track record and explanation of the market opportunity;

- numerous communications often necessary to coordinate schedules and arrange meetings with investors in an efficient fashion;

- travel to and attendance at meetings with potential investors (including public pension plans) to ensure that all questions are answered and to enable coordination of follow-up information requests;

- responses to specific due diligence requests and/or questionnaires;

- follow-up phone calls and meetings, providing ongoing explanation and clarification;

- terms negotiation and closing coordination.

A high-quality placement agent will substantially improve the efficiency of this process.

Employing full-time staff to organize capital raising is inefficient and impractical for the majority of investment advisers - Capital raising work is sporadic for closed-end private investment funds. Investment advisers managing closed-end private investment funds will typically seek to raise capital for a new fund once every 3 to 4 years. Therefore, employing senior, full-time staff to work on fundraising is inefficient and uneconomic for all but the largest investment advisers. Furthermore, any individuals who are engaged full-time in raising capital from investors in private funds and receive any form of transaction-based compensation for doing so generally would be deemed to be acting as brokers that would need to be properly licensed and registered as such. Given that the vast majority of investment advisers to private funds are neither registered as broker-dealers nor affiliated with a registered broker-dealer, it is not practical for most investment advisers to arrange for their employees who are engaged full-time in capital raising activities to be licensed and supervised as registered representatives of a registered broker-dealer. Registered placement agents and their registered representatives therefore provide a service and a function that most investment advisers cannot themselves provide.

Third-party placement agent expertise, relationships and market knowledge cannot realistically be replicated in-house by investment advisers - If each of the thousands of investment advisers to private investment funds has to "re-invent the wheel" in order to navigate the private fund capital raising market, many will fail. Placement agents provide experience and familiarity with the complex private fund capital raising market by helping investment advisers get their message right and deliver it to the investors most likely to be receptive to their message. This benefits both sides by reducing the occurrence of wasted marketing presentations by investment advisers to investors who are unlikely to be receptive to the presentations. In addition, we provide smaller fund managers with access to expertise and knowledge of the fundraising markets that otherwise would only be available to the largest funds. An analogy might be the usefulness of an attorney to a litigant in presenting its case. Banning investment advisers from using placement agents to make their case to investors would be similar to requiring all commercial litigants to represent themselves.

Valuable insight through familiarity – Calling on investors frequently regarding multiple investment opportunities provides insight into their investment preferences and processes for evaluating potential investments and allows us to interpret their reactions to opportunities more accurately. This in turn helps us to advise our clients on how to adapt their strategy to reflect market need and demand (*e.g.,* we can advise our clients that a particular investor likely will require decreased reliance on leverage.) It also helps us to advise our clients from which investors they should not seek capital. For example, a particular private fund's strategy may not be a good fit for a given public pension plan's allocation. This saves time for both the staff at the investing institution who would otherwise be inundated with these offerings that do not match their preferences, and also creates efficiency and cost savings for the investment adviser who is then only calling on viable investor candidates.

Building relationships helps establish meaningful dialogue - Calling on investors frequently also allows us to build a relationship based on knowledge and trust. If we do this well and the investor thinks of us as having a thoughtful and intelligent understanding of the market and of the private investment funds we represent, they will be more likely to engage with us in discussion, and be more receptive to our ideas going forward. This again is very valuable to our investment adviser clients as it means they are more likely to get a more thoughtful and fulsome hearing from investors.

In summary, we believe that compliant, registered placement agents, such as Monument Group, provide significant value to their investment adviser clients, the public pension plans and other institutional investors they contact (and by extension to the underlying beneficiaries of those public pension plans) and promote the efficient functioning of private capital markets.

(b) Institutional Investors and Public Pension Plans

When investment advisers hire high-quality registered placement agents, institutional investors and public pension plans benefit in significant ways.

Quality screen – High-quality, registered placement agents do a great deal of due diligence on prospective clients prior to introducing them to any investors, including public funds. They do this to preserve their own credibility with investors and they do it because they only want to represent investment advisers that they believe sophisticated investors will support after doing their own due diligence – hence ensuring the placement agent gets paid. As a result, placement agents can provide a good "quality screen" for public pension plan managers. This is particularly important in the light of the vast amount of potential investment opportunities from around the world that public pension plans need to evaluate with limited staff.

Preqin Ltd., a leading source of research on the private investment funds market, reports that 7,324 closed-end private investment funds have either completed their capital raise since 2003 or are currently being raised[8]**.** Monument Group considers over 200 fundraising opportunities each year and only acts for about 5 or 6 of them. The most significant basis for our refusal to act as a placement agent for a private investment fund that we have considered is our assessment of their quality and their prospects for meeting their return objectives. We have declined to act for hundreds of managers who we believed did not stack up against our investment quality criteria. The criteria we use to consider investment advisers as clients are very similar to that used by institutional investors. While our due diligence requests when we are selecting a prospective client are extensive, the main criteria are:

- Strong investment returns on a risk adjusted basis that are appropriate for the investment strategy and are in excess of the relevant benchmarks;
- Clear and replicable investment strategy and process that is consistent with previous experience, the proposed investment fund and macroeconomic environment;
- Strong investment team to whom the historical track record can be attributed;
- Impeccable ethics and no insurmountable conflicts of interest; and

[8] Data extracted from Preqin Ltd. database - www.preqin.com (includes closed-end funds that have completed their capital raising and those that are currently raising capital).

- Strong alignment of interests with investors, based on both ongoing operating procedures and the legal documents governing the partnership.

As an example, in 1998 a team of young but knowledgeable and enthusiastic analysts and investment bankers approached Monument Group with the idea to raise an industry-specific private equity fund. We provided them with advice as to how to gain principal investing experience, which at that time they did not have. They took our advice and over the next several years periodically updated us on their expanding base of experience. After many in-person meetings, due diligence on their backgrounds and verification of their emerging track record, we agreed to represent this investment adviser to raise its first institutional fund. The capital raising took almost one year, from November 2001 to a final closing of $320 million in October 2002. In that fund, four public pension plans were investors. As of June 30, 2009, that 2002 fund had an aggregate gross IRR of 74%, and a gross realized IRR and gross investment multiple of 54% and 3.1x, respectively. While we cannot know for sure if this private equity fund opportunity would have been uncovered by many investors without Monument Group's assistance, we do believe that both our investment adviser client and the institutional investors who invested in their fund, including the four public pension plans, benefitted from our role as placement agent. This particular investment adviser has since successfully raised additional investment funds.

We believe that it is impossible for any one investor to survey the vast and diverse universe of potential private investment fund opportunities in anything but the most superficial way. As a result, genuinely high-quality opportunities can easily be overlooked. We believe that good placement agents are able to uncover and promote some of the better funds that would not otherwise get onto the radar screen of many institutional investors, but which are of genuinely high quality. Without the assistance of a placement agent, most of these private investment funds, and in particular the smaller, emerging fund managers or those managers located outside the U.S., would not come to the attention of public pension plans, and this would limit the opportunity set and, by extension, the returns of the private investment fund portfolios of those public pension plans.

Due diligence assistance – On behalf of their investment adviser clients, good value-add placement agents compile and provide prospective investors with extensive due diligence packages on the investment opportunity that typically include references, historical track record verification and analysis, models to test market variables (leverage, P/E or EBITDA multiples, for instance) and independent macroeconomic data useful to provide context to the market opportunity. Providing this information leverages the investment staffs at all prospective investors, but particularly at public pension plans that are often understaffed and overwhelmed with potential investment opportunities.

In a recent example of a fund raised by Monument Group in which 36% of capital came from 14 public pension plans, all 14 took advantage of Monument-generated due diligence information. Seven of them submitted lengthy questionnaires that ranged in length from 27 pages to 91 pages to the investment adviser who managed the fund. These questionnaires were completed by Monument Group. Without this assistance, the investment staff of these public pension plans would have had to pull together the information themselves from various offering materials and spend considerable amounts of time talking to the fund manager to fill in the gaps. In each case, we estimate that the involvement of Monument Group saved the public pension investment professionals dozens of hours of work. This no doubt freed them up to look at other opportunities that they would not have otherwise had time to consider, thereby improving their investment decision making, and enabling them to do a better job for their plan beneficiaries.

Through value-added, registered placement agents, the universe of prospective investment opportunities available to public pension plans and other investors is wider, which should enhance the potential returns to those investors. This occurs because many of the most talented investment advisers are independent from bulge-bracket, Wall Street firms and are not large multi-asset investment firms. As such, the grand majority of investment advisers of private investment funds do not have the budget or the ability from a regulatory standpoint to employ permanent in-house capital raising personnel. Registered placement agents play that role for many independent investment advisers of private investment funds, because such placement agents have the business and regulatory infrastructure to engage in full-time capital raising activities. Fundraising for independent private investment funds has been the lifeblood of the U.S. investment industry for decades – the tree has constantly been refreshed by highly talented investment individuals branching out on their own.

Conduit for feedback - Registered placement agents play an important role for public pension plans and other institutional investors by acting as an informed conduit back to investment advisers. Our firm has personally acted as go-between in helping our clients, the investment advisers, understand limits to the amount of capital they should raise, the fees they can charge, and other important governance terms. Experienced and knowledgeable registered placement agents assist public pension plan investors, particularly smaller and less sophisticated ones, in getting their voices heard by investment advisers that manage private investment funds. For example, Monument Group is frequently consulted by its clients regarding the development of annual meetings and presentations and other investor communications, in order to ensure that they address topics of greatest interest to their investors, including public pension plan investors.

3. MSRB Rule G-38 is an Inappropriate Model

The Staff has requested comments on whether MSRB Rules G-37 and G-38 should be used as the models for proposed Rule 206(4)-5.:[9] As we have reviewed this analogy, we feel that while these functions are relevant and useful to compare, the parties involved in the municipal bond sales process and in the private investment funds process are not appropriately analogous to draw the conclusions made in the Release. We have elaborated below.

In the Release, MSRB Rule G-38 is stated to be a central pillar to the Commission's proposal to ban the use of placement agents to solicit government entities. In particular, our comments are based on the following statements:

> "Although today's proposal is similar to the one we made in 1999, we are proposing a few critical changes . . . to conform our proposal to measures undertaken in recent years to curtail pay to play activities by the MSRB and various State and local authorities and

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[9] *See* Release, 74 Fed. Reg. at 39846, "Are there significant differences in governments' selection process for municipal underwriters and investment advisers that we have not addressed but that should be reflected in the rule?"

> to deter circumvention of the restrictions through the use of third-party placement agents . . . ."[10]

> "After the adoption of rule G–37 in 1994, the MSRB observed that municipal securities dealers sought to circumvent rule G–37 by hiring third-party consultants to solicit government clients on their behalf. These third-party consultants would make political contributions or otherwise seek to exert influence designed to secure municipal business for the municipal securities firm. Two years later, in 1996, the Commission approved, and the MSRB adopted, rule G–38, which required municipal dealers to disclose publicly the terms of their agreements with consultants. In 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.

> "We are concerned that our 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. Indeed, we have alleged that third-party solicitors have played a central role in each of the enforcement actions against investment advisers that we have brought in the past several years involving pay to play schemes."[11]

While we give credit to MSRB Rule G-38 for removing unregistered consultants from the municipal securities business, we would argue that Rule G-38 is fundamentally not analogous to the proposed Rule. The diagrams illustrate the operation of Rule G-38 and the proposed Rule:

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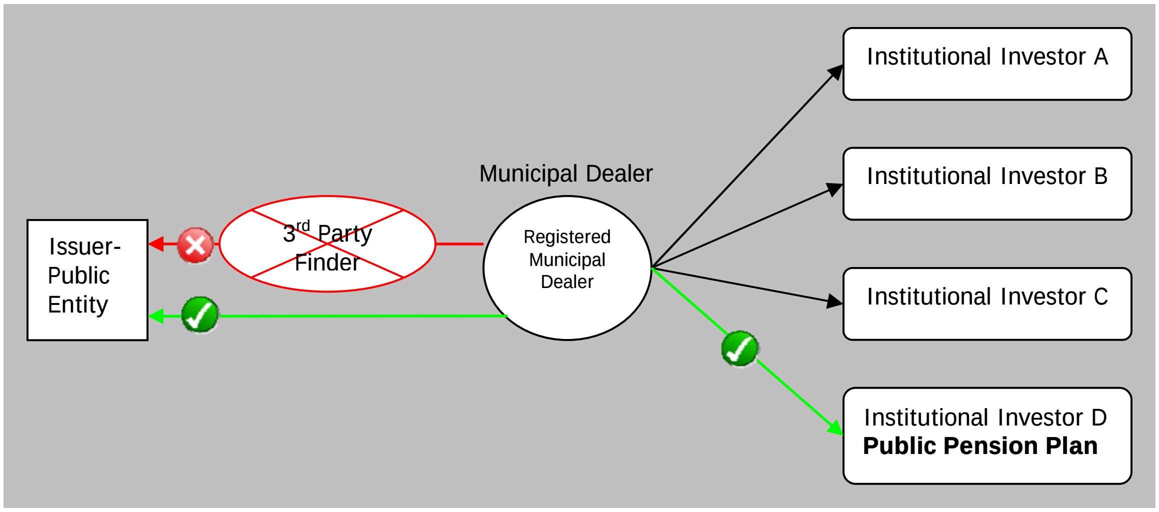
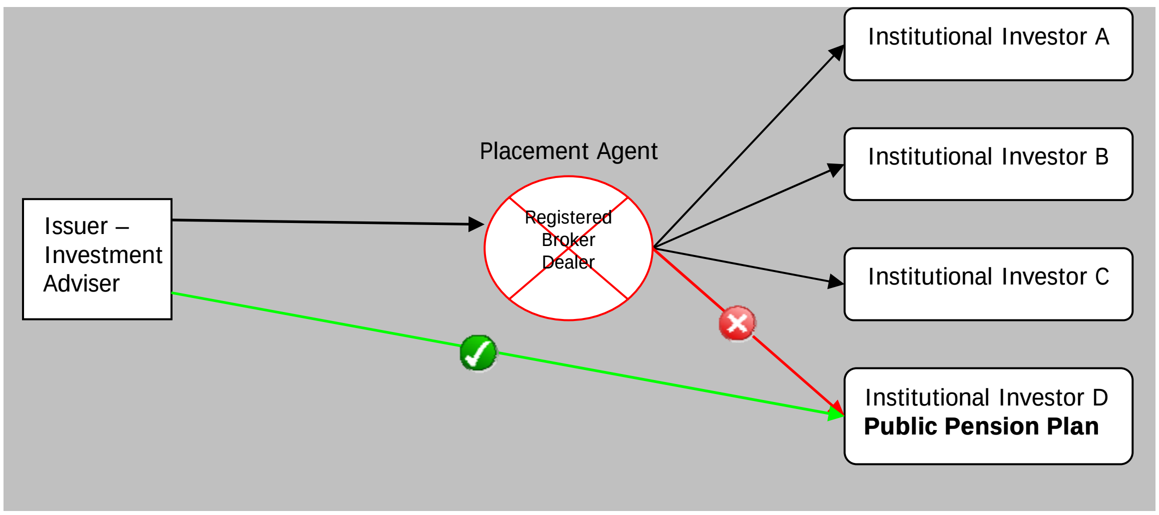
[10] Id.

[11] Id. at 39851, 39852.

MSRB Rule G-38



Proposed SEC Rule 206(4)-5(a)(2)(i)



MSRB Rule G-38 permits a broker-dealer that is unaffiliated to an issuer to market that issuer's securities to a public pension plan or any other investor. The proposed Rule prevents this and seeks to entirely disintermediate the process as between the issuer of a security and the ultimate investor. This is wholly different in scope and impact than Rule G-38 to which the existence of a registered intermediary is implicit.

Placement agents, who would be banned under the proposed Rule from interacting with public pensions on behalf of investment advisers, are analogous to the municipal dealer that is being regulated by Rule G-38. If Rule G-38 were analogous to the proposed rule it would force government issuers of municipal securities to market these directly to the ultimate investor, if that investor was a public pension plan, and it would also ban government issuers from using a municipal dealer as an intermediary.

4. Relevance of Comments to the 1999 Proposal

A key element of the justification for the proposed ban on placement agents interacting with public pension plans on behalf of investment advisers is the feedback received in relation to an anti- pay-to-play proposal made by the Commission in 1999. In the Release proposing new Rule 206(4)-5, the Commission states that:

> "In our 1999 proposal, contributions to a government official by an adviser's third-party solicitor, engaged by the adviser to obtain clients, would have triggered a two-year 'time out' for the adviser. Several commenters opposed inclusion of contributions by third-party solicitors as a trigger for the 'time out.' Most argued that this aspect of the rule was unfair and created significant compliance challenges because these solicitors were not, according to the commenters, controlled by advisers." … "In light of these considerations, including the apparent difficulties for advisers to monitor the activities of their third-party solicitors, we are proposing to prohibit investment advisers from using third-party solicitors to obtain government clients."[12]

We believe that the commenters on the 1999 proposal who felt that being penalized for the actions of their third-party solicitors was unfair were considering it in relation to the status quo. They were not asked to comment on the alternative of being banned from using placement agents altogether. If so, we believe they would have found the latter to be considerably less fair.

Moreover, we believe that investment advisers can in fact exert effective control over a placement agent through their contract of engagement, in the same way as they can be responsible for employees and other covered associates and in the same way that any principal is responsible for the acts of its agent. We believe that ample precedent exists for situations whereby investment advisers are currently penalized for the actions of their placement agents. For example in situations where the latter breaches the private placement rules and inadvertently creates an unregistered public offering, the investment adviser is bound to observe the marketing moratorium that may be imposed by the Commission as a penalty.

We contend further that if investment advisers are only allowed to use placement agents that are (i) SEC-registered broker-dealers and FINRA members, (ii) clearly identified as the funds' placement agents in the private placement memoranda, (iii) subject to reasonable record keeping and annual declaration requirements, and (iv) subject to their own two-year time-out rule as we recommend below, investment advisers would have a greater degree of confidence in their placement agents' compliance. As mentioned elsewhere, we at Monument Group have already taken these measures on an ongoing basis.

Finally, we believe that investment advisers should be subject to the time-out rule in respect of any pay to play payment made by their placement agent as if it were a covered associate of the investment adviser. Those investment advisers that are not prepared to accept the risk of being sanctioned for the activities of a "rogue" agent can always choose not to hire a placement agent. The choice of whether to use a placement agent must lie with the investment adviser.

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[12] Id. at 39852.

5. **Current SEC and SRO Rules Already Cover the Activities that the Third-Party Solicitor Ban is Designed to Preclude**

We believe that the third-party solicitor ban contained in proposed Rule 206(4)-5(a)(2)(i) is not necessary or advisable, because current SEC and FINRA rules, including Securities Exchange Act Rule 10b-5, Advisers Act Rule 206(4)-8, and FINRA Rules 2010, 2020 and 440, already cover the types of activities that proposed Rule 206(4)-5(a)(2)(i) is designed to prohibit. The Commission argues in the Release that the purpose for the prohibition on third-party solicitation of government investment advisory business is to ensure that advisers do not circumvent the proposed substantive pay-to-play restrictions simply by using third parties to engage in improper solicitation or influencing of government officials with whom advisers seek to do business. As discussed above, we make these comments from the perspective of an intermediary between public pension plan investors and investment advisers to private investment funds. In that capacity, we would like to point out that it is our belief that a third-party broker-dealer acting as an intermediary for an investment adviser is already prohibited from engaging in fraudulent activity with respect to solicitation of investments from government entities, and that existing SEC and FINRA rules, and other federal laws, could and should be used to prosecute such fraudulent activities by placement agents acting on behalf of investment advisers.

(a) SEC Rules

With respect to advisers to pooled investment vehicles such as private investment funds, the proposed rule seeks to prohibit an investment adviser and its covered associates from making a contribution, promise of a contribution, or other payment to a governmental official who (1) directs that public monies (*e.g.*, pension plan assets) be invested in that investment adviser's investment fund; (2) chooses that investment adviser to be an adviser to a government-sponsored plan; or (3) chooses that investment adviser's investment fund as an investment option in a government-sponsored plan; Proposed Rule 206(4)-5(a)(2)(i) is intended to prevent an investment adviser of a private placement fund from being able to conduct these same activities indirectly through a third-party solicitor, such as a placement agent who makes the contribution, promise or payment to the government official in lieu of the investment adviser or its covered associates making the payment directly. However, to the extent that payments, promises or contributions made by a placement agent to government officials are either (a) undisclosed or (b) intended to improperly influence the government official to choose an investment adviser based not upon merit but rather upon the basis of payments or contributions made by the placement agent, such payments and contributions are already prohibited under existing Exchange Act Rule 10b-5 and Advisers Act Rule 206(4)-8.

Rule 10b-5 is quite broad in its prohibition of any "device, scheme, or artifice to defraud" and any "act, practice, or course of business which operates or would operate as a fraud or deceit upon *any person*" [emphasis added] in connection with the purchase or sale of any security. As a result, a placement agent acting on behalf of an investment adviser to a private fund that sells the fund's securities by means of undisclosed payments to a government official with the purpose of improperly influencing the government official to invest a government plan's assets in the private fund would violate Rule 10b-5, because such payments would be a fraud and a deceit upon participants in the government plan. Even in the unlikely event that a fraudulent situation occurs where there is no sale or purchase of a security, Rule 206(4)-8 under the Advisers Act, which applies to investment advisers of private funds and protects all investors in such funds, also contains a very broad prohibition on fraudulent activity. In fact, the final rule release for Rule 206(4)-8 emphasizes the breadth of this Rule.[13]

Rule 206(4)-8 prohibits both untrue or misleading statements or omissions of material fact in communications made by an investment adviser to current or prospective investors in a fund managed by the investment adviser and prohibits any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any current or prospective investor in the fund. We believe that an investment adviser to a private investment fund that hires or otherwise causes a third-party solicitor to influence a prospective government client through contributions or promises of contributions or other payments would be a material fact and that the failure to disclose such contributions or payments to current or prospective investors in the fund would be a material omission that would result in a violation of Rule 206(4)-8. Furthermore, as the Commission recognizes in the Release, causing a third party to influence a prospective government client through contributions or other payments would be a practice that is fraudulent, deceptive, and manipulative with respect to both the government client and the other clients of the adviser[14], either of which scenario would constitute a violation of Rule 206(4)-8.

(b) <u>FINRA Rules</u>

Any third-party solicitor who, for transaction-related compensation, solicits public pension plans or other public customers in the U.S. to invest in the securities issued by a private investment fund generally should be registered with the Commission as a broker-dealer and be a member of FINRA. As such, placement agents that act as third-party solicitors for investment advisers to private investment funds, such as Monument Group, generally should be registered broker-dealers and FINRA members. FINRA member broker-dealers must comply with several FINRA rules that would prohibit the activities that the proposed third-party solicitor ban in proposed Rule 206(4)-5(a)(2)(i) purportedly is designed to prevent, as discussed below.

FINRA Rule 2010 prohibits FINRA members from engaging in acts that fail to comport with "high standards of commercial honor and just and equitable principles of trade." An undisclosed contribution or payment by a FINRA member placement agent to a government official for purposes of influencing that government official's decision regarding an investment in a private investment fund or choice of investment adviser would violate Rule 2010.

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[13] For example, the Commission states in the final rule release for Rule 206 (4)-8 that "our intent is to prohibit all fraud on investors in pools managed by investment advisors" and quotes a case approvingly to the effect that "Novel or atypical methods [of fraud] should not provide immunity from the securities laws." The SEC also refused to adopt a more precise definition of fraudulent devices or schemes for Rule 206(4)-8, arguing that "This approach would be inconsistent with our historical application of the federal securities laws under which broad prohibitions have been applied against specific harmful activity." See 72 Fed. Reg. 172 at 44756-44763.

[14] Release, 74 Fed. Reg. at 39844.

Further, much like Rules 10b-5 and Rule 206(4)-8, FINRA Rule 2020 prohibits FINRA members from effecting "any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." Thus, a FINRA member placement agent would violate FINRA Rule 2020 if the placement agent makes an undisclosed, deceptive or fraudulent contribution or payment to a government official to induce the government official to select the investment adviser that hired the placement agent.

In addition, FINRA Rule 3220 prohibits FINRA members and their associated persons from giving or paying anything of value in excess of $100 per year to any individual where such payment is in relation to the business of the recipient's employer. A FINRA member placement agent would therefore be prohibited by Rule 3020 from making any payments over $100 in a given year to any government official where (i) the employment duties of the government official include administering or making investment decisions for a government-sponsored investment plan and (ii) the placement agent made the payment to the government official in order to induce the government official to invest the government sponsored plan's assets in a private investment fund managed by an investment adviser that hired the placement agent.

(c) Other Federal Laws

In addition to federal laws aimed specifically at fraudulent activities in connection with securities transactions, it is a federal crime to engage in any "scheme or artifice to deprive another of the intangible right of honest services."[15] When an investment adviser uses an agent to make a contribution or payment to elected officials or candidates having authority over a public pension plan with the intention of influencing the investment selection process of that plan, the investment adviser deprives the beneficiaries of that plan of the right to that official's honest services.

For all of the reasons discussed above, we believe the proposed ban on the use of third-party placement agents in proposed Rule 206(4)-5(a)(2)(i) is unnecessary and duplicative of existing regulation.

6. Consideration of Impact on the Economy and Small Businesses

We believe that the proposed ban on the solicitation of government entities by placement agents would create significant collateral harm, not just to placement agents and their investment adviser clients, but to many other stakeholders, including the public pension plans and their beneficiaries, and to the economy in general. In short, the proposed ban would have a substantially adverse effect on efficient capital formation, with no identified benefits.

While some of the better known placement agents are departments of major Wall Street firms, the vast majority of independent placement agents are small businesses. In addition, many independently owned placement agents are minority- or women-owned businesses.

[15] See 18 U.S.C. § 1343 and 1346. See also *U.S. v. Troutman*, 814 F.2d 1428, 1456 (10th Cir. 1987).

We also believe that the proposed ban on using third parties to solicit government business will disproportionately impact the ability of certain investment advisers, such as those that are smaller and less established, to compete in the market to provide advisory services to government clients.[16]

In terms of direct economic impact on the economy, we estimate that the annual direct effect of this ban will greatly exceed $100 million per year, making this a "major" rule in terms of its effect on the economy. The hundreds of millions of dollars in impact includes: (a) the potential revenue loss for placement agents for the forgone placements to public funds,[17] assuming a prohibition were in place, and (b) perhaps most importantly, we believe that prohibiting placement agents from doing business with public pension plans could have significant adverse impact on investment returns for those plans and their beneficiaries as a result of their reduced access to high quality, placement agent-vetted funds.

(a) Lost Revenue for Placement Agents

As shown in the table below, Preqin reports that 7,324 closed-end private investment funds have completed their capital raise since 2003 or are currently being raised[18]**.** Private equity, venture capital, real estate and energy/infrastructure funds comprise the majority of closed-end private investment funds. From 2006 to 2008, an average of over 1,000 closed-end private funds were raised per year. Of these, over half are smaller funds of less than $300 million in size. Additionally, about half of the total is located outside of the U.S. In 2008 alone, nearly half of the total capital raised on a global basis for closed-end private funds was raised with the assistance of placement agents. The impact of a ban on placement agents assisting closed-end private investment funds in the raising of capital from public pension plans could easily have an economic impact beyond the immediate universe of agents themselves.

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[16] Release, 74 Fed. Reg. at 39854.

[17] See table and related discussion, pp. 17-18.

[18] Data extracted from Preqin database - www.preqin.com (includes closed-end funds that have completed their capital raising and those that are currently raising capital).

Private Fundraising Statistics: 2003-present

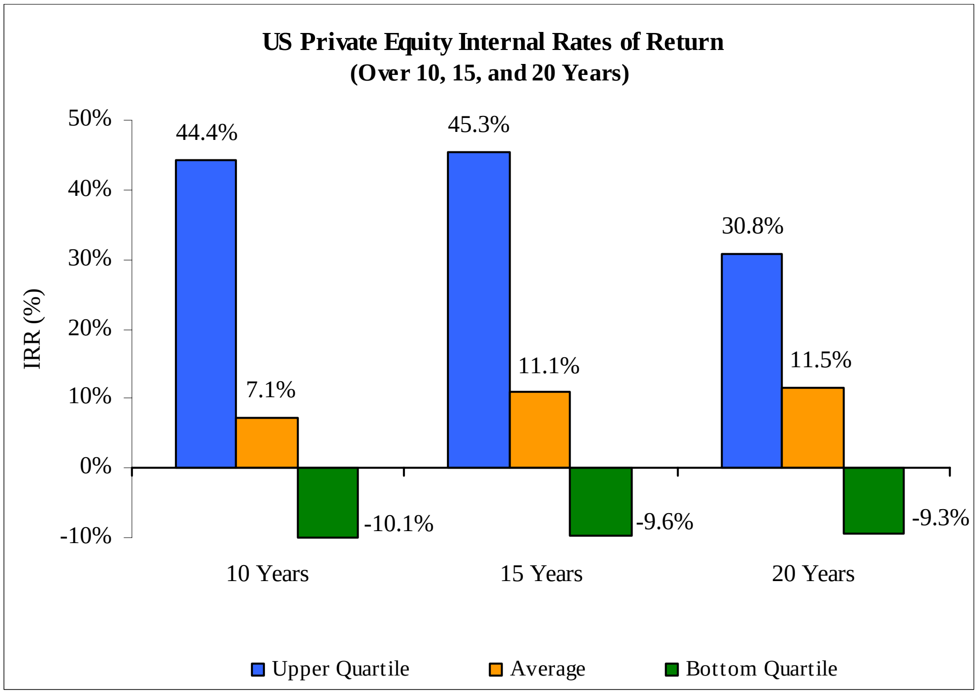
Year	# of Funds (US)	# of Funds (ex-US)	Total # of Funds	Total Capital Raised ($bn)
2003	223	194	417	97
2004	407	299	706	206
2005	517	412	929	343
2006	519	570	1089	535
2007	578	592	1170	642
2008	499	472	971	618
2009YTD	138	123	261	166
Raising	852	929	1781	179
TOTAL	**3,733**	**3,591**	**7,324**	**2,787**

Source: Preqin, September 2009

According to research conducted by Preqin, 47% of participating investment advisers used a placement agent for funds raised from 2005 to 2008. If this percentage is applied to all of the capital raised by these funds in that period, it would imply that over $1,000 billion, or an average of over $250 billion per year, was raised in those four years with the help of a placement agent. Assuming that approximately 24% of capital raised is from public pension plans (based on our data), then this would imply that funds represented by placement agents raised, on average, over $60 billion of new capital per year from public pension plans. If placement agents earned an average fee of 1% (an estimate that we believe to be conservative) on this capital, that would equate to aggregate placement agent revenues of over $600 million per year, on average. Thus, this lost revenue alone would constitute an economic impact of greater than $100 million per year. This economic impact analysis would benefit from further careful review of the actual revenue data reported by registered placement agents and from other industry sources. However, we believe that this estimate is reasonable and useful for this discussion. We are quite confident that in-depth review of the actual data would show the potential lost revenue to placement agents to be generally what we have estimated, and certainly well in excess of an average of $100 million per year.

(b) Adverse Impact on Investment Returns for Public Pension Plans

In terms of investment returns, the proposed rule would be likely to reduce the presence of funds represented by placement agents in the investible universe of public pension plans and thus, we would argue, reduce the return potential of that universe. Since the range between the best and worst performing funds in private equity and private real estate is wider than in most other asset classes, selectivity and maximizing access to the investible universe are even more critical to successful investing than in other asset classes. For reference, the upper quartile, average and bottom quartile returns (as represented by the pooled Internal Rates of Return) for mature private equity funds over a ten, fifteen and twenty year period are graphically depicted on the next page.



To provide some empirical data, the 30 largest U.S. public pension plans held $1,980.2 billion in total assets as of September 30, 2008 and of those assets, $340.4 billion were held in private investment funds, according to *Pensions & Investments*. Just a 3 basis point difference in annualized returns would equate to more than a $100 million drop in average returns per year across these top 30 public pension plans in aggregate and indirectly to their beneficiaries. Three basis points is small compared to the difference in spreads from the upper quartile to the bottom quartile of funds.

Of course, this analysis would pertain to any asset class, but the spreads between the most successful and least successful private fund managers are so much wider than in any other asset class, the opportunity for excess gain or loss is much more likely. While we would never be so confident as to suggest that all placement agent affiliated investment advisers will always outperform, we contend that as long as value-added placement agents are able to interact with public pension plans, public plans will be exposed to the broadest set of private investment choices, and have one more resource to improve their investment selection. The converse suggests the negative investment impact shown by example above.

7. <u>Suggested Alternative Measures to Eliminate Pay to Play</u>

In place of an outright ban on placement agents interacting with public pension plans on behalf of investment advisers, we would support less draconian alternative measures, such as a rule (as suggested by the Commission) that would permit government solicitation activities by third parties if such third parties (and their related persons) commit not to contribute to (or solicit contributions for) officials of any government entity from which any adviser that hires them is seeking business.[19]

We would also support all or some combination of the following alternatives to an outright ban on placement agents:

1. In any situation where a private investment fund is going to be marketed to a public pension plan through a placement agent:
   a. the placement agent should be an SEC registered broker-dealer and a FINRA member;
   b. the placement agent, as well as any agents hired as sub-agents, must be identified as the fund's placement agent prominently in the placement memorandum; and
   c. the placement agent and investment adviser should include in their contract a mutual and express obligation to refrain from any pay to play activities.

2. Registered placement agents should:
   a. by express, written policy prohibit their employees from making any political contribution if the employee is ineligible to vote for the candidate and limit contributions for state and local elections to reasonable levels (such as the suggested $250) in situations where the employee is eligible to vote for the candidate[20]; and
   b. be subject to the adequate record-keeping requirements in the proposed Rule and incorporate these requirements in its annual compliance review as a registered broker-dealer.

3. In the event that any placement agent makes a pay to play contribution:
   a. that placement agent should forfeit any contingent fee on the resulting investment;
   b. that placement agent should be barred from soliciting investments from public pension plans in that state for a period of 2 years; and
   c. the investment adviser should be subjected to the 2-year time-out rule as though the placement agent had been an employee or covered associate of the investment adviser.

   These penalties should be subject to a curative period for unknowing campaign contribution violations returned within 60 days of discovery.

4. In the event that a placement agent employs a former employee of a public pension plan, that placement agent should be barred from receiving payment for soliciting investments from that public pension plan for a period of at least 2 years.

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[19] Release, 74 Fed. Reg. at 39853.

[20] We do, however, believe that the definition of campaign contributions should be limited so as to exclude volunteer time for helping on campaigns and other non-financial contributions. We believe that completely eliminating such efforts serves to deter citizens from supporting public servants who run for office, and, further, discourages highly qualified individuals to run for public office.

Although not specific rule recommendations, we would also urge the following actions:

5. Enforce fiduciary standards at public funds, as we would suspect that, in general, guilty investment advisers and placement agents have not instigated pay-to-play payments, but have been coerced to do so by unethical public officials.

6. Consider requiring the addition of independent directors at all public funds, serving on a completely volunteer basis with only nominal out-of-pocket costs reimbursable by the funds. This would be similar to the use of independent directors for mutual funds, but without the compensation. Another analogy would be boards of trustees of not-for-profit organizations that hold investable assets. Make it clear that as directors they hold liability for violations of prudent person standards.

We believe that these alternatives would accomplish the Commission's objective of curtailing pay-to-play practices while minimizing the impact on small entities such as independent SEC-registered placement agents and the emerging private fund managers who rely on them to assist with capital formation projects. Further, the proposed policy alternatives have the added benefit of not preventing public pension plans and their beneficiaries from accessing the full spectrum of private investment options represented by compliant, regulated placement agents. Moreover, we believe that they are more consistent with the public policy behind the Advisers Act, namely that of full disclosure, rather than the prohibition of specific transactions.

* * * *

Thank you in advance for considering these comments. I am available for and would welcome further discussion.

Yours sincerely,

Alicia M. Cooney, CFA

Alicia M. Cooney, CFA
Managing Director

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
Andrew J. Donohue, Esq.