January 24, 2011

VIA ELECTRONIC MAIL

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

Re: Rules Implementing Amendments to the Investment Advisers Act of 1940; Proposed Amendments to Advisers Act Rule 206(4)-5; SEC Rel. IA-3110; File No. S7-36-10

Dear Ms. Murphy:

The Investment Adviser Association[1] appreciates the opportunity to submit comments on the Commission's proposal to amend pay to play Rule 206(4)-5 under the Investment Advisers Act of 1940 ("Advisers Act").[2] The new pay to play rule adopted in July 2010 permits investment advisers to pay a "regulated person" to solicit a government entity for investment advisory services on behalf of the adviser where the regulated person is either a registered broker-dealer (subject to a Financial Industry Regulatory Authority ("FINRA") pay to play rule) or an SEC-registered investment adviser.[3] Compliance with this aspect of the new rule is required by September 13, 2011.

The Commission's Pay to Play Proposal would eliminate the option for an adviser to pay a "regulated person," including an adviser's affiliated broker-dealer or affiliated investment adviser, to solicit government entities for the adviser. Instead, the proposal would

[1] The Investment Adviser Association is a not-for-profit association that represents the interests of SEC-registered investment adviser firms. Founded in 1937, the IAA's membership consists of more than 500 firms that collectively manage in excess of $10 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

[2] Rules Implementing Amendments to the Investment Advisers Act of 1940, SEC. Rel. IA-3110 (Nov. 19, 2010) ("Pay to Play Proposal" or "Proposal"), available at http://www.sec.gov/rules/proposed/2010/ia-3110.pdf. The IAA is submitting a separate comment letter on the Proposal's proposed amendments to Form ADV, Part 1.

[3] Political Contributions by Certain Investment Advisers, SEC Rel. No. IA-3043 (July 1, 2010) ("Adopting Release"), available at http://www.sec.gov/rules/final/2010/ia-3043.pdf. The rule also permits an adviser to pay a person that is an executive officer, general partner, managing member (or person with a similar status or function), or employee of the adviser to solicit a government entity for the adviser. Solicit is defined to mean, with respect to investment advisory services, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser.

allow an adviser to only pay a third party "regulated municipal advisor" to solicit government entity clients for investment advisory services on behalf of the adviser. A "regulated municipal advisor" is defined to mean a "municipal advisor" registered with the Commission under Section 15B of the Securities Exchange Act of 1934 ("Exchange Act") and subject to rules of the Municipal Securities Rulemaking Board ("MSRB") that prohibit municipal advisors from engaging in distribution or solicitation activities if certain contributions are made, and that impose substantially equivalent or more stringent restrictions on municipal advisors than the Advisers Act pay to play rule.[4]

Summary

Many investment advisers currently compensate their affiliated broker-dealers or affiliated investment advisers for soliciting or referring government entities to them for investment advisory services.[5] However, many of these affiliated broker-dealers and affiliated investment advisers do not meet the statutory definition of "municipal advisor." Therefore, the unintended consequence of the Pay to Play Proposal would eliminate an adviser's ability to continue to pay these affiliated entities to solicit government entity clients on the adviser's behalf. While we understand the Commission's policy goal of subjecting solicitors of government entities for advisory services to some type of pay to play rule, we believe the proposed approach should be reconsidered and make the following recommendations:

- The Commission should amend the pay to play rule to continue to permit advisers to pay affiliated broker-dealers (subject to a pay to play rule to be adopted by the SEC or by FINRA that mirrors proposed MSRB Rule G-42) and affiliated investment advisers (already subject to the SEC's pay to play rule), *in addition to* permitting advisers to pay third party municipal advisors to solicit government entities;

- The Commission should permit advisers to pay related persons and soliciting employees of related persons to solicit government entities on the adviser's behalf so long as the adviser deems such soliciting persons to be covered associates of the adviser; and

- The Commission should extend the compliance date for the third party solicitor provisions of the pay to play rule to September 13, 2012.

[4] Proposed Rule 206(4)-5(f)(9). The MSRB proposed Rule G-42 on January 14, 2011 (*see* MSRB Notice 2011-04, Request for Comment on Pay to Play Rule for Municipal Advisors ("MSRB Rule G-42 Proposal")), available at http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-04.aspx).

[5] It is notable that the Commission's original pay to play rule proposal in 2009 permitted related persons to solicit government entities on behalf of investment advisers. *See* Political Contributions by Certain Investment Advisers, SEC Rel. No. IA-2910 (Aug. 3, 2009) ("2009 Proposal"), available at http://www.sec.gov/rules/proposed/2009/ia-2910.pdf. *See also*, Advisers Act Rule 206(4)-3.

I. The Commission Should Permit Advisers to Pay Affiliated Broker-Dealers and Investment Advisers as Solicitors in Addition to Municipal Advisors

The Commission's proposed amendment unfairly affects advisers that pay affiliated broker-dealers and affiliated investment advisers to solicit government entities on behalf of the adviser. As we discuss below, neither of these groups meets the definition of "municipal advisor," and therefore, advisers with this structure would be unnecessarily penalized by the rule's resulting prohibition on such payments.

Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") took effect on October 1, 2010 and created a new category of SEC-registered entities called "municipal advisors." On September 1, 2010, the Commission adopted an interim final temporary rule and Form MA-T requiring municipal advisors to register with the Commission by October 1, 2010.[6] On December 20, 2010, the Commission published new proposed permanent rules and revised Form MA to establish a permanent municipal advisor registration program with the Commission that would replace the Commission's temporary registration process after December 31, 2011.[7]

The term "municipal advisor" is defined under the Dodd-Frank Act as "a person (who is not a municipal entity or an employee of a municipal entity) that – (i) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or (ii) *undertakes a solicitation of a municipal entity*."[8] (emphasis added). "Solicitation of a

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[6] *See* Temporary Registration of Municipal Advisors, SEC Rel. No. 34-62824 (Sept. 1, 2010), available at http://www.sec.gov/rules/interim/2010/34-62824.pdf. Municipal advisors were required to register with the MSRB by December 31, 2010 in order to engage in municipal advisory activities. *See* MSRB Rule A-12, available at http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/Administrative/Rule-A-12.aspx (requiring municipal advisors to register with the MSRB and pay a registration fee) and MSRB registration information, available at http://www.msrb.org/Rules-and-Interpretations/MSRB-Registration.aspx.

[7] *See* Registration of Municipal Advisors, SEC Rel. No. 34-63576 (Dec. 20, 2010) ("Municipal Advisor Proposal"), available at http://www.sec.gov/rules/proposed/2010/34-63576fr.pdf. The IAA intends to comment on the Municipal Advisor Proposal, which is open for comment until February 22, 2011.

[8] Section 975(e)(4) of the Dodd-Frank Act. The Dodd-Frank Act specifically excludes from the definition of municipal advisor "any investment adviser registered under the Advisers Act, or persons associated with such investment advisers who are providing investment advice." Proposed Exchange Act Rule 15Ba1-1(2)(ii) included in the Municipal Advisor Proposal interprets this statutory exemption and excludes from the definition of "municipal advisor" "[a]n investment adviser registered under the Investment Advisers Act of 1940 [ ] or a person associated with such registered investment adviser, unless the registered investment adviser or person associated with the investment adviser engages in municipal advisory activities other than providing investment advice that would subject such adviser or person associated with such adviser to the Investment Advisers Act." *See* Municipal Advisor Proposal at 216.

municipal entity or obligated person" is defined under Section 975(e)(9) of the Dodd-Frank Act to mean a "direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser [ ] *that does not control, is not controlled by, or is not under common control with* the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity." (emphasis added). Accordingly, as the Commission notes in the Municipal Advisor Proposal, persons soliciting on behalf of affiliated entities would not fall within the definition of municipal advisor and would not be required to register pursuant to Section 15B of the Exchange Act.[9] Thus, under the Pay to Play Proposal, advisers would not be permitted to pay their affiliated broker-dealers or investment advisers to solicit government entities on their behalf.

The Commission recognizes this problem in the Pay to Play Proposal and seeks comment whether it should amend the rule expressly to allow advisers to pay these affiliated solicitors and to provide that any person that controls, is controlled by, or is under common control with an investment adviser (and, if that person is an entity, its personnel) would be deemed to be a "covered associate" of the adviser if the adviser pays or agrees to pay such a person (or such personnel) to solicit a government entity on its behalf.[10] Subsequently, in the Municipal Advisor Proposal, the Commission proposes to address this problem by permitting the advisers' affiliated broker-dealers and affiliated investment advisers to *register voluntarily* as municipal advisors in order to receive payment for soliciting government entities on behalf of the adviser under the pay to play rule.[11]

We respectfully disagree that *voluntary* registration as a municipal advisor by an adviser's affiliated broker-dealer or affiliated investment adviser that solicits government entities for the adviser is a workable approach. We believe such an approach would significantly disadvantage advisers with affiliates that solely solicit for the adviser rather than for any other third party. Many advisers are affiliated with entities that do not have a

[9] Municipal Advisor Proposal at 30. *See also* MSRB Rule G-42 Proposal (noting that "persons who solicit investment advisory business from municipal entities on behalf of their affiliates are not within the statutory definition of 'municipal advisor.'")

[10] *See* Pay to Play Proposal at 72-73.

[11] *See* Municipal Advisor Proposal at 30 ("The statute would not, however, preclude such persons from registering as municipal advisors and being subject to the rules and regulations applicable to registered municipal advisors.") The Commission states that "[a]llowing entities to register as municipal advisors and subject themselves to the regulatory regime for municipal advisors as a condition to being paid as solicitors on behalf of affiliated investment advisers does not contravene this Congressional intent." Municipal Advisor Proposal at 31, n.104.

municipal advisory business or separate solicitation business, but rather merely cross-refer among affiliates. There is no compelling rationale to subject firms with this limited solicitation activity to a comprehensive new regulatory and registration regime governing a wide range of municipal advisory activities for the sole purpose of applying a pay to play rule to that limited activity. Affiliates that conduct no municipal advisory activities but only solicit for their affiliated advisers would not likely choose to register with the Commission and the MSRB as a municipal advisor on a voluntary basis, particularly because the plain language and intent of the Dodd-Frank Act *excludes* such affiliated solicitors from the definition of municipal advisor. These entities are already registered with and subject to oversight by the SEC, and for broker-dealers, FINRA as well. Moreover, the costs and burdens associated with an additional municipal advisor registration are significant and would not result in any additional investor protection or other benefit where the entity does not meet the statutory definition.

Instead, we urge the Commission to permit advisers to continue to pay their affiliated broker-dealers and affiliated investment advisers to solicit government entities on the advisers' behalf. Registered investment advisers that solicit for affiliated investment advisers are already subject to the Advisers Act pay to play rule and do not meet the plain language of the statutory definition of "municipal advisor." Further, we see no policy reason why the Commission, or FINRA, could not adopt a pay to play rule for affiliated broker-dealers that also do not meet the plain language of the definition of "municipal advisor" under the Dodd-Frank Act. Such a pay to play rule for broker-dealers soliciting for affiliated investment advisers could be based upon the MSRB's proposed Rule G-42 for municipal advisors. Under these circumstances, the Commission should permit advisers to continue to pay affiliated broker-dealers and affiliated investment advisers subject to their own pay to play rules to solicit government entities on behalf of the adviser.[12]

II. The Commission Should Permit Advisers to Pay Affiliated Solicitors and their Soliciting Personnel if the Adviser Treats Them as "Covered Associates"

As discussed above, the Commission requests comment on whether it should amend Rule 206(4)-5 to provide that any person that controls, is controlled by, or is under common control with an investment adviser (and, if that person is an entity, its personnel) would be deemed to be a "covered associate" of the investment adviser if the adviser pays or agrees to

[12] We note that contributions by third party solicitors would not otherwise trigger the rule's two-year compensation ban for the adviser. Adopting Release at 96-97. An affiliated entity would be subject to appropriate penalties if it were to violate a pay to play rule governing it. Of course, the provision in the Advisers Act rule that prohibits acts done indirectly, which, if done directly, would violate the rule would prohibit an adviser or its covered associates from funneling payments through third parties, including affiliated companies, as a means to circumvent the rule. *See* Adopting Release at 96.

pay such person (or such personnel) to solicit a government entity on its behalf. We strongly believe the Commission should do so.[13]

In particular, the Commission should amend the third-party solicitor provision in Rule 206(4)-5(a)(2)(i) to add an additional category of persons whom an adviser may pay to solicit government entity clients for investment advisory services on behalf of the adviser in order to reflect the Commission's proposed rule language in 2009.[14] Specifically, the Commission should permit advisers to pay any "related person of the investment adviser or, if the related person is a company, an employee of that related person" to solicit a government entity for investment advisory services on behalf of the adviser, so long as the adviser treats that person or employee as a "covered associate" under the Rule.[15] This solution is far better tailored to the Commission's goals than the unworkable approach of voluntary municipal advisor registration by entities that do not meet the statutory definition. Moreover, affiliated solicitors that would be deemed covered associates would be subject to the investment adviser's policies and procedures governing the conduct prohibited by the pay to play rule, including recordkeeping, and the Commission's policy goal of subjecting such solicitors to a pay to play rule will be achieved.

III. The Commission Should Extend the Compliance Date for the Third-Party Solicitor Provisions

The Commission has proposed a significant and problematic change to the final pay to play rule it adopted July 2010. The current September 13, 2011 compliance date is less than eight months away, and yet the Commission has not adopted a final rule to permit advisers to compensate third-party solicitors for soliciting government entities. Advisers will require a reasonable amount of time once the final amendment is adopted to consider and implement the changes. If the Commission takes the unfortunate position of adopting the amendment as

[13] Accordingly, advisers would be able to pay affiliates to solicit on their behalf that are either (1) investment advisers, broker-dealers, or municipal advisors subject to their own pay to play rules, or (2) deemed to be covered associates under the Advisers Act pay to play rule. *See, e.g.*, Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, CFTC Proposed Section 23.451, Political contributions by certain swap dealers and major swap participants (Dec. 9, 2010) (defining "regulated person" in its pay to play proposal as: any person subject to pay to play rules promulgated by the SEC, CFTC, or SRO; a general partner, managing member or executive officer of such person, or other individual with a similar status; or an employee of such person who solicits a municipal entity for the swap dealer or major swap participant and any person who supervises, directly or indirectly, such employee). This approach will provide flexibility to firms with various business models while achieving the SEC's policy goals.

[14] In its 2009 Proposal, the SEC proposed to permit advisers to compensate parent companies and other owners, subsidiaries and sister companies because it recognized that "there may be efficiencies in allowing advisers to rely on these particular types of persons to assist them in seeking clients." 2009 Proposal at 49.

[15] *See, e.g.*, 2009 Proposal (defining "related person" of an adviser as "any person, indirectly or directly, controlling or controlled by the investment adviser, and any person that is under common control with the investment adviser.")

proposed, we believe significant disruptions will take place in the market for advisory services to government entities as advisers struggle with a rule that requires them to fundamentally alter the way they do business with affiliated entities. If the Commission amends the rule to permit payment to affiliated entities and their personnel to solicit government entities and to permit advisers to treat them as covered associates, advisers will need to assess which entities and individuals will be affected by the political contribution provisions of the pay to play rule, develop policies and procedures at the affiliated entity level, train affiliate employees who solicit for the adviser, and implement recordkeeping procedures and systems to capture more information about political contributions from more people than previously covered.

Either way, advisers will need additional time to comply with the new third-party solicitor provisions in the Commission's final pay to play rule amendments. Accordingly, we request the Commission to extend the current compliance date applicable to the third-party solicitor provisions from September 13, 2011 for at least one year to September 13, 2012. Advisers request adequate and ample time to assess the significant impact of the final rule as it relates to their advisory business for government entity clients.

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The IAA supports the prohibition against pay to play practices by investment advisers or their employees. However, we urge the Commission to reconsider its prohibition against advisers paying affiliated broker-dealers and affiliated investment advisers to solicit government entities on behalf of the adviser. We welcome the opportunity to work with the Commission to craft an amendment to the third-party solicitor provisions that is fair to advisers with such affiliated solicitors and that reflects the statutory language of the Dodd-Frank Act. We believe our recommendations would accomplish the Commission's policy goals of eliminating pay to play practices in the advisory profession while refraining from imposing inequitable prohibitions. We appreciate the Commission's consideration of our comments on the proposed rule amendments. Please contact Karen L. Barr, IAA General Counsel, or the undersigned at (202) 293-4222 if we may provide additional information regarding these or other issues.

Sincerely,

/s/ Monique S. Botkin

Monique S. Botkin
IAA Assistant General Counsel

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner

The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

Jennifer B. McHugh, Acting Director, Division of Investment Management