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Invested in America

January 24, 2011

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

Re: File No. S7-36-10

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association (**"SIFMA"** or **"we"**)[1] welcomes this opportunity to comment on the proposed amendments to Rule 206(4)-5, the **"Pay-to-Play Rule"** applicable to certain investment advisers, which the Securities and Exchange Commission (**"SEC"**) issued for comment on November 19, 2010 and published in the Federal Register on December 10, 2010.[2] SIFMA continues to strongly support the SEC's goal of eliminating "pay-to-play" practices from the selection of investment advisers by government entities.[3]

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. IA-3110 (Dec. 10, 2010), 75 Fed. Reg. 77052, 77070-72 (**"Proposed Amendment NPRM"**). The Pay-to-Play Rule is codified at 17 C.F.R. § 275.206(4)-5.

[3] In this comment, "**government entities**," as defined in the Pay-to-Play Rule, refers to any state or political subdivision of a state, as well as any agency, authority, instrumentality of the state or a political subdivision, a pension fund or other pool of assets sponsored and established by a state or political subdivision or any agency, authority, or instrumentality thereof. *See* Rule 206(4)-5(f)(5).

We write, however, to express our concern about one of the proposed amendments to the Pay-to-Play Rule, which would require a covered investment adviser to use either its own employees or a "regulated municipal advisor" in soliciting government entities for investment advisory services (the **"Proposed Amendment"**). The Pay-to-Play Rule currently allows advisers to use their employees or a "regulated person" to solicit government entities. We believe that adoption of the Proposed Amendment would result in confusion and unintended distortions of the placement agent market, and would result in duplicative and unnecessary registration of already-regulated persons.[4] We also believe that the Proposed Amendment is premature, given that the proposed regulatory definition of "municipal advisor," as well as the contours of the potentially onerous registration and regulatory regime applicable to such municipal advisors, has yet to be conclusively determined.[5]

Accordingly, SIFMA respectfully recommends that the SEC combine the approach of the current Pay-to-Play Rule with the Proposed Amendment so that investment advisers may continue using a broad range of regulated entities to solicit government entities. Adding "regulated municipal advisors" to the existing category of "regulated persons" would accomplish this result. We believe that this minor change would enable a clearer rule to be promulgated promptly. If, however, the SEC proceeds with replacing "regulated persons" with "regulated municipal advisors," we would recommend that the SEC suspend its rulemaking until the definition of "municipal advisor," the contours of the registration and regulatory regime for municipal advisors, and the related Municipal Securities Rulemaking Board's (**"MSRB"**) proposed G-42 pay-to-play rule[6] are finalized. At that point, all solicitors covered by the Pay-to-Play Rule would be identified and the industry would have an opportunity to meaningfully comment to the SEC on how the Proposed Amendment would interact with the defined group of "municipal advisors" and the MSRB's pay-to-play rule, including whether the scope of solicitors defined as "municipal advisors" is over- or under-inclusive for the purposes of the Pay-to-Play Rule.

I. THE PROPOSED AMENDMENT IS NOT AN ADEQUATE AND APPROPRIATE SUBSTITUTE FOR THE SOLICITATION PROVISION OF THE PAY-TO-PLAY RULE

The current Pay-to-Play Rule covers more relevant market participants than the Proposed Amendment, leaves more room for legitimate business practices, and provides clearer guidance to investment advisers as to which solicitors they are permitted to use when seeking investments or advisory business from municipal entities.

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[4] We understand that the SEC has proposed in its municipal advisor rulemaking that affiliated solicitors may "voluntarily" register as "municipal advisors" in order to continue to solicit advisory business under the Pay-to-Play Rule. Registration of Municipal Advisors, Release No. 34-63576 (Jan. 6, 2011), 76 Fed. Reg. 824, 831-32 (**"Municipal Advisors NPRM"**). This proposal would result in duplicative and unnecessary registration of already-regulated persons, and would potentially subject all affiliated solicitors to fiduciary duties under 15 U.S.C. § 78o-4(c)(1). SIFMA intends to comment separately on this proposed rule to elaborate on these concerns.

[5] *See* Municipal Advisors NPRM, 76 Fed. Reg. at 824. *See also* notes 20-21 and accompanying text.

[6] *See* Request for Comment on Pay to Play Rule for Municipal Advisors, MSRB Notice 2011-04 (Jan. 14, 2011), *available at* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-04.aspx?n=1. SIFMA intends to comment separately on this proposed rule.

The Proposed Amendment replaces the existing solicitation provision of the Pay-to-Play Rule, which permits a covered investment adviser to compensate any "regulated person" (defined as a registered investment adviser or broker-dealer subject to the SEC's pay-to-play rules or a substantially equivalent regime) to solicit a government entity for investment advisory services or fund investments, with a new solicitation provision that only permits covered advisers to compensate a "regulated municipal advisor" for solicitation services.[7] We presume this change is intended to harmonize the Pay-to-Play Rule[8] with Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (**"Dodd-Frank Act"**),[9] which created a new category of "municipal advisors" subject to the jurisdiction of the MSRB. But nothing in the Dodd-Frank Act requires such harmonization and the effect of the Proposed Amendment will be to narrow significantly the scope of individuals that covered advisers may use under the current Pay-to-Play Rule to solicit government entities.

The initial proposal for Rule 206(4)-5 expressly prohibited covered advisers from using third-party placement agents to solicit government entities for advisory business.[10] In its comment letter on that rule proposal, SIFMA recommended among other things that the SEC reconsider its ban on third-party placement agents and instead permit advisers to use any broker-dealer placement agent—affiliated or non-affiliated—provided the placement agent was both appropriately registered and subject to a pay-to-play regime to be promulgated by the Financial Industry Regulatory Authority (**"FINRA"**).[11] This approach was consistent with the existing securities law structure for registered broker-dealers and ensured that solicitors for advisers were appropriately registered and subject to an adequate pay-to-play regime. The SEC agreed with this general approach and adopted its final rule permitting an investment adviser to retain "regulated persons"—defined to include investment advisers and broker-dealers registered with the SEC and subject to a pay-to-play regime promulgated by the SEC or FINRA—for the solicitation of investment advisory services.[12]

The Proposed Amendment undermines this approach, which the SEC adopted after extensive notice-and-comment and deliberation, by replacing "regulated persons" with "regulated municipal advisors." This change limits the scope of available solicitors for advisers because the statutory definition of "municipal advisor" expressly excludes affiliated parties and potentially other solicitors currently defined as "regulated persons."[13] The Proposed Amendment would pose significant problems for covered advisers and for investors, particularly for those advisers who use affiliated broker-dealers to place the interests in their funds. It would also

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[7] Proposed Amendment NPRM, 75 Fed. Reg. at 77071. Both versions of the solicitation provision permit a covered adviser to use its own employees to solicit government entities.

[8] *Id*. at 77070 (stating "[w]e are proposing three amendments to the rule that we believe are needed as a result of the enactment of the Dodd-Frank Act").

[9] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[10] *See* Proposed Rule: Political Contributions by Certain Investment Advisers, Release No. IA-2910, 74 Fed. Reg. 39840, 39851-54 (Aug. 7, 2009) (**"Proposed Pay-to-Play Rule"**).

[11] *See* Ltr. from SIFMA to Elizabeth Murphy, Sec'y, SEC (Oct. 5, 2009), *available at* http://sec.gov/comments/s7-18-09/s71809-166.pdf.

[12] *See* Rule 206(4)-5(a)(2), (f)(9).

[13] *See infra* note 16.

increase costs for such advisers as they will be forced to alter their current solicitation arrangements. Moreover, it will result in the unnecessary and duplicative registration of otherwise already-regulated affiliates. Finally, it will undoubtedly require covered advisers to alter compliance structures created in reliance on the recently promulgated Pay-to-Play Rule.

This change cannot be justified by either the anti-corruption rationale underlying the Pay-to-Play Rule or congressional intent as expressed in the Dodd-Frank Act,[14] and would require advisers which employ affiliated placement agents and potentially other regulated persons under the Pay-to-Play Rule to engage in a significant and needless restructuring of their business lines and operations. Ultimately, the Proposed Amendment may be even more problematic—the definition of "municipal advisor" is still subject to a pending rulemaking; the registration, regulatory, and recordkeeping regime for municipal advisors has yet to be determined; and it is possible that the final definition of "municipal advisor" will exclude additional categories of placement agents.[15]

The following charts illustrate that the terms "regulated persons" and "regulated municipal advisors" appear to cover different groups of market participants.[16] As set out below, the Proposed Amendment would result in a potentially significant number of "regulated persons" —who covered advisers may retain under the current Pay-to-Play Rule—being required to voluntarily register as municipal advisors if they wish to continue soliciting government entities. This will be the case regardless of the outcome of the SEC's proposal on the definition of "municipal advisor."

The current Pay-to-Play Rule (and the FINRA rulemaking it contemplates) allow investment advisers to retain affiliated and non-affiliated "regulated persons" to solicit advisory business and place fund interests:

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[14] *See* S. REP. NO. 111-176, at 147 (2010) (committee report on Dodd-Frank states that Section 975 "broadens current municipal securities market protections to cover previously *unregulated* market participants") (emphasis added).

[15] *See* Municipal Advisors NPRM, 76 Fed. Reg. at 824. The comment period does not end until February 22, 2011.

[16] Section 975 of the Dodd-Frank Act defines "municipal advisor" in relevant part as a "person" that either "(i) provides advice to or on behalf of a municipal entity . . . 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." 15 U.S.C. § 78o-4(e)(4). "[S]olicitation" is defined in relevant part as:

> a direct or indirect communication with a municipal entity . . . 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 . . . *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.*

Id. § 78o-4(e)(9) (emphases added). Although SIFMA will be commenting on the SEC's proposed definitions and interpretations of "municipal advisor" and related terms, the plain text of the statute does not cover affiliated placement agents soliciting fund investments or affiliated placement agents soliciting advisory services, or third-party placement agents placing fund interests with municipal entities. *See id.* (defining "solicitation" to exclude solicitation by affiliated persons and include only solicitation on behalf of certain enumerated entities).

Regulated Persons	Placing Fund Interests	Soliciting Advisory Business
Affiliated Person	**Yes**	**Yes**
Non-Affiliated Person	**Yes**	**Yes**

By contrast, the category of parties that will be required to register as municipal advisors under Dodd-Frank—and therefore the only parties who would qualify as permissible solicitors under the Proposed Amendment absent voluntary registration[17]—is substantially more circumscribed:

Regulated Municipal Advisors	Placing Fund Interests	Soliciting Advisory Business
Affiliated Person	**No**	**No**
Non-Affiliated Person	**Maybe**[18]	**Yes**

In sum, the statutory category of "municipal advisor" potentially excludes three of the four above-described types of solicitors when compared to the category of "regulated persons" in the current Pay-to-Play Rule. Thus, many "regulated persons" who are already subject to federal registration and oversight will be compelled to additionally register as municipal advisors, thereby becoming subject to further and duplicative regulatory and recordkeeping requirements, if they wish to continue to solicit government entities.

Given that the original proposal for the Pay-to-Play Rule permitted advisers to only compensate affiliated solicitors (and employees),[19] we do not believe this exclusion of affiliated solicitors was the intended result of the Proposed Amendment and therefore we urge the SEC to retain "regulated persons" in the Pay-to-Play Rule while adding "registered municipal advisors." If the SEC nonetheless decides to replace the category of "regulated persons" with "regulated municipal advisors," then we recommend timing consideration of the Proposed Amendment until after promulgation of a final rule defining "municipal advisor," the registration and regulation obligations therein, and a final Rule G-42 by the MSRB.

[17] In each scenario where registration is not required by statute, the SEC's proposed approach would require a potential solicitor to register "voluntarily" as a municipal advisor to be able to solicit government entities. The consequences of registering are potentially onerous (though the full significance and cost are presently unknown) and such consequences are not justified where a less burdensome and more tailored approach exists, as discussed *infra*. Moreover, the SEC should not expect (nor does it have the authority to require) registration by entities that the Dodd-Frank Act does not require to register. *See, e.g.*, *Michigan v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001) ("if there is no statute conferring authority, a federal agency has none").

[18] Non-affiliated persons placing fund interests are not included under the plain text of the statute, *see supra* note 16, but the SEC's Municipal Advisors NPRM (if adopted as a final rule) could capture such persons.

[19] *See* 74 Fed. Reg. at 39853 & n.140, 39870.

II. THE SEC SHOULD PERMIT INVESTMENT ADVISERS TO CONTINUE TO USE AFFILIATED AND OTHER SOLICITORS

A. Proposed Solution To Permit The Use Of Affiliated And Other Solicitors

SIFMA believes the Proposed Amendment should be modified to restore the ability of investment advisers to compensate affiliated and other potentially excluded solicitors who are regulated and covered by a pay-to-play regime. Therefore, we believe that the SEC should include both the "regulated person" category of the current Pay-to-Play Rule and the Proposed Amendment's provision allowing the use of "regulated municipal advisors" to solicit municipal business. The SEC could do this by simply expanding the definition of "regulated person" in the current rule[20] to include the category of "regulated municipal advisor" as defined in the Proposed Amendment. (See Appendix A.)

Under the current Pay-to-Play Rule, investment advisers may retain placement agents so long as (i) they are registered as an investment adviser or broker-dealer with the SEC and (ii) subject to the SEC's pay-to-play scheme or one as stringent as the SEC's. Adding the category of "regulated municipal advisor" to this scheme would be consistent with the existing rule. While we express no preference as to the appropriate regulator, we do not want to create an additional layer of unnecessary MSRB registration and regulation for solicitors who are already subject to other federal registration requirements and pay-to-play rules. Because there are pay-to-play regimes proposed or in place for municipal advisors and registered investment advisers, respectively, it is therefore only necessary to create a pay-to-play regime for registered broker-dealers. These broker-dealers are already subject to FINRA's regulatory purview and FINRA could adopt a mirror rule to proposed Rule G-42 for those broker-dealers who solicit municipal entities on behalf of investment advisers. FINRA and the MSRB have a history of successfully administering a comparable regulatory scheme (*i.e.*, MSRB Rule G-37 and the broader rule harmonization process that has occurred over the last few years) and this approach would draw on that experience and enable investment advisers to continue utilizing a wide range of solicitors who would be subject to a consistent pay-to-play regime. Such an approach is appropriately tailored to address the problem of pay-to-play in the marketplace and would avoid duplication and potential conflicting regulatory regimes.

B. The Proposed Amendment Should At A Minimum Be Coordinated With The Municipal Advisor Rulemaking And Proposed MSRB Rule G-42

We recommend the above solutions in the first instance. But if the SEC determines to replace "regulated persons" with "regulated municipal advisors," we recommend the SEC suspend consideration of the Proposed Amendment so that it may coordinate the Proposed Amendment with the rulemaking to define "municipal advisor," the registration and regulation regime for such persons, and proposed MSRB Rule G-42. Such coordination also would allow the SEC to address at one time how the use of the "municipal advisor" category in the Pay-to-Play Rule may necessitate additional and conforming changes. For instance, upon completing the municipal advisor rulemaking the SEC may need to consider whether to amend the Pay-to-Play Rule to expand the scope of appropriately regulated solicitors permitted to be retained by

[20] *See* Rule 206(4)-5(a)(2)(i), (f)(9).

investment advisers. This could include solicitors that are employees of affiliated entities but who are not covered municipal advisors under the municipal advisor rule. (See, e.g., Appendix B.) Such a change would be consistent with the purposes of the Pay-to-Play Rule, while providing covered investment advisers with a broad range of solicitors who are subject to comparable levels of regulation and pay-to-play regimes.[21]

Until the SEC finalizes the definition of "municipal advisor" in its rulemaking, and the MSRB finalizes its pay-to-play rule for municipal advisors, those who will be affected by the proposed changes do not know what the potential contours of the regulatory regime will be for municipal advisors.[22] As noted above, the outcome of the proposed regulatory definition of "municipal advisor" is particularly unclear at present—the SEC's proposed definition is inconsistent with "municipal advisor" as defined under the Dodd-Frank Act, and therefore the ultimate scope of the category is highly uncertain. This is particularly significant for those entities that may need to voluntarily register as municipal advisors, since the registration, regulatory, and recordkeeping requirements are as yet unknown and are potentially onerous and conflicting. When an agency's notice of proposed rulemaking necessarily leaves potentially affected parties guessing at the basic structure of the regulation, there is no meaningful opportunity for comment and the participatory nature of the rule adoption process is weakened. Therefore, a decision to replace the category of "regulated person" with that of "municipal advisor" in the absence of a finalized definition of "municipal advisor"—much less a final set of registration and recordkeeping requirements—cannot be squared with the SEC's obligation to afford affected parties an opportunity to comment.[23] This is particularly true given that the SEC has proposed a definition of "municipal advisor" that is broader in certain respects than the terms of the statutory text.[24]

Accordingly, SIFMA respectfully recommends that if the SEC decides to proceed in replacing the category of "regulated person" with that of "municipal advisor," it suspend consideration of the Proposed Amendment until the notice-and-comment process on its proposed rule for municipal advisor registration and regulation and on the MSRB's proposed pay-to-play regime for municipal advisors are complete. This would provide the industry with a meaningful opportunity to comment on how the Proposed Amendment would affect covered advisers'

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[21] Indeed, the use of any affiliated solicitor subject to an adequate pay-to-play regime—whether a broker-dealer subject to a FINRA pay-to-play regime as a "regulated person," a municipal advisor subject to an MSRB pay-to-play regime, or any other entity (such as a bank) subject to another pay-to-play regime—would be sound policy. The SEC recognized as much in the Proposed Pay-to-Play Rule, which would have allowed affiliates to solicit government entities as "related persons" of advisers. *See* 74 Fed. Reg. at 39853 & n.140, 39870. Thus, a general rule permitting the use of solicitors registered with a federal regulator subject to a pay-to-play regime comparable to the SEC's regime would adequately address the risk of political corruption without unduly restricting the investment advisers or affiliated entities themselves.

[22] *See* Municipal Advisors NPRM, 76 Fed. Reg. at 824.

[23] *See, e.g., Am. Water Works Ass'n v. EPA*, 40 F.3d 1266, 1274-1275 (D.C. Cir. 1994) (agencies must "provide sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully" (internal quotation marks omitted)); *Shell Oil Co. v. EPA*, 950 F.2d 741, 751 (D.C. Cir. 1991) (affected parties cannot be "expected to divine the [agency's] unspoken thoughts").

[24] *Homemakers North Shore, Inc. v. Bowen*, 832 F.2d 408, 413 (7th Cir. 1987) (whether interpretation is "newfangled" affects judicial review).

solicitation activities.

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SIFMA appreciates this opportunity to comment upon the Proposed Amendment. Please do not hesitate to contact me with any questions at (202) 962-7373 or Marin Gibson, SIFMA Managing Director and Counsel, at (212) 313-1317; or Barbara Stettner and Charles Borden, of O'Melveny & Myers LLP, at (202) 383-5283 and (202) 383-5269, respectively.

Sincerely,

Ira D. Hammerman

Senior Managing Director
and General Counsel

cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Kathleen L. Casey
The Hon. Luis A. Aguilar
The Hon. Troy A. Paredes
The Hon. Elisse B. Walter
David M. Becker, General Counsel

Appendix A

§ 275.206(4)-5 Political contributions by certain investment advisers.

(f) *Definitions.* For purposes of this section:

…

(9) *Regulated person* means:

(i) An investment adviser registered with the Commission that has not, and whose covered associates have not, within two years of soliciting a government entity:

(A) Made a contribution to an official of that government entity, other than as described in paragraph (b)(1) of this section; and

(B) Coordinated or solicited any person or political action committee to make any contribution or payment described in paragraphs (a)(2)(ii)(A) and (B) of this section; or

(ii) A "broker," as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)) or a "dealer," as defined in section 3(a)(5) of that Act (15 U.S.C. 78c(a)(5)) **or a "municipal advisor," as defined in Section 15B of that Act (15 U.S.C. 78o-4),** that is registered with the Commission, and is a member of a ~~national securities association~~**self-regulatory organization as defined in Section 3(a)(26) of that Act (15 U.S.C. 78c(a)(26))**, provided that:

(A) The rules of the ~~association~~ **organization** prohibit members from engaging in distribution or solicitation activities if certain political contributions have been made; and

(B) The Commission, by order, finds that such rules impose substantially equivalent or more stringent restrictions on ~~broker-dealers~~**its members** than this section imposes on investment advisers and that such rules are consistent with the objectives of this section.

Appendix B

§ 275.206(4)-5 Political contributions by certain investment advisers.

(a) *Prohibitions.* As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts, practices, or courses of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b–6(4)), it shall be unlawful:

…

(2) For any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b–3(b)(3)) or any of the investment adviser's covered associates:

(i) To provide or agree to provide, directly or indirectly, payment to any person to solicit a governmental entity for investment advisory services on behalf of such investment adviser unless such person is a regulated person, or is an executive officer, general partner, managing member, (or, in each case, a person with a similar status or function), ~~or~~ employee of the investment adviser**, or a covered associate of such investment adviser**, and

…

(f) *Definitions.* For purposes of this section:

…

(2) *Covered associate* of an investment adviser means:

(i) Any general partner, managing member or executive officer, or other individual with a similar status or function;

(ii) Any employee **of the investment adviser** who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; ~~and~~

(iii) Any employee of any person who controls, is controlled by, or is under common control with the investment adviser who solicits a government entity on behalf of such adviser and who is supervised directly by such adviser, or an employee thereof, for the purposes of such solicitation; and

~~(iii)~~ **(iv)** Any political action committee controlled by the investment adviser or by any person described in paragraphs (f)(2)(i)~~and~~ **,** (f)(2)(ii)**, or (f)(2)(iii)** of this section.