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January 24, 2011

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Rules Implementing Amendments to the Investment Advisers Act of 1940
(File Number S7-36-10)

Dear Ms. Murphy:

The Investment Company Institute[1] appreciates the opportunity to comment on the Securities and Exchange Commission's recent proposals under the Investment Advisers Act of 1940.[2]

We have several comments on discrete aspects of the proposal that apply to all registered investment advisers, including certain proposed amendments to Form ADV, proposed amendments to the recently adopted pay-to-play rule, and proposed new rule 203A-5.[3] Our main recommendations include:

- As proposed, the Commission should add a question to Form ADV requiring advisers to state whether all soft dollar benefits received qualify for the safe harbor under Section 28(e) of the Securities Exchange Act of 1934 ("Exchange Act"), but should clarify that the answer is based upon the adviser's reasonable belief and the disclosure should not be viewed as providing a legal opinion on the qualification of the soft dollar

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.31 trillion and serve over 90 million shareholders.

[2] *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Release No. IA-3110 (Nov. 19, 2010) (the "Release"), available at http://www.sec.gov/rules/pro posed/2010/ia-3110.pdf.

[3] Many of the proposed rules, amendments and other changes would implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") that increase the statutory threshold for registration by investment advisers with the Commission, require advisers to hedge funds and other private funds to register with the Commission, and require reporting by certain investment advisers that are exempt from registration. We express no view on those issues.

benefits. In addition, the Commission should not require advisers to quantify soft dollar benefits or list the brokers or dealers from whom it receives soft dollar benefits.

- We strongly support the proposal that total assets as determined on the adviser's balance sheet for the most recent fiscal year, rather than assets under management, should be used to determine the universe of advisers with over $1 billion in assets for purposes of Section 956 of Dodd-Frank.

- Before accelerating the deadline for filing annual updates to Form ADV to 60 days or some other shorter time period, the Commission should carefully consider the impact of the changes proposed in the Release and other significant changes to Form ADV, such as the recently adopted changes to Form ADV Part 2, on advisers. To the extent that the Commission decides to shorten the annual updating deadline, we urge it to do so after advisers have had a chance to gain experience with the range of new disclosure requirements in Form ADV.

- The Commission should address its pay-to-play concerns through less restrictive means than those proposed. Specifically, we recommend that the Commission permit any employee of an affiliate to solicit government business for compensation on behalf of an adviser that controls, is controlled by, or is under common control with the affiliate as long as the employee is treated as the adviser's "covered associate."

- The Commission should provide additional guidance with respect to the definition of "covered associate" in the pay-to-play rule, and the term "solicit" within that definition.

- The Commission should require broker-dealers and other persons subject to the Commission's jurisdiction to provide advisers and funds with the account information the adviser is required by law to have in order to comply with the Commission's pay-to-play rule.

- The Commission should extend the current compliance date for the third-party solicitor provisions in its pay-to-play rule if it adopts the proposed amendments in order to provide advisers with additional time to comply with the new provisions.

- The Commission should adopt proposed Rule 203A-5, but only with respect to those advisers that rely upon assets under management tests to determine their registration status.

Each of these recommendations is explained more fully below.

Proposed Amendments to Form ADV

Item 8: Participation or Interest in Client Transactions. Item 8 of Form ADV currently requires advisers to state whether they, or any related persons, receive soft dollar benefits in connection with client securities transactions. The Commission proposes to add a follow-up question asking whether all such soft dollar benefits qualify for the safe harbor under Section 28(e) of the Exchange Act.[4] The Institute supports this part of the proposal as long as the Commission clarifies that the adviser's disclosure is based upon the adviser's reasonable belief. The adviser's disclosure should not be viewed as providing a legal opinion on the qualification of the soft dollar benefits.

The Release also asks whether Form ADV should solicit information about advisers' receipt of soft dollar benefits, such as requiring advisers to quantify the benefits they receive. For the reasons discussed below, the Institute believes it will be difficult to quantify soft dollar benefits with the consistency and specificity necessary to make this disclosure meaningful. Accordingly, we do not support such a requirement.

The term "soft dollars" is not defined under the federal securities laws. The Commission has interpreted the term to mean products and services, other than the execution of securities transactions, that an investment manager receives from or through a broker-dealer in exchange for the adviser's direction of client brokerage transactions to the broker-dealer.[5] In other words, soft dollars may be viewed as that portion of a brokerage commission that exceeds the lowest rate available for basic execution services.[6]

The Commission has stated that the allowable products and services provided by the soft dollars safe harbor are limited to legitimate brokerage and research services and has provided guidance on what services are included in permissible soft dollar services. Often the soft dollar services come in the form of research, which may be categorized as either "proprietary" research, produced by the broker-dealer executing the securities transaction or its affiliates, or "third-party research," produced or

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[4] Section 28(e) protects advisers from claims of breach of fiduciary duty if the adviser causes client accounts to pay more than the lowest available commission rate, provided that the adviser determines in good faith that the commission charges are reasonable in relation to the brokerage and research services.

[5] *See Disclosure by Investment Advisers Regarding Soft Dollar Practices,* Release No. 34-35375 (Feb. 14, 1995), available at http://www.sec.gov/rules/proposed/soft.txt.

[6] *See* THOMAS P. LEMKE & GERALD T. LINS, SOFT DOLLARS AND OTHER BROKERAGE ARRANGEMENTS § 1.1 (2009-10) ("LEMKE & LINS").

provided by someone other than the executing broker-dealer.[7] Proprietary research may be the most difficult aspect of soft dollars to quantify. Proprietary research is often provided to an investment adviser partly as a *quid pro quo* for brokerage business given by the adviser to the broker producing the research, or may be provided without being expressly requested and considered part of the services obtained in exchange for "full service" or "bundled" commissions. Generally, proprietary research services are available only for soft dollars, and cannot be purchased with cash or "hard dollars."[8]

The value of the products and services obtained, such as proprietary research, is very subjective and different advisers may well ascribe different values to the same research.[9] The same is true for many brokerage services. For example, a broker-dealer might provide superior execution services, liquidity in handling large orders, or more timely executions, all of which justify paying a higher commission or use of a soft dollar arrangement. Again, the value of such services can be very difficult to quantify. Given this subjectivity, we do not believe that soft dollar benefits could be quantified with any meaningful precision or consistency for disclosure. As a result, a requirement to quantify soft dollar benefits for purposes of Form ADV disclosure would be difficult to implement, and would generate disclosure that would not facilitate comparison across different funds.

Others who have considered this type of disclosure have reached the same conclusion. For example, the Department of Labor in crafting its retirement plan disclosures recognized that quantifying, or even estimating, soft dollar benefits simply is not practical.[10] And a mutual fund task force formed by the NASD (now FINRA) in 2004 specifically considered and rejected the idea.[11] The task force cited the lack of a uniform calculation methodology and the resulting lack of comparability, and the probability that numerical breakdowns would mislead or confuse investors and outweigh any

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[7] *See, e.g.*, *Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices*, Release Nos. 34- 58264; IC-28345; IA-2763 (July 30, 2008), at 21.

[8] *See* LEMKE & LINS, at § 1.14.

[9] By contrast, the use of soft dollars to obtain third-party research generally may be quantified, as third party research services typically have an identifiable price. *Id.*

[10] *See Revision of Annual Information Return/Reports*, 72 Fed. Reg. 64731, at 64742 (Nov. 16, 2007) ("The Department recognizes that it may not be practicable to provide a formula or estimate to calculate the value of certain types of 'soft dollar' non-monetary compensation at the plan level, particularly so-called 'proprietary' soft dollar arrangements, such as access to information from certain research specialists.")

[11] *Soft Dollars and Portfolio Transaction Costs*, Report of the Mutual Fund Task Force (Nov. 11, 2004) (in which the task force specifically "considered recommending that the SEC require that a fund…provide a reasonable, good faith estimate of the percentage of commissions and/or the fund's NAV that was used to obtain soft dollar benefits").

potential benefits of such disclosure. More recently, Canadian regulators decided not to adopt requirements for the quantitative disclosure of soft dollar benefits it had proposed in 2008.[12]

For all of these reasons, we do not support requiring advisers to quantify soft dollar benefits.

The Release also asks whether advisers should be required to disclose the names of the brokers or dealers from whom the adviser receives soft dollar benefits. We do not believe this would generate meaningful disclosure. Because nearly every broker may conduct transactions from time to time at commission rates higher than the lowest available rate, advisers may decide that the only way to ensure compliance would be to disclose the name of every broker used by the fund. This would not provide any meaningful disclosure about advisers' soft dollar practices, and it would run the risk of requiring advisers to publicly disclose proprietary information about which executing brokers they employ. Even if disclosure is limited to broker-dealers for which an adviser has an explicit soft dollar arrangement, the disclosure would be of dubious value. It would single out this type of arrangement from the use of a full-service broker-dealer, which does not seem warranted and could provide a distorted view of the providers of soft dollar services. In addition, we question whether a list of broker-dealers providing soft dollar benefits to an adviser would result in any meaningful information to the adviser's clients. In other important contexts, the Commission has recognized that investors can suffer from information overload, and that disclosure requirements should be tailored to those key items of information that investors would find most useful.[13] Accordingly, the Institute does not support such disclosure.

Item 1: Identifying Information. The Commission proposes, among other things, to add a question to Item 1 of Form ADV requiring advisers to indicate whether they had $1 billion or more in total assets as determined on the adviser's balance sheet for the most recent fiscal year. This information is necessary to enable the SEC to identify advisers that are subject to Section 956 of Dodd-Frank.[14]

We strongly support the Commission's clarification that, for purposes of Section 956 of Dodd-Frank, the appropriate metric for an adviser's assets is balance sheet assets, and not assets under management. The language of Section 956 applies to certain financial institutions with more than $1 billion "in assets," which, with respect to advisers, could refer to balance sheet assets or assets under

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[12] *See NI 23-102 Use of Client Brokerage Commissions and Companion Policy 23-102CP*, 32 OSCB 8079, at 8095 (October 9, 2009) ("Based on the comments received and in light of developments in the U.S., including the proposed amendments to the SEC's Form ADV, we have decided not to proceed with quantitative disclosure requirements at this time.").

[13] *See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-end Management Investment Companies,* Release No. 33-8998; IC-28584 (Jan. 13, 2009), available at http://www.sec.gov/rules/final/2009/33-8998.pdf.

[14] Section 956 requires the Commission, jointly with other federal financial regulators, to prescribe guidelines or rules relating to incentive compensation practices.

management. In our view, the Commission's decision to use balance sheet assets is correct and entirely appropriate, given that Section 956 applies to a laundry list of different types of financial institutions, all of which have balance sheet assets but only one of which – investment advisers – has assets under management. In order to promote the consistent application of the Section 956 guidance or rules, balance sheet assets must be the metric used for all covered financial institutions.

Deadline for Annual Update. Advisers currently have 90 days from their fiscal year ends to provide an annual update to Form ADV. Although not part of the proposal, the Commission asks in the Release whether it should consider accelerating this deadline to 60 days or some other shorter time period.[15] We caution against shortening this deadline. Although technological advances have made the annual update process somewhat easier, the business has also evolved and the disclosures may be more difficult to craft. This will be particularly true in the coming years, as advisers will be digesting the impact of the changes proposed in the Release and other significant changes to Form ADV, such as the recently adopted changes to Form ADV Part 2.[16] To the extent that the Commission decides to shorten the annual updating deadline, we urge it to do so after advisers have had a chance to gain experience with the range of new disclosure requirements in Form ADV.

Proposed Amendments to Pay-to-Play Rule

Amendments to the Solicitation Provisions. The proposal would amend the Commission's pay-to-play rule, Rule 206(4)-5, to permit an adviser to pay only a "regulated municipal advisor," instead of any "regulated person," to solicit government entities on its behalf. A "municipal advisor" would be required to register with the Commission and the Municipal Securities Rulemaking Board ("MSRB") and would be defined as any person who undertakes a "solicitation of a municipal entity," including any third-party solicitor, such as a registered investment adviser or a broker-dealer.[17] A "solicitation of a municipal entity," in relevant part, would be a communication with a municipal entity made by a person, for compensation, on behalf of an adviser that does not control, is not controlled by, or is not under common control with the person undertaking the solicitation for the purpose of obtaining or retaining an engagement by the municipal entity of the adviser to provide investment advisory services.

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[15] *See supra* note 2 at 67.

[16] Indeed, recognizing the difficulty in creating new disclosures, the Commission recently extended the compliance date for advisers to create brochure supplements by four months. *See Amendments to Form ADV; Extension of Compliance Date*, Release No. IA-3129 (Dec. 28, 2010), available at http://www.sec.gov/rules/final/2010/ia-3129.pdf.

[17] A registered investment adviser and its associated persons would be exempt from the requirement to register as a municipal advisor with respect to the provision of any investment advice pursuant to the Investment Advisers Act of 1940. *See Registration of Municipal Advisors*, Release No. 34-63576 (Dec. 20, 2010) ("Municipal Advisor Release"), available at http://www.sec.gov/rules/proposed/2010/34-63576.pdf. We ask that, in connection with this current proposal, the Commission also refer to comments that the Institute will submit on February 22, 2011 in response to the Municipal Advisor Release; the comments we will provide in that response are related to the comments in this letter.

The proposal therefore effectively prohibits an affiliate from soliciting government business for compensation on behalf of its affiliated investment adviser.

It is not necessary, in the public interest, to prevent all affiliates of investment advisers from soliciting government business for compensation on behalf of the adviser. We believe that the pay-to-play concerns that have led the Commission to take this approach could be satisfactorily addressed through less restrictive means. Indeed, so long as the affiliate's solicitation activities are subject to the same regulatory regime governing the adviser's own solicitation activities, a ban on solicitation is not necessary. Accordingly, we recommend that the Commission permit any employee of an affiliate to solicit government business for compensation on behalf of an adviser that controls, is controlled by, or is under common control with the affiliate as long as the employee is treated as the adviser's "covered associate."[18] Specifically, the rule should recognize that affiliates may be paid to solicit and that only the employees of such affiliates who are actually being compensated for such solicitation and the supervisory personnel of those employees will be treated as "covered associates."[19]

We oppose, as an alternative to our recommendation, the Commission subjecting all affiliates with employees who solicit on behalf of the adviser to registration with the Commission and the MSRB as municipal advisors.[20] We fail to see the public purpose served by such registration. Not only does

[18] We understand that, absent clarification from the Commission on numerous questions regarding identifying "covered associates," many advisers intend to treat their affiliates' employees as "covered associates" under the pay-to-play rule because of the draconian consequences of a violation of the rule. The term "covered associate" includes: (i) any general partner, managing member or executive officer, or other individual/person with a similar status or function; (ii) any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) any political action committee.

[19] To accommodate the multitude of business models and interactions between advisers and affiliates, we also recommend that the Commission permit advisers to pay affiliated broker-dealers to solicit government entities subject to a pay-to-play rule to be adopted by the Commission or FINRA. We believe a pay-to-play rule designed specifically for broker-dealers would be a more appropriate approach to balance regulatory burdens with regulatory goals, including investor protection, and would be consistent with the language in Dodd-Frank. We also believe that any pay-to-play rule adopted by the Commission or FINRA for broker-dealers should mirror the Commission's rule for advisers to ensure consistency and aid compliance efforts across the industry. As an alternative to adopting a separate rule for broker-dealers, the Commission could permit them to comply with one of the existing pay-to-play rules (*i.e.,* Rule 206(4)-5 or MSRB Rule G-37) subject to public identification of the rule to which they will comply.

[20] As noted in the Release, the MSRB has yet to adopt pay-to-play rules for municipal advisors but anticipates doing so by September 13, 2011. If, however, it is unable to meet that deadline, the Commission states in the Release that it will consider whether to take alternative action. This uncertainty begs the question of how persons subject to registration as a municipal advisor because of their solicitation activities are going to develop policies and procedures to be in compliance with the Commission's alternative action by September 13.

this seem unnecessary in the public interest but it is unduly burdensome and costly to such affiliates.[21] Registration would subject affiliates to the panoply of rules applicable to municipal advisors under both the Commission and the MSRB's regulatory regimes – many of which have yet to be developed.[22] Apart from the burden of filing duplicative registration forms and regularly updating them, these rules would include obligations under the Exchange Act, complying with the MSRB's fair dealing rule,[23] paying initial and annual fees to the MSRB, complying with professional qualification tests and continuing education requirements, and exercising a fiduciary duty with respect to municipal entities. This regulatory overreaching could be avoided, without any diminution in the protection afforded to the public, by tailoring the regulation to the affiliate's solicitation activity, which is consistent with the Institute's recommendation.

We are additionally concerned that imposing these additional regulatory burdens on affiliates could result in unintended consequences that would negatively affect government entities. To avoid the additional regulatory obligations associated with municipal advisor registration and regulation, affiliates may choose not to engage with municipal entities, thereby denying government entities access to useful information that would be valuable in making an informed decision regarding advisory service providers.[24]

We do not believe that registration as a municipal advisor and subjugation to the MSRB's anticipated pay-to-play rule would provide investors with any greater protections from pay-to-play activity than regulating employees of affiliates as covered associates under the Commission's pay-to-play rule. In fact, in balancing the regulatory benefits with the costs and burdens of the proposed amendments, it would be more appropriate for the Commission instead to draft a pay-to-play rule specifically for affiliates to advisers than to pursue the proposed amendments.

Finally, we question whether the proposed amendments are consistent with Congressional intent and the direct statutory language of Dodd-Frank. As discussed, the amendments would force affiliates that seek to solicit business from government entities on behalf of an affiliated adviser to

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[21] Investment adviser and broker-dealer affiliates are already registered with and subject to oversight by the Commission, and for broker-dealers, FINRA as well. Municipal advisor registration would be duplicative of many of these affiliates' existing regulatory obligations. In addition, this superfluous registration of affiliates as municipal advisors imposes additional burdens on the Commission staff to oversee these registrants at a time in which the Commission's budget is severely constrained and resources are, therefore, at a premium.

[22] *See* Section 975 of Dodd-Frank.

[23] *See* MSRB Rule G-17.

[24] For example, an employee of an affiliated entity could include an IT person who, under normal circumstances, would provide a prospective municipal entity client with information regarding the adviser's computer security program. This example assumes that the affiliate is either directly or indirectly compensated by the adviser for its services and the described conduct constitutes soliciting.

register as municipal advisors in order to receive compensation. As modified by Dodd-Frank, however, the Exchange Act appears to permit an affiliate of an investment adviser, broker and other specified entities to solicit, for compensation, a municipal entity on behalf of the adviser without having to register as a municipal advisor.[25] The statute defines "solicitation of a municipal entity" to only apply to persons who are **not** an affiliate of the investment adviser, broker or other specified entities. The statute does not include any qualifications suggesting that an affiliate only may solicit for compensation if it registers as a municipal advisor.[26]

Additional Clarification Regarding the Definition of "Covered Associate." The proposal would clarify that a "covered associate"[27] of an adviser would include a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser.[28] We support this interpretation but request guidance as to whether all officers of the managing member would be considered covered associates of the adviser, even if they did not solicit on the adviser's behalf.

In addition, as members have begun to develop policies and procedures to implement the new pay-to-play rule, a number of questions have arisen regarding use of the term "solicit" within the definition of "covered associate." We seek additional guidance from the Commission with respect to these terms, especially as they apply to the scenarios discussed below.

The pay-to-play rule defines "solicit" 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.[29] In the Adopting Release, the Commission stated that the determination of whether a particular communication is a solicitation is dependent upon the specific facts and circumstances relating to such communication. As a general proposition, any communication made under circumstances reasonably calculated to obtain or retain an advisory client would likely be

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[25] *See* Section 15B of the Exchange Act.

[26] *See supra* note 17. In the Municipal Advisor Release, the Commission states that persons soliciting on behalf of affiliated entities would not fall within the definition of municipal advisor and would not be required to register with the Commission and MSRB, although they would be permitted to voluntarily register. The Commission also states that the term "municipal advisor" may include affiliated entities of an adviser. Under the proposed amendments and the related rule proposal, however, an affiliate **must** register as a municipal advisor if it wants to solicit for an adviser for compensation – it is not voluntary. An advisers' ability to use the exclusion provided by the Dodd-Frank Act is, in essence, eliminated.

[27] *See supra* note 18.

[28] We seek clarification that the term "person" in the second prong of the definition of "covered associates" is limited to an individual or employee. We do not think the inclusion of "legal entities" in this part of the definition is necessary or appropriate to achieve the Commission's goal of preventing pay-to-play conduct.

[29] *See Political Contributions by Certain Investment Advisers,* Release No. IA-3043 (July 1, 2010) ("Adopting Release"), available at http://www.sec.gov/rules/final/2010/ia-3043.pdf.

considered a solicitation unless the circumstances otherwise indicate that the communication does not have the purpose of obtaining or retaining an advisory client.

Many of our members are struggling with how to classify employees who do not meet with clients for the principal purpose of obtaining and retaining business, but who either are involved in the preparation and/or dissemination of communications to government entities or provide information about the adviser's operations or policies, procedures or controls. The primary concern among our members is that the Commission's overly broad definition of "solicit" does not recognize the many degrees in the types of regular communications or interactions that may occur between employees and clients or prospective clients.

At most advisory firms, communications between clients and prospective clients, including government entities, occur regularly, as often as daily, with employees from many different departments other than those who have covered associate status. For example, a client services department responds to oral and written client requests for various kinds of information about the government entity's account. It may also routinely complete in-depth questionnaires about the adviser's business as well as respond to requests for proposals from clients and prospective clients. In addition, other departments such as legal, compliance, operations and information technology, routinely respond to requests from existing and prospective government clients by phone or email, especially during contract negotiations or the account set-up process, and through periodic written compliance certifications or reporting that such clients require. These departments also may participate to a limited extent in the client's due diligence process by meeting with the clients, at their request, to address questions within their area of expertise.

In the Adopting Release, the Commission indicated that its interpretation of what it means to "solicit" government business is consistent with the MSRB's *Interpretive Notice on the Definition of Solicitation under Rules G-37 and G-38* ("Interpretive Notice").[30] The Interpretive Notice provides guidance and contains examples of the circumstances in which a communication may not be considered a solicitation with the purpose of obtaining or retaining services. The guidance in the Interpretive Notice, however, relates to municipal securities business and is not easily applied to an adviser's business model for investment advisory services.

The Interpretative Notice states that communications that are *incidental* to tasks needed to complete business for which a person has already been engaged generally would not be considered a solicitation. We believe that the types of communications undertaken by employees in the examples

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[30] *See* MSRB *Interpretive Notice on the Definition of Solicitation under Rules G-37 and G-38* (June 8, 2006), available at http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-38.aspx?tab=2#_6E7D5C54-C56D-4DB5-BEC5-914028440CDC.

above are incidental to the services provided by the adviser. Such communications are not made with the principal purpose of obtaining, retaining or referring a government entity, and employees having such incidental communications are not incentivized to engage in activities the pay-to-play rule is designed to protect against. We request that the Commission confirm our understanding, consistent with the application of the Interpretive Notice to the advisory business, and provide additional guidance concerning incidental communications that would not involve soliciting under the Commission's pay-to-play rule.[31]

Need for Regulatory Obligations for Intermediaries. The pay-to-play rule imposes detailed reporting and recordkeeping requirements on advisers. Advisers, however, do not own, control or possess all information they are required by the rule to maintain (*i.e.*, the identity of government entities invested in a fund advised by the adviser). As a result, they must obtain this information from the mutual funds holding the government accounts. More often than not, this information also is not within the fund's ownership, control or possession, because the majority of accounts held on funds' books and records are omnibus accounts held by financial intermediaries and the persons holding positions within the account are unknown to the mutual fund.

Many of these financial intermediaries are broker-dealers that are subject to the Commission's jurisdiction. Yet, the Commission has not imposed upon them a legal duty to provide to advisers (or to funds on behalf of the advisers) the information these intermediaries own, control and possess regarding which government entities hold accounts with the fund through the intermediary. As a result of this disconnect, advisers have been frustrated and stymied in their ability to obtain this information from their intermediaries in order to comply with their new regulatory requirements.

We strongly recommend that the Commission remedy this situation by requiring broker-dealers and other persons subject to the Commission's jurisdiction to provide advisers and funds with the account information the adviser is required by law to have in order to comply with the Commission's pay-to-play rule. This could be accomplished as part of a pay-to-play rule for broker-dealers, if the Commission pursues our recommendation to adopt or have FINRA adopt such a rule.

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[31] Absent additional guidance, any employee who communicates with a government entity may be deemed to be soliciting that entity and considered a "covered associate" subject to the pay-to-play rule. The only way to avoid "covered associate" status would be to severely restrict communications with clients in a manner that would hamper an adviser's ability to communicate openly or meet its contractual duties to these clients. Alternatively, an adviser could classify every employee as a "covered associate," but this approach has the effect of over-regulating employees and increasing advisers' compliance burdens. (For example, the political contributions of non-covered associates would be limited under the Commission's pay-to-play rule and the adviser's recordkeeping and compliance obligations could expand significantly.) Moreover, had this been the Commission's intent when it adopted the pay-to-play rule, it would have required advisers to classify as a "covered associate" all employees who have any interaction with government entities.

We fear that the Commission's failure to do so will result in advisers' inability to comply fully with the new pay-to-play rule's recordkeeping and reporting requirements through no fault of their own.[32]

Alternatively, the Commission could ask FINRA to adopt a requirement for broker-dealers to provide this information to advisers (or to funds on behalf of advisers). In light of the pay-to-play rule's fast approaching compliance deadline, however, time is of the essence and it would appear more expeditious for the Commission to adopt such a requirement as part of its current rulemaking initiative. Should the Commission fail to take such action, we recommend that it strongly encourage FINRA to impose this obligation on broker-dealers and, until such obligation is imposed, to encourage its members to provide this information upon request of the adviser or fund.

Request for Extension of Compliance Deadlines. Mid-stream, the Commission has proposed a major and problematic change to the final pay-to-play rule it adopted July 2010. We request that, if the Commission adopts the proposed amendments, the Commission provide advisers with additional time to comply with the new third-party solicitor provisions. We recommend that the Commission extend the current compliance date for the third-party solicitor provisions for one year, from September 13, 2011 to September 13, 2012. This will address several concerns that the proposal presents to advisers.

First, advisers to funds must comply with the third-party solicitor provisions in less than eight months, yet the Commission has yet to finalize those provisions. Second, advisers have expended resources and are deep into the process of developing policies, procedures and compliance systems designed to comply with the rule as it was adopted. Third, the proposed amendments to the solicitation provisions will cause advisers to significantly alter the way in which they do business with affiliated entities. Fourth, numerous interpretive questions have arisen as advisers attempt to implement the requirements of the rule. The proposed amendments certainly will raise questions that must be answered by the Commission before advisers are able to develop their strategies to implement the proposed amendments. For each of these reasons, advisers will need sufficient time to reassess, develop and finalize their approach to compliance with the Commission's pay-to-play rule.

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[32] Our recommendation would apply only to broker-dealers and other intermediaries subject to the Commission's jurisdiction. It would not capture, for example, financial intermediaries such as third-party administrators of retirement plans, bans, and trust departments, among others. We therefore recommend that the Commission permit an adviser to a mutual fund to satisfy its recordkeeping requirements by implementing policies and procedures that are reasonably designed to obtain the required account information and documenting the adviser's efforts to obtain the information from any financial intermediary holding an account directly with such fund. This approach would address advisers' concerns that, notwithstanding their best efforts, they are unable to obtain information on government entities holding covered accounts from intermediaries that are unwilling or unable to provide such information.

Proposed New Rule 203A-5

The Commission proposes a new rule, rule 203A-5, which would require each registered investment adviser to file an amendment to its Form ADV no later than August 20, 2011 to report the market value of its assets under management determined within 30 days of the filing. The filing is intended to "provide the Commission and the state regulatory authorities with information necessary to identify those advisers required to transition to state registration and to understand the reason for the transition or basis for continued Commission registration."[33]

We support the adoption of the proposed rule, but only with respect to those advisers that rely upon assets under management tests to determine their registration status. Advisers to registered investment companies are required to register with the Commission, regardless of assets under management.[34] With respect to these advisers, the filing serves no meaningful purpose and should not be required.

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If you have any questions or need additional information, please contact me at (202) 326-5815.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel

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

Jennifer B. McHugh, Acting Director
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[33] *See supra* note 2 at 10.

[34] *See* Sections 203A-1(a)(1)(ii) and 203A-1(a)(2)(i) of the Advisers Act.