SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

1440 NEW YORK AVENUE, N.W.
WASHINGTON, D.C. 20005-2111

TEL: (202) 371-7000
FAX: (202) 393-5760
www.skadden.com

DIRECT DIAL
202-371-7017
DIRECT FAX
202-661-8289
EMAIL ADDRESS
KHONG@SKADDEN.COM

FIRM/AFFILIATE OFFICES
BOSTON
CHICAGO
HOUSTON
LOS ANGELES
NEW YORK
PALO ALTO
SAN FRANCISCO
WILMINGTON
BEIJING
BRUSSELS
FRANKFURT
HONG KONG
LONDON
MOSCOW
MUNICH
PARIS
SÃO PAULO
SHANGHAI
SINGAPORE
SYDNEY
TOKYO
TORONTO
VIENNA

March 8, 2011

BY EMAIL

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

RE: Release No. IA-3110 (File No. S7-36-10): Rules Implementing Amendments to Investment Advisers Act of 1940 (the "Proposing Release")[1]

Dear Ms. Murphy:

We respectfully submit this letter in response to the Commission's request for comments regarding the Proposing Release. Specifically, this letter addresses the portion of the Proposing Release that would amend Rule 206(4)-5 under the Investment Advisers Act of 1940 (the "Advisers Act") as it pertains to the solicitation of government entities by investment adviser affiliates (the "Proposed Amendment"). Our comments are prompted by recent informal advice we received from Commission staff as to how the Proposed Amendment would be implemented. As a result, we understand the Commission staff will fully consider these comments despite the fact that we are submitting them after the January 24, 2011 deadline for comments.

---

[1] 75 FR 77052 (December 10, 2010).

I. PROPOSED AMENDMENT

The Proposed Amendment, if adopted, would prohibit investment advisers from paying persons to solicit government entities for investment advisory services on its behalf unless such persons are its own employees, managing members or general partners, or "regulated municipal advisors" registered under Section 15B of the Securities Exchange Act of 1934 ("Exchange Act") and subject to the Municipal Securities Rulemaking Board ("MSRB") anti-"pay-to-play" rules.

If adopted, the Proposed Amendment would replace the Commission's current pay-to-play rule that prohibits an investment adviser from paying persons to solicit a government entity for investment advisory services on its behalf unless such persons are its own employees, managing members or general partners, or "regulated persons," including a registered broker-dealer complying with the pay-to-play rules issued by the Financial Industry Regulatory Authority, Inc. ("FINRA") and a registered investment adviser complying with Rule 206(4)-5.

Under the amendments to the Exchange Act made by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), a regulated municipal advisor includes, among others, any person who "solicits" a "municipal entity" on behalf of an investment adviser (for example, any person that solicits a public pension plan for investment advisory services on behalf of an investment adviser). Dodd-Frank further provides that a "solicitation of a municipal entity" does not include any solicitation by a person that controls, is controlled by, or is under common control with the investment adviser (*e.g.*, being an affiliate of the investment adviser on behalf of which the solicitation occurs). Thus, the Exchange Act does not require an entity or its employees to register as a municipal advisor in order to solicit a municipal entity on behalf of an affiliate.[2]

II. STAFF INFORMAL GUIDANCE ON APPLICATION OF PROPOSED AMENDMENT TO SPECIFIC FACTS

We recently discussed with Commission staff whether the Proposed Amendment would require an investment adviser's affiliated broker-dealer to register as a municipal advisor under the following circumstances: The affiliate is a special purpose broker-dealer formed by the adviser for the sole purpose of acting as private placement agent on behalf of investment funds managed or advised by the adviser. All persons who engage in private placement activities on behalf of the broker-dealer are registered representatives of the broker-dealer and are also employees of its affiliated investment adviser. The employees of the investment adviser, in their

---

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

capacity as registered representatives of the broker-dealer, from time to time solicit government entities to invest in the investment funds managed or advised by the investment adviser (such as a hedge fund or private equity fund). The investment adviser pays its affiliated broker-dealer an annual, flat fee for the services provided by its affiliated broker-dealer (regardless of the success of the broker-dealer in raising assets for the investment adviser), and also covers the broker-dealer's expenses. Neither the affiliated broker-dealer nor any of its registered representatives otherwise receives any sales commissions or direct selling compensation related to the broker-dealer's private placement activities.

Commission staff informally advised that the investment adviser would be prohibited from paying its affiliated special purpose broker-dealer an annual, flat placement fee if its employees who are registered representatives of the broker-dealer from time-to-time solicit government entities on the investment adviser's behalf, unless the affiliated broker-dealer registered as a municipal advisor and complied with the MSRB's separate anti-"pay-to-play" rules—notwithstanding that all of the broker-dealer's registered representatives are "covered associates" of its affiliated adviser and therefore directly subject to Rule 206(4)-5.

III. SOLICITATION OF MUNICIPAL ENTITIES BY INVESTMENT ADVISER EMPLOYEES WHO ARE REGISTERED REPRESENTATIVES OF AN AFFILIATED SPECIAL PURPOSE BROKER-DEALER SHOULD NOT TRIGGER REGISTRATION BY THE BROKER-DEALER AS A MUNICIPAL ADVISOR

Under the scenario described above, the Commission should permit the special purpose broker-dealer to receive compensation in connection with soliciting for the affiliated adviser without registering as a municipal advisor.

The SEC staff's interpretation of the Proposed Amendment as requiring the broker-dealer to register as a municipal advisor under these facts is not necessary to accomplish the Commission's pay-to-play concerns and is contrary both to good public policy and the unambiguous language and intent of Dodd-Frank. The potential pay-to-play policy concerns under the scenario set forth above (or, for that matter, any scenario involving solicitation of government entities by investment adviser employees who are registered representatives of an affiliated broker-dealer) are already fully addressed under Rule 206(4)-5 in that the employees of the investment adviser who are registered representatives of the affiliated broker-dealer that solicit government entities would be treated as the investment adviser's "covered associates" for purposes of the rule. Moreover, the investment adviser could not evade compliance with Rule 206(4)-5 by indirectly making contributions to covered

candidates through its affiliated special purpose broker-dealer. Such an evasion clearly would be prohibited under Rule 206(4)-5, which prohibits an investment adviser from doing indirectly that which it cannot do directly under the rule.

Subjecting the broker-dealer to duplicative pay-to-play regimes for the same activity and in connection with the same advisory business does not serve, and is in fact contrary to, public policy. As noted above, any pay-to-play issues that could be caused by political contributions by employees of the investment adviser who are registered representatives, or by the broker-dealer itself, are already fully addressed by Rule 206(4)-5. Additional registration and regulation does not provide any increased protection for the public against pay-to-play practices; rather, such duplicative requirements would only add confusion as to the broker-dealer's and its registered representatives' responsibilities under the various laws and regulatory authorities. Under the scenario described above, the registered representatives of the special purpose broker-dealer could eventually be subject to three different regulatory regimes, all aimed at regulating the same activities: Rule 206(4)-5; FINRA's Series 7 licensing, and the MSRB rules applicable to municipal advisors. In fact, it would be unclear to the registered representatives described above whether their activities were subject to Dodd-Frank's fiduciary duty standards applicable to municipal advisors or the Exchange Act's fair dealing rules applicable to broker-dealers—in addition to such persons' responsibilities under the Advisers Act as employees of the investment adviser.

Our recommendation is consistent with the plain language and intent of the municipal advisor provisions in Dodd-Frank. As noted above, the Dodd-Frank definition of "solicitation of a municipal entity" explicitly excludes solicitations of municipal entities by affiliates. The Commission, however, in footnote 104 of its proposed rulemaking on Registration of Municipal Advisors,[3] suggests that affiliates voluntarily register as municipal advisors as a condition to being paid to solicit on behalf of an affiliate, and further suggests that this does not contravene legislative intent. We strongly disagree and respectfully submit that this reading by the Commission is contrary to the intent of Dodd-Frank. Absent modification, the Proposed Amendment without question would effectively ***require*** an entity that solicits government entities on behalf of its investment adviser affiliate to register as a municipal advisor – there is nothing voluntary about it. Requiring a broker-dealer to register as a municipal advisor to solicit on behalf of an affiliate – particularly when all of the broker-dealer's registered representatives are employees of its affiliated investment adviser for whom it solicits – is clearly contrary to the plain language of the statute and Congressional intent to permit such solicitations without

---

[3] 76 FR 824, at 832 (January 6, 2011).

registration as a municipal advisor. We submit that such a requirement by the Commission would be tantamount to rewriting the statute and falls outside the Commission's rulemaking authority.[4]

For the reasons stated above, the Commission should clarify in the adopting release that an affiliated special-purpose broker-dealer that merely licenses employees of an affiliated adviser need not register as a municipal advisor in order to receive a fee from the affiliated adviser to cover its operations. This of course assumes the Proposed Amendment is adopted.

Moreover, our argument has equal merit with respect to any scenario involving the solicitation of government entities by a broker-dealer on behalf of its affiliated investment adviser. Therefore, as an alternative to our recommendation above, we recommend that the Commission retain the placement agent rule in current Rule 206(4)-5, but only with respect to affiliated broker-dealers and investment advisers. Under this alternative, the Commission would permit payments to affiliated broker-dealers to the extent that the registered representatives of the affiliated broker-dealer soliciting a government entity for investment advisory services on behalf of its investment adviser affiliate are "covered associates," or treated as "covered associates" of the investment adviser. This alternative would effectively be a return to the Commission's similar proposal from 2009,[5] and would be consistent with MSRB Rule G-38 and MSRB proposed Rule G-42 for municipal advisors.

Please contact me with any questions.

Respectfully submitted,

Ki P. Hong

Patricia M. Zweibel
Skadden, Arps, Slate, Meagher & Flom LLP

cc: Melissa Roverts

---

[4] See Chevron U.S.A. v. Natural Res. Def. Council, 467 U.S. 837, 842-843 (1984).

[5] Political Contributions by Certain Investment Advisers, 74 FR 39840 at 39853, FN 140 (August 7, 2009).