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Re: **File No. S7-18-09**
Political Contributions by Certain Investment Advisers

October 6, 2009

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

Dear Ms. Murphy:

We are writing in response to the Commission's request for comments on Proposed Rule 206(4)-5 and proposed amendments to Rules 204-2 and 206(4)-3 (collectively, the "**Proposed Rule**")[1] under the Investment Advisers Act of 1940, as amended (the "**Advisers Act**"). We appreciate the opportunity to comment on the Proposed Rule.[2]

We recognize and strongly support the Commission's important role in protecting public pension plans and other government programs as well as their sponsors and beneficiaries from the adverse consequences of "pay-to-play" practices, particularly in light of recent events that have highlighted examples of ethical misconduct. We believe the Proposed Rule in many respects will further the Commission's goals. However, we respectfully submit that certain provisions of the Proposed Rule as drafted are vague and overbroad, while other provisions will significantly burden investment advisers without contributing substantially to the realization of the Commission's objectives. We ask that the Commission consider the following recommendations prior to adopting the Proposed Rule.

I. Summary of Recommendations

- Due to the significant differences that exist between investment advisers and municipal underwriters in the nature and frequency of services provided, we do not believe that Municipal Securities Rulemaking Board ("**MSRB**") rules G-37 and G-38 (the "**MSRB model**") are appropriate models for the Proposed Rule for curbing the "pay-to-play" practices of investment advisers. In particular, we

[1] Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 2910, 74 Fed. Reg. 39,840 (proposed August 3, 2009). Page references to the Proposed Rule herein are to the Proposed Rule as released in Commission Proposing Release IA-2910.

[2] The opinions expressed herein represent those of the undersigned and not necessarily those of our clients.

believe the two-year ban on compensation of the MSRB model would have a drastic and deleterious effect on the business activities of investment advisers with government clients. We therefore urge the Commission to replace the two-year ban on compensation with a strong general prohibition on "pay-to-play" practices that, when combined with the Proposed Rule's new recordkeeping requirements for registered investment advisers, should curb "pay-to-play" abuses without the unintended consequences of the proposed ban.

- To the extent the two-year ban on compensation is adopted, we urge the Commission to narrow the scope of its language so that it targets "pay-to-play" transactions without imposing requirements that are likely to result in a *de facto* ban on all political contributions by investment advisers and their employees. Specifically, we urge the Commission to clarify its definition of "officials" to whom contributions may be made without triggering the two-year ban on compensation and specify that the determination as to whether an individual is an "official" is made at the time of the contribution. We request that the Commission eliminate any ambiguity as to who qualifies as a "covered associate" of the investment adviser by (i) rectifying the circularity in the definition of "executive officer," (ii) limiting the scope of the definition to those "executive officers" who, in connection with their regular duties, perform investment advisory services for, or solicit, government clients for the investment adviser, or supervise any person who does so, and (iii) specifying that employees of the investment adviser's parent company or any other affiliate are not "covered associates." We also ask that the Commission limit the application of prohibitions to "covered investment pools" to those where the investment adviser has the ability to control the soliciting, marketing or acceptance of government clients and, therefore, knows the identities of such government clients.

- We believe that the two-year look back provision (the "**Look Back**") imposes unreasonable due diligence burdens on investment advisers that exceed any corresponding benefit. We request that the Commission modify the Look Back to reduce these burdens. Specifically, we suggest that it (i) exclude persons hired or promoted to "covered associate" status and (ii) be limited to no more than six months' duration.

- We recommend that the Commission expand the "cure" provisions of the Proposed Rule to cover inadvertent violations of the restrictions on political contributions to "officials" and payments to political parties where the investment adviser has established reasonable policies and procedures to comply with the restrictions.

- We request that the Commission clarify and streamline the language of the proposed recordkeeping requirement to minimize any ambiguities and unnecessary administrative burdens imposed on investment advisers. In connection with recordkeeping relating to an investment adviser that is "seeking to provide" investment advisory services to government entities, we suggest, among other things, that the Commission utilize a bright-line test limited to concrete actions taken by the investment adviser, such as the completion of a government client's request for proposal as the Commission suggests or the

submission of other similar initial due diligence questionnaires or supporting documents requested by the government client.

- We believe that the proposed ban on the use of all third-party solicitors of government clients is unnecessarily expansive and the costs inflicted on government clients (as well as on investment advisers) from lack of access to the valuable services provided by third-party solicitors outweigh the expected benefits to be gained from the ban. We urge the Commission to consider (i) excepting from the proposed ban placement agents who are registered as broker-dealers with the Commission and who regularly engage in the business of soliciting clients, including government clients, for investment advisory services on behalf of investment advisers, (ii) subjecting such placement agents to appropriate "pay-to-play" restrictions and (iii) prohibiting investment advisers and such placement agents from using any third-party solicitor or intermediary that does not satisfy the requirements set forth in (i) and (ii) immediately above. Alternatively, to the extent a ban is adopted, we urge the Commission to clarify the language of the Proposed Rule by excluding from such ban certain enumerated services provided by third-party solicitors that would not trigger the "pay-to-play" concerns that the Commission seeks to address.

- We urge the Commission to adopt a transition period with an effective date no less than six months from the date the Final Rule is published. This will provide the minimum time needed by an investment adviser to develop effective compliance programs for the new Rule; create or modify and implement software programs; revise its code of ethics and educate and train its employees with respect to the new restrictions; gather and process information on political contributions by "covered associates;" and if third-party solicitors are banned, develop in-house marketing capability to replace the services previously provided by third-party solicitors.

- We ask the Commission to confirm that all of the prohibitions and requirements of the Proposed Rule apply only on a prospective basis. It would be unfair and unreasonable to impose any of the prohibitions or requirements contained in the Final Rule before investment advisers were on notice that previously permissible conduct would become prohibited. We ask the Commission to clarify the language of the Proposed Rule to provide that political contributions or payments made prior to the effective date of the Final Rule will not fall within the scope of the Proposed Rule. Additionally, we recommend the Commission "grandfather" contractual arrangements between investment advisers and third-party solicitors entered into prior to the effective date of the Final Rule.

- We believe that the Commission may have substantially underestimated the number of investment advisers that will be affected by the Proposed Rule and its costs and market effects in concluding that many of the aspects of the Rule would impose only minimal additional costs and burdens on investors and investment advisers. Moreover, we believe that the Commission did not consider the costs and market effects of the Proposed Rule on the government clients and their respective beneficiaries. We request that the Commission take into

consideration these additional costs and burdens in evaluating the costs and benefits of the Proposed Rule.

II. Restricting Political Contributions

A. Use of the MSRB Model and the Two-Year Ban on Compensation

We wholeheartedly endorse the Commission's efforts to prevent "pay-to-play" abuses through the adoption of the Proposed Rule. However, as discussed in our 1999 comment letter,[3] we do not regard the MSRB model for the Proposed Rule as an appropriate or suitably tailored approach to curbing "pay-to-play" practices by investment advisers. An investment adviser's business relationships with government clients are ongoing and long-term and thus the two-year ban on compensation generates much harsher results for investment advisers than for municipal underwriters, who typically provide services to government clients on a sporadic or short-term basis.

In response to the Commission's question regarding the use of the MSRB model,[4] we believe there are significant differences in a government client's selection process for municipal underwriters and investment advisers that have not been addressed, but should be reflected in the Proposed Rule. Even as compared to instances where the municipal underwriting relationship is long-standing,[5] a two-year prohibition imposed on investment advisers may have far greater consequences than for municipal underwriters. A government entity may make numerous securities offerings each year. Following a two-year prohibition, a municipal underwriter could compete for each new offering. By contrast, advisory contracts tend to be long-term in nature and are infrequently put up for rebidding. Thus, the automatic prohibition for investment advisers could effectively last far longer than two years and may become permanent. Under the Proposed Rule, an investment adviser could continue to provide its services to a government client without further compensation during a two-year period. However, MSRB rule G-37 does not similarly place municipal underwriters in the position of losing a client permanently or providing free underwriting services.

The two-year ban on compensation is particularly ill-suited in the context of private funds and registered investment companies ("**RICs**") that are closed-end funds with investments in illiquid assets. Private funds, such as private equity funds, venture capital funds and hedge funds that pursue more illiquid investment strategies, are frequently established for the purpose of making long-term investments in illiquid securities. The Commission acknowledges that an investment adviser may need to redeem the government client's investment to avoid being required to provide services without compensation. However, an investment adviser may not be able to cause a fund to redeem an investor's interest in the fund for several years due to the illiquid nature of the securities in which these funds invest. Further, if a government client were permitted to redeem its interest prematurely, the position of the remaining investors could be seriously jeopardized.

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[3] *See* Pierre de Saint Phalle, Nora M. Jordan, and Terrance J. O'Malley, Comment Letter to Release IA-1812 (Nov. 1, 1999).

[4] Proposed Rule, 23.

[5] *See* Proposed Rule, 23 n.67 (stating the Commission's belief that "[w]hile municipal underwritings themselves tend to be episodic, underwriting relationships are often longstanding" and "[as] a result, the [Proposed Rule's] time outs may have similar effects").

The two-year ban on compensation poses different, but equally serious issues for mutual funds that qualify as "covered investment pools" because they are often used as funding vehicles for, or investments of, government-sponsored savings and retirement plans.[6]

The Commission recognizes that restricting compensation related to a government client's investment in a RIC is limited both by (i) provisions under the Investment Company Act that prohibit disparate treatment of shareholders within a particular class[7] and (ii) the potentially adverse tax consequences of special distributions to government clients.[8] The Commission suggests that a RIC investment adviser subject to the two-year ban on compensation could comply with the Proposed Rule by waiving its advisory fee "for the fund as a whole in an amount approximately equal to fees attributable to the government entity."[9] We believe that such an option would unjustly enrich the other shareholders, creating a perverse result in which mutual funds generate greater returns for their shareholders when their investment advisers violate the Proposed Rule, than when they comply.

A possible unintended consequence of the proposed two-year ban on compensation is that investment advisers of both private funds and RICs could decide that accepting a government client as an investor in the fund or being selected as an investment option for a government-savings plan is not worth the risk of a two-year ban on compensation or a redemption of the government client's investment, thereby closing off an entire sector of investment opportunities for government clients to the detriment of their beneficiaries. Moreover, non-government clients may also resist participating in a fund in which their investments could be affected by a withdrawing government client.

In response to the Commission's inquiry for an alternative approach,[10] we believe there is another approach that would cause less disruption to the government client than the two-year ban on compensation. Instead of the two-year ban on compensation, we urge the Commission to adopt a general rule that prohibits "pay-to-play" practices and requires an investment adviser to adopt policies and procedures designed to monitor compliance with this prohibition. We believe that such policies and procedures, when combined with the new recordkeeping requirements proposed by the Commission for registered investment advisers and the Commission's existing array of enforcement tools available under the Advisers Act, should be an alternative approach that should curb "pay-to-play" abuses without the unintended consequences of the proposed ban. In addition, investment advisers that currently rely on an exemption from registration and are not required to file a Form ADV could also be required to adopt policies and procedures and to maintain records of contributions made to government

[6] Unlike the 1999 proposal, the Proposed Rule applies not only to investment advisers managing private funds but also to investment advisers managing "covered investment pools." *See* Proposed Rule, 60. A "covered investment pool" is defined as "any investment company, as defined in section 3(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(a)), or any company that would be an investment company under section 3(a) of that Act but for the exclusion provided from that definition by either section 3(c)(1), section 3(c)(7) or section 3(c)(11) of that Act (15 U.S.C. 80a-3(c)(1), (c)(7) or (c)(11)), except that for purposes of paragraph (a)(1) of this section, an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a), the shares of which are registered under the Securities Act of 1933 (15 U.S.C. 77a), shall be a covered investment pool only if it is an investment or an investment option of a plan or program of a government entity." Proposed Rule 206(4)-5(f)(3).

[7] *See, e.g.*, Rule 18f-3 under the Investment Company Act. In general, Section 18(f) makes it unlawful for any registered open-end company to sell any class of senior securities.

[8] Proposed Rule, 68.

[9] Proposed Rule, 69.

[10] Proposed Rule, 23.

clients by the investment adviser and any of its "covered associates," equivalent to that proposed for registered advisers.

Alternatively, the Commission could limit the applicability of the two-year ban on compensation to *future* investments by a government client, so as not to disrupt the existing investment advisory relationship that may harm not only the government client and its beneficiaries but the other investors in the same fund. This form of ban on future compensation, limited to future investments, could presumably be combined with the Commission's existing enforcement tools under the Advisers Act.

Additionally, we request that the Commission define a maximum time period that would constitute "a reasonable period of time"[11] for an investment adviser to be obligated, upon the triggering of the two-year ban on compensation, to continue to provide uncompensated advisory services to satisfy its fiduciary duties owed to the government client, absent specified contractual provisions. We recommend that such time period not exceed three months. A finite three-month period should provide sufficient time for the government client to select an appropriate replacement adviser, coincide conveniently with any quarterly advisory fee calculations and set clear expectations for the transition time frame, which is in the best interests of both the government client and the investment adviser.

B. Clarification of Language of Proposed Rule

To the extent the two-year ban on compensation is adopted, we urge the Commission to narrow the scope of its language so that it targets "pay-to-play" transactions without imposing requirements that are likely to result in a *de facto* ban on all political contributions by investment advisers and their employees. We believe that certain provisions of the Proposed Rule are vague and ambiguous, which will make compliance difficult for investment advisers. We also believe certain provisions are overly broad, which will lead many investment advisers to ultimately conclude that banning *all* political contributions by *all* employees, affiliates and family members, regardless of whether any such contribution would violate the Proposed Rule, is the only practical way to avoid an inadvertent violation and ensure compliance. Therefore, we urge the Commission to clarify the proposed language to enable investment advisers to clearly and confidently identify which contributions will trigger the two-year ban on compensation and to narrow the proposed language so that the Proposed Rule properly targets the impermissible contributions that the Commission seeks to eliminate without imposing limitations on conduct the Commission does not intend to regulate.

To comply with the Proposed Rule, investment advisers would need more definitive answers to the following questions:

1. *To which "officials" can an investment adviser make a <u>contribution</u> without triggering the two-year ban on compensation?* The Proposed Rule squarely places the onus on the investment adviser to identify which elected officials fall within the scope of the definition of "official." Under the Proposed Rule, an "official" includes any incumbent, candidate or successful candidate for an elective office that "is directly *or indirectly* responsible for, *or can*

[11] *See* Proposed Rule, 27. ("An adviser subject to the prohibition would likely, at a minimum, be obligated to provide (uncompensated) advisory services for a reasonable period of time until the government client finds a successor to ensure its withdrawal did not harm the client, or the contractual arrangement between the adviser and the government client might obligate the adviser to continue to perform under the contract at no fee.") (footnotes omitted).

influence the outcome of, the hiring of an investment adviser by a government entity or has the authority to appoint any person who is directly *or indirectly* responsible for, *or can influence the outcome of*, the hiring of an investment adviser by a government entity."[12] Because the governance structures for public pension plans and other government clients widely vary from state to state and locality to locality,[13] it will be extraordinarily challenging and would require significant resources for an investment adviser to identify each of the elected officials who are "indirectly" responsible for a hiring decision in a particular jurisdiction. Where the inquiry focuses on who "can [indirectly] influence the outcome of" a hiring decision, making a determination only becomes all the more difficult due to the vague and broadly expansive nature of this phrase.

In response to the Commission's request for comments on the definition of "official,"[14] we recommend that the Commission eliminate the phrase "or indirectly." While the Proposed Rule contains a general prohibition on regulated persons and entities from doing indirectly that which would violate the Rule if done directly,[15] here the phrase "or indirectly" refers not to the conduct of the regulated party but rather to the authority of officials whose "indirect" ability to influence the outcome of a hiring decision may be wholly unknown to the investment adviser and, in many circumstances, may not be reasonably susceptible of being correctly ascertained.

Additionally, we also suggest the Commission delete the phrase "or can influence the outcome of [the hiring of an investment adviser]" from the definition of "official." This phrase is particularly difficult to comply with due to its vagueness and might be interpreted, absent clarification by the Commission in its Final Rule, to capture almost any elected official. For example, arguably every state senator, state assembly person or the state governor could be deemed to have the ability to "influence the outcome" of the hiring decision.

We urge the Commission to make clear that the test as to whether an individual is an "official" is made as of the time the contribution is made. It is particularly unfair and unreasonable to impose a two-year ban on compensation if the person to whom a contribution was made had no responsibility for, or influence over, the hiring decision of an investment adviser at the time of the contribution, and only later qualified as an "official."

We note that government clients are in a far better position than investment advisers or the Commission to identify which persons fall within the definition of an "official." To provide clearer guidance on this issue, we ask the Commission to urge each government client to publish and maintain a list of "officials" who are responsible for, or have "influence" over, the hiring decision. We recommend that the Commission clarify that when investment advisers rely on such lists, on representations made by an elected official that he or she does not fall within the proposed definition and on any other information or materials provided by the government client prior to the date of the contribution (including any website of the government client), that

[12] Proposed Rule 206(4)-5(f)(6) (emphasis added).

[13] The Commission acknowledges this in its proposing release. *See* Proposed Rule, 10-11 ("[T]he elected officials that govern the funds are also often involved, directly or indirectly, in selecting advisers to manage the public pension funds' assets. These officials may have the sole authority to select advisers, may be members of a governing board that selects advisers, or may appoint some or all of the board members who make the selection.") (footnotes omitted).

[14] Proposed Rule, 29.

[15] Proposed Rule 206(4)-5(d) ("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 Advisers Act (15 U.S.C. 80b-6(4)), it shall be unlawful 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 to do anything indirectly which, if done directly, would result in a violation of this section.").

such reliance be dispositive of whether an elected official falls within the definition of "official," even if the lists, representations, information or materials later prove to be incorrect. Further, the investment adviser should not be subject to any ban on compensation due to a contribution made in reliance on such information provided by a government client.

2. ***Who qualifies as a "covered associate" of the investment adviser?*** We agree with the Commission's decision to narrow the category of individuals and entities whose contributions would trigger the two-year ban on compensation under the Commission's 1999 proposing release[16] and instead to limit the category to the investment adviser and its "covered associates."[17]

We believe, however, that the definitions of "covered associate"[18] and "executive officer"[19] require further clarification. The Proposed Rule imposes a host of prohibitions upon a "covered associate." Therefore, it is imperative that the Final Rule eliminate all ambiguity in these defined terms and be tailored to address the abuses it is intended to eradicate.

We first note that the definition of "covered associate" includes an "executive officer," but the definition of "executive officer" is circular to the extent it includes "any other *executive* officer" (emphasis added) whose duties fall within the Proposed Rule. As noted above, we strongly support the Commission's decision to limit its definition of "covered associate" to those who "are more likely to have an economic incentive to make contributions to influence the advisory firm's selection" and those who the Commission has found, in its enforcement actions, "typically make contributions."[20] Such circularity, however, may create ambiguity in this key definition in the Proposed Rule. We suggest that the Commission revise its definition of "executive officer" by deleting the phrase "any other executive officer" and replacing it with "any other *senior* officer" to provide investment advisers with better guidance.

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[16] *See* Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 1812, 64 Fed. Reg. 43,556 (proposed Aug. 4, 1999).

[17] *See* Proposed Rule, 33 n.98 ("Under our 1999 proposal, the rule would have applied more broadly to "partners" (not just a general partner or equivalent) and "executive officers" (which we proposed to define as "the president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions, for the investment adviser"). . . . Commenters in 1999 suggested that, instead of applying the rule to all partners, we narrow the rule to apply only to a firm's general partner (or equivalent) and other owners that have a significant ownership interest in the firm. Commenters also suggested that we either exclude executive officers of divisions unrelated to the firm's solicitation and/or advisory functions or limit the rule's application to only the most senior officers of an adviser, such as persons required to be listed on Schedule A of Form ADV. In light of these comments, we have included in our proposed definition of "covered associates" only those persons associated with an investment adviser who we believe are more likely to have an economic incentive to make contributions to influence the advisory firm's selection and who we have found, in our enforcement actions, typically make contributions.").

[18] Proposed Rule 206(4)-5(f)(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 who solicits a government entity for the investment adviser; and (iii) Any political action committee controlled by the investment adviser or by any person described in paragraphs (f)(2)(i) and (f)(2)(ii) of this section.").

[19] Proposed Rule 206(4)-5(f)(4) ("Executive officer of an investment adviser means the president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), or any other executive officer of the investment adviser who, in each case, in connection with his or her regular duties: (i) Performs, or supervises any person who performs, investment advisory services for the investment adviser; (ii) Solicits, or supervises any person who solicits, for the investment adviser, including with respect to investors for a covered investment pool; or (iii) Supervises, directly or indirectly, any person described in paragraph (f)(4)(i) or (f)(4)(ii) of this section.").

[20] *See* Proposed Rule, 33 n.98.

In addition, the definition of "executive officer" is overbroad. As currently drafted, the definition includes any executive officer who "(i) performs, or supervises any person who performs, investment advisory services for the investment adviser," or any executive officer who "(ii) solicits, or supervises any person who solicits, for the investment adviser, including with respect to investors for a covered investment pool." This language should be narrowed to refer only to those executive officers who perform investment advisory services for, or solicit, *government clients* for the investment adviser (or supervise those who do). Executive officers who confine their activities to clients *other than* government clients do not present the same type of harm that the Commission seeks to eliminate in the "pay-to-play" arena as do officers whose job responsibilities include interacting with government clients. Moreover, any concerns the Commission may have that the Proposed Rule would be circumvented should be adequately covered by either: (1) subsection (iii) of the definition, which includes any executive officer who directly or indirectly supervises any person who performs investment advisory services for, or solicits, (government clients) for the investment adviser, or (2) section (d) of the Proposed Rule, which prohibits investment advisers from circumventing the purpose of the Rule by indirectly facilitating contributions to "officials" by means of other employees not falling within the definition of "covered associate." Therefore, in response to the Commission's question as to which executive officers should be excluded from the Proposed Rule, we urge the Commission to limit the definition of "executive officer" to those who, in connection with their regular duties, perform investment advisory services for, or solicit, government clients for the investment adviser or supervise any person who does so.

Finally, we ask the Commission to specify that the definition of "executive officer" (and, by extension, the definition of "covered associate") does *not* include the executive officers, general partners or other employees of the investment adviser's parent company or any other affiliate of the investment adviser. Any concerns the Commission may have that the Proposed Rule would be circumvented are addressed adequately by the provisions in the Proposed Rule that one cannot do indirectly what would be prohibited if done directly.

C. Limit the Application of Prohibitions to "Covered Investment Pools"

The two-year ban on compensation under the Proposed Rule would be equally applicable to an investment adviser that directly provides advisory services to a government client as well as to an investment adviser that manages investments through a "covered investment pool" in which a government client invests or is solicited to invest.[21] The Proposed Rule fails to distinguish the situation where an investment adviser is hired to provide advisory services to a fund, but is unaffiliated with the fund sponsor and has no ability to control the soliciting, marketing, or acceptance of government clients in that fund, such as in a platform arrangement. In such circumstances, the investment adviser may never know the identity of the investors in the fund it has been hired to advise. Consequently, the investment adviser would not be able to influence government clients to invest in such fund, and, without knowledge of the identity of the investors, it would not be able to ascertain whether it is in compliance with the Proposed Rule. We encourage the Commission to limit the application of prohibitions to "covered investment pools" to those where the investment adviser has the ability to control the

[21] Proposed Rule 206(4)-5(c) ("Prohibitions as applied to covered investment pools. For purposed of this section, an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest shall be treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity.").

soliciting, marketing or acceptance of government clients and, therefore, knows the identities of such government clients.

Moreover, in our experience working with RICs, it is common for most client shares to be held in a single omnibus account at a broker-dealer plan administrator or other financial intermediary. There would be no practical way for a RIC investment adviser to comply with the Proposed Rule because the investment adviser may not know if any assets in the omnibus account of financial intermediaries are attributable to government clients. The Commission acknowledges that "in many circumstances in which a government entity determines to make an investment in an investment company for cash management or other purposes, the investment adviser may not even be aware that a government entity has made an investment."[22] Mindful of the "substantial compliance challenges" that would arise if an investment adviser had to monitor all investments by government entities in its companies, the Commission has limited its two-year ban on compensation to RICs that are included in government-sponsored savings plans.[23] However, it is possible for a RIC to be an investment option for a government plan without the RIC's knowledge. We encourage the Commission to restrict the definition of "covered investment pool" to a RIC "only if [the investment adviser has been advised by the government client that] it is an investment or an investment option of a plan or program of [such] government entity" for purposes of the Proposed Rule.

D. Two-Year Look Back

We strongly urge the Commission to limit the scope of the Look Back as noted below. We believe that the Look Back imposes an overly restrictive and unreasonable compliance burden on investment advisers to determine its employees' and potential employees' contributions for the preceding two-year period and will likely result in more widespread bans by investment advisers of all political contributions by all employees, deterring legitimate political support.

We recommend that the Commission modify the Look Back to exclude contributions made by an employee during the two-year period prior to being employed as a "covered associate" by an investment adviser. As currently drafted, the Look Back imposes on an investment adviser strict liability for the actions of persons who were not previously under its control and supervision or who were not employed as "covered associates" and therefore outside the scope of the Proposed Rule. The language of the Proposed Rule covers employees who, after having made a political contribution to an "official" when not in the position of a "covered associate," are either hired or promoted to "covered associate" status or become a "covered associate" due to a business combination such as a merger, joint venture or acquisition. The broad scope of the Proposed Rule in this regard would require investment advisers to make hiring and promotion decisions based not only on exhaustive background checks and work performance, but also in reliance upon a candidate's memory and perceived honesty in disclosing his or her prior political contributions. Requiring a candidate to disclose information regarding his or her political party affiliations should not be relevant to hiring or promotion decisions. Not only does it create onerous compliance burdens, but it could have the unintended effect of allowing political contributions or affiliations to become a factor in hiring or promoting

[22] Proposed Rule, 64.

[23] Proposed Rule 206(4)-5(f)(3).

that in turn could interfere with the primary goal of finding the most qualified candidate for the job.

We believe that the Commission overestimates the risk that investment advisers will seek to "circumvent the rule by hiring individuals shortly after they have made significant contributions that could influence government officials."[24] Even if that unlikely scenario were to occur, such behavior is already sufficiently covered by the prohibition against doing indirectly that which, if done directly, would result in a violation of the Proposed Rule.[25]

We further urge the Commission to modify the Look Back provision to permit an investment adviser to rely on signed representations made by a "covered associate" in identifying his or her past contributions or confirming that he or she has made none. It would be impossible for an investment adviser to independently confirm the information provided by a "covered associate" and therefore a two-year ban on compensation should not be imposed on an investment adviser if it satisfied its compliance obligation by requesting the appropriate information from its "covered associates."

In response to the Commission's question as to what would be an appropriate Look Back period, we propose that the Commission reduce the length of the Look Back period to no more than six months. We believe that this time period should sufficiently blunt the "influential" impact of political contributions about which the Commission is concerned, without imposing an excessive due diligence burden on the investment adviser. It is time-consuming and difficult for an investment adviser to identify and analyze every political contribution made by each of its "covered associates" during the prior two years, and it is our view that a two-year Look Back period is excessive and unwarranted.

E. Cure Provisions

In response to the Commission's inquiry,[26] we submit that there are other circumstances under which an investment adviser should be able to avail itself of an exception to the Proposed Rule. We are concerned that the Proposed Rule does not offer a reasonable cure provision for inadvertent violations of the restriction on political contributions and offers no cure provision for inadvertent violations of the proposed ban on "bundling" or other solicitation and coordination of contributions and payments. While there is a limited cure provision for a contribution of less than $250 by a "covered associate" to an official for whom the "covered associate" is not entitled to vote, this cure provision is both extremely restrictive in timing and application and also fails to cover inadvertent violations which exceed the $250 minimum amount. Although the Commission may grant exemptive relief under Proposed Rule 206(4)-5(e), the only situation under which exemptive relief is available is far too narrow in scope to be meaningful and obtaining such exemptive relief would be time-consuming and expensive.

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[24] Proposed Rule, 38 n.113 ("Commenters in 1999 urged us to reduce the look back period, arguing that politically active individuals might be discouraged from joining advisory firms. However, we are concerned about the prospect of advisers seeking to circumvent the rule by hiring individuals shortly after they have made significant contributions that could influence government officials.").

[25] Proposed Rule 206(4)-5(d) ("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 Advisers Act (15 U.S.C. 80b-6(4)), it shall be unlawful 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 to do anything indirectly which, if done directly, would result in a violation of this section.").

[26] Proposed Rule, 42.

We believe that if an investment adviser has established reasonable policies and procedures to prescreen and monitor contributions by existing "covered associates," but fails to discover and prevent wrongful contribution or solicitation activities by a "covered associate" despite the implementation of such policies and procedures, the investment adviser should not be penalized with the extremely harsh two-year ban on compensation. We therefore request that the Commission expand the currently proposed exception by allowing an investment adviser to rely on established prescreening and monitoring policies and procedures as a defense for any violation by a "covered associate" of the restriction on political contributions or the ban on solicitation and coordination of contributions and payments, regardless of whether the contribution (or payment, as applicable) made or solicited was to those officials for whom the "covered associate" was entitled to vote.

We advocate that investment advisers be encouraged to establish a monitoring and recordkeeping system based on "negative reporting," as recommended by the Association for Investment Management and Research, whereby "covered associates" are asked to certify that they have not made contributions to certain candidates or officials.[27] A negative reporting system would both minimize the administrative recordkeeping burden imposed on the investment adviser and protect, to the extent possible, the "covered associate's" privacy with respect to his or her political contributions. We also request that the Commission create exceptions for instances where the contribution (or solicitation of contributions or payments) was intentionally made by a "covered associate" without the knowledge of the investment adviser, despite appropriate compliance procedures having been adopted, such as in the case of a disgruntled employee who seeks to undermine the investment adviser.

F. Recordkeeping

The recordkeeping requirements imposed by the Proposed Rule are substantial.[28] The Proposed Rule requires the investment adviser to maintain records of "all government entities for which the investment adviser or any of its covered associates is providing or *seeking to provide* investment advisory services . . . ."[29] To minimize the associated costs and burdens of such requirements, we request that the Commission include a definition of the term "seeking to provide" under Proposed Rule 206(4)-5(f). Because many investment advisers constantly seek new government clients and operate their advisory business on a national scale, the Proposed Rule could generate a large administrative recordkeeping burden with little resulting public benefit. In effect, the Proposed Rule requires an investment adviser to keep ongoing, continuously updated lists of *prospective* government clients even if its firm has not been selected to provide advisory business.

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[27] *See* Deborah A. Lamb and Linda L. Rittenhouse, Chair, AIMR Advocacy Committee and AIMR Vice President and Associate General Counsel, Comment Letter to Release IA-1812 (Nov. 1, 1999) ("Under this approach, a firm would circulate on a routine basis, a list of all public clients, as well as public entities that are being solicited by the firm. All those subject to the rule would have to confirm that they had not made political contributions (in excess of the mandated limit) to officials (or candidates) in those jurisdictions, except as disclosed. This system would allow employers to effectively screen pay to play practices and establish an effective recordkeeping system, without unnecessarily compromising privacy issues.").

[28] *See* Deborah R. Gatzek, Senior Vice President, Franklin Templeton Group, Comment Letter to Release IA-1812 (Nov. 12, 1999) ("We disagree with the statement in the release that the fact that the [P]roposed [R]ule is modeled after MSRB rule G-37 should minimize the compliance burden, since very few investment advisers have broker-dealer affiliates that underwrite municipal securities.").

[29] Proposed Rule, 204-2(a)(18)(i)(B) (emphasis added).

The Commission notes that an "investment adviser would be seeking to provide advisory services to a government entity when it responds to a request for proposal, communicates with a government entity regarding that entity's formal selection process for investment advisers, or engages in *some other solicitation* of investment advisory business of the government entity."[30] We suggest that "seeking to provide" be further clarified by a bright-line test. This test should be limited to concrete actions taken by the investment adviser, such as the completion of a government client's request for proposal as the Commission suggests or the submission of other similar initial due diligence questionnaires or supporting documents requested by the government client.

III. Banning Third-Party Solicitors

In an effort to curtail the inappropriate "pay-to-play" practices of some third-party solicitors,[31] the Commission proposes to ban an investment adviser and its "covered associates" from paying all third-party solicitors, including placement agents that are broker-dealers registered with the Commission, to solicit a government client on behalf of the investment adviser. In response to the Commission's inquiry,[32] we do not believe that the prohibition on the use of third-party solicitors as currently proposed is an appropriate means to deter "pay-to-play" practices. While we strongly support the underlying purpose of the Proposed Rule, we believe that this ban on all third-party solicitors is overly expansive and the costs inflicted on both investment advisers and government clients from lack of access to the valuable services provided by most third-party solicitors outweigh any expected benefits to be gained from its adoption. Therefore, we urge the Commission to consider (i) excepting from the proposed ban placement agents who are registered as broker-dealers with the Commission and who regularly engage in the business of soliciting clients, including government clients, for investment advisory services on behalf of investment advisers ("**Permitted Placement Agents**"), (ii) subjecting Permitted Placement Agents to appropriate "pay-to-play" restrictions and (iii) prohibiting investment advisers and Permitted Placement Agents from using any third-party solicitor or intermediary that does not satisfy the requirements set forth in (i) and (ii) immediately above. We submit that such a limited exception would preserve the benefits that third-party solicitors who are registered broker-dealers provide to investment advisers and government clients while prohibiting unregulated "finders" who are retained solely to take advantage of their relationships with specific officials and are thus prone to the "pay-to-play" abuses that the Proposed Rule seeks to address.

Alternatively, to the extent a ban is adopted, we urge the Commission to clarify the language of the Proposed Rule by excluding from such ban certain enumerated services provided by third-party solicitors that would not trigger the "pay-to-play" concerns that the Commission seeks to address.

We represent a range of investment advisers and funds, large and small. Our clients often use and rely on third-party solicitors in the course of their fundraising activities. Additionally, some of our clients are themselves third-party solicitors who are registered broker-dealers and, in some cases, affiliated with investment advisers. In our experience, third-party

[30] Proposed Rule, 53 n.150 (emphasis added).

[31] *See* Proposed Rule, 43-45. (citing concerns that "adoption of a rule addressing pay to play practices by advisers would lead to a . . . use of consultants or solicitors by investment advisers to circumvent the rule").

[32] Proposed Rule, 51.

solicitors provide valuable services to prospective government clients as well as to funds (especially to smaller, emerging, foreign, specialized and women- and minority-owned funds). Third-party solicitors not only introduce the investment adviser to potential investors, but also perform in-depth due diligence on the investment adviser's performance, track record and management team as part of the third-party solicitor's own client selection process. They also provide assistance in the drafting of offering documents and presentation materials, lend advice on market practice and business strategy, organize fundraising roadshows and provide other important marketing functions. Third-party solicitors also serve a useful public function by assisting a government client, directly or indirectly through the government client's external advisors or "gatekeepers," in identifying and prescreening alternative investment opportunities in furtherance of the government client's fiduciary obligations to its beneficiaries and of its investment objectives.[33]

An outright ban on the use of third-party solicitors places smaller, emerging, foreign, specialized and women- and minority-owned funds at a competitive disadvantage in seeking investments from public pensions and other government clients and entrenches larger and well-known or existing investment advisers. The Commission estimates that small fund investment advisers comprise 1,300 of the 1,764 registered investment advisers that will be affected by the Proposed Rule, or about 74% of affected registered investment advisers.[34] Unlike larger fund investment advisers that typically have ongoing launches and continuous offerings of multiple funds at any given time, these smaller fund investment advisers do not have the need, capability or resources to establish, develop and maintain equivalent in-house marketing personnel and services that would be permitted under the Proposed Rule.[35] As a result, the ban will not "level the playing field" for smaller, emerging, foreign, specialized and women- and minority-owned funds seeking to obtain investment advisory business from government clients, as the Commission had hoped. Instead, the ban will inevitably (i) make it more difficult for smaller, emerging, foreign, specialized, women- and minority-owned funds to compete for business against larger, better capitalized and well-known peers, (ii) decrease the array of investment opportunities made available to government clients, (iii) increase the costs of investment in such opportunities and (iv) inadvertently favor the selection of existing larger fund investment advisers that may not necessarily be the most suitable investment advisers, but simply the most visible and available.

A. Limited Exception for Permitted Placement Agents; Subject Permitted Placement Agents to Appropriate "Pay-to-Play" Restrictions

As noted above, we recommend and urge that in lieu of a ban on the use of all third-party

[33] *See* Denise L. Nappier, Treasurer of the State of Connecticut, Hartford, Connecticut, Comment Letter to Release IA-2910 (Sept. 10, 2009); Robert Palmer, Interim Executive Director, State Association of County Retirement Systems (SACRS), Sacramento, California, Comment Letter to Release IA-2910 (Sept. 8, 2009); James R. Meynard, CFA, Executive Director, Georgia Firefighters' Pension Fund, Comment Letter to Release IA-2910 (Sept. 3, 2009); Keith Bozarth, Executive Director, State of Wisconsin Investment Board, Comment Letter to Release IA-2910 (Aug. 31, 2009); Michael Travaglini, Executive Director, Pension Reserves Investment Management Board, Comment Letter to Release IA-2910 (Aug. 26, 2009); Steven R. Myers, South Dakota Investment Council, Comment Letter to Release IA-2910 (Aug. 26, 2009); Rick Dahl, Chief Investment Officer, Missouri State Employees Retirement System, Comment Letter to Release IA-2910 (Aug. 13, 2009).

[34] *See* Proposed Rule, 81.

[35] *See* Proposed Rule, 47 (allowing the use of a third-party solicitor if such solicitor is: "(i) a 'related person' of the investment adviser or, if the related person is a company, an employee of that related person; or (ii) any of the adviser's employees, general partners, LLC managing members, executive officers (or other person with a similar status or function, as applicable)").

solicitors, including Permitted Placement Agents, the Commission (i) except Permitted Placement Agents from the proposed ban, (ii) subject Permitted Placement Agents to appropriate "pay-to-play" restrictions and (iii) preclude investment advisers and Permitted Placement Agents from using any third-party solicitor or intermediary that does not satisfy the requirements set forth in (i) and (ii) immediately above.

Specifically, we request that the Commission adopt the following limited exception and requirements:

1. ***Limited exception for Permitted Placement Agents.*** We request that the Commission except from the ban Permitted Placement Agents who regularly engage in the business of soliciting clients, including government clients, for investment advisory services on behalf of investment advisers. Permitted Placement Agents not only provide valuable services to investment advisers and government clients, but are already extensively regulated by the Commission and the Financial Industry Regulatory Authority ("**FINRA**"). Requiring third-party solicitors to be registered broker-dealers under the Proposed Rule would result in consistent regulation and oversight of third-party solicitors engaged to solicit government clients.

2. ***Subject Permitted Placement Agents to appropriate "pay-to-play" restrictions.*** We request that the Commission subject Permitted Placement Agents to appropriate "pay-to-play" restrictions because we believe that penalties for "pay-to-play" violations should fall on those who commit them. Registered broker-dealers that provide legitimate placement agent services could be required by the Commission to comply with "pay-to-play" restrictions as a logical extension of the already-existing regulatory scheme governing the conduct of broker-dealers instead of being made subject to an outright ban. The Commission would have the direct authority to determine these restrictions as well as the oversight, control and enforcement of penalties over any violations. The restrictions could be tailored to operate with the same underlying purpose and effect on Permitted Placements Agents as the "pay-to-play" restrictions imposed on investment advisers.

Additionally, we believe that Permitted Placement Agents and their key personnel should be subject to the same restriction imposed on investment advisers under Proposed Rule 206(4)-5(d), which would prohibit them from doing anything indirectly which, if done directly, would result in a violation of any of the above requirements. Such a restriction would further align the requirements imposed on Permitted Placement Agents to those imposed on investment advisers under the Proposed Rule.

3. ***Ban on the use of third-party solicitors that are not Permitted Placement Agents.*** Consistent with the limited exception discussed above, we request that the Commission ban the use by investment advisers and Permitted Placement Agents of any third-party solicitor or intermediary to solicit government clients that fails to satisfy the two requirements above. Such a prohibition would ensure that only Permitted Placement Agents, subject to regulatory oversight by the Commission and FINRA, are utilized to solicit government clients.

By limiting the use of third-party solicitors to Permitted Placement Agents who regularly engage in the business of soliciting clients on behalf of investment advisers, we believe the Commission may avoid the draconian effects of an absolute ban while curtailing the "pay-to-play" abuses intended to be addressed by the Proposed Rule.

B. Clarification of Language of Proposed Rule

We further believe that the Proposed Rule's definition of "solicit" is unnecessarily vague and overbroad. With respect to investment advisory services, the Proposed Rule broadly defines "solicit" to mean "to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser . . . ."[36] According to the Commission, whether a "particular communication constitutes a 'solicitation' . . . depends on the specific facts and circumstances relating to the communication."[37] Due to the overbreadth of the definition of "solicit," virtually any activity by a third-party solicitor could be construed to be a form of indirect communication for the purpose of "obtaining or retaining a client or a contribution."[38] The facts and circumstances standard also adds uncertainty as to what constitutes a "solicitation."

To the extent that the ban on third-party solicitors is adopted, we urge the Commission to clarify the language of the Proposed Rule by expressly excluding from the definition of "solicit" those legitimate services provided by third-party solicitors to investment advisers that do not implicate the "pay-to-play" concerns the Commission intends to address.[39] Such activities would include, but are not limited to, assistance in the drafting of offering documents and presentation materials, advice on market practice and business strategy, due diligence, research and marketing functions that do not involve direct or indirect contact between the third-party solicitor and the applicable government client and are not specific to government clients but benefit all clients. We recommend that the Proposed Rule expressly exclude "non-solicitation activities," defined as marketing, consulting and/or advisory services provided by a third-party solicitor to an investment adviser which consist of (i) due diligence, screening and/or research services (other than assistance in the preparation of a government client's request for proposal and the submission of other similar initial due diligence questionnaires or supporting documents requested by the government client), (ii) assistance in the preparation of written materials or oral statements by the investment adviser in the course of the investment adviser's fundraising activities, (iii) any combination of the foregoing services, or (iv) any other similar services, activities or functions.

By excluding those types of services by third-party solicitors that do not implicate the valid "pay-to-play" concerns of the Commission, the Final Rule will permit third-party solicitors to continue to furnish valuable legitimate services to investment advisers without compromising its underlying purpose. Moreover, unless these types of services are excepted from the definition of "solicit," an investment adviser could be restricted from hiring a third-party solicitor to assist with the preparation of offering documents even if it anticipates offering investments to very few government clients.

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[36] Proposed Rule 206(4)-5(f)(10).

[37] Proposed Rule, 50.

[38] Proposed Rule, 50.

[39] The Commission states that the underlying purpose of the proposed ban on third-party solicitors is to prevent investment advisers from circumventing the pay-to-play restrictions proposed by the Proposed Rule through the use of third-party solicitors who themselves engage in pay-to-play practices. *See* Proposed Rule, 43-45 (citing concerns that "adoption of a rule addressing pay to play practices by advisers would lead to a . . . use of consultants or solicitors by investment advisers to circumvent the rule").

IV. Effective Date

As currently drafted, the Proposed Rule does not provide for a transition period. We urge the Commission to adopt a transition period of at least six months from the date the Final Rule is published to allow investment advisers sufficient time to develop and incorporate the requirements of the Final Rule into an effective compliance program. Investment advisers need a transition period to create or modify and implement software programs, develop and execute additional compliance procedures, revise its code of ethics and educate and train its employees with respect to the new restrictions and, if the ban on the use of third-party solicitors is retained in the Final Rule, hire marketing services staff and develop in-house marketing capabilities. Investment advisers also need sufficient time to instruct "covered associates" to gather any pertinent information relating to contributions and for the investment adviser in turn to process and evaluate such information in order to comply with the provisions of the Final Rule.

V. No Effect Given to Contributions or Payments Made Prior to the Effective Date; No Impairment of Existing Contracts with Third-Party Solicitors

At present, there are no federal limitations on investment advisers in the "pay-to-play" arena. Although the Proposed Rule serves the public interest, it would be unfair and unreasonable to impose any of the prohibitions and requirements contained in the Final Rule before investment advisers were on notice that previously permissible conduct would become prohibited. We ask the Commission to confirm that all of the prohibitions and requirements of the Proposed Rule, including the recordkeeping requirements and the Look Back, apply only on a prospective basis. The Commission should clarify the language of the Proposed Rule to provide that political contributions or payments made prior to the effective date of the Final Rule will not be deemed to be "contributions" or "payments" for purposes of applying the prohibitions and restrictions of the Proposed Rule. Concomitantly, the Look Back requirement should not go into effect for a period of time equal to the length of the Look Back period after the Final Rule is published.

Additionally, we recommend the Commission "grandfather" contractual arrangements between investment advisers and third-party solicitors entered into prior to the effective date of the Final Rule. Before the effective date of the Final Rule, investment advisers were not on notice that there was any federal prohibition on the use of third-party solicitors. Further, investment advisers may have contractual obligations to third-party solicitors and may have provided disclosure documents and other offering materials in connection with fundraising and soliciting potential investors, including government and non-government clients.

VI. Costs and Burdens of the Proposed Rule

We are concerned that the release issued in connection with the Proposed Rule has substantially underestimated the costs of compliance. Ongoing compliance with obligations under the Advisers Act generates very significant costs for investment advisers, including the opportunity costs of time spent away from the management of investments and the costs of legal and other professional services. Our view is that such costs will substantially increase with the adoption of the Proposed Rule, and will in some form be borne by investors and thereby diminish their returns.

The cost benefit analysis is based solely on an estimated 1,764 registered investment advisers and does not account for the costs and burdens of compliance attributable to investment advisers exempt from registration. The estimated number of investment advisers unregistered in reliance on Section 203(b)(3) of the Advisers Act (2,000) and estimated to be subject to the Proposed Rule (231), appears to be low. In its comment letter, the Third Party Marketers Association notes that the number of advisory firms exempted from registration may be "over two times the estimate of the Commission."[40] Although unregistered investment advisers currently are not subject to the recordkeeping requirements of the Proposed Rule, they nevertheless will need to establish similar due diligence policies and adopt equivalent procedures to ensure compliance by all "covered associates" and to prevent triggering any Look Back that could result in a two-year ban on compensation. Such costs are not accounted for in the release for the Proposed Rule.

The Proposed Rule also significantly underestimates the costs of compliance by registered investment advisers, particularly with respect to the hours that will be required to be expended by smaller firms to develop initial compliance procedures and maintain ongoing compliance compared to the hours that would be required by medium-sized firms which, according to the Commission's figures, do not have a considerably greater number of "covered associates." As a practical matter, although there may be significant differences in the number of hours dedicated to ongoing annual compliance between firms of different sizes, the estimated number of hours needed to develop initial compliance procedures will be similar for all firms, regardless of size. The initial effort of designing and implementing new policies and procedures and educating personnel will require similar effort and upfront fixed costs. Additionally, the Proposed Rule's estimates of initial and ongoing compliance costs to advisory firms are too low to adequately account for the investment adviser's initial and ongoing design or modification and implementation of computer software, development and execution of additional compliance procedures, revision of its code of ethics, time devoted to the education and training of its employees of the new restrictions and other necessary due diligence and information gathering and processing procedures.

The Proposed Rule also appears to underestimate the costs of legal services required for drafting policies and procedures and for the ongoing legal analysis and advice needed to ensure compliance due to the ambiguity of the Proposed Rule juxtaposed against difficult day-to-day fact patterns, as well as the costs entailed in the preparation of exemption requests. We believe a considerably larger percentage of firms of all sizes will engage outside legal counsel for these services and that the hours of engagement will be substantially higher than estimated (particularly for firms that do not have in-house lawyers). We also believe that the Proposed Rule's estimate of five exemption requests per year underestimates the number of firms that will seek such exemptions. We expect that the lack of a reasonable cure provision, combined with the lack of clarity in the language and the severe penalties for non-compliance, will complicate compliance. Thus, we anticipate that this will result in a higher number of annual exemption requests.

The Proposed Rule also fails to take into account the costs to government clients caused by a ban on third-party solicitors. Government clients also will need to develop or enhance existing resources to conduct the services previously performed by third-party solicitors hired by

[40] Donna DiMaria, President, Third Party Marketers Association, Comment Letter to Release IA-2910 (Aug. 27, 2009).

the investment advisers in the areas of prescreening, due diligence and selection of investment opportunities consistent with the government client's stated investment objectives.

Finally, not addressed in the release relating to the Proposed Rule is the potential impact of recent legislative proposals that would have the effect of dramatically increasing the number of investment advisers required to register with the Commission. Given the substantial resources investment advisers would be required to devote to complying with the Proposed Rule in its current form, we are concerned that smaller investment advisers newly required to register may be particularly burdened by the necessity to concurrently establish Advisers Act compliance programs and implement the additional compliance and recordkeeping procedures required by the Proposed Rule. Such additional burdens, together with the increased strain on the Commission's resources that may result from such legislation, underline the need for a targeted approach to addressing "pay-to-play" abuses that is based on sound risk assessments and careful cost-benefit analyses. We respectfully request that the Commission evaluate and consider the costs and burdens relating to the Proposed Rule in light of the foregoing additional costs and burdens.

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We appreciate the opportunity to respond to the Commission's request for comments and we hope that these comments and observations contribute to the important work of the Commission. If you have any questions with respect to the matters raised in this letter, please contact Yukako Kawata (see contact information below) or Susan Reibstein at 212-450-4872 or susan.reibstein@davispolk.com.

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