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October 6, 2009

Ms. Elizabeth M. Murphy

Secretary, Securities and Exchange Commission

100 F Street, NE

Washington, D.C. 20549-1090

RE: File Number S7-18-09

Dear Ms. Murphy,

I am writing this letter on behalf of the National Society of Compliance Professionals, Inc. ("NSCP"). NSCP is the largest nonprofit membership organization dedicated to serving and supporting compliance officials in the securities industry, with a membership of more than 1,700. NSCP's membership includes professionals from broker-dealers, investment advisers, banks, insurance companies, registered investment companies, advisers to hedge funds, accounting firms and law firms. NSCP's mission is to serve compliance professionals exclusively, including through education, the Certified Securities Compliance Professional® certification, publications, consultation forums, and regulatory advocacy.

NSCP appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC") proposed rule under the Investment Advisers Act of 1940 prohibiting an investment adviser from providing advisory services for compensation to a government client for two years after the adviser or certain of its executives or employees make a contribution to certain elected officials or candidates. The purpose of this letter is to inform the SEC of NSCP's concerns regarding the proposed rule as currently written and to respond to questions from the SEC. We applaud the SEC's continued efforts to make a rule for investment advisers regarding the SEC's pay-to-play concerns, and as part of this effort, NSCP would like to suggest certain ways in which the proposed rules could be improved.

**Proposed Two Year Ban On Compensation**

Unlike the municipal securities industry where a broker-dealer's relationship with a governmental issuer is episodic in nature, investment

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advisers provide services to public funds on an ongoing basis, with relationships between a public fund and an investment adviser sometimes lasting for decades. Although proposed Rule 206-(4)-5 merely prohibits a firm from accepting compensation for advisory services and not from providing such services, the practical result of the ban will be that an adviser will be economically compelled to end its relationship with a governmental entity. Indeed, most investment adviser agreements have a provision under which a party may terminate the relationship without cause usually within thirty (30) days of giving notice. Imposing a ban under which an adviser must, as a practical matter, sever such long-standing relationships will be particularly harmful to the participants and beneficiaries of the public funds given the great deal of public fund-specific knowledge amassed by the adviser during that time. It will be difficult, if not impossible, for a public fund to hire a comparable replacement adviser especially if the first adviser achieved superior performance. Moreover, the process in finding a new investment adviser in the specific strategy they are seeking can take time as these entities would likely take time using the typical detailed RFP process.

We believe that the two year ban is too harsh, and disallowance of any compensation even as the adviser continues to service the client's accounts is not appropriate. Indeed, the ban will deprive participants and beneficiaries of public funds of well qualified advisers and drive up the cost of investment advisory services due to higher compliance costs.

We note that the SEC does not believe that the on-going relationship investment advisers have with their clients is that much different for purposes of implementing this rule than the MSRB rule in light of the fact that underwriters for broker-dealer municipal securities' relationships with the government public funds "are often longstanding." Therefore, the proposed rule and the MSRB in the mind of the SEC will "have similar effects." We respectfully disagree. Even if a municipal broker-dealer has a longstanding relationship with a government entity, the broker-dealer is only paid for episodic transactions done on behalf of the government entity and thus is only engaged in the details of the government entity's business while a transaction is ongoing. Investment advisers, however, are paid for daily management of the investments, which implies a greater depth of a relationship than one with a broker-dealer who occasionally participates in a transaction. Moreover, MSRB broker-dealers comprise a tiny portion of the overall broker-dealers, as opposed to this Rule that will affect at a minimum all registered investment advisers that not only advise governmental public pension funds, but also may cover investment companies in which governmental pension funds choose to invest.

At a minimum, we believe that any ban should be subject to certain limitations such as: 1) exceptions for *de minimis* contributions of \$1,000 each year or at a minimum per election for each covered person, 2) an exception for those that contribute to their own state, city and local governmental officials for whom they are entitled to vote, as well as contributions to political parties, PACs, etc., and 3) limiting the rule's application to direct or indirect contributions from executive officers (CEO, CFO, COO) of the adviser and employees who solicit business.

Another alternative is to create a stepped approach to the ban based on such things as contribution amounts above \$1,000 and the number of times contributions were made over the last year, such that only advisers that are repeatedly and knowingly violating the rule are subject

to the two-year ban. This approach is more practical since the greater the amount contributed, the greater likelihood of an actual intent to influence a government official. Additionally, if the governmental official who received a contribution leaves office while the ban is in place, the ban should be lifted.

Finally, we do not believe that it is appropriate to restrict all compensation for the investment adviser when a prohibited contribution is made and also require the investment adviser to continue to advise the governmental entity pursuant to its fiduciary duties for an extended period of time without compensation.

### **Prohibition Against Third Parties To Solicit Governmental Entities for Advisory Services**

We believe an absolute prohibition of investment advisers hiring solicitors is inappropriate. First, as many commentators have observed, such a prohibition would discriminate against new and smaller investment advisers. Advisers lacking capital to hire employees to obtain government clients or the experience and sophistication to do so would be placed at a material competitive disadvantage. Investment advisers should be able to enlist the expertise of effective solicitors to guide them and assist in obtaining clients, without the obligation of adding potentially large operating expenses of expanded payrolls. Besides hampering the ability of new and smaller investment advisers to succeed, the proposal may well have the unintended effect of reducing the ability of qualified advisers to achieve access to state and municipal investment pools. This could in turn disadvantage the beneficiaries of those investment pools whose managers may be denied the opportunity to evaluate every worthy opportunity. Furthermore, the examples of improper and illegal behavior cited by the Commission arose out of the bad behavior of third-party solicitors, not the fact that the solicitors were independent from the investment advisers retaining them.

We would propose an alternative which has been recently implemented by CalPERS. CalPERS' strong interest in addressing pay-to-play issues caused it to adopt a registration, supervision and disclosure approach. Specifically,

- CalPERS investment partners and external managers must disclose their retention and placement agents, the fees they pay them, the services performed and other information about their engagement.
- Placement agents must register as broker-dealers with the SEC and FINRA – or CalPERS would decline the opportunity to retain or invest with the external manager or investment vehicle.
- Disclosed information must include agents' identities, resumes of key people, description of compensation and services, copies of agreements and if the agent is registered with the SEC or as a lobbyist in any state or national government.

If the CalPERS approach was integrated into the proposed rule, the SEC-registered solicitors would be required to comply with whatever “anti pay-to-play” requirements are finally adopted. This way, the concerns of the SEC related to prohibiting pay-to-play are met while allowing the advisers to compete effectively in the marketplace for government business.

Moreover, considering the investment advisers or broker-dealers have their own obligations on solicitation, we believe that oversight of third party political contributions should be similar to the oversight responsibility an adviser has under Rule 206(4)-7 (i.e., the adviser should be able to rely on attestations from the third party solicitor that they are in compliance with the provisions of the rule.) In addition, we believe that solicitors should be subject to the same exceptions as noted above such as the *de minimis* exception. Additionally, we suggest the same type of stepped up penalty as described above for solicitors. We believe that third party solicitors should not be prohibited unless the third party directs contributions to a government official who can influence the selection of a government plan’s investment adviser.

#### **Use of MSRB Rules G-37 and G-38 as Models for Proposed Rule 206(b)(4)**

As discussed above, we note the vast differences between the relatively small fraction of the broker-dealer community subject to the MSRB Rules and the large number of investment advisers that would be covered by this proposed pay-to-play rule. By recognizing this fact, the recommended course is to ensure the SEC proposed rule is sufficiently tailored and focused so as to only effect and deter the investment advisers truly engaged in the pay-to-play the SEC is attempting to disrupt. For example, the two year ban, as discussed above, is much harsher for an investment adviser than a municipal underwriter. The on-going nature of investment advisers’ fiduciary relationships with their clients makes a two year ban a potential death sentence for investment advisers to ever recover that business again. The same is not necessarily true for municipal underwriters who do not have the same fiduciary relationship with the government plans.

#### **Addition of Pay-to-Play Prohibition in Investment Adviser Policy Manual or Ethics Code and Discussion about Certifications**

The SEC requested comment on whether the SEC should amend its code of ethics rule or compliance rule. We believe that these rules should not be amended. As noted, many advisers have established restrictions on pay-to-play practices in their code of ethics and compliance policies. We believe investment advisers subject to this proposed rule when implemented will take it seriously and appropriately implement policies to ensure the rule is enforced. Suggesting a best practice of including the rule as part of the investment adviser’s compliance manual or code of ethics is the most that we believe is necessary. We also do not believe an annual certification by the investment adviser is necessary or should be required. We also believe that the reporting and disclosure system similar to the one imposed by MSRB Rule G-37(e)(ii) is appropriate and will also effectively deter the behind-the-scenes pay-to-play actions the SEC seeks to prevent.

### **Definition of “Official”**

We believe the definition of “Official” is too expansive if it includes individuals who currently hold a position with influence over the hiring of investment advisers for government plans but who are receiving a contribution solely in connection with the run for a federal position or other position outside of one with influence to hire investment advisers for a government plan. With the notion that this rule needs to be limited to the target to deter pay-to-play, contributing to an individual’s campaign for a position where that person has no ability to exert influence anymore is too tenuous to be covered by this rule and fraught with the potential to affect investment advisers not intended to be affected by the rule. We are concerned about the ability for advisers to effectively implement this sweeping proposed rule as it is currently written, and believe that at a minimum, the SEC should provide concrete examples about the individuals the SEC contends fall within the definition of "Official." We also recommend that the SEC clarify the due diligence required of a firm in order to meet its obligations and to determine who is an "Official" under the rule.

### **Definition of “Contribution”**

We also wish to respond to the SEC’s request for comment whether a prohibited contribution should include a contribution to the official’s PAC, the official’s state or local inauguration or transition committee or the local or state political party of the official who provides assistance to such an official or a foundation or other charitable contribution institution associated with such an official. We are concerned about the breadth of this rule. We do not believe that the rule should cover a contribution to a PAC simply because the official is associated with that PAC. If the SEC wishes to include contributions to the official’s state or local inauguration or transition committee, we are comfortable with that rule as long as the *de minimis* amount is increased to at least \$1,000. We do not believe a \$250 contribution to such is high enough to exert the influence the SEC is concerned about and the corresponding proposed 2-year ban is disproportionate to such a contribution. Concerning contributions to state or local political parties, we believe it important to have a specific statement in the rule making clear that contributions to these organizations are not prohibited under the rule. Last, we believe including a prohibition to a foundation or charitable institution simply because an official may be “associated” with such an entity is too broad. At a minimum, we believe foundations and charitable institutions should only be included when explicit requests are made by an "Official" that has influence over the decision making of a governmental plan's investment adviser. Moreover, the rule should be limited to situations where the adviser "knowingly" makes contributions to such institutions that would violate the SEC's concerns regarding pay-to-play.

Moreover, we believe it will be too burdensome to require an investment adviser to conduct due diligence on all contributions made to foundations or charitable institutions and determine whether those entities are associated with a particular official. Last, in responding to the SEC’s question about conference expenses, we do not believe it appropriate to expand the rule to include as a prohibited act, covering expenses of a conference simply because a government official is asked to speak or attends the conference. It is very common for investment advisers to contribute towards conference costs. To limit the adviser’s ability to solicit the business of a

public fund simply because a related official attends or speaks at the conference where the investment adviser paid expenses associated with the conference will negatively affect relationship building, and negatively affect the adviser's business while at the same time not furthering the goals of the SEC.

### **Definition of "Executive Officer" and "Covered Associates"**

We believe the definitions of "executive officer" and "covered associate" are too broad. The MSRB rule G-37 is substantially more limited in our opinion, in that it limits the rule to only those engaged in municipal finance, which we explained earlier is a small subset of broker-dealer professionals. We observe that the proposed rule defines "covered associates" as executives and "any employee who solicits ... for the investment adviser," which is too vague and ambiguous as to its meaning in our opinion.

Many firms, both investment advisers and broker-dealers, utilize an independent agent or franchise business model. It may not be clear that such agents are "covered associates" since they are not employees. Similarly, would such independent agents be considered to be "related persons" since they might contest whether they are directly or indirectly controlled by an investment adviser. Further, many broker-dealers have registered representatives ("RRs") who work with states and municipal investment pools, *e.g.*, pension plans. RR's may be asked to assist a fund's managers in finding appropriate money managers. Or an RR may approach a covered investment pool's managers about the selection of investment advisers from many advisers that the RR has worked with. Could the rule be construed broadly enough to restrict an RR from offering many different valuable services to governmental accounts? Will investment advisers be restricted in their ability to offer their services on a broker-dealer's platform since those brokers are clearly independent from them, but may well be regarded as soliciting business for them?

In light of these concerns and in an effort to focus the definition appropriately, we believe that the current proposed rule should be limited to only executive officers (CEO, CFO, COO) and those professionals who actively engage in the direct or indirect solicitation of government plans for an investment adviser rather than identify every executive or employee that might have an incentive to do so.

### **"Look Back" Provision**

We believe that the current compliance requirements of the "look-back" provision impose substantial challenges, as the required level of monitoring and administrative record keeping is often difficult to meet. If the SEC determines to retain the look-back provision in its current form, we recommend certain modifications that reflect a tempered approach in two situations.

As currently proposed, contributions above the \$250 *de minimis* amount by individuals to an official may prevent an adviser from engaging in advisory business for compensation during the two years following the contribution, even in cases where (1) the covered associate was not associated with the investment adviser at the time of the contribution, and (2) the individual later

left the adviser. Nevertheless, the investment adviser still remains unable to collect compensation from the government plan. While we do not advocate the creation of a blanket exemption for these cases, we do believe that the rule should be modified.

Specifically, in response to questions posed by the SEC, we are concerned that, on balance, applying the two-year look-back provision risks penalizing individuals without achieving counterbalancing benefits for the industry. In both cases, we recommend that rule allow a higher *de minimis* amount (\$1,000) in the two instances noted above. We believe that this approach will not undermine the rule or substantially increase the risk that investment advisers will manipulate the system to take advantage of these individuals' prior contributions.

We also recommend that the SEC clarify the due diligence required of a firm in order to meet its obligations under the two-year look-back provisions. Particularly with new hires, the firms must be able to rely on an individual's statement as to the timing and amount of past political contributions. To do otherwise would impose an unreasonably large administrative burden on the firm. Therefore, we ask that the SEC make clear that an investment adviser will satisfy its obligations under the rule if it uses reasonable grounds for making a conclusion as to an employee's political activities, including the express reliance upon that employee's statement.

We also believe that if the SEC intends on keeping this look-back provision, any penalty should not be one-size-fits-all and should certainly be less than the proposed two year ban on compensation. We suggest that in addition to the increase in the *de minimis* amount, for look-back violations, the ban be no more than one year.

Last, we believe it is appropriate to recognize that a one-size-fits-all rule without exceptions is not workable. For example, large organizations, such as banks with affiliated advisers, would in effect be forced to control and review contributions for people in the larger affiliated organization. A rule with such expansive requirements creates unnecessary burdens and problems for such advisers and affiliated entities where actions by persons in the affiliated entities will not result in the pay-to-play problems the SEC's proposed rule is intended to correct.

### **Exception for Returned Contribution**

We believe that it is appropriate to allow this exception for all contributions. Furthermore, we recommend that this exception apply if the covered person promptly requests the return of the contribution but the "Official" cannot or will not return the contribution. We believe that in those circumstances, if the investment adviser can provide written evidence of the attempt to recover the contribution and states affirmatively or provides evidence that the "Official" will not or under law cannot return the contribution, the investment adviser should obtain an automatic exception rather than have to apply for an exemption. We also do not think that advisers who make a covered contribution more than twice in one year should be prevented from using this exemption. We believe allowing the adviser to explain its particular circumstances will protect against the multiple inadvertent contributions that will likely happen to many investment advisers over the next few years as they learn to implement this new rule. Additionally, we want to make sure this exception applies to situations where the adviser knew of the contribution but

had a good faith basis to believe that the contribution was not prohibited. We also believe that at least for the next two years, the time period for this exception should be at least six months rather than four months as advisers begin to implement the new rule.

### **Covered Investment Pools**

We are concerned about including publicly registered investment pools in the proposed rule. As the SEC commented, requiring investment advisers to keep track of contributions to relevant government officials creates substantial compliance challenges. For example, many publicly available funds carry accounts in the name of various broker-dealers. In such cases, the adviser has no way of knowing the identity of the investor. Further, investments in publicly registered funds are generally liquid investments. A government entity has no contractual obligation to the adviser of a public fund and may sell its investment at any time. Related to open end funds that are sold pursuant to a prospectus that discloses the management fee, the funds are generally offered to a large group of investors, and not just government plans. Requiring an adviser to deviate from the prospectus with respect to the management fee in situations where purported contributions are made under the SEC's pay-to-play rule is problematic and creates potential disclosure problems for the adviser.

Regarding private pools, we acknowledge the compliance difficulties noted by the SEC. Specifically, many private pools only allow withdrawals at certain times specified in the fund's operating agreement. Thus, the adviser could be forced to continue management of the government entity's funds with no compensation for an undetermined period of time. As noted above and at a minimum, we believe that any ban should be subject to certain limitations discussed on page 2.

### **Record Keeping**

We agree that record keeping should be required and Form G-37 related to MSRB Rule G-37 provides an adequate template. However, we maintain our position regarding who should be covered, the amount of contributions deemed relevant, an exemption for contributions made to foundations or charitable institutions, and an exemption for contributions that cover conference expenses. As proposed, the rule will require advisers to collect contribution information from executive officers even if the adviser has no one soliciting for public funds management. Many advisers do not have governmental clients but will still have to collect the information or attestations which would increase compliance costs while providing no public benefit at all. If the "covered associate" definition is not changed as we recommend, we believe that the books and records section should provide relief to advisers not involved in public funds management.

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NSCP appreciates the opportunity to provide comments on the SEC's proposed rule under the Investment Advisers Act of 1940 prohibiting an investment adviser from providing advisory services for compensation to a government client for two years after the adviser or certain of its executives or employees make a contribution to certain elected officials or candidates and hopes you find the comments useful. NSCP would be pleased to assist the SEC in any way that it can going forward. Please feel free to contact the undersigned if you have any questions or require further information regarding our comments.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Joan Hinchman', with a long horizontal flourish extending to the right.

Joan Hinchman

Executive Director, President and CEO