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COMMON CAUSE
Holding Power Accountable

October 6, 2009

Via Email

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

Re: Proposed Rule 206(4)-5: *Political Contributions by Certain Investment Advisers* File Number S7-18-09

Dear Ms Murphy,

Common Cause and its indicated state chapters, Common Cause/New York, Common Cause New Mexico, California Common Cause, Common Cause Oregon, Common Cause Pennsylvania and Colorado Common Cause, are grateful for the opportunity to comment on Proposed Rule 206(4)-(5). We strongly support the purpose of the proposed rule 206(4)-5 *Political Contributions by Certain Investment Advisers*.

Common Cause is a nonpartisan, grassroots organization dedicated to restoring the core values of American democracy, reinventing an open, honest and accountable government that serves the public interest, and empowering ordinary people to make their voices heard in the political process. Founded with 4,000 core members in 1970 to serve as a people's lobby, Common Cause has grown into a nationwide network of more than 400,000 members and supporters, with offices in 36 states and Washington, D.C.

One of our core initiatives at both the state and federal levels is to curb the excessive influence of money on government decisions and elections and illuminate the connections between lobbying money coming in and government expenditures going out.

Common Cause seeks to curb the excessive influence of money on government decisions and elections.

Pay-to-play has not only the potential to compromise an investment adviser's ethical and legal duties under the Investment Advisers Act of 1940, but in several high profile cases across the nation, has already done so, negatively impacting the public perception of government decision making and, in some cases, costing the taxpayer millions of dollars and placing billions of dollars in pension funds at risk.

With chapters in a number of the states hit by pay to play scandals, Common Cause monitors both state and federal policy aimed at tackling this issue.

Corruption violates public trust in politicians and the political process. Government investments should serve the interests of the public, not just a powerful and connected few. However, people are endlessly clever in finding personal profit, so that the challenge in designing appropriate regulations is to ensure that they are broad and flexible enough to discourage those who would "cut corners" in the future and encompass future creative ways to gain influence and pick the public purse.

Recent Cases of Pay-to-Play

New York

In March 2009 New York State indicted Hank Morris, chief political advisor to former New York State Comptroller Alan Hevesi, and David Loglisci, New York State Pension Fund's chief investment officer. It was alleged that Morris and Loglisci extracted campaign contributions for Hevesi and took millions of dollars in fraudulent placement agent fees from companies conducting business or seeking to conduct business before the Comptroller's Office.

In May 2009 New York's Attorney General developed a Code of Conduct banning the use of placement agents by investment firms. To avoid pay-to-play schemes, the Code also prohibits investment firms (and their principals, agents, employees and family members) from doing business with a public pension fund for two years after the firm has made a campaign contribution to an elected or appointed official who can influence the fund's investment decisions.

On September 23, 2009, the New York State Comptroller, who has sole investment authority over billions of dollars in state pension funds, issued an executive order implementing an interim policy, in advance of the proposed SEC rule 206(4)-5, that prohibits the New York State Pension Fund from doing business with any investment adviser who has made a political contribution to the State Comptroller or a candidate for State Comptroller. The Comptroller had already banned the use of third-party placement agents and other paid intermediaries, including lobbyists, from involvement in the investment of New York State Pension Fund assets in April 2009.

The New York City Comptroller administers the nation's largest municipal pension system, with more than $80 billion in assets to invest. As of last year, New York City law limits campaign contributions from firms that do business with the city, including fund managers, to $400 in mayoral and comptroller races. At the behest of the New York City Comptroller, all five City pension funds have suspended the use of the agents, firms and middlemen.

Common Cause/New York strongly endorses the efforts made in New York.

New Mexico

The pay-to-play scandal in New York has caused a ripple effect in New Mexico. In January 2009, Frank Foy, a former chief investment officer at the New Mexico Education Retirement Fund, filed a lawsuit in state court alleging that he was pressured to invest in a company that had given substantial campaign contributions to Governor Bill Richardson. In June 2009, Foy

expanded his suit to incorporate a wide range of additional pay to play allegations that ostensibly led to New Mexico taxpayers being defrauded of tens of millions of dollars. This litigation is ongoing. In April, 2 of New Mexico's public pension funds suspended a private equity fund implicated in the New York pay-to-play scandal. In July, New Mexico's the State Investment Council determined that it will not do business with firms represented by a placement or marketing agent on the proposed investment before the agency, as a result of the scandals in New York. A federal grand jury is seeking records from the New Mexico Educational Retirement Board concerning the pension fund's investments and its relationship to a firm tied to the pension fund scandal in New York. Common Cause New Mexico strongly endorses the proposed rule change as a first step toward removing conflicts of interest from the bodies governing state pension funds.

Substantive Comments

We commend the SEC for its decision to model proposed rule 206(4)-5 upon rules G-37 and G-38 of the Municipal Securities Rulemaking Board ("MSRB") which address pay-to-play practices in the municipal securities markets. Proposed ruling 206(4)-5 appropriately expands upon MSRB G-37 and G-38 to start to address the corruption extant in the aforementioned cases. We believe that it is a strong start in controlling corruption, balancing the rights of the advisors and their executives with the very real detriment to the public which the numerous cases of pay-to-play involving public pension funds and other public entities have caused.

Scope of Rule:

Due to the repeated and persistent nature of pay-to-play problems involving public pension funds, Common Cause believes that the proposed rule should have the widest possible applicability. We do not believe that the rule should be limited solely to advisers required to be registered with the SEC, but should also apply to all advisers exempt under all categories of Advisors Act section 203(b). The impetus to engage in corrupt behavior is not limited by the categories of the Advisors Act.

Classification of Covered Associates:

Due to the extensive network of third parties involved in cases of pay-to-play the SEC is correct to pursue the broad definition "covered associate" in this ruling rather than a narrower drawn definition equivalent to the "municipal financial professionals" covered by MSRB G-37 and G-38. We believe that the scope of the rule is properly calibrated by covering contributions by all executive officers who, as part of their regular duties, perform investment advisory services or supervise someone who performs them. We would oppose any narrowing of this scope. If the rule's scope in this regard is too narrow, we will request that it be amended. However, at this time, we believe that it is appropriate as proposed.

We note that the rule is more narrowly drawn than pay-to-play prohibitions or limitations contained in New York City's campaign finance law which includes in its ambit not only the managers of the company doing business with the government entity but their immediate family members as well. We note that the New York Attorney General's Public Pension Fund Reform Code of Conduct expressly covers contributions by any Related Party or Relative of a Related Party, which is defined to include anyone related by blood or affinity who resides in the same

household. We suggest that the Commission specifically consider whether the language of §275.206(4)-5(d) should be amended to expressly cover family members, or whether the Commission believes that the language, as drafted, is sufficiently broad to include contributions made by family members. Common Cause believes that expressly including family members removes any future difficulties or ambiguities in enforcement.

Indirect Prohibition:

The proposed rule states that contributions can be made indirectly to officials through payments to political parties or PACs. We have found that people are most creative in devising ways around regulation, particularly if there are large sums of money involved. Accordingly, Common Cause agrees that the rule should prohibit anything done by an investment adviser or covered association indirectly, that if done directly, would result in a violation of the proposed rule.

"Look Back" Provision:

We share the Commission's concern that covered advisers would seek to circumvent the rule by hiring individuals shortly after they make significant political contributions if there is no "look back" provision or if the black-out period would be shorter than two years. Accordingly, Common Cause supports the rule as currently drafted. However, we believe that fairness requires that the prohibitions on providing investment advisory services and payments to solicit arise only from contributions and payments made on or after the effective date of the section, and we support this aspect of the proposed rule as well.

De Minimis Exception:

Common Cause believes that the provision to allow contributions up to $250 is accurately calibrated and does not need to be raised. Any amount over $250 could correctly be perceived as an attempt to unduly influence the selection process for an investment adviser. The amount appears properly set to cover the wide range of government entities which would be covered. In contrast, New York City sets the contribution limit for those doing business with the City at $400 for citywide races and $250 for City Council races.

While we strongly support the limitations on the exception for certain returned contributions, we do anticipate that the exception may not be available to all who contribute close to the date of an election, as campaigns are required to close their books fairly promptly after election day in some jurisdictions and may not be permitted to refund the donation, depending on timing. These limitations create, we believe, even more incentive for diligence on the part of covered employees.

Prohibition on Third Party Solicitors of Government Business:

We strongly support this proposed ban. As previously detailed, such prohibitions are already in place in New York. Common Cause believes that the most egregious violations of the public trust in this area have come from placement agents and those seeking finder's fees. The outright ban on their use to deter play-to-play schemes is entirely appropriate.

In reading comments submitted by advisers who have used placement agents, we have been struck by the fact that they do not seem at all to understand that the fact that the placement agent

they employ facilitated their getting around the consultants or staff designated to review all applicants by arranging meetings with board members who could "over-rule" the professionals and retain the commenter is *precisely* the conduct which is objectionable. Facilitating presentations by smaller, minority and women-owned advisors or investment opportunities to a wider number of funds is certainly desirable; facilitating that access through well-connected and highly paid placement agents and finders is not. This is an issue that should be addressed separately. We have great faith in the creativity of both the government entities and the advisors to find better and more appropriate ways to connect and do business. Perhaps what could be considered is an industry-wide application fee from advisors which could be used by investing government entities to hire staff charged with researching and finding the more unusual meritorious investment opportunities. Such staff would be prohibited from receiving gifts from investment advisors and could, perhaps, be rewarded with bonuses tied to the above-market performance of their assets over a 3-5 year period. In any case, such solutions should be separately considered after some experience under the prohibition to determine if there is a problem which should be addressed.

Common Cause would like to take this opportunity to suggest that public funding for the elections of State officials would circumvent the problems of pay-to-play. A voluntary system of publicly funded political campaigns at the federal and state level would help put an end to the culture of endorsements and political favoritism arising in instances such as the pension fund scandals due to outsized campaign contributions from an influential minority.

Yours sincerely,

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Common Cause

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Susan Lerner, Executive Director
Common Cause/New York

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