



February 25, 2011

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

**Re: File No. S7-36-10 & File No. S7-45-10**

Dear Ms. Murphy:

This letter serves as a companion to our February 25, 2011 letter<sup>1</sup> to the Municipal Securities Rulemaking Board (“**MSRB**”) on “**Proposed Rule G-42**”<sup>2</sup> in order to highlight a potential and serious collateral consequence of the interaction of that rule and the Securities Exchange Commission’s (“**SEC**”) rulemakings to implement Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**” or “**the Dodd-Frank Act**”).<sup>3</sup> Specifically, we are concerned that the SEC’s rulemakings unintentionally exclude broker-dealer placement agents—*i.e.*, persons registered with the SEC and the Financial Industry Regulatory Authority (“**FINRA**”) who are engaged in the solicitation of municipal entities for investments in funds (“**BD placement agents**”)—from coverage under a pay-to-play regime.<sup>4</sup> As SIFMA has previously requested from the SEC during the notice-and-comment process for

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<sup>1</sup> Ltr. from SIFMA to Ronald W. Smith, Corporate Sec’y, MSRB (Feb. 25, 2011) (“**SIFMA Rule G-42 Letter**”).

<sup>2</sup> MSRB Notice 2011-04: Request for Comment on Pay to Play Rule for Municipal Advisors (Jan. 14, 2011), *available at* <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-04.aspx?n=1>.

<sup>3</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>4</sup> *See also* Ltr. from SIFMA to Elizabeth M. Murphy, Sec’y, SEC (Jan. 24, 2011) (“**SIFMA Letter on Implementing Amendments**”), *available at* <http://www.sec.gov/comments/s7-36-10/s73610-34.pdf>.

the “**Pay-to-Play Rule**,”<sup>5</sup> we respectfully renew our request that the SEC ensure that BD placement agents are covered by a single, non-duplicative, and jurisdictionally sound pay-to-play regime no later than September 13, 2011.

## I. OVERVIEW OF THE PROBLEM

The SEC’s Pay-to-Play Rule allows investment advisers to pay only (i) their employees or (ii) “regulated persons”—defined to include investment advisers and broker-dealers registered with the SEC and subject to a pay-to-play regime promulgated by the SEC or a pay-to-play regime as strict as the SEC’s—to solicit investment advisory services from a government entity.<sup>6</sup> Under the current compliance deadlines in the Pay-to-Play Rule, investment advisers will not be able to pay “regulated persons” to solicit municipal business unless they are subject to an adequate pay-to-play regime by September 13, 2011.<sup>7</sup> Unlike registered investment advisers, BD placement agents are not yet subject to a pay-to-play regime. When it promulgated the Pay-to-Play Rule, the SEC anticipated that FINRA would develop an appropriate regime for BD placement agents in time to meet the September 13th deadline.<sup>8</sup>

In the Implementing Amendments NPRM,<sup>9</sup> however, the SEC departed from its original approach by proposing to replace the category of “regulated person” in the Pay-to-Play Rule with that of “regulated municipal advisor,”<sup>10</sup> presumably on the theory that the latter category encompasses the former. As the SEC explained, it believes FINRA’s pay-to-play rulemaking is no longer necessary in light of the MSRB’s work on Proposed Rule G-42, which will apply to municipal advisors.<sup>11</sup> But as the SEC has recognized in Municipal Advisors NPRM, the “municipal advisor” definition in Section 975 of the Dodd-Frank Act is in crucial respects narrower than the “regulated person” category in the Pay-to-Play Rule: for example, all affiliated persons—including affiliated BD placement agents—are expressly excluded from the “municipal advisor” definition.<sup>12</sup>

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<sup>5</sup> See Final Rule: Political Contributions by Certain Investment Advisers, 75 Fed. Reg. 41,018 (July 14, 2010) (“**Pay-to-Play Rule**”).

<sup>6</sup> 75 Fed. Reg. at 41,041-42.

<sup>7</sup> *Id.* at 41,051.

<sup>8</sup> *Id.* (“We understand from our staff . . . that FINRA plans to act within the timeframe. . . .”) See also Ltr. from Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA to Andrew J. Donohue, Director, Division of Investment Management, SEC (Mar. 15, 2010).

<sup>9</sup> Rules Implementing Amendments to the Investment Advisers Act of 1940, 75 Fed. Reg. 77,052 (Dec. 10, 2010) (“**Implementing Amendments NPRM**”).

<sup>10</sup> *Id.* at 77,070-72.

<sup>11</sup> *Id.* at 77,071.

<sup>12</sup> Registration of Municipal Advisors 76 Fed. Reg. 824, 831-32 (Jan. 6, 2011) (“**Municipal Advisors NPRM**”). Moreover, in its Municipal Advisors NPRM, the SEC has proposed a

As discussed in our Rule G-42 Letter<sup>13</sup> and our February 22, 2011 letter to the SEC,<sup>14</sup> we do not believe Section 975 of Dodd-Frank covers BD placement agents as “municipal advisors”.<sup>15</sup> We do not repeat the basis for our position here; however, if the SEC ultimately agrees that BD placement agents are not “municipal advisors,” they would not be covered by MSRB Rule G-42 (the pay-to-play rule for municipal advisors) and therefore must become subject to an analogous pay-to-play regime by September 13, 2011. If BD placement agents are not subject to an adequate pay-to-play rule by this date, they may not be paid by investment advisers to solicit government entities (“**the September Problem**”).<sup>16</sup>

The SEC proposes to address the September Problem by presenting BD placement agents with a Hobson’s choice—either “voluntarily” register as “municipal advisors” and subject themselves to the full panoply of requirements for municipal advisors simply to ensure coverage by a pay-to-play regime (MSRB Rule G-42), or withdraw from the pool of permissible solicitors to government entities on behalf of investment advisers.<sup>17</sup> Given the importance of BD placement agent activity, forcing BD placement agents to withdraw from the pool of permissible solicitors is not a viable option.<sup>18</sup> And effectively requiring BD

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definition of “municipal advisor” that would include unaffiliated BD placement agents. *Id.* But as we discuss in our February 22, 2011 letter (at 18-20, 23-26) to the SEC, the statutory definition of “municipal advisor” does not extend to BD placement agents because persons soliciting municipal entities for investments in funds are not soliciting advisory business within the meaning of the statute. In the event that the SEC determines that unaffiliated BD placement agents are not covered municipal advisors, then the MSRB’s Proposed Rule G-42 would not apply to them.

<sup>13</sup> See *supra* note 1.

<sup>14</sup> Ltr. from SIFMA to Elizabeth M. Murphy, Sec’y, SEC (Feb. 22, 2011) (“**SIFMA Letter on Municipal Advisors NPRM**”).

<sup>15</sup> See SIFMA Letter on Municipal Advisors NPRM at 23-26 & SIFMA Rule G-42 Letter at 4-6.

<sup>16</sup> See Pay-to-Play Rule, 75 Fed. Reg. at 41,018.

<sup>17</sup> See Municipal Advisors NPRM, 76 Fed. Reg. at 831-32; see also Implementing Amendments NPRM, 75 Fed. Reg. at 77,070-72.

<sup>18</sup> Municipal entities regularly rely on BD placement agents to access management and advisory services. See, e.g., Ltr. from SIFMA to Elizabeth W. Murphy, Sec’y, SEC 13 (Oct. 5, 2009), available at <http://www.sec.gov/comments/s7-18-09/s71809-166.pdf> (commenting on the SEC’s pay-to-play proposal) (“As the Chief Investment Officer of the Missouri State Employees Retirement System stated, ‘limiting the role of placement agents would reduce our ability to access some of the best managers throughout the world and ultimately result in lower investment returns for our members.’ Moreover, ‘without the efforts of legitimate placement agents, mid-sized and smaller pension funds would not have known about a number of excellent fund opportunities, especially those from foreign, emerging and women and minority-owned investment funds.’”). During the notice-and-comment period for the Pay-to-Play Rule, the SEC received a significant number of letters attesting to the market benefits of BD placement agents. See Pay-to-Play Rule, 75 Fed. Reg. at 41,021, 41,038 (noting many comments that discussed “valuable services” BD placement agents “provide . . . for advisers seeking clients and for the public pension plans that employ them”).

placement agents to register as municipal advisors is unnecessary to solve the September Problem, and would impose upon them substantial new registration, recordkeeping, and regulatory requirements even though Congress has not required it.

## II. ENSURING BD PLACEMENT AGENTS ARE SUBJECT TO A SOUND PAY-TO-PLAY REGIME

SIFMA has strongly supported and, indeed, has been asking for a pay-to-play regime specific to BD placement agents. Since the proposal of the Pay-to-Play Rule, our paramount concern is that BD placement agents are subject to an appropriately tailored, non-duplicative, and jurisdictionally sound pay-to-play rule by September 13, 2011. We also submit that the regulatory scheme should not be premised on voluntary decision-making by the regulated community, which opens the door to regulatory arbitrage and fractured, inconsistent regulatory regimes.<sup>19</sup> We therefore request that the SEC take the necessary steps to ensure that an appropriate regulatory authority—*i.e.*, one with jurisdiction over all BD placement agents (both affiliated and non-affiliated)—promulgates a single mandatory and consistent pay-to-play rule for BD placement agents.

Given the MSRB's regulatory experience with Rule G-37, and its current role in promulgating G-42, it would be a logical agency to promulgate a pay-to-play regime for BD placement agents. It is not clear, however, that Congress has delegated to the MSRB authority (i) to promulgate rules for BD placement agents who are engaged in the sale of non-municipal securities to a government entity or (ii) to regulate persons who "voluntarily" register as municipal advisors.<sup>20</sup> This lack of clarity creates potential jurisdictional problems as well as a possibility of regulatory gaps; for example, it is undisputed that *affiliated* BD placement agents are not "municipal advisors" under Section 975 of Dodd-Frank. Accordingly, as the SEC has recognized, unless affiliated BD placement agents "voluntarily" register as municipal advisors, they will not be covered by a pay-to-play rule.<sup>21</sup>

While SIFMA supports developing a pay-to-play regime for BD placement agents, we do not believe that an approach which requires parties to subject themselves to full municipal advisor status merely to ensure that they are

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<sup>19</sup> Consistent and mandatory regulatory requirements may also address the concerns of state-based regulators who are considering state-based placement agent regulation.

<sup>20</sup> In our view, the SEC does not have authority to require BD placement agents to register as municipal advisors in order to continue their businesses because Congress determined that BD placement agents are not municipal advisors. *See supra* note 15. *See also, e.g., Mich. v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001) ("if there is no statute conferring authority, a federal agency has none"). We recognize, of course, that some entities may continue in their present temporary registration status or register as a municipal advisor for the first time in order to continue their businesses after September 13th.

<sup>21</sup> Municipal Advisors NPRM, 76 Fed. Reg. at 831-32 & n.104.

subject to pay-to-play regulation represents an appropriate solution. BD placement agents are already subject to stringent regulation by the SEC and FINRA with respect to their solicitation activities, including but not limited to rules and regulations addressing sales practices and just and equitable principles of trade limitations. Compelling BD placement agents to register as municipal advisors, thereby subjecting themselves to potentially onerous, duplicative, and conflicting registration, recordkeeping, and regulatory requirements largely unrelated to their activities, would be unnecessary and unduly burdensome. For example, there is a potential that municipal advisor professional reporting and regulatory requirements will be overlaid on the reporting and regulatory requirements imposed on the Series 7 registered representatives who place fund interests,<sup>22</sup> who are already required among many other things to submit and keep current a Form U-4. Similarly, with respect to affiliated solicitors, the requirements are duplicative to Form ADV.

If the SEC concludes that the MSRB neither has (nor can be delegated) the authority to promulgate a single pay-to-play rule for all BD placement agents, we believe the appropriate solution would be for the SEC (or FINRA) to promulgate a pay-to-play rule for BD placement agents. Both the SEC and FINRA clearly have jurisdiction to promulgate a single pay-to-play rule for BD placement agents. Subjecting BD placement agents to a single pay-to-play rule, and municipal advisors to the MSRB's Rule G-42, would result in an appropriately tailored pay-to-play regime that would avoid unnecessary and potentially onerous, duplicative, and conflicting regulation.<sup>23</sup>

Regardless of the regulator involved, however, we strongly urge that the SEC ensure that a regulatory gap does not force BD placement agents to have to choose between submitting to a potentially inapplicable regulatory regime or withdrawing from an already regulated line of business on September 13, 2011.<sup>24</sup> Such an unintended consequence of the SEC's attempt to harmonize its rules with Dodd-Frank would decrease the pool of available solicitors and thus significantly reduce the amount of investment opportunities for municipal entities and inhibit

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<sup>22</sup> See SIFMA Letter on Municipal Advisors NPRM at 39-40.

<sup>23</sup> FINRA and the MSRB are both self-regulatory organizations subject to oversight by the SEC, and their rules must be approved by the SEC. Thus, the SEC has both the authority and means to ensure comparability and consistency of the application of a pay-to-play rule if action by the two organizations is deemed necessary to accomplish the goal of covering BD placement agents with a pay-to-play regime.

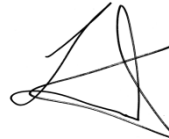
<sup>24</sup> If necessary, the SEC could extend the September 13, 2011 deadline to allow for additional consideration of the potential jurisdictional and coordination problems discussed here, provided it ensures that BD placement agents may continue to solicit municipal entities on behalf of investment advisers until such extended deadline.

the ability of small and mid-size investment funds to solicit municipal investment.<sup>25</sup>

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Please do not hesitate to contact me with any questions at (212) 313-1130, or Marin Gibson, SIFMA Managing Director and Counsel, at (212) 313-1317; or Barbara Stettner and Charles Borden, of O'Melveny & Myers LLP, at (202) 383-5283 and (202) 383-5269, respectively.

Sincerely,

A handwritten signature in black ink, appearing to be 'L. Norwood', written in a cursive style.

Leslie M. Norwood  
Managing Director and  
Associate General Counsel

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<sup>25</sup> These concerns were raised and addressed by the SEC in its Pay-to-Play rulemaking. *See supra* note 18.

cc: The Honorable Mary L. Schapiro, Chairman  
The Honorable Kathleen L. Casey, Commissioner  
The Honorable Elisse B. Walter, Commissioner  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Troy A. Paredes, Commissioner  
Robert Cook, Director, Division of Trading and Markets  
James Brigagliano, Deputy Director, Division of Trading and Markets  
David Shillman, Associate Director, Division of Trading and Markets  
Martha Haines, Assistant Director and Chief, Office of Municipal Securities  
Victoria Crane, Assistant Director, Office of Market Supervision  
Robert Plaze, Associate Director, Division of Investment Management

Lynnette Hotchkiss, Executive Director, Municipal Securities Rulemaking Board