To	Marcia E. Asquith Office of the Corporate Secretary Financial Industry Regulatory Authority 1735 K Street NW Washington, DC 20006-1506 **Submitted by electronic mail:** pubcom@finra.org
Date	December 22, 2014
Subject	FINRA Regulatory Notice 14-50

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("**SIFMA**" or "**we**")[1] is grateful for the opportunity to comment on Proposed Rules 2271,[2] 2390,[3] and 4580[4] (together, the "**Proposed Rules**"), issued for comment in Regulatory Notice 14-50 by the Financial Industry Regulatory Authority ("**FINRA**").[5] SIFMA has long supported efforts to combat "pay-to-play" practices[6] and appreciates the extent to which the Proposed Rules are harmonized with Rule 206(4)-5 of the Securities and Exchange Commission (the "**SEC**") under the Investment Advisers Act of 1940, as amended (the "**SEC Pay-to-Play Rule**").[7] Our comments below are focused on those aspects of the Proposed Rules that diverge from the SEC Play-to-Play Rule.

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, please visit www.sifma.org.

[2] Proposed FINRA Rule 2271 ("**Proposed Rule 2271**").

[3] Proposed FINRA Rule 2390 ("**Proposed Rule 2390**").

[4] Proposed FINRA Rule 4580 ("**Proposed Rule 4580**").

[5] FINRA Requests Comment on a Proposal to Establish a 'Pay-to-Play' Rule, FINRA Regulatory Notice 14-50, (Nov. 14, 2014), available at: http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p601679.pdf ("**Regulatory Notice 14-50**").

[6] *See*, *e.g*., Comment Letter of SIFMA to Elizabeth Murphy, Sec'y, SEC (Oct. 5, 2009), *available at* http://sec.gov/comments/s7-18-09/s71809-166.pdf (the "**2009 Letter**").

[7] Political Contributions by Certain Investment Advisers, Final Rule, Investment Advisers Act Release No. IA-3043, 75 Fed. Reg. 41018, 41019 (Jul. 14, 2010) ("**SEC Pay-to-Play Final Release**"). The SEC Pay-to-Play Rule is set forth in Rule 206(4)-5, Political Contributions by Certain Investment Advisers, 17 C.F.R. § 275.206(4)-5 (2014), under the Investment Advisers Act of 1940, as amended, 15 U.S.C. § 80b-1 *et seq*. (2012) (the "**Advisers Act**").

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The SEC Pay-to-Play Rule includes a provision that prohibits an investment adviser and its covered associates from "provid[ing] or agree[ing] to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of such investment adviser unless such person is a *regulated person*..." (emphasis added).[8] On account of the SEC Pay-to-Play Rule's expanded definition of "investment advisory services," this prohibition applies to parties soliciting a government entity both (i) to enter into an advisory relationship and (ii) to purchase an ownership interest in a pooled investment vehicle, and accordingly would prevent a FINRA member from engaging in either type of solicitation activity unless it qualified as a "regulated person."[9] A FINRA "covered member"[10] qualifies as a "regulated person" for purposes of the SEC Pay-to-Play Rule to the extent that FINRA adopts its own pay-to-play rule that the SEC deems to impose restrictions on covered members that are substantially equivalent to or more stringent than, and otherwise consistent with the objectives of, the SEC Pay-to-Play Rule (the "**Regulated Person Requirement**").[11]

The Regulated Person Requirement is scheduled to take effect on April 1, 2015.[12] If FINRA covered members are not subject to an SEC-approved pay-to-play rule by that time, they will be effectively banned from engaging in solicitation activity covered by the SEC Pay-to-Play Rule.[13] We agree with FINRA that a disruption of these solicitation activities would be harmful not only to the covered members themselves but also to the investment advisers and government entities that rely on them,[14] resulting in higher costs for investment advisers, reduced investment opportunities for government entities, and an overall decrease in the "allocative efficiency" of capital markets.[15] Given the limited time remaining before the April 1 effective date, we believe that it would be imprudent to include provisions in this rulemaking that are neither required by, nor necessary to effectuate, the Regulated Person Requirement.

We therefore recommend that FINRA (i) eliminate Proposed Rule 2271 or, at a minimum, remove it from this rulemaking for consideration on a separate track, (ii) harmonize key terms appearing in both the Proposed Rules

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[8] 17 C.F.R. § 275.206(4)-5(a)(2)(i).

[9] Although the Advisers Act does not extend to brokerage activities, the SEC Pay-to-Play Rule provides that "an investment adviser to a covered investment pool in which a government entity invests or is solicited to invest [is] treated as though that investment adviser were providing or seeking to provide investment advisory services directly to the government entity." 17 C.F.R. § 275.206(4)-5(c). The SEC Pay-to-Play Rule defines "covered investment pool" as (i) any registered investment company "that is an investment option of a plan or program of a government entity" or (ii) any entity that would be a registered investment company but for its reliance on an exclusion under Sections 3(c)(1), 3(c)(7), or 3(c)(11) of the Investment Company Act of 1940, as amended, 15 U.S.C. § 80a-1 *et seq*. (2012). 17 C.F.R. § 275.206(4)-5(f)(3). The Proposed Rules use the same definition of "covered investment pools" as the SEC Pay-to-Play Rule and otherwise mirror the SEC Pay-to-Play Rule's approach. *See* Proposed Rule 2390(e); Proposed Rule 2390(h)(3); Proposed Rule 2271(c) (stating that "the terms used in [Proposed] Rule 2271 shall have the same meaning as defined in [Proposed] Rule 2390")); Proposed Rule 4580(c) (stating that "the terms used in [Proposed] Rule 4580 shall have the same meaning as defined in [Proposed] Rule 2390").

[10] "Covered member" is defined for purposes of the Proposed Rules as "any [FINRA] member except when the member is engaging in activities which would cause the member to be a municipal advisor." Proposed Rule 2390(h)(4). Solicitations of government entities with respect to investment advisory relationships by a FINRA member on behalf of an unaffiliated investment adviser are regulated by the municipal advisor rules set forth under Section 15B(e)(4) of the Securities Exchange Act of 1934, as amended (the **"Exchange Act"**). 15 U.S.C. § 78o-4(e)(4); 17 C.F.R. § 240.15Ba1-8. FINRA members that must register as municipal advisors as a result of engaging in such third-party solicitation activity are not subject to the Proposed Rules. *See* Regulatory Notice 14-50, at 4. Covered members therefore fall into three general categories of government entity solicitors: (i) broker-dealers soliciting investment in a covered investment pool on behalf of an affiliated investment adviser, (ii) broker-dealers soliciting investment in a covered investment pool on behalf of an unaffiliated investment adviser, and (iii) broker-dealers soliciting investment advisory relationships on behalf of an affiliated investment adviser. Categories (i) and (ii) involve brokerage activity, *i.e*., the solicitation of a security, and are accordingly governed by the Exchange Act and the rules thereunder (including FINRA rules). In contrast, category (iii) involves advisory activity, *i.e*., the solicitation of a fiduciary investment advisory relationship, which is governed by the Advisers Act and the rules thereunder.

[11] Under the Regulated Person Requirement, a FINRA member qualifies as a "regulated person" if "(A) [FINRA rules] prohibit members from engaging in distribution or solicitation activities if certain political contributions have been made; and (B) the [SEC], by order, finds that such rules impose substantially equivalent or more stringent restrictions on broker-dealers than [the SEC Pay-to-Play Rule] imposes on investment advisers and that such rules are consistent with the objectives of [the SEC Pay-to-Play Rule]." 17 C.F.R. § 275.206(4)-5(f)(9)(ii).

[12] By rule, the Regulated Person Requirement takes effect nine months after the compliance date of a final rule establishing registration requirements for municipal advisors. *See* Advisers Act Release No. 3418, 77 Fed. Reg. 35263 (June 13, 2012). The SEC adopted the final municipal advisor rule on September 20, 2013, with a compliance date of July 1, 2014. Exchange Act Release No. 70462, 78 Fed. Reg. 67468 (Nov. 12, 2013). April 1, 2015 falls nine months after July 1, 2014. *See* Regulatory Notice 14-50, at 3.

[13] *See* Regulatory Notice 14-50, at 12 ("FINRA must propose its own pay-to-play rule to enable member firms to continue to engage in distribution and solicitation activities for compensation with government entities on behalf of investment advisers.").

[14] *Id*.

[15] *Id*. *See also* 2009 Letter, at 9.

and the SEC Pay-to-Play Rule, (iii) harmonize the recordkeeping requirements of Proposed Rule 4580 and the SEC Pay-to-Play Rule, and (iv) remove the mandatory disgorgement provision from Proposed Rule 2390.

I. FINRA SHOULD NOT IMPOSE THE PROPOSED DISCLOSURE REQUIREMENTS

As a threshold matter, the rationale for including Proposed Rule 2271 in the present rulemaking is unclear, since, as noted above, Proposed Rule 2271's disclosure requirements are unrelated to FINRA's primary objective of putting into place a FINRA pay-to-play regime by the April 1, 2015 deadline. No other federal pay-to-play rule, including the SEC Pay-to-Play Rule, imposes similar disclosure obligations on covered parties, and FINRA has not explained why a different approach is necessary here.[16] Indeed, in adopting the Regulated Person provision, the SEC determined that a disclosure regime would be ineffective in addressing pay-to-play concerns. In particular, in response to commenters who had suggested adoption of a disclosure regime in lieu of the proposed blanket ban on payments to solicitors, the SEC noted that disclosure is not "…useful when plan fiduciaries themselves are participants in the pay-to-play activities" and that "the [Municipal Securities Regulatory Board ("**MSRB**") ha[s] already sought *unsuccessfully* to address the problem of placement agents and consultants engaging in pay to play activities on their principals' behalf through mandating greater disclosure" (emphasis added).[17] Furthermore, it is not apparent that Proposed Rule 2271 is necessary for purposes of investor protection. Broker-dealers are already subject to numerous investor protection-related disclosure and conduct requirements that apply to the solicitation activity covered by Proposed Rule 2271,[18] and Regulatory Notice 14-50 does not fully examine why additional disclosures are needed beyond what is already required for a broker-dealer selling a security to, or soliciting an investment advisory relationship with, a government entity.

Proposed Rule 2271 also presents insurmountable legal and operational challenges. First, the proposed disclosure requirements—and especially the "relationship" disclosure requirement of Proposed Rule 2271(a)(6)—are unworkable in light of their scope, timing, and requirement for rolling disclosure updates. Second, Proposed Rule 2271 is neither tailored to deal with the variations in the multiple business lines that will be subject to the proposed disclosure requirements nor sufficiently considers overlapping and related regulated regimes.

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[16] FINRA observes in a footnote to Regulatory Notice 14-50 that "the SEC imposes similar disclosure requirements [to Proposed Rule 2271] in connection with cash payments by investment advisers to solicitors with respect to solicitation activities," citing Advisers Act Rule 206(4)-3, 17 C.F.R. § 275.206(4)-3 (2014) (the "**Cash Solicitation Rule**"). Regulatory Notice 14-50, at n. 56. As discussed below, however, the proposed disclosure requirements are significantly broader than the disclosures required under the Cash Solicitation Rule and, in particular, include a "relationship" disclosure obligation that is not part of that rule. More importantly, we note that—in contrast to Proposed Rule 2271—the Cash Solicitation Rule only applies to the fiduciary context of the solicitation of investment advisory relationships and has no application to brokerage transactions. We therefore encourage FINRA to refrain from applying the Cash Solicitation Rule's rationale and objectives indiscriminately to disclosure obligations for parties engaged in typical broker-dealer activities, such as the sale of interests in covered investment pools, at least until such time as FINRA and other interested parties have duly considered the consequences of this conflation of the separate regulatory regimes normally applicable to investment advisers and broker-dealers. To the extent that FINRA seeks to impose disclosure obligations on covered members that solicit or refer investment advisory relationships, SIFMA has no objection to maintaining consistency with the Cash Solicitation Rule for such activity.

[17] SEC Pay-to-Play Final Release, at 41039. *See also* Comment Letter of the Investment Company Institute to Marcia E. Asquith, Office of the Corp. Sec'y, FINRA (Dec. 15, 2014), at 4 ("**ICI Letter**").

[18] *See*, *e.g.*, Securities Act of 1933, 15 U.S.C. § 77q(b) (2012) (making it unlawful for any person to use jurisdictional means to "publish, give publicity to, or circulate any notice, circular, advertisement, newspaper article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof"); SEC Rule 10b-5, Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2014) (making it unlawful for any person to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading"); SEC Rule 10b-10, Confirmation of Transactions, 17 C.F.R. § 240.10b-10 (2014) (requiring disclosure of "specified information in writing to customers at or before completion of a transaction," including the name of any entity on whose behalf the broker-dealer is acting and details as to any remuneration received or to be received by the broker-dealer); SEC Rule 206(4)-3, Cash Payments for Client Solicitations, 17 C.F.R. 275.206(4)-3 (requiring a separate written disclosure document to be furnished by solicitors with respect to solicitation of advisory relationships on behalf of an investment adviser); FINRA Rule 2010 (requiring FINRA members to "observe high standards of commercial honor and just and equitable principles of trade"); FINRA Rule 2020 (prohibiting FINRA members from "effect[ing] any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance"); FINRA Rule 2210 (setting forth standards governing the content, approval, recordkeeping, and filing of retail and institutional communications for the duration of the retention period required by SEC Rule 17a-4).

SIFMA accordingly believes that Proposed Rule 2271 should be eliminated in its entirety. If FINRA is inclined to proceed with promulgating Proposed Rule 2271, however, SIFMA would ask, at a minimum, that the considerable burdens and ambiguities associated with Proposed Rule 2271 be ameliorated by decoupling the rule from the other Proposed Rules for later consideration and substantial modification via a separate rulemaking process.

A. The scope, timing, and updating requirements of Proposed Rule 2271 preclude effective implementation of the rule.

Proposed Rule 2271 would impose extraordinary burdens on covered members, which would be exacerbated by the timing and updating requirements of the rule. The required disclosures must be made "in writing" and "at the time of the initial distribution or solicitation on behalf of each investment adviser."[19] Covered members must also "update in writing…any material changes to the information previously provided to the government entity…within 10 business days of the date of such change" during "any period in which [such covered member] is engaging in the distribution or solicitation activities for compensation with a government entity on behalf of an investment adviser."[20] When combined with the broad scope and ambiguous text of Proposed Rule 2271, these requirements as to the manner and timing of disclosures along with the requirement for rolling disclosure updates would make compliance with Proposed Rule 2271 unworkable.

Compliance with Proposed Rule 2271 requires the preparation of lengthy, tailored, and written disclosures. Perhaps the most burdensome of the proposed disclosure requirements is Proposed Rule 2271(a)(6), which would mandate that a covered member disclose at the time of first solicitation "the existence and details of any pecuniary, employment, business or other relationships between the covered member or any covered associate and any person affiliated with the government entity that has influence in the decision-making process in choosing an investment adviser."[21] The breadth of this provision is only increased by the lack of a limiting principle. The degree of separation necessary to establish such "relationships" is unclear, as the rule text leaves undefined the terms "pecuniary," "employment," or "business" and includes a virtually unlimited savings clause to cover all "other relationships." Our experience with various state law disclosure regimes highlights the administrative complexities involved with policing the boundaries of human relationships.[22] FINRA has given no indication as to how broadly or narrowly covered members are meant to interpret Proposed Rule 2271(a)(6). Does a "pecuniary" or "business" relationship exist where a covered associate's brother patronizes a restaurant owned by a government affiliate's wife? Does an "employment" relationship exist where a government official began his career as an employee of the covered member? Does an "other relationship" exist where the children of a covered associate and government affiliate attend the same university? To comply with such a rule would necessitate substantial due diligence research as to the "pecuniary, employment, business or other" relationships (however defined) of each covered associate employed by a covered member.

After mapping this network of relationships, a covered member would then have to cross-check the list against a list of associates of government entities possessing the requisite degree of "influence in the decision-making process in choosing an investment adviser." Determining this list of "influencers" is not necessarily a fact subject to immediate or obvious confirmation in all cases and would itself require an ongoing due diligence process. For example, while the chief investment officer of a state employee pension fund may generally be

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[19] Proposed Rule 2271(a)

[20] Proposed Rule 2271(b).

[21] Proposed Rule 2271(a)(6).

[22] A handful of jurisdictions (*e.g*., Virginia Retirement System, North Carolina Retirement System) have begun to require more narrow and tailored "relationship"-related disclosure obligations than those required under Proposed 2271(a)(6). Because these disclosures obligate covered members to assess, monitor, and make legal representations concerning the professional and personal relationships between individuals affiliated with the covered members and individuals affiliated with government entities, however, compliance with even these more narrow and tailored regimes involves substantial administrative and compliance burdens. Moreover, these burdens would be substantially magnified under Proposed Rule 2271, which, unlike the state and local regimes, would require such "relationship"-related disclosures to be made at the time of the initial solicitation, a requirement that we consider to be unworkable.

presumed to be an "affiliated person" with the necessary degree of "influence," other pension fund employees may present a more ambiguous case. Yet Regulatory Notice 14-50 provides no indication of whether, and to what extent, covered members are under an obligation to perform such diligence or even submit pre-solicitation inquiries to government entities. Compounding this difficulty, each time that the covered member employs a new covered associate or the "influencers" within a government entity change, this process must be repeated and committed to a new written document along with the other disclosures required by the rule.

All of the above preparatory due diligence activity must be completed *ex ante*, that is, prior to the first meeting with any covered affiliate of a government entity, since a covered member's disclosure document must be maintained current for use at the time of "initial distribution or solicitation." "Initial solicitations" may take many forms, including, for example, chance encounters at public events. In our experience, potential customers would almost certainly be reluctant to sign an acknowledgment of receipt of such disclosures so early in the investment process, as opposed to at the time of closing or the execution of the advisory agreement, as is common in most state or entity-level disclosure regimes.[23]

A simple numerical example may help to illustrate these burdens. Suppose that a covered member employs 10 covered associates, whose mandate is to place fund interests with 50 state employee pension funds. Suppose further that the covered member had through due diligence determined that each such pension fund employed 10 persons with the requisite degree of influence over the investment adviser selection process. The relationship mapping phase in this stylized example would, at a minimum, require the covered member to ascertain the nature of 5,000 separate bilateral relationships between covered associates and affiliates of government entities. Each of these bilateral relationships would be analyzed according to the vague and ill-defined categories discussed above and could conceivably involve highly complex networks of hundreds or thousands of individuals, depending on the definitions of "pecuniary," "employment," "business," and "other" relationships. If the covered member were mandated to place interests of 10 different funds managed by 10 separate investment advisers, thus requiring disclosure of 10 different compensation arrangements, the number of possible permutations of the disclosure document would soon become astronomical. No two disclosure documents would be alike; thus, covered members would not be in a position to prepare a uniform set of disclosures for general use. Each of these permutations would need to be carried in some form, presumably electronic, in the back pockets of each of the covered associates in any context in which such covered associates might potentially engage in a solicitation of a government entity.

Next, pursuant to the updating requirements of Proposed Rule 2271(b), the covered member would be obligated to establish compliance policies to account for the addition of new covered associates or the real-time creation of new "relationships," cross-referenced against an updated list of government entity "influencers." Where, for example, the covered member discovers that one of its covered associates has established a "relationship" with a government entity influencer, the covered member would then be under an obligation to provide a revised and updated disclosure document to any affected government entity within 10 business days, on a rolling basis, for the duration of the "distribution or solicitation" period. This requirement could have a particularly long tail if the distribution or solicitation period were interpreted to be coextensive with the full period of the engagement. Not only would such a requirement be so burdensome as to be unworkable for the covered member, government entities across the country would be inundated with duplicative and essentially meaningless disclosure documents from every covered member with whom they do business.

Other provisions of Proposed Rule 2271 are similarly unworkable. For example, Proposed Rule 2271(a)(4) would require covered members engaged in covered brokerage activity to disclose the terms of any "compensation arrangement" with an investment adviser on whose behalf the member solicits government

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[23] *Id.*

entities, as well as "a description of the compensation paid or to be paid" to the member.[24] A covered member soliciting government entities to invest covered investment pools, however, regularly makes solicitations that involve multiple covered investment pools, with the covered member subject to a different compensation arrangement with respect to each covered investment pool. Requiring tailored disclosure of each of these compensation arrangements at the time of initial solicitation adds considerably to the complexity of implementing Proposed Rule 2271 and also exposes covered members to potentially severe competitive effects.[25] Moreover, the term "compensation" is not defined for purposes of Proposed Rule 2271(a)(4), and it is therefore unclear what qualifies as compensation for purposes of the rule. For example, would "compensation" include the reimbursement of a covered member's solicitation-related expenses by an investment adviser? Would it include the payment of fees for general back-office and administrative support in connection with marketing a particular fund? Nor is it clear what level of detail is required in connection with the obligation to disclose the "terms" of a compensation arrangement. Would it be sufficient to provide a general description that a covered member is paid on a basis of total assets raised, or would Rule 2271 require a fee schedule that specifies the fee ratio to be paid for each tier of assets raised and that indicates how much has been raised to date?

SIFMA would argue that, in light of the extensive SEC, FINRA, state, and entity-level disclosure regimes to which broker-dealers are already subject, the further disclosures mandated by Proposed Rule 2271 are unnecessary, duplicative, and potentially confusing to the recipient government entities. The compliance costs of the regime established by Proposed Rule 2271 would create a strong incentive for broker-dealers to exit the market for government entity placements, thus denying government entities access to a competitive market for placement agent services and limiting the opportunities of these entities to invest public resources profitably and efficiently. The implementation challenges outlined in this section become exponentially greater when the variety of covered business lines and overlapping or related regulatory regimes at the federal, state, or local levels are taken into account, as detailed in the following section.

B. The proposed disclosure requirements do not fully account for the variety of business lines affected and the numerous overlapping and related regulatory regimes.

Proposed Rule 2271 also should be eliminated in light of the fact that (i) the rule takes a one-size-fits-all approach to disclosure when covered members will engage in a wide range of activities that will be subject to the Proposed Rules and (ii) covered members will need to implement these requirements against the backdrop of a regulatory landscape that imposes inconsistent and contradictory requirements. As a consequence, SIFMA is concerned that Proposed Rule 2271 would impose indiscriminately broad requirements, and that such requirements would not be tailored to different business contexts nor harmonized with other applicable legal requirements.

First, Proposed Rule 2271 would demand identical disclosures from all business lines subject to the rule, without regard to the wide range of circumstances in which members solicit government entities on behalf of investment advisers. For example, Proposed Rule 2271 would require uniform disclosures from broker-dealers acting on behalf of affiliates and those acting on behalf of third parties, from covered members that assist advisers to obtain business through a formal procurement process and those that engage in "cold-calling" of government entities, and from placement agents soliciting new business and those that are seeking to obtain the extension of existing contracts. SIFMA believes that the context of a solicitation should inform the need for particular

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[24] Proposed Rule 2271(a)(4). Although the Cash Solicitation Rule includes a similar compensation disclosure obligation for parties soliciting investment advisory relationships on behalf of third parties, no comparable disclosure requirement presently exists for any of the categories of government entity solicitor principally covered by the Proposed Rules. *See supra* note 16.

[25] In addition, as noted above, broker-dealers—including those soliciting government entities to invest in covered investment pools—are already subject to numerous disclosure obligations, including obligations to disclose their compensation to investors. These obligations, however, do not apply at the point of solicitation. *See supra* note 18.

disclosures. We note that certain state disclosure regimes have accordingly been tailored to account for the circumstances in which particular solicitations are made.[26] Similarly, at the federal level, broker-dealers who solicit *investment advisory relationships* on behalf of affiliated and third-party investment advisers are currently covered by the Cash Solicitation Rule, which is designed to address the potential conflicts of interest that may arise in compensated solicitations of fiduciary relationships.[27] Moreover, the SEC tailored the Cash Solicitation Rule's disclosures to distinguish between affiliated and third-party solicitations.[28] The lack of any such tailoring in Proposed Rule 2271 increases the compliance burdens for covered members while simultaneously reducing the informational value of the proposed disclosures for government entities.

Second, Proposed Rule 2271 does not fully account for the dense regulatory landscape in which the proposed disclosure requirements will operate. In addition to the federal securities laws and state and local disclosure regimes discussed above,[29] there are other regulatory regimes that either regulate the solicitation activity covered by the Proposed Rules or related conduct. These regimes should be examined and addressed in assessing the costs, benefits, and likely effectiveness of Proposed Rule 2271. Put simply, the proposed disclosure requirements have not been harmonized or otherwise limited to account for these disclosure regimes, which both overlap with and diverge from Proposed Rule 2271.[30] As a result, in many instances, covered members will be required to make a number of different disclosures relating to the same activity, each of which is required at a different time and using different regulatory definitions. For example, a number of covered members may solicit both governmental plans and retirement plans subject to the Employee Retirement Income Security Act of 1974 ("**ERISA**")[31] to include a specific registered investment company as a plan option. Those members are required to make detailed compensation and conflict disclosures pursuant to the Department of Labor's regulation under ERISA Section 408(b)(2) when doing business with ERISA retirement plans, and—although governmental plans are not subject to ERISA—many governmental plans affirmatively request such disclosures.[32] Thus, in practice, Proposed Rule 2271 may result in the provision of multiple sets of disclosures to a governmental plan in connection with a single transaction.

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[26] For example, although the California state public pension law requires disclosure of payments to persons who qualify as "placement agents" with respect to state and local retirement systems, it excludes from that obligation any individual who is (i) an employee, officer, director, equityholder, partner, member, or trustee of an external manager and (ii) who spends one-third or more of his or her time, during a calendar year, managing the securities or assets owned, controlled, invested, or held by the external manager (known as the "portfolio manager" exception). *See* Cal. Gov. Code §§ 7513.85 (requiring a retirement board to adopt a policy requiring the disclosure of payments to placement agents), 7513.8 (providing a definition of "placement agent"). The law imposes additional disclosure obligations on "placement agents" by requiring them to register as state lobbyists and to make disclosures under the state lobbying law prior to soliciting a state retirement system, and also requiring them to comply with applicable local lobbying laws. *See* Cal. Gov. Code §§ 7513.86, 7513.87. With respect to these lobbying-related disclosure requirements, the law includes an exception for certain solicitations made in the context of a competitive bidding process, and other exclusions may apply depending on the circumstances. *See* Cal. Gov. Code § 82047.3(b) (providing an exception to state lobbying registration tied to participation in a competitive bidding process), 7513.87(b) (providing a similar exception to the local lobbying requirement); *see also* California Fair Political Practices Commission Advice Letter No. I-11-015 (Apr. 7, 2011) (discussing a further exception to lobbyist registration and reporting for an individual who accompanies a registered placement agent to provide further information in meetings with public pension fund representatives on no more than an occasional basis).

[27] *See generally*, Mayer Brown LLP, SEC No-Action Letter (July 28, 2008) (noting further that "investors in investment pools (as such) do not typically enter into investment advisory contracts with the investment advisers of the pools").

[28] Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Final Rule, Investment Advisers Act Release No. IA-688, 44 Fed. Reg. 42126, 42128 (Jul. 18, 1979) ("In light of the comments, the Commission has concluded that the objective circumstances surrounding all employees of the adviser and certain close affiliates are such as to ensure that prospective clients would be aware of the solicitor's bias. As long as a client is aware that the recommended adviser is the solicitor's employer or a close affiliate of the solicitor's employer, there appears to be little need to require the imposition of additional disclosure and recordkeeping requirements regardless of the specific duties of the solicitor."). Although we understand the temptation to extend the Cash Solicitation Rule beyond the solicitation of advisory relationships and have it apply to all of the solicitation activity covered by the Proposed Rules, the Cash Solicitation Rule has never been applied to brokerage activity and more consideration is required to determine whether such a regime is appropriate in the brokerage context. *See supra* notes 10 and 16.

[29] *See supra* notes 18 and 22.

[30] Although Regulatory Notice 14-50 briefly touches on the application of the Proposed Rules to an entity registered as a broker-dealer, municipal advisor, and investment adviser, noting that such an entity "should follow the rules that apply to the services it is performing," Regulatory Notice 14-50 at n. 21, this limited statement only focuses on one area of potential regulatory overlap and does not address how Proposed Rule 2271 may interact with or affect other, non-pay-to-play-related regulatory obligations to which covered members are subject.

[31] 29 U.S.C. § 1001 *et seq*. (2012).

[32] 29 C.F.R. § 2550.408b-2.

SIFMA is concerned that this will result in high compliance costs for covered members and confusion on the part of government entities, which will be left to reconcile the divergent and seemingly contradictory statements that covered members are required to provide under different regimes. In our view, the lack of harmonization or consideration of the existing legal landscape further calls into question the need for new disclosure requirements.

C. If not eliminated in its entirety, Proposed Rule 2271 should at a minimum be considered via a separate rulemaking process, so as to allow a fuller consideration of the rule and to avoid disrupting the adoption of Proposed Rule 2390.

As FINRA has explained, the purpose of the current rulemaking is to adopt a "pay-to-play rule to enable member firms to continue to engage in distribution and solicitation activities" with government entities once the Regulated Person Requirement becomes effective.[33] Proposed Rule 2271 is unrelated to this goal and would moreover impose novel and complex disclosure requirements without precedent in other federal pay-to-play rules, including the SEC Pay-to-Play Rule. Given the unprecedented nature of the proposal, FINRA has not had the benefit of an administrative record on whose basis it can assess the legal and operational issues discussed in this letter, nor have FINRA members had an adequate opportunity to consider the potential burdens of the rule.[34]

We are furthermore concerned that consideration and implementation of Proposed Rule 2271, which is not required for purposes of the Regulated Person Requirement, could potentially interfere with the adoption of Proposed Rule 2390, which clearly *is* required at this time. As stated above, the SEC Pay-to-Play Rule provides that a broker-dealer may qualify as a "regulated person," but only to the extent that the broker-dealer is a "member of a national securities association" that has adopted rules that "prohibit members from engaging in distribution or solicitation activities if certain political contributions have been made."[35] In addition, the SEC must, by order, find that the association's rules "impose substantially equivalent or more stringent restrictions" on broker-dealers than the SEC Pay-to-Play Rule imposes on investment advisers.[36] Proposed Rule 2271 is not necessary to satisfy either requirement, and if the rule is eventually included in a proposed rulemaking by the SEC in accordance with its obligations under the Administrative Procedure Act,[37] we expect that the rule will be subject to considerable public comment, threatening a delay of Proposed Rule 2390.

Consequently, we respectfully request that, if FINRA decides to proceed with promulgating Proposed Rule 2271, it do so via a separate rulemaking process not subject to the Regulated Person Requirement's April 1, 2015 deadline.

II. FINRA SHOULD CONFIRM THAT KEY TERMS IN THE PROPOSED RULES HAVE THE SAME MEANING AS THOSE IN THE SEC PAY-TO-PLAY RULE

The Proposed Rules use several undefined or ambiguous terms that are identical to terms used in the SEC Pay-to-Play Rule. We therefore request confirmation that the terms "distribution," "covered associate," "executive officer," and "indirect contribution" as used in the Proposed Rules bear the same meaning as those terms have for purposes of the SEC Pay-to-Play Rule.[38]

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[33] Regulatory Notice 14-50, at 12.

[34] In addition, as noted above, the limited administrative record from the SEC Pay-to-Play Rule rulemaking indicates that disclosure requirements would not be "useful" in furthering pay-to-play goals. *See* SEC Pay-to-Play Final Release, at 41039.

[35] 17 C.F.R. § 275.206(4)-5(f)(9)(ii).

[36] *Id.* at §275.206(4)-5(f)(9)(ii)(B).

[37] 5 U.S.C. § 500 *et seq*. (2012).

[38] *See* ICI Letter, at 3.

"Distribution"

The term "distribution" is used in multiple provisions of Proposed Rule 2271 and is critical to the Proposed Rules generally—indeed, the term appears in the titles of each of the Proposed Rules and repeatedly throughout their substantive provisions. For example, Proposed Rule 2271 mandates that "a covered member engaging in *distribution* or solicitation activities for compensation with a government entity on behalf of one or more investment advisers shall, at the time of the initial *distribution* or solicitation on behalf of each investment adviser, disclose to such government entity in writing (which may be electronic) [certain] information with respect to each investment adviser" (emphasis added).[39] Several of the required disclosures also make reference to a "covered member…engaging in *distribution* or solicitation activities" (emphasis added).[40] The requirement to update such disclosures on a rolling basis similarly applies "during the period in which [the covered member] is engaging in *distribution* or solicitation activities…" (emphasis added).[41] Nevertheless, FINRA has provided neither an explicit definition nor guidance as to the interpretation of the term "distribution." By contrast, the definition of "solicit" in Proposed Rule 2390 makes specific reference to "investment advisory services."[42] Our understanding is that the phrase "distribution and solicitation," as used in the SEC Pay-to-Play Rule, is interpreted to mean "the solicitation of investment advisory services."[43] In the interests of harmonization, we would request that FINRA clarify that for purposes of the Proposed Rules, the phrase "distribution and solicitation" pertains exclusively to the solicitation of investment advisory services and that the scope of the Proposed Rules is coterminous with the SEC Pay-to-Play Rule.

"Covered Associate"/"Executive Officer"

The term "covered associate" is used throughout the Proposed Rules and, importantly, in Proposed Rule 2271(a)(6), which sets forth the "relationship" disclosure requirement discussed above. As noted by FINRA in Regulatory Notice 14-50,[44] Proposed Rule 2390(h)(2) is consistent with the SEC Pay-to-Play Rule in defining "covered associate" to mean, *inter alia*, "any general partner, managing member[,] or *executive officer* of a covered member..." (emphasis added).[45] The term "executive officer," however, is not defined in Proposed Rule 2390. We would request that FINRA include the definition of "executive officer" from the SEC Pay-to-Play Rule in Proposed Rule 2390(h)'s list of defined terms.

"Indirect Contribution"

SIFMA also requests that FINRA confirm that the term "indirect contribution" as used in the Proposed Rules has the same meaning as the equivalent term in SEC Rule 204-2(a)(18)(i)(C).[46]

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[39] Proposed Rule 2271(a).
[40] *See* Proposed Rule 2271(a)(1), (2), (4), (5).
[41] Proposed Rule 2271(b).
[42] Proposed Rule 2390(h)(10) ("Solicit means (A) with respect to *investment advisory services*, to communicate, directly or indirectly, for the purpose of obtaining or retaining a client for, or referring a client to, an investment adviser….") (emphasis added).
[43] 17 C.F.R. § 275.206(4)-5(f)(9)(ii).
[44] *See* Regulatory Notice 14-50, at n. 34.
[45] Proposed Rule 2390(h)(2).
[46] SEC Rule 204-2(a)(18)(i)(C), Books and Records to be Maintained by Investment Advisers, 17 C.F.R. § 275.204-2(a)(18)(i)(C) (2014) (requiring books and records containing a list of "all direct or *indirect contributions* made by the investment adviser or any of its covered associates to an official of a government entity, or direct or indirect payments to a political party of a State or political subdivision thereof, or to a political action committee" (emphasis added)).

III. THE RECORDKEEPING REQUIREMENTS OF PROPOSED RULE 4580 SHOULD BE REVISED TO ELIMINATE RECORDKEEPING OBLIGATIONS WITH RESPECT TO UNSUCCESSFUL SOLICITATIONS

Proposed Rule 4580 requires that covered members engaged in distribution or solicitation activities create and maintain books and records pertinent to Proposed Rules 2271 and 2390, including records of "all government entities with which the covered member has engaged in distribution or solicitation activities."[47] SIFMA does not believe that recordkeeping requirements should extend to unsuccessful solicitations where the covered member receives no compensation because maintaining such records would impose significant costs on covered members with little corresponding benefit. Indeed, a similar provision in the proposed SEC Pay-to-Play Rule was specifically rejected on those grounds.[48]

Under the SEC Pay-to-Play Rule, the SEC requires investment advisers to maintain records of all "government entities to which the investment adviser provides or has provided investment advisory services, or which are or were investors in any covered investment pool to which the investment adviser provides or has provided investment advisory services."[49] Thus, the SEC Pay-to-Play Rule requires recordkeeping only with respect to *successful* solicitations. The SEC initially considered a broader recordkeeping requirement that would have required investment advisers to "maintain lists of government entities solicited that do not become clients,"[50] but ultimately removed the proposed requirement from the final rule. In so amending the proposal, the SEC acknowledged the concerns of some commenters that "solicitation does not trigger [the] two-year time out [provision of the SEC Pay-to-Play Rule], rather it is providing advice for compensation that does so."[51] In addition, we note that there are numerous existing FINRA recordkeeping rules pursuant to which communications with government entities must already be maintained.[52]

Similarly, Proposed Rule 4580(a) is not necessary to supervise member firms' compliance with Proposed Rule 2390. Proposed Rule 2390(a) would prohibit member firms from "engag[ing] in distribution or solicitation activities for compensation with a government entity" within two years of a covered contribution.[53] Solicitations for which a member firm does not receive compensation do not implicate the rule, and therefore recordkeeping obligations with respect to unsuccessful solicitations are unnecessary. Accordingly, SIFMA respectfully requests that Proposed Rule 4580(a) be modified to read as follows:

> The name and business address of all government entities with which the covered member has engaged in distribution or solicitation activities *for compensation* on behalf of an investment adviser within the past five years, but not prior to [insert the effective date of the Rule].

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[47] Proposed Rule 4580(a).
[48] SEC Pay-to-Play Final Release, at 41050.
[49] SEC Rule 204-2(a)(18), 17 C.F.R. § 275.204-2(a)(18).
[50] SEC Pay-to-Play Final Release, at 41050.
[51] *Id*.
[52] *See*, *e.g*., SEC Rule 17a-4(b)(4), Records to be Preserved by Certain Exchange Members, Brokers, and Dealers, 17 C.F.R. § 240.17a-4(b)(4) (2014) (requiring preservation of copies of all external communications relating to a broker-dealer's securities or investment banking business); FINRA Rule 2210(b)(4) (requiring FINRA members to maintain all retail communications and institutional communications for the duration of the retention period required by SEC Rule 17a-4); FINRA Rule 3110 (requiring the establishment of supervisory procedures for the review of incoming and outgoing written (including electronic) correspondence relating to a member's investment banking or securities business); FINRA Rule 4511 (requiring that members "make and preserve books and records as required under the FINRA rules [and] the [Exchange Act and rules thereunder]").
[53] Proposed Rule 2390(a).

IV. THE DISGORGEMENT REMEDY OF PROPOSED RULE 2390(a) SHOULD NOT BE MANDATORY

Where a covered member violates Proposed Rule 2390(a)'s prohibition on certain compensated distribution or solicitation activities within two years of a covered contribution,[54] Proposed Rule 2390(b)(2) imposes a disgorgement remedy that prohibits "such covered members…from receiving any compensation or other remuneration pertaining to, or arising from [such] distribution or solicitation activities from (A) the investment adviser or covered investment pool advised by the investment adviser on whose behalf the covered member was soliciting…; or (B) the government entity solicited by the covered member on behalf of the affected investment adviser…."[55] The provision also mandates payment of any such compensation or remuneration in accordance with a strict "waterfall" of parties in order of payment priority.[56]

While disgorgement is the almost universal remedy for violations of various pay-to-play rules, SIFMA is concerned that making application of the remedy mandatory could have the deleterious effect of dissuading covered members from voluntary disgorgement of fees where such members discover pay-to-play violations themselves.[57] Moreover, specifying the precise waterfall of payment priorities may in some cases lead to perverse outcomes and windfalls, as the disgorged compensation would not be paid to the party that generally is responsible for paying placement agent fees, namely, the investment adviser itself. We encourage FINRA to leave application of the remedy and the question of payment priority open to be decided on a case-by-case basis, thus reducing opportunities for gaming or unjust enrichment of third parties.

Proposed Rule 2390(b)(2) prohibits the receipt of "any compensation or other remuneration *pertaining to, or arising from*" the distribution or solicitation activities of the covered member (emphasis added).[58] It is unclear from the text of Proposed Rule 2390(b)(2) precisely what "compensation or other remuneration" is subject to the disgorgement penalty. Historically, under other pay-to-play rules, only fees collected in connection with the violative conduct, however defined, have been subject to disgorgement, not other fees or remuneration that may have a tangential connection to the conduct in question.[59] We therefore request similar treatment under Proposed Rule 2390(b)(2): only fees collected directly in connection with the solicitation of a government entity in violation of Proposed Rule 2390(a) should be subject to disgorgement. This would exclude any other compensation or remuneration that may be received by a covered member that is arguably "pertaining to, or arising from" its solicitation activities.

V. FINRA SHOULD REVISIT ITS COST-BENEFIT ANALYSIS OF THE PROPOSED RULES

While SIFMA believes that addressing pay-to-play practices that undermine the merit-based selection of investment advisers by government entities is an important and laudable effort, FINRA appears to have dramatically understated the compliance costs that the Proposed Rules would impose on covered members.

In describing the expected costs of implementing the Proposed Rules, FINRA identifies a number of factors that are expected to affect compliance costs, including "the number of covered associates, business models of

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[54] Proposed Rule 2390(a). For the reasons discussed above, and in the interest of harmonization with the SEC Pay-to-Play Rule, we would request that FINRA clarify that "distribution and solicitation activities" refers only to the solicitation of investment advisory services.
[55] Proposed Rule 2390((b)(1).
[56] Proposed Rule 2390(b)(2) (specifying the order of payment as "(A) a covered investment pool in which the government entity was solicited to invest, as applicable; (B) the government entity; (C) any appropriate entity designated in writing by the government entity if the government entity or covered investment pool cannot receive such payments; or (D) the FINRA Investor Education Foundation if the government entity or covered investment pool cannot receive such payments and the government entity cannot or does not designate in writing any other appropriate entity.").
[57] *See also*, ICI Letter, at 5.
[58] *Id*.
[59] *See*, *e.g.*, T.L. Ventures, Inc., Advisers Act Release No. 3859 (June 20, 2014); Goldman, Sachs & Co., Exchange Act Release No. 67934 (Sept. 27, 2012). *See also* ICI Letter, at 5.

member firms and the extent to which their compliance procedures are automated, whether the covered member is (or is affiliated with) a registered investment adviser subject to the SEC Pay-to-Play Rule, and whether the covered member is a registered municipal securities dealer and thus subject to [Municipal Securities Rulemaking Board] pay-to-play rules."[60] FINRA also states that "a small covered member with fewer covered associates may expend fewer resources to comply with the [Proposed Rules] than a large covered member."[61] On the assumption that the Proposed Rules are consistent with the SEC Pay-to-Pay Rule, FINRA's estimate of the compliance costs of the Proposed Rules is based on the SEC's own compliance cost estimates. In that rule, the SEC estimated such costs for "smaller firms" (fewer than 5 covered associates), "medium firms" (between 5 and 15 covered associates), and "larger firms" (more than 15 covered associates).[62] The SEC estimated that initial compliance costs for smaller firms, medium firms, and larger firms would be $2,352, $29,407, and $58,813, respectively. The SEC also estimated that annual, ongoing compliance expenses for such firms would be $2,940, $117,625, and $235,250, respectively.

SIFMA believes that these estimates do not accurately reflect the true compliance costs associated with the Proposed Rules, and particularly the costs associated with the disclosure requirements of Proposed Rule 2271, which does not have a corresponding provision under the SEC Pay-to-Play Rule. As discussed above, the Proposed Rules are in fact far more stringent and extensive than is required in order to comply with the Regulated Person Requirement. Proposed Rule 2271 exposes covered members to an enormous and ongoing compliance burden with respect to the relationship mapping of their covered associates. This burden correlates strongly with the size of the covered member, such that a larger firm with many covered associates and thousands of "relationships" will be subject to exceedingly burdensome mapping and disclosure obligations. Even for smaller firms, which may lack in-house marketing units, the costs associated with staffing an internal team to monitor and maintain updated disclosures will in many cases be prohibitive. These substantial costs are further justification for eliminating Proposed Rule 2271 or, at a minimum, for removing it from this rulemaking for separate consideration. We therefore urge FINRA to revisit its cost-benefit analysis of the Proposed Rules, with a particular focus on the costs of Proposed Rule 2271.

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SIFMA appreciates this opportunity to comment on the Proposed Rules. Should you have any questions regarding our analysis or recommendations, please do not hesitate to contact me at (212) 313-1317 or mgibson@sifma.org, or contact our counsel Barbara Stettner (Tel.: (202) 683-3850; E-mail: barbara.stettner@allenovery.com) and Charles Borden (Tel.: (202) 683-3852; E-mail: charles.borden@allenovery.com) of Allen & Overy LLP.

Respectfully submitted,

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[60] Regulatory Notice 14-50, at 13.
[61] *Id*.
[62] *Id*. at 14.