



3PM

THIRD PARTY MARKETERS ASSOCIATION

April 21, 2010

Mr. Lawrence M. Schloss
Chief Investment Officer
Office of the Comptroller
City of New York
1 Centre Street
New York, NY 10007

Dear Mr. Schloss,

We would like to thank you and your colleagues for taking the time to meet with myself and Frank Minard on April 5, 2010 to discuss 3PM's concerns regarding the NYC Comptrollers Office's proposed Placement Agent Policy.

Subsequent to our meeting, we have received some comments and questions from members of the City's Pension Boards regarding your revised proposal and the Association's position on the specifics contained therein. Having reviewed a copy of this policy I would like to provide you with the following feedback.

In our original letter to your office, we stated our concerns about two particular sections of the proposed policy. The first concern involved the requirement that Placement Agents and Third Party Marketers be registered with the SEC or FINRA. Our issue with this provision stemmed from the fact that Third Party Marketers who are working with Registered Investment Advisers offering products through separate accounts would be eliminated from the process since there was no mechanism for them to register with either the SEC or FINRA. We are pleased to see that in the proposal, the staff extended the registration requirement to include registration with the State of New York as an investment adviser and that these third party marketers are no longer excluded from participating in the investment process.

Our second issue was the requirement that "Placement Agents and Marketers show that they have raised \$500 MM in at least two of the past three years from entities other than New York City pension funds." In our initial letter we mentioned that such a restriction would make it extremely difficult for small placement agents and third party marketers who represented emerging and minority owned firms to meet such a hurdle given the state of the economy and the diminishing level of search activity in the past three years. We also discussed that the criteria was adversely exclusionary to marketers representing long-only managers, a factor that could endanger the success of the City's current emerging manager program.

In our meeting, you mentioned that, in part, your rationale for such a requirement was to differentiate legitimate placement agents from those who are not providing a value added service. We are in total agreement with your assessment that there has to be a way to identify those that are operating legal and ethical businesses and were pleased to see that the proposed policy made a distinction between true placement agents and individuals known as finders. Notwithstanding this, we did express our views that determining whether a placement agent was legitimate is determined through means other than assets raised in a given period. We also do not believe that the extension of the asset based requirement to include an additional year alleviated the concerns we have for those working with private equity or real estate funds. As such, we suggested that experience, licensure and other qualifying information could be used to supplement an asset based requirement while still achieving the original objective, an idea that seemed to be well received by your staff when it was proposed. In this regard, we believe this aspect of the proposal remains deficient.

Finally, we were shocked to see language stating that placement agents would not be able to receive a fee that was “contingent on a commitment from the System.” This was the first time we had heard anything about the City’s plan to prohibit the use of contingency fees. We have never seen such a provision for doing business with the City of New York mentioned anywhere in the press. Certainly, had it been a topic for discussion at the time of our personal meeting, we would have expressed our grave concerns. As for similar legislation proposed in other states, the Association vehemently disagrees with a ban on contingency fees and we have redoubled our efforts to try to stop such a ban from being enacted. Since we were not aware of this restriction at the time we met with you and were not able to voice our concerns on this matter, now we feel we must go on record and make you aware of our position as it relates to contingency fees.

A Ban on Contingency Fees is a Ban on Placement Agents

While the Comptroller’s Office is attempting to avoid banning placement agents from the investment process, we believe the result of their approach is likely to lead to unintended consequences. The current proposal would prohibit placement agents from accepting a fee that is “contingent on a commitment from the System.” If contingency fees are eliminated, placement agents would need to restructure their entire compensation structure to comply with this rule. If this policy is passed, it is likely that the only acceptable form of payment would be in the form of a flat fee. Most emerging managers lack the resources to pay a placement agent a flat fee or a “retainer” since much of their capital is allocated to the facilities and personnel required to manage portfolios.

If contingency fees were prohibited, we believe the consequences would harm both small and emerging funds and the NYC Pension Plan. First, since most small and emerging managers would have difficulty paying a fixed fee, their access to public pension funds would decrease. Second, given the large universe of available funds, it is likely that the Pension Funds will not have enough staff to evaluate the wide array of investment options presented to them.

We believe the restriction on contingency fees will drive opportunity away from New York City. Placement agents working with more compelling managers will steer those managers towards other

investors, creating an adverse selection process that will likely hurt the investment returns achieved by the NYC Retirement System. Finally, since placement agents assist many investors by screening managers that are not a good fit for an investor's portfolio, a bias will likely develop for NY whereby the System will either continue to invest with existing managers, or place bigger amounts of money with managers because they do not have the bandwidth to properly assess and evaluate new offerings, resulting in an investment bias toward larger funds, which we believe runs counter to prudent investment strategy.

Contingent compensation arrangements help to align interests among all of the parties involved in the fund manager selection process. Placement agents need to make good manager choices, or they won't be successful or get paid. Managers win because they only have to pay a placement agent based on the results the placement agent is able to achieve. This type of fee structure also assists investors. Placement agents serve as a filter that weeds out managers not worthy of investment and narrows down the universe of managers which they need to review.

The manner in which placement agents are currently compensated is no different than any success-based compensation program. Contingency fees are used in a variety of industries as a way to incentivize service providers, align the interests of various parties and share the risks involved in processes with uncertain outcomes. Throughout the United States, contingent fee arrangements are used to compensate lawyers, real estate agents, brokers and sales professionals. They are also commonplace in the investment arena including many New York state government agencies, where they are used as part of the compensation package for portfolio managers, investment analysts, traders and of course for sales professionals. The critical point for consideration should not be focused on the form of the payment, but rather on three key elements: i) knowing who is being incented, ii) making sure that the person or organization is legitimate and is providing an actual service, and iii) providing transparency as to how any such payment could influence investment decisions.

Often contingency fees are used by pension plans and other investors, in the form of performance fees, to try to garner high returns from the investment managers they hire. The thought behind this kind of fee structure is that the more incentive the portfolio manager has to generate returns the harder he or she will work to attain that stated goal, creating a win-win situation for all parties involved.

It should also be noted that when a contingency fee is paid to a placement agent, the fee is not paid by the investors, but rather by the investment manager retaining the placement agent's services. This approach is no different than the compensation an internal sales professional would receive. In fact, by hiring a placement agent, an investment manager could actually save money by reducing the overhead costs allocated to full-time employees. These funds could then be allocated to other areas of their businesses which could help achieve higher investment returns.

Sales and marketing are essential to growing most businesses regardless of industry. The cost for this imperative resource is generally chalked up to the cost of doing business. We believe by prohibiting contingency fees, the NYC is in fact dictating the manner in which an investment manager can run their business, simply because a handful of political officials acted badly.

Without contingency fees, investment managers will need to find other ways to grow their assets or risk going out of business. Some may resort to unethical approaches and use loopholes to get around the rules. Managers, who “game” the system by finding alternative ways to get paid higher fees if business is awarded, will be further injuring the integrity of the investment process rather than improving it.

We believe that the NYC Comptrollers Office’s proposal favors larger funds, funds capable of affording to allocate resources to internal infrastructure. This policy is problematic not only to the investment management firm, but also to the pension plans hiring them. This will result in a natural bias toward larger funds which can afford such an allocation of resources, and runs counter to many NYCERS policies which encourage the pension plan to invest in minority and emerging managers. For smaller firms, unable to hire dedicated sales personnel, portfolio managers will now have to split their time between managing portfolios and their new sales and marketing function. It is likely that they will also need to spend time learning how to market their products, identifying the appropriate contacts, scheduling meetings, as well as creating presentations and other collateral materials required by the sales process, all of which will take away from their primary responsibility, to manage the monies given to them to achieve maximum returns. As fiduciaries, pension plans should want to see their portfolio managers spending as much of their time as possible on investments, rather than travelling around the country attending sales meetings. Whether you realize this or not, this is the behavior that your placement agent policy will engender.

While we are all in agreement that change is necessary, it is evident that we believe that there are different routes to get to the same destination. If you have any questions or comments regarding 3PM’s position please feel free to contact either of us.

Regards,



Donna DiMaria
President
Third Party Marketers Association



Frank Minard
Chair of the Strategy Committee
Third Party Marketers Association

cc: Thad Mctigue
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