



3PM

THIRD PARTY MARKETERS ASSOCIATION

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Position Paper Regarding A Ban on the Use of Third Party Marketers

Recent events call into question the use of placement agents and other paid intermediaries by private equity firms. The essence of the allegations goes to the integrity of the process followed when making investment decisions. In some jurisdictions, the official reaction to these events has resulted in an all-encompassing ban on the use of these intermediaries. This action is grossly unfair to the vast majority of independent brokers and other sales and marketing professionals who operate in an ethical manner and who follow the regulatory rules and regulations currently in place. This ban also provides a disservice to investment advisors and general partners who have chosen this proven sales approach to effectively introduce their products to, among others, large public fund investors. Moreover, investors should have access to the best managers, some of whom are represented by these intermediaries either by necessity or by design.

The Third Party Marketing Association (“3PM”) neither condones nor defends any of the alleged behavior. It is our position that the decision making process was compromised as it unfairly affected the investment managers who were denied fair and equal consideration in their efforts to provide investment services. Further, this compromise, which favored relationships rather than merit, also disadvantaged the Pension Plan retirees’ interests.

Third Party Marketers and Other Intermediaries

Recent press regarding Placement Agents and other intermediaries fails to distinguish between the services provided by a variety of different individuals and/or organizations. The single common denominator is that all receive compensation from an investment manager whether that manager’s strategy is private equity, hedge funds or publicly traded securities.

Placement agents, solicitors, finders and lobbyist all function as agents of an investment manager. It is the investment manager that pays for the service, which generally does not represent any added cost to the investor. This manner of compensation is no different than any success-based compensation program, whether it applies to third parties or internal employees, or whether it applies to marketers, sales personnel, portfolio managers or traders. Financial markets are driven by incentive compensation. Clearly the critical point for consideration is to understand who is being incited and how that influences investment decisions.

For the purpose of this paper, we will use the term “third party marketer” to encompass the myriad of terms used to describe these paid intermediaries. The term “investment manager” will be used to collectively include firms or individuals that oversee the management of client assets in a specified investment strategy. This group includes registered investment advisors, fund managers as well as managers that do not legally require registration with the SEC, FINRA or other governing bodies.

Most third party marketers provide investment managers with value added sales and marketing services. A third party marketer's role is much more than merely arranging a meeting between an investment manager and potential investors. In fact, most third party marketers aid in identifying the most appropriate target market for the investment manager's products and identify which distribution channels would be most effectively and efficiently utilized. Third party marketers also help their investment managers position their products in what has become a very competitive industry, and spend a great deal of time creating and drafting marketing materials such as presentation books, RFPs (Requests for Proposals), due diligence questionnaires and other collateral materials used in the sales and marketing process. In addition to arranging meetings, third party marketers create meeting agendas, organize required materials, and moderate the meetings along with the investment manager ensuring the clarity of the manager's message while focusing on the investment objectives of each potential investor. Frequently, the job doesn't end there. Once the investment manager has been selected, the third party marketer may have an ongoing client servicing role which helps to facilitate communication between the investment manager and the potential investor.

The Third Party Marketing Association (3PM)

The Third Party Marketers Association began in 1998 with seven member firms. Today, the international Association is comprised of more than 75 member firms. 3PM was formed to maintain a standard of excellence in the industry and to share information and ideas among independent sales and marketing firms. The Association helps to cultivate relationships and business opportunities among its members, and works to provide them with information and on-going education about the investment management industry. 3PM's goal is to enhance our profession's standards, integrity and business practices. This is accomplished by advancing ongoing agendas such as regulatory compliance and adherence to the highest standards and best practices applied throughout the financial services industry.

A typical 3PM member firm consists of two to five highly experienced investment management marketing executives with, on average, 10+ years experience of selling success in the institutional and/or retail distribution channels. The Association's members run the gamut in terms of the products they represent. Approximately 50% work with traditional separate account managers covering strategies such as domestic and international equity, as well as fixed income. In the alternative arena, members represent fund products such as mutual funds, hedge funds, private equity, fund of funds and real estate. More than two-thirds of 3PM's members offer both types of product offerings.

Opposition to the Ban on the use of Third Party Marketers

3PM believes a general ban on the use of legitimate third party marketers is an unreasonable and unjustified response that affects an entire industry segment as a result of the alleged illegal misconduct of a few. This response is wrong-minded for several reasons:

- It tarnishes the image, perception and reputation of the vast majority of third party marketers who are professional, ethical and provide invaluable services to stakeholders who include investment managers, potential investors and consultants.

- It introduces inefficiencies into the investment process that will effectively limit access to investment opportunities from investment managers who may not have adequate resources to directly approach potential investors.
- Most importantly, this approach inadvertently reduces the transparency needed to promote greater integrity in the investment decision making process by the pension fund's staff.

3PM urges those investors who have instituted such a ban to develop policies and procedures that can effectively monitor the conduct of all parties involved in the process and appropriately identify individual interests that may negatively influence investment policies and practices. If this is accomplished, these new policies will reinforce and augment the investment process, and better define the rules for disclosure.

Efficiency and Effectiveness

The universe of potential investments has expanded dramatically over the past decade, with an ever-expanding world of potential strategies, vehicles and managers. It is estimated that during 2008, more than 1,200 private equity and real estate funds went to market in an attempt to actively raise capital. Conservatively, this represents less than one-third of the total number of alternative investment managers that will be looking to raise capital during the next three years. In addition, there are thousands of registered investment advisors and hedge fund managers also seeking capital investments.

As a practical matter, it is unreasonable to expect all of these investment managers will have the experience, staff, or marketing acumen to adeptly represent themselves to institutional investors as they try to raise assets. It is also unrealistic to expect any Pension Fund's internal investment staff will have sufficient people to interview, conduct due diligence on, and effectively evaluate the myriad of investment opportunities available in the marketplace. Given these realities, the investment opportunities most likely to be missed or dismissed will be those offered by first time or emerging managers, minority managers or funds that are focusing on new and upcoming sectors or geographies. Classic examples would include investments in emerging markets, venture capital, clean technology, infrastructure, socially and/or economically targeted investments, and the like. This constraint could also deprive the funds of investments that would be additive to the funds' overall investment strategies, thereby increasing the rate of return ensuring retirement security for the plan participants and perhaps lower taxes for the state's taxpayers.

Any ban on the use of third party marketers also provides a disservice to investment managers who chose this proven sales approach to effectively introduce their products to, among others, large public fund investors. Moreover, Investors should have access to the best managers, and some of those are represented by intermediaries either by necessity or by design.

While third party representation does carry the recognition that a primary relationship exists between the investor and the investment manager, this concern should be tempered by the recognition that a third party marketer does not typically represent a product that is not competitive, or of institutional quality. To do so would result in a failed business strategy in both the near and long term. To this extent, the third party marketer and investor have a common ground, i.e., finding appropriate products in which an institution may invest.

Regulatory Framework

The issues experienced by a few pension plans are a grave disappointment to all third party marketers who have, and continue to, aspire to maintain the integrity of our industry. The majority of third party marketers comprising this industry conduct themselves ethically and within the parameters of the current legal framework. Despite the problems that have occurred, it is encouraging to know the current regulatory framework does work, and that wrong-doing by a very small percentage of the overall industry can be uncovered and corrected.

The fundamental issue raised by the current discussions is one of integrity in the decision making process of pension funds. This is an issue going beyond a few individuals and one segment of the investment industry. This reaches into the overall regulatory framework governing the offering of investment products and most importantly into the governance and oversight provisions designed and implemented by the investors themselves.

While 3PM believes the current regulatory environment has been generally effective, it should be noted that third party marketers are not governed by a single set of rules or by a single authority. In effect, there are three different groups providing oversight in this process. The difficulty arises because there is generally no consistently applied approach across jurisdictions, asset classes or investment strategies.

The SEC and FINRA provide oversight for a variety of investment functions under the Securities Acts of 1933 and 1934, and through the Investment Advisors Act of 1940. These oversight functions require registration by, and monitoring of, a variety of investment activities offered by broker dealers and registered investment advisers. It is important to note the majority of these regulations do not extend to investment firms who are engaged in private placements.

A second level of oversight is provided by each State's regulatory authority. Generally, this group's oversight is intended to protect individual investors who are residents within a given State. It is important to note that many, if not most, of the States have not adopted a uniform regulatory code, with the result that requirements are not consistent among and between jurisdictions. Furthermore, many States have enacted regulations providing exemptions or exclusions from registration to investment managers with a deminimis number of clients, usually less than six, or for firms focused solely on institutional investors. As a result, many investment managers, placement agents and third party marketers are not registered in a particular State because they are not required to be.

The third level of oversight is provided by the institutional investor itself. Often pension plans will implement their own rules and regulations that may or may not correspond to the rules enacted by the SEC, FINRA or the States. This is the case in the ban on the use of third party marketers. While the SEC, FINRA and the States all have rules in place which provide oversight to a third party marketer's behavior, the pension plans can determine whether or not to even permit managers to use the services of third party marketers. Additionally, while the State and Federal Regulators provide third party marketers with disclosure requirements, pension plans are now electing to put their own disclosure requirements in place rather than working within the regulatory rules and guidelines currently in place.

While this inconsistency in requirements does not excuse or justify inappropriate behavior, it does clearly suggest the underlying issue of integrity and fair dealing is not the simple result of a failure to register with appropriate authorities. Rather, it reflects a more fundamental issue of disclosure, monitoring and management of the investment decision making process and the need for consistency by those with oversight.

While improvements always need to be considered, a ban on the use of third party marketers essentially removes the great majority of the safeguards noted earlier. Rather than increase the transparency of the process, the ban makes the process more opaque, and leaves the responsibility for compliance to individual investment firms which may not be regulated and may not be subjected to oversight, audits, and the like. Rather than increase visibility, the ban removes the marketing and sales process from constant scrutiny provided through this oversight and will likely lessen confidence in the investment process.

Conclusion

Third party marketers contribute to the investment process by making it more efficient and effective. For this reason, 3PM believes the ban on the use of third party marketers unfairly and unnecessarily impacts an entire industry, the majority of who conduct themselves in an ethical, professional and legally compliant manner. Such a ban will also result in the unintended consequence of limiting the universe potential opportunities investors have to consider and could negatively impact the investor by decreasing the plan's overall rate of return, undermining the retirement security of the plan's participants and raising taxes for the State's taxpayers. Furthermore, such a ban is likely to have the opposite result of what it was supposed to do which is to make the sales and marketing process more transparent, easier to monitor and instill investor confidence in the process.

3PM fully endorses a framework that increases the integrity of the investment decision making process. 3PM urges institutional investors to develop meaningful policies and procedures that can effectively monitor the conduct of all parties (transparency) and can appropriately identify individual interests that may influence investment policies and practices (disclosure). The changes required should include enough transparency to identify those who will receive compensation from investment activities and disclose the interests they have in recommending such investments. It should also require disclosure by any individual or firm that has made campaign contributions or participated in a political campaign of any state officer who participates in the investment process.

Rather than pursuing an avenue of dismissal and avoidance, investors should pursue policies and procedures that increase transparency from all parties involved with the clear goal of improving the investment process, the resulting portfolio, and most importantly investment performance. Moreover, it is our belief these policies should take into consideration some of the disclosure requirements already enacted by the SEC, FINRA and the state regulatory authorities which are currently being followed by third party marketers.

Published by:

The Third Party Marketers Association

191 Clarksville Road

Princeton Junction, NJ 08550

www.3PM.org

For more information please contact:

Kaitlin Friedmann

Manager, Public Relations

(609) 297-2215

kfriedmann@cmasolutions.com