

**MEMO# 24911**

January 27, 2011

## **ICI Comment Letter on Proposed Changes to Form ADV and Amendments to Pay-to-Play Rule**

[24911]

January 27, 2011

TO: CHIEF COMPLIANCE OFFICER COMMITTEE No. 4-11  
CLOSED-END INVESTMENT COMPANY MEMBERS No. 11-11  
FIXED-INCOME ADVISORY COMMITTEE No. 11-11  
INVESTMENT ADVISER MEMBERS No. 4-11  
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 4-11  
SEC RULES MEMBERS No. 19-11  
SMALL FUNDS MEMBERS No. 11-11 RE: ICI COMMENT LETTER ON PROPOSED CHANGES TO FORM ADV AND AMENDMENTS TO PAY-TO-PLAY RULE

The Institute has filed a comment letter on the Securities and Exchange Commission's proposed changes to Form ADV and amendments to the pay-to-play rules. [\[1\]](#) The letter has three main sections: 1) proposed amendments to Form ADV; 2) proposed amendment to the pay-to-play rules; and 3) proposed new rule 203A-5. [\[2\]](#) It is attached and briefly summarized below.

### **Proposed Amendments to Form ADV**

Soft dollar disclosure. Item 8 of Form ADV currently requires advisers to state whether they, or any related persons, receive soft dollar benefits in connection with client securities transactions. The Commission proposes to add a follow-up question asking whether all such soft dollar benefits qualify for the safe harbor under Section 28(e) of the Securities Exchange Act of 1934. The letter supports that part of the proposal.

The Commission asks whether, in addition to that follow-up question, Form ADV should solicit information about advisers' receipt of soft dollar benefits, such as requiring advisers to quantify the benefits they receive. The letter explains that it will be difficult to quantify soft dollar benefits with the consistency and specificity necessary to make this disclosure meaningful. Accordingly, it recommends against such a requirement.

Reporting of over \$1 billion in assets. The Commission proposes, among other things, to add a question to Item 1 of Form ADV requiring advisers to indicate whether they had \$1 billion or more in total assets as determined on the adviser's balance sheet for the most recent fiscal year. This information is necessary to enable the Commission to identify advisers that are subject to Section 956 of the Dodd-Frank Act, which mandates executive compensation rules or guidance for advisers and certain other financial institutions with over \$1 billion in assets. The letter strongly supports the way the Commission chose to interpret Section 956 as applying to advisers with over \$1 billion in balance sheet assets, rather than \$1 billion in assets under management.

Timing of annual updates to Form ADV. Advisers currently have 90 days from their fiscal year ends to provide an annual update to Form ADV. Although not part of the proposal, the Commission asks whether it should consider accelerating this deadline to 60 days or some other shorter time period. The letter cautions against doing so, particularly in the next few years as advisers are digesting the impact of these and other significant changes to Form ADV.

## **Proposed Amendments to the Pay-to-Play Rules**

Amendments to the solicitation provisions. The letter takes issue with the Commission's proposal to amend its pay-to-play rule to permit an adviser to pay only a "regulated municipal advisor" to solicit government entities on its behalf. It explains that the pay-to-play concerns that have led the Commission to effectively prohibit an affiliate from soliciting government business for compensation on behalf of its affiliated investment adviser could be satisfactorily addressed through less restrictive means. Specifically, the letter recommends that any employee of an affiliate be permitted to solicit government business for compensation on behalf of an adviser that controls, is controlled by, or is under common control with the affiliate as long as the employee is treated as the adviser's "covered associate." It states that the Commission could narrowly tailor the regulation to an affiliate's solicitation activity without losing any protections afforded to the public. [\[3\]](#) The letter also questions whether the proposed amendments are consistent with Congressional intent and the statutory language in Section 975 of the Dodd-Frank Act.

Additional clarification regarding the definition of "covered associate." The letter seeks additional guidance from the Commission with respect to the term "covered associate" and the use of the term "solicit" within that definition. It explains that many Institute members are struggling with how to classify employees who do not meet with clients for the principal purpose of obtaining and retaining business, but who either are involved in the preparation and/or dissemination of communications to government entities or provide information about the adviser's operations or policies, procedures, or controls. Citing an MSRB Interpretive Notice, the letter requests that the Commission confirm our understanding that the term "solicit" would not include communications that are incidental to the services provided by the adviser (i.e., communications that are not made with the principal purpose of obtaining, retaining, or referring a government entity).

Need for regulatory obligations for intermediaries. The proposed amendments present the opportunity to comment on pay-to-play issues more generally, and the letter does so by recommending that the Commission provide regulatory assistance to advisers in obtaining information from intermediaries in order to comply with their recordkeeping and reporting requirements under the pay-to-play rule. The letter explains that advisers are subject to detailed reporting and recordkeeping requirements under the pay-to-play rule, but they do

not own, control, or possess all information they are required by the rule to maintain. It therefore recommends that the Commission require financial intermediaries, such as broker-dealers and other persons, subject to its jurisdiction to provide advisers and funds with the account information the adviser is required by law to have in order to comply with the Commission's pay-to-play rule. The letter suggests that this could be accomplished through the recommended pay-to-play rule for broker-dealers or through a separate requirement adopted by FINRA. It concludes that the Commission's failure to do so will result in advisers' inability to comply fully with the new pay-to-play rule's recordkeeping requirements through no fault of their own.

**Request for extension of compliance deadlines.** The letter requests, if the Commission adopts the proposed amendments, the Commission provide advisers with additional time to comply with the new third-party solicitor provisions. It specifically recommends that the Commission extend the current compliance date for the third-party solicitor provisions for one year, from September 13, 2011 to September 13, 2012.

## **Proposed New Rule 203A-5**

This new rule would require each adviser to file an amendment to its Form ADV no later than August 20, 2011 to report the market value of its AUM. The filing is intended to facilitate compliance with the new AUM thresholds for federal adviser registration. The letter points out that advisers to registered investment companies are required to register with the Commission, regardless of AUM. Accordingly, with respect to these advisers, the filing serves no meaningful purpose and should not be required.

Robert C. Grohowski  
Senior Counsel  
Securities Regulation - Investment Companies Heather L. Traeger  
Associate Counsel  
Securities Regulation - Capital Markets  
[Attachment](#)

### **endnotes**

[\[1\]](#) See Memorandum No. 24746, dated Nov. 30, 2010.

[\[2\]](#) Much of the Commission's proposal would give effect to provisions of Title IV of the Dodd-Frank Act that, among other things, increase the statutory threshold for registration by investment advisers with the Commission, require advisers to hedge funds and other private funds to register with the Commission, and require reporting by certain investment advisers that are exempt from registration. The comment letter does not address these topics.

[\[3\]](#) The letter also recommends that the Commission permit advisers to pay affiliated broker-dealers to solicit government entities subject to a pay-to-play rule to be adopted by the Commission or FINRA.

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.