The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 7261

September 13, 1995

DRAFT INSTITUTE COMMENT LETTER ON REPROPOSED RULE 3A-4

1 Memorandum to Investment Advisers Committee No. 33-95 and SEC Rules Committee No. 89-95, dated August 1, 1995. September 13, 1995 TO: INVESTMENT ADVISERS COMMITTEE No. 38-95 SEC RULES COMMITTEE No. 102-95 RE: DRAFT INSTITUTE COMMENT LETTER ON REPROPOSED RULE 3a-4

_____ As we previously informed you, the Securities and Exchange Commission recently reproposed Rule 3a-4 under the Investment Company Act of 1940, to provide a nonexclusive safe harbor from the definition of "investment company" for certain investment advisory programs.1 Attached is a copy of the Institutes draft comment letter on the proposal. The comment period expires October 2, 1995. Please provide any comments on the Institutes letter by Thursday, September 21, 1995. We especially would appreciate your comments concerning the costs and benefits of the proposals for written policies and procedures, recordkeeping, and the filing of a new Form N-3a4. 1. The Institutes General Comments on the Proposal The Institutes letter notes that we opposed the Commissions 1980 proposal of Rule 3a- 4, out of a concern that it would permit the operation of unregulated mutual funds. While the Institute continues to have concerns about the proposed safe harbor, we recognize that many of the conditions of the original proposal have become de facto law since 1980 through the no- action process and it does not appear that the application of these conditions has permitted widespread evasion of the investor protections under the Act. Moreover, more formal guidance from the Commission on the operation of these programs would be useful. Consequently, the Institute generally supports reproposed Rule 3a-4. 2. Suitability The Institutes letter does, however, recommend that the Commission include as an express condition of the rule a requirement that investment managers make individualized suitability determinations, to provide a critical distinction between investment adviser accounts and investment companies. Our letter recognizes that the scope of such a requirement must depend, at least in part, upon the nature of the services being provided 3. Minimum Account Requirement In response to the Commissions request for comments, the Institutes letter opposes the substitution of a minimum account size requirement for other conditions of the rule, and states that such a requirement would not appear practical even if it were an additional condition. 4. Clarification Concerning Reasonable Restrictions Requirement The Institutes letter requests clarification that the proposal to authorize clients to place "reasonable restrictions" on management of their accounts and to make "instructions" concerning this management, would not authorize clients to direct their investments. 5. Interpretive Release The proposing release states that the Commission will issue an interpretive release addressing various issues in connection with wrap fee and similar products, such as appropriate suitability requirements, best execution obligations, the applicability of Section 206(3) under the Investment Advisers Act

of 1940, and mutual fund wrap disclosure. The Institute recommends that the Commission consider these issues in the context of the general principles applicable to the client-adviser relationship and solicit more detailed information concerning these issues. The Institutes specific comments are summarized as follows: Suitability Requirements -- The Institute urges clarification that a portfolio manager for a wrap account or other advisory program may rely on guidelines supplied by the client (or sponsor) in discharging these obligations. Best Execution -- The Institutes letter states that the question of best execution is not relevant to mutual fund asset allocation programs that charge a fee covering only advisory services and not brokerage expenses. With respect to other programs, if a client agrees that portfolio transactions will be executed by the sponsor, then the sponsor or the investment manager must make certain disclosure to the client. Section 206(3) -- The Institutes letter states that Section 206(3) generally should not apply to agency cross-transactions or principal transactions with a sponsor who does not provide investment advice concerning the particular transactions. Mutual Fund Wrap Disclosure -- The Institutes letter strongly supports the disclosure requirements currently applicable to mutual fund wrap accounts set forth in several no- action letters, because they provide full disclosure to investors concerning all applicable charges and expenses and the availability of the mutual funds outside of the program. Thomas M. Selman Associate Counsel Attachment

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