The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 3571

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PROPOSED FINAL TEXT OF CALIFORNIA INVESTMENT ADVISER REGULATIONS; INSTITUTE COMMENTS

March 9, 1992 TO: INVESTMENT ADVISERS COMMITTEE NO. 10-92 CALIFORNIA ASSOCIATE INVESTMENT ADVISER MEMBERS RE: PROPOSED FINAL TEXT OF CALIFORNIA INVESTMENT ADVISER REGULATIONS; INSTITUTE COMMENTS

_____ As we previously informed you, the California Department of Corporations has proposed several regulations relating to investment adviser activities. (See Memorandum to Investment Advisers Committee No. 59-91 and California Associate Investment Adviser Members, dated December 9, 1991). After considering the comments received, the Department amended the proposed rules and, because the final text of the rules differs from the initial proposal, the Department issued the proposed final text of the rules for comment. The proposed final rule prohibiting an adviser from charging an unreasonable fee incorporates the Institute's recommendation not to include a specific ceiling (i.e., 3%) as to what is deemed reasonable. (See Memorandum to Investment Advisers Committee No. 4-92 and California Associate Investment Adviser Members, dated January 28, 1992.) Instead, proposed Rule 260.238(j) states that the following is not a fair or equitable practice: Charging a client an advisory fee that is unreasonable in light of the type of services to be provided, the experience and expertise of the adviser, the sophistication and bargaining power of the client, and whether the adviser has disclosed that lower fees for comparable services may be available from other sources. (New language underlined.) While the Institute supported the deletion of the specified ceiling of 3% in paragraph (j) of Rule 260.238, we were troubled by the proposed factors listed therein for determining whether a fee is reasonable. Specifically, we commented that the last factor, whether the adviser has disclosed that lower fees for comparable services may be available from other sources, is inappropriate. Instead, we recommended that the Department follow the approach taken by the SEC staff in an earlier no- action letter in which it stated that (1) the fee charged by other advisers for comparable services is only one of several factors that should be considered in determining the reasonableness of an adviser's fee and (2) disclosure about the availability of similar services for lower fees should be required only where an adviser's fee is larger than normally charged taking into consideration factors such as the size, location and nature of the advisory business to be compared. A copy of the proposed final rules and the Institute's letter is attached. We will keep you informed of developments. Amy B.R. Lancellotta Associate General Counsel Attachments