

MEMO# 5603

February 23, 1994

DRAFT COMMENT LETTER ON SEC WRAP FEE PROPOSAL

February 23, 1994 TO: INVESTMENT ADVISERS COMMITTEE NO. 13-94 SEC RULES COMMITTEE NO. 17-94 RE: DRAFT COMMENT LETTER ON SEC WRAP FEE PROPOSAL

As we previously informed you, the Securities and Exchange Commission (the "Commission") issued for comment proposed revisions to Form ADV and the disclosure rules under the Investment Advisers Act of 1940 to define the disclosures that should be made to investors by sponsors of wrap fee programs. (See Memorandum to Commission Rules Committee No. 3-94, Investment Adviser Members No. 4-94, and Investment Adviser Associate Members No. 4-94, dated January 19, 1994.) Attached is a copy of the Institute's draft comment letter on the Commission's proposal. The Institute generally supports the Commission's proposed amendments to Form ADV to require disclosure about wrap fee programs. The Institute strongly encourages the Commission to follow these amendments with a review of the legal issues associated with these accounts, including the criteria for distinguishing such account programs from unregistered investment companies. The Institute's comments on specific aspects of the proposed amendments to Form ADV are summarized below.

1. Requirement that advisers publish separate brochure The Commission's proposal would require sponsors of wrap fee programs to publish separate brochures relating solely to such programs. The Institute's letter recommends that an adviser be permitted the flexibility, which it has under current law, to determine whether to incorporate the required wrap fee disclosures into an existing brochure or publish a separate brochure. To the extent the Commission is concerned that the wrap fee disclosures may become obscured if incorporated into an existing brochure, the Institute recommends that the Commission: (1) require a table of contents be included at the front of any brochure used by the adviser; (2) encourage advisers to use a separate brochure when offering only a wrap fee program to particular clients; and (3) require that the wrap fee information be placed at the front of the brochure.
2. Definition of wrap fee proposal The Commission's proposal would apply to wrap fee programs and mutual fund asset allocation programs in which the sponsor is affiliated with the funds. The Institute's letter recommends, based upon the differences in these two types of programs, that the proposal be amended to exclude mutual fund asset allocation programs. In support of this recommendation, the Institute states that the disclosures that are relevant to a client of a wrap fee program are either inappropriate for or inapplicable to a client of an asset allocation program or currently provided through Part II of Form ADV.
3. Disclosure of Fees and Compensation Arrangements The Commission has requested comment on: whether the range within which a wrap fee may be negotiated should be disclosed; whether disclosure about the compensation paid to a portfolio manager is relevant to an investor; and whether the compensation paid to a registered representative should be disclosed. The Institute recommends that none of this information be required.

The Institute asserts that this information is irrelevant to investors. The Institute further asserts that information on a portfolio manager's compensation is available through such manager's independent compliance with Rule 204-3 under the Investment Advisers Act (the "brochure rule"). With respect to a registered representative's compensation, the Institute's letter notes that: this is not information that is required in transactions not involving wrap fees; the pay-out schedules may vary among representatives; and several factors, which may not be easily explainable, may influence the compensation paid to individual representatives.

4. Performance Information The Commission's Release requests comment on whether the Commission should consider proposing the use of standardized formulas for the calculation of performance information. The Institute recommends that, should the Commission be interested in pursuing this matter, it be undertaken separate and apart from the wrap fee proposal.

5. A Client's Access to the Portfolio Manager Under the Commission's proposal, the sponsor of a wrap fee program would have to disclose any limitations on a client's access to the portfolio manager. The Institute questions whether this disclosure is intended to signal a change in the position of the Commission and its staff that any such limitations could cause the program to be deemed an unregistered investment company under the Investment Company Act. If so, the Institute recommends that such change be dealt with in a separate release. * * * * * Please contact me with any comments you may have no later than Wednesday, March 2, 1994. My direct number is 202/326-5825. Alternatively, you may fax your comments to me at 202/326-5828. Tamara K. Cain Assistant Counsel Attachment