

MEMO# 5858

May 9, 1994

DRAFT COMMENT LETTER ON SEC PROPOSED RULES RELATING TO SUITABILITY AND CUSTODIAN ACCOUNT STATEMENTS

May 9, 1994 TO: INVESTMENT ADVISERS COMMITTEE NO. 33-94 RE: DRAFT COMMENT LETTER ON SEC PROPOSED RULES RELATING TO SUITABILITY AND CUSTODIAN ACCOUNT STATEMENTS _____ As we previously informed you, the Securities and Exchange Commission (the "Commission") issued for comment two proposed new rules under the Investment Advisers Act of 1940 (the "Advisers Act") relating to an adviser's duty to make suitable recommendations to clients and to the delivery of custodian account statements to clients on a periodic basis. (See Memorandum to Investment Advisers Committee No. 23-94, dated March 18, 1994.) Attached is a copy of the Institute's draft comment letter on the Commission's proposal. The Institute's comments on these proposed new rules are summarized below.

1. Proposed Suitability Rule
The Institute supports adoption of the proposed suitability requirement (Rule 204(4)-5). The Institute's letter recommends, however, that the Commission provide clarification regarding: (1) an adviser's ability to rely upon investment parameters (i.e., investment objectives, guidelines, instructions, or restrictions) provided by the client or the client's agent; (2) an adviser's obligation to make certain assumptions where the client does not provide the adviser with comprehensive financial information; (3) the different weight to be accorded the factors considered by an adviser in making a suitability determination; and (4) an adviser's duty to update client information where the adviser-client relationship has been terminated. In addition, we request that the proposed Rule be amended to establish a presumption in making a suitability determination against knowledge of an affiliate being imputed to the adviser. With respect to an adviser's duty to update suitability information, the Institute recommends that the Commission not mandate the frequency of such updates, but rather, defer to the discretion of the adviser. On the issue of maintaining records of the adviser's suitability determination, the Institute strongly recommends that the recordkeeping requirements be applied only to prospective clients and that an adviser not be required to document the bases upon which suitability determinations have been made, either generically or in connection with each piece of advice.

2. Custodian Account Statements
The Institute opposes adoption of this new Rule in that: (1) it would not prevent or deter the fraudulent conduct about which the Commission is concerned; (2) there is no need for the Rule because advisory clients already receive statements, pursuant to rule 10b-10 under the Securities Exchange Act of 1934 reflecting account activity; and (3) it would require advisers to be accountable for the conduct of persons (i.e., custodians) over whom they have no control. The Institute is particularly interested in receiving comments

from members regarding the discussion of the current requirements of federal law (e.g., Rule 10b-10) relating to receipt of account statements by clients and the ability of clients to monitor account activity through such statements. Should the Commission decide to pursue adoption of the proposed Rule the Institute recommends that it clarify issues arising from: (1) client statements that are sent from the custodian to a mail drop at the client's request; (2) clients that waive receipt of statements from a custodian; and (3) a custodian's written representations that it delivers statements to the adviser's client. Also, inasmuch as the proposed Rule requires the adviser to obtain a copy of the custodial account statements indicating that they were delivered to clients, the Institute recommends that the Commission clarify how the statements are to so indicate delivery. The Commission sought comment on how the proposed Rule should address shares of open-end management investment companies. The Institute's letter recommends that such shares be expressly excluded from the coverage of the proposed Rule. If the Commission determines there is a need to include such shares, the Institute recommends that the Commission undertake consideration of this issue in a separate Release. 3. Transition Period While the Commission has proposed delaying effectiveness of the custodian statement Rule for 60 days after adoption, the Institute's letter recommends this period be extended to 180 days after adoption. * * * * * Comments on the proposal are due to the SEC by May 23, 1994. Please contact me with any comments you may have on the Institute's letter no later than Wednesday, May 18, 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

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