The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 9057

July 10, 1997

PROPOSED REGULATORY INITIATIVES

* We have not included the issue regarding the Commission*s interpretation in the Piper Capital enforcement action of the phrase "completion of the transaction" in connection with principal transactions under Section 206(3) of the Advisers Act because we have been advised by SEC staff that the Office of Chief Counsel in the Division of Investment Management is handling this matter rather than the Task Force. July 10, 1997 TO: INVESTMENT ADVISERS COMMITTEE No. 24-97 RE: PROPOSED REGULATORY INITIATIVES _____ As most of you are aware, the Securities and Exchange Commission has established a Task Force on Investment Adviser Regulation. The Task Force is charged with implementing the investment adviser provisions of the National Securities Markets Improvement Act of 1996 (NSMIA). In this regard, we have learned that one of the Task Forces first projects will be to consider whether to amend new Rule 203A-3(a) to allow investment adviser representatives to accept more clients on an accommodation basis than they may be able to accept under the rule. Set forth below in Section I is a proposal regarding this matter. In addition, the Task Force will review existing Commission adviser regulations and forms and develop recommendations to modernize them in light of changes in the marketplace and the advisory industry. The creation of the Task Force presents an opportunity for the industry to recommend changes to the rules under the Advisers Act to enhance the effectiveness and efficiency of investment adviser regulation. Set forth below in Section II is a preliminary list of recommended changes and issues for your consideration.* In addition to your general comments on these recommendations and whether there are any other changes that should be considered, we are particularly interested in your thoughts on the issues highlighted below in bold print. Please provide your comments on the items set forth below to the undersigned (at 202/326-5824 or by e-mail at amy@ici.org) by July 30, 1997. After we receive your comments, we will draft more detailed submissions on the items below and circulate them for your review. I. Accommodation Clients In the Release adopting rules under the Advisers Act to implement NSMIA, the Commission expressed concern that, by not adopting an asset test as alternative criterion to a client test for determining whether a supervised person is an "investment adviser 2representative" under new Rule 203A-3(a), an adviser representative who works on institutional or business client accounts may be limited as to the number of accommodation clients it may accept. To address this concern, we are considering recommending that the Commission amend the rule to exclude persons affiliated with non-natural clients (i.e., directors, officers, trustees or employees of institutional and business clients) from treatment as natural persons for purposes of the definition of "investment adviser representative." Further, to ensure that such clients are being accepted only on an accommodation basis, we would recommend that an adviser representative be prohibited from soliciting them. Thus, an adviser representative, for example, would be prohibited from sending out a mass mailing to all employees of a bank client. Do members agree with this proposal? II. Proposed Regulatory Initiatives A.

Advertisements. Seek clarification, preferably in an interpretive release rather than in a rule under the Act, of the requirements for advertising an investment advisers performance data. In addition, are there any modifications to Rule 206(4)-1 that we should seek (e.g., is the definition of "advertisement" appropriate? should advertisements tailored for the institutional market be subject to different standards? should testimonials be permitted under certain circumstances?)? B. Performance Fees. Under NSMIA, the Commission was granted authority to exempt from the Advisers Acts general prohibition on performance fees an advisory contract with any person that the Commission determines does not need to be protected against performance fees on the basis of such factors as, among other things, financial sophistication, net worth, and knowledge of and experience in financial matters. Are there any such persons that we should recommend be exempt? Should any of the requirements in Rule 205-3 permitting performance fees in certain instances be modified? C. Custody Requirements. The staffs positions as to what constitutes "custody" under the Advisers Act are expressed in a number of different no-action letters. It would be useful to the industry if these positions were consolidated and set forth in a comprehensive interpretive release on this issue. Should any of the provisions in Rule 206(4)-2 regarding custody of client assets be modified? D. Proxy Voting. In 1994, the Department of Labor issued an interpretive bulletin summarizing its previous statements about the proxy voting duties of ERISA fiduciaries. Is any additional guidance needed regarding an advisers proxy voting responsibilities? What about for advisers to non-ERISA accounts? E. Solicitors. The staff should provide interpretive guidance regarding the payment of referral fees by investment advisers to clear up some of the general confusion that currently exists. In addition, Rule 206(4)-3 applies only to registered investment advisers. Therefore, persons excluded from the definition of an investment adviser (e.g., banks) are not subject to the rule. Should the rule should be modified to cover all investment advisers, regardless of 3whether they are registered under the Act? Finally, the rule only covers the payment of cash referral fees. Should the rule be expanded to cover non-cash referral fees? F. Codes of Ethics. Paragraphs (a)(12) and (a)(13) of Rule 204-2 under the Advisers Act require every investment adviser to keep records of the personal securities transactions of the adviser and its "advisory representatives" (as defined in the rule). There is no requirement that advisers adopt a written code of ethics comparable to the requirement in Rule 17j-1 under the Investment Company Act. Should the Commission adopt such a requirement? G. Foreign Advisers to U.S. clients/U.S. Advisers to Foreign Clients. Are there any issues regarding the activities of foreign advisers to U.S. clients or of U.S. advisers to foreign clients that should be addressed by the Commission? Specifically, should the Unibanco and subsequent related no-action letters be summarized in a comprehensive interpretive release? H. Form ADV. Do members have any suggestions for revising Form ADV or the schedules thereto? Instead of a check-the-box approach, should the form allow registrants greater flexibility in disclosing the information in a different format (e.g., a narrative format)? Should any of the requirements in Part II be eliminated or simplified consistent with the Commissions overall objective of improving disclosure provided to investors? On a related matter, should the "brochure rule" be revised to require that a brochure be written in "plain English"? I. Wrap Fee Programs. Are there any issues raised by wrap fee programs on which the Commission staff should provide interpretive guidance (e.g., what are the suitability obligations of a programs portfolio managers?). Should any of the disclosure requirements for wrap fees programs contained in Schedule H to Form ADV be modified? J. Recordkeeping Requirements. Should any of the requirements in Rule 204-2 setting forth an advisers recordkeeping obligations be modified? Should advisers be permitted to store records on medium other than those already permitted (i.e., computer, magnetic disk or tape)? Amy B.R. Lancellotta Associate Counsel