

MEMO# 5914

May 25, 1994

INSTITUTE COMMENTS ON SEC PROPOSED RULES RELATING TO SUITABILITY AND CUSTODIAN ACCOUNT STATEMENTS

May 25, 1994 TO: INVESTMENT ADVISERS COMMITTEE NO. 36-94 RE: INSTITUTE COMMENTS ON SEC PROPOSED RULES RELATING TO SUITABILITY AND CUSTODIAN ACCOUNT STATEMENTS _____

As we previously informed you, the Securities and Exchange Commission (the "Commission") has proposed two new rules under the Investment Advisers Act of 1940 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.) The Institute recently submitted to the Commission the attached comment letter on the proposal, which is summarized below.

1. **Proposed Suitability Rule** The Institute supports adoption of the proposed suitability requirement (Rule 206(4)-5). The Institute's letter recommends, however, that in the release adopting the Rule the Commission provide clarification regarding: (1) an adviser's ability to rely upon investment parameters provided by the client or the client's agent without having to make a determination that such parameters are suitable for the client; (2) where the client does not provide the adviser with comprehensive financial information, that an adviser need not assume that the client has no other assets or sources of income unless such assumption is reasonable based upon the facts known to the adviser; (3) that the factors considered by an adviser in making a suitability determination (i.e., the client's financial situation, investment experience, and investment objectives) are intended to be given different weight in different circumstances; and (4) with respect to an adviser's duty to update client information, that there may be situations in which the adviser has no such duty -- for instance, where the relationship between the adviser and the client has been terminated. Where the duty to update does exist, the Institute recommends that the Commission not mandate the frequency of such updates. The Institute's letter additionally recommends that the proposed Rule be amended to: (1) establish a presumption against knowledge of an adviser's affiliate being imputed to the adviser; (2) provide that the recordkeeping requirements will not be applied to existing accounts; and (3) not require advisers to document the bases for their suitability determinations.

2. **Custodian Account Statements Rule** The Institute opposes adoption of this new Rule, which would require an investment adviser to have a reasonable belief that custodian account statements are being delivered to clients, because (1) it would not prevent or deter the type of fraudulent conduct the Commission is attempting to remedy, (2) it is not needed given other provisions of current law, and (3) it is inappropriate for the Commission to use adviser

regulations to direct the activities of other persons over whom it does not have jurisdiction - i.e., bank custodians. If the Commission nevertheless adopts the Rule, the Institute's letter recommends that it be amended to (1) permit clients to waive receipt of custodial account statements and (2) provide explicitly that an adviser, which has received a written representation from either the custodian or the customer that account statements will be, or are being, delivered to the adviser's client, may rely conclusively on such representations. Our letter further recommends that the adopting release clarify that (1) the Rule would not apply in situations where the adviser knows that the client has made arrangements with the custodian to have its statements delivered to a convenience address for collection on a periodic basis and (2) the copy of the custodian account statement received by the adviser need not expressly state that it is a duplicate or that a copy has been sent to the client in order for the adviser to have a reasonable belief that the client has received a copy of it. 3. Transition Period While the Commission has proposed delaying effectiveness of the proposed custodian statement Rule for 60 days after adoption, the Institute's letter recommends this period be extended to at least 180 days after adoption. Tamara K. Cain Assistant Counsel Attachment

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