

MEMO# 9976

May 28, 1998

DRAFT SUBMISSIONS TO THE SEC PROPOSING REVISIONS TO ANTI-FRAUD RULES AND FORM ADV

* See Memorandum to Investment Advisers Committee No. 7-98, dated February 11, 1998. [9976] May 28, 1998 TO: INVESTMENT ADVISERS COMMITTEE No. 21-98 RE: DRAFT SUBMISSIONS TO THE SEC PROPOSING REVISIONS TO ANTI-FRAUD RULES AND FORM ADV

As we previously advised you, the Institute has been working with outside counsel on proposals to submit to the SEC that would recommend revisions be made to the anti-fraud rules under the Investment Advisers Act and to Part II of Form ADV.* Attached are draft submissions on each of these proposals, which we plan to discuss at the upcoming Investment Advisers Committee meeting on June 8th. If you are not planning to attend the meeting, please provide your comments on the draft letters to me by the morning of June 8th by phone (202/326-5825), fax (202/326-5827) or e-mail (tamara@ici.org).

A. Proposed Revisions to the Advisers Act Anti-Fraud Rules The Institute's submission recommends that certain rules adopted under Section 206 of the Advisers Act be revised to be more consistent with the general anti-fraud principles set forth in the section as well as more consistent with Commission interpretations. These recommendations are as follows:

1. Rule 206(4)-1, Advertising -- The SEC should eliminate the current "laundry list" of specific practices that are defined to be per se fraudulent and replace it with general guidelines for advisers to follow to ensure that they do not disseminate false and misleading advertising. In particular, we would recommend that the new rule be patterned after Rule 156 under the Securities Act of 1933, which contains general guidelines for the preparation of investment company advertising.
2. Rule 206(4)-2, Custody -- The current rule should be revised and updated in several significant respects, including: (1) to expand the types of entities eligible to maintain custody of client assets to include, among others, an affiliated entity of an adviser; (2) to eliminate the requirement that securities be physically segregated, in recognition of the fact that most securities today are uncertificated; (3) to eliminate the annual accountant's audit; and (4) to allow a client to waive receipt of reports on a quarterly basis. The exception in the rule for advisers that are also registered broker-dealers should be retained and expanded to include additional exceptions where an adviser's fee is deducted directly from a client's account.
3. Rule 206(4)-4, Financial and Disciplinary Disclosure -- The Institute proposes to recommend that the SEC repeal the rule and require appropriate disciplinary/financial condition disclosures instead be included in the brochure delivered to clients.

B. Proposed Revisions to Part II of Form ADV The Institute's submission relating to Part II of Form ADV would recommend two fundamental changes to the current form. First, we would recommend that the disclosure be in a narrative format, rather than the current "check-the-box" format. Second, we would

recommend that advisers have the option of using a two-part brochure, similar to the prospectus and SAI format. The first part of the brochure would include key information and would be required to be provided to clients. The second part of the brochure would supplement the information included in the first part and would be made available promptly upon request. Moreover, we would recommend that advisers be permitted to use multiple brochures, each of which might be targeted at particular types of advisory clients. All such brochures and supplements would be required to be filed with the Commission. As detailed in the attached submission, the brochure provided to clients should include information regarding: the nature of services offered (both advisory and non-advisory); client eligibility criteria; fees; the background of advisers and advisory personnel; conflicts of interest; and material disciplinary and financial information. The letter also recommends that outdated requirements in the current form be eliminated. The supplement would include disclosure regarding other business and financial industry activities or affiliations of the adviser; procedures for review of accounts; and details about procedures addressing potential conflicts of interest (e.g., personal trading policies; soft dollar arrangements). * * * Tamara Cain Reed Associate Counsel Attachments

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