

MEMO# 7153

August 1, 1995

SEC REPROPOSES RULE 3A-4 UNDER THE INVESTMENT COMPANY ACT

August 1, 1995 TO: INVESTMENT ADVISERS COMMITTEE No. 33-95 SEC RULES COMMITTEE No. 89-95 RE: SEC REPROPOSES RULE 3a-4 UNDER THE INVESTMENT COMPANY ACT

The Securities and Exchange Commission recently repropose Rule 3a-4 under the Investment Company Act of 1940, to provide a nonexclusive safe harbor from the definition of "investment company" for certain investment advisory programs, and proposed Form N-3a4, which sponsors of these programs would have to file in order to notify the Commission of their reliance on Rule 3a-4. Interests in these programs also would not require registration under the Securities Act of 1933. A copy of the proposing release is attached. The comment period for the proposal ends 60 days from Federal Register publication. A meeting has been scheduled for Wednesday, September 6, 1995, at 10 a.m. at the Institute to discuss the proposal. Please return the attached form by August 14th if you plan to attend. Please return the attached form by August 14th if you plan to attend. If you are unable to attend, please direct your comments to the undersigned (at 202/326-5819) by September 6th.

1. Conditions of Proposed Rule 3a-4 Proposed Rule 3a-4 would impose the following conditions on any investment advisory program intending to rely upon the rule: each client's account must be managed on the basis of the client's financial situation, investment objectives, and instructions; if a program has more than one sponsor, one person would have to be designated as the principal sponsor to carry out the sponsor's duties under the rule; the program's sponsor must obtain, and maintain, information from each client that is necessary to manage the client's account individually; the sponsor and portfolio manager must be reasonably available to consult with clients; each client must be able to impose reasonable restrictions on the management of the account; each client must receive a quarterly statement of all activity in the client's account; each client must retain certain specific indicia of ownership over the account; the sponsor must establish and effect written procedures that are reasonably designed to ensure that each of the conditions of the rule is met, must maintain the documents relating to the program as set forth in the rule, and must furnish to the Commission upon demand copies of specified documents, even if the sponsor is excepted from the definition of "investment adviser" under the Investment Advisers Act. (The release asks whether any of the conditions concerning written procedures and agreements imposes an undue burden and whether the burden of any condition outweighs its benefits (p. 25).); and if the sponsor designates another person to perform certain obligations under the rule, the sponsor must obtain from that person a written agreement to perform those obligations.

2. The Commission's 1980 Proposal In 1980, the Commission had proposed (but never adopted) an earlier version of Rule 3a-4. The revised proposal differs from the original proposal in several respects. Most notably, revised proposed Rule 3a-4, unlike the original proposal,

would not require a portfolio manager to make separate determinations regarding the appropriateness of each transaction for each client prior to effecting the transaction, and would permit the use of model portfolios. 3. Specific Requests for Comment The Commission requests comment on the following specific issues: Should the rule specifically require that client information obtained under the rule be conveyed to the portfolio manager that is managing the clients account? (p. 17) The rule would not impose a minimum account size. Should a minimum account size be required and, if so, what size should it be and should it be required to be met only when the account is opened? Should clients be removed from the program if the account size fell below the initial minimum due to investment loss rather than withdrawal? Should a minimum account size apply to the clients aggregate investment in the program or to each account managed by a portfolio manager? Would any other proposed condition be rendered unnecessary by a minimum account size requirement? Should programs with small account minimums be subject to additional conditions? (pp. 20-21) What are the costs and benefits of the proposed rule and form? 4. The Commissions Future Interpretive Release The proposing release notes that wrap fee and other investment advisory programs raise issues under the Investment Advisers Act, including those concerning suitability, best execution, principal and agency cross-transactions, and disclosure regarding various fees associated with mutual fund wrap programs. The Commission requests comment on these issues. The proposing release states that the Commission will publish an interpretive release addressing many of these issues after the comment period on proposed Rule 3a-4 has expired. Thomas M. Selman Associate Counsel Attachments