

MEMO# 5654

March 7, 1994

INSTITUTE LETTER ON SEC WRAP FEE PROPOSAL

March 7, 1994 TO: INVESTMENT ADVISERS COMMITTEE NO. 20-94 SEC RULES COMMITTEE NO. 29-94 RE: INSTITUTE LETTER ON SEC WRAP FEE PROPOSAL

As we previously informed you, the Securities and Exchange Commission recently proposed revisions to Form ADV and rules under the Investment Advisers Act of 1940 to define the disclosure that should be made to investors by sponsors of wrap fee programs. (See Memorandum to Investment Advisers Committee No. 4-94 and SEC Rules Committee No. 9-94, dated January 19, 1994.) The Institute recently submitted to the Commission the attached comment letter on the proposal, which is summarized below.

1. Proposed Separate Brochure Requirement The Commission's proposal would require sponsors of wrap fee programs to provide clients with a separate brochure containing the disclosures specified on proposed Schedule H to Form ADV. The Institute recommended that the proposal be amended to provide advisers the flexibility they have under current law to determine whether to incorporate the requisite wrap fee program disclosure into an existing brochure or to provide a separate brochure. To the extent the Commission is concerned that material information concerning wrap fee programs may be obscured if advisers are permitted to incorporate the disclosures into an existing brochure, the Institute further recommended that the Commission (1) require a table of contents be included at the front of the brochure, and (2) encourage advisers to use a separate brochure when offering only a wrap fee program to particular clients.

2. Proposed Definition of "Wrap Fee Program" The proposed definition of "wrap fee program" would include mutual fund asset allocation programs. The Institute recommended that such programs be deleted from the definition inasmuch as most of the Schedule H disclosure would be either inappropriate for or inapplicable to such programs. Accordingly, requiring such programs to provide Schedule H disclosure may result in investors receiving less meaningful disclosure than they do under current law.

3. The Proposed Schedule H Disclosures The Commission specifically requested comment on the various disclosure items included in Schedule H. In response, the Institute commented on, among other things, the proposed disclosure of: (1) the range within which the adviser's fees may be negotiated; (2) the portion of the wrap fee paid to the portfolio manager; and (3) the compensation paid to registered representatives. With respect to (1), the Institute recommended that the range within which the adviser's fee may be negotiated not be required disclosure because for the disclosure to be meaningful, the factors that influence negotiability, which may not be easily discernable or describable, also would have to be disclosed. In addition, such disclosure would be inappropriate and potentially meaningless to investors. With respect to (2), inasmuch as the advice to be provided by the portfolio manager is a highly significant service under the wrap fee account, the Institute concurred that a sponsor should disclose the portion of the wrap fee paid to the portfolio manager.

Finally, the Institute recommended that the Commission not require disclosure of the compensation paid to the registered representative because this may be proprietary information and is not generally required of other persons in the securities or investment advisory business. In response to the Commission's request for comment on whether it should consider proposing the use of standardized formulas for the calculation of performance information for portfolio managers in wrap fee programs or for investment advisers generally, the Institute recommended that any consideration of this issue be undertaken separate and apart from the Commission's consideration of the standards relating to wrap fees as it would require further extensive study. 4. The Continuing Need for Uniformity The Institute's letter noted that, although the Commission's wrap fee proposal was developed in conjunction with the North American Securities Administrators Association ("NASAA"), who also issued its own proposal, there remain differences between the two proposals. The Institute recommended that the Commission and NASAA continue to work together to ensure that the final product of their collective efforts provides for fully consistent regulation. Tamara K. Cain Assistant Counsel Attachment

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