The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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ICI RESPONSE TO LETTER OPPOSING RULEMAKING PETITION CONCERNING PORTFOLIO INVESTMENT PROGRAMS

[13775] July 26, 2001 TO: BOARD OF GOVERNORS No. 37-01 INVESTMENT ADVISERS COMMITTEE No. 18-01 SEC RULES COMMITTEE No. 63-01 RE: ICI RESPONSE TO LETTER OPPOSING RULEMAKING PETITION CONCERNING PORTFOLIO INVESTMENT PROGRAMS As we previously informed you, in March 2001 the Institute submitted a rulemaking petition to the Securities and Exchange Commission urging the adoption of a definitional rule that would clarify that certain portfolio investment programs ("PIPs") are "investment companies" within the meaning of the Investment Company Act of 1940.1 In June, the Securities Industry Association ("SIA") submitted a letter to the SEC opposing the Institute's petition.2 The SIA argues, among other things, that the regulation of PIPs under the Securities Exchange Act of 1934 or the Investment Advisers Act of 1940 provides adequate investor protection and that 1940 Act regulation would chill innovation and should await a demonstrated record of abuse. The SIA further argues that as long as investors have the option to control their portfolio investments, "reliance on the efforts of others" cannot serve as a basis for regulation of PIPs as separate securities. The SIA also asserts that PIPs are not discretionary advisory programs and that, even if they are, they qualify for the safe harbor from 1940 Act regulation under Rule 3a-4. In response to the SIA's letter, the ICI recently submitted a letter to the SEC, which maintains that none of the SIA's arguments has any foundation in law, fact or policy.3 Both the SIA and the ICI letters are attached, and the ICI letter is described in more detail below. Regarding the adequacy of existing regulation governing PIPs, the Institute's letter notes that sponsors of PIPs have chosen to be regulated, if at all, as either broker-dealers under the 1934 Act or as investment advisers under the Advisers Act, neither of which, alone or in combination, adequately address the risks of investor abuse that can arise from investment in PIPs. In contrast, investment company regulation focuses on protecting investors from these 1 See Memorandum to Board of Governors No. 16-01, Investment Advisers Committee No. 9-01, and SEC Rules Committee No. 32-01, dated April 3, 2001. 2 See Letter from Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated June 14, 2001. 3 See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated July 24, 2001. 2risks. In response to the SIA's contention that 1940 Act regulation would chill innovation, the ICI letter points out that this argument ignores the innovation that the regulation has fostered, such as the development and rapid growth of money market funds, exchange-traded funds and variable contracts. The Institute's letter further states that the SIA's assertion that PIP investors do not rely on the sponsor's efforts ignores the Supreme Court's and other courts' repeated

holdings that an investment opportunity forms a security separate from the underlying portfolio securities if, based on the sponsor's offer, it is reasonably likely that investors will rely on the sponsor's efforts, even where an investor has the right to control the management of his or her investment. It is reasonably likely that many investors will expect profits through reliance upon the specialized investment management expertise and upon the essential trading services that PIPs' sponsors offer through pre-packaged portfolios. Regarding PIPs' status as discretionary advisory programs, the ICI letter notes that PIPs should not be treated as non-discretionary programs as a matter of Commission policy because PIPs' sponsors offer pre-packaged portfolios and periodic updates that investors can, and likely will, purchase unchanged or with minimal changes. Additionally, PIPs would not qualify for the Rule 3a-4 safe harbor because they do not give investors individualized investment advice, one of two necessary conditions for qualification under the safe harbor. Finally, the letter states that, contrary to the SIA's assertion, it is not in the public interest for the Commission to wait until investors are harmed before appropriately regulating investment products such as PIPs. Doretha VanSlyke Zornada Assistant Counsel Attachments Attachment no. 1 (in .pdf format)

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