

## COMMENT LETTER

April 27, 1998

# Institute Comments on Agenda for Upcoming Conference on Uniformity of Federal-State Securities Regulation, April 1998

April 27, 1998

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: 1998 Conference on Federal-State Regulation  
File No. S7-11-98

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> (the "Institute") appreciates the opportunity to comment on issues to be considered by the U.S. Securities and Exchange Commission (the "Commission") and the North American Securities Administrators Association, Inc. ("NASAA") at the fifteenth Annual Conference on Federal-State Securities Regulation held pursuant to Section 19(c) of the Securities Act of 1933 (the "Section 19(c) Conference"). The Institute is pleased with the breadth of the proposed agenda for the upcoming Section 19(c) Conference. Indeed, in the wake of the National Securities Markets Improvement Act of 1996 ("NSMIA"), it is especially important for the states and the Commission to continue to discuss areas of mutual concern in order, among other things, to ensure that the cessation of duplication of their regulatory responsibilities has not inadvertently resulted in any regulatory gaps.

## I. NSMIA's Impact on State Regulation

Prior to the enactment of NSMIA, the Institute would use the opportunity of the Section 19(c) Conference to encourage the Commission and the states to work together to achieve greater consistency in the regulation of investment companies, particularly the regulation of prospectus disclosure. As a result of the enactment of NSMIA, which vested the exclusive authority for investment company regulation in the Commission, such concerns have largely been resolved. Indeed, those items in the agenda proposed for this year's Section

19(c) Conference that relate to providing greater uniformity between the Commission and the states in those areas that remain subject to their overlapping jurisdiction do not appear to be issues that involve investment companies. Notwithstanding this, however, the Institute concurs that it remains important for the states to be familiar with various Commission initiatives in areas such as electronic delivery of disclosure documents, issues relating to the year 2000, and the status of discussions concerning proposed amendments to Rules 17a-3 and 17a-4, the recordkeeping rules under the Securities Exchange Act of 1934. We encourage the Commission and the states to continue their ongoing dialogue in these and other areas of mutual interest.

## **A. Investment Company Regulation**

We are pleased to report that, since October 1996, when the amendments in NSMIA to the Securities Act of 1933 become effective, the states have made a very concerted and diligent effort to comply with both the letter and the spirit of the new law. Moreover, they have welcomed the involvement of industry in crafting their securities acts and procedures to conform to NSMIA. To date, the Institute has worked with each of the approximately forty-two states that have amended, or attempted to amend, their securities acts in whole or in part to implement NSMIA. Although the differences in individual state's securities acts have made it impossible to have complete uniformity among the states, there does appear to be substantive uniformity in their regulation of investment companies and in the notice filing requirements imposed on such companies. The Institute and the states, through NASAA, worked collectively to adopt a uniform notice filing form, Form NF, that has been accepted by each state in the United States. This form has obviated the need for investment companies to file a copy of their complete federal registration statement, and has thereby eased the filing burdens on the funds while concomitantly easing the processing burdens on the states. The Institute and NASAA continue to work together to review the Form NF on a regular basis to ensure its continued efficacy.

## **B. Investment Adviser Regulation**

Unfortunately, in contrast to the treatment of investment companies under NSMIA, there continues to be disparity among the states in the treatment of federally registered investment advisers and their representatives in the aftermath of NSMIA. In fairness to the states, it has been our experience that many of these differences result from states' uncertainty as to the division of regulatory authority between the states and the Commission in the regulation of such persons. Accordingly, we are very pleased to see this topic included as an item on the agenda for the upcoming Section 19(c) Conference. In this regard, there are two issues in particular that the Institute believes would be beneficial for the Commission and the states to discuss in more detail during the Conference: the limits imposed by NSMIA on (1) state regulatory authority and (2) state enforcement authority.

### **1. State Regulatory Authority**

Since the enactment of Title III of NSMIA, the Investment Advisers Supervision Coordination Act, there has been much confusion among the states as to the reach of this Title's preemptive provisions. While the Commission attempted to address some of these issues in Commission Release No. IA-1633, this confusion remains. For example, as set forth in this Release, it would appear that any state laws imposing substantive regulation on the operations of a federally registered investment adviser, such as regulations relating to contractual provisions or performance fee arrangements, have been preempted by NSMIA. However, many states have not read NSMIA to include such a limitation and therefore intentionally have elected to retain such regulatory authority, notwithstanding the

Commission's Release. Related to this concern—that states continue to directly regulate the conduct of federally registered investment advisers—is a concern that states may attempt to impose such regulation indirectly through state law provisions that regulate the conduct of the representatives of such entities. To address these issues, the Institute strongly encourages the Commission to address them in its upcoming Section 19(c) Conference.

## **2. State Enforcement Authority**

The second area in which there appears to be some confusion among the states in the implementation of NSMIA relates to state enforcement authority. According to the amendments in NSMIA to Section 203A(b)(2) of the Investment Advisers Act of 1940, the only enforcement authority preserved to the states is that relating to "investigating and bringing enforcement actions with respect to fraud or deceit." Notwithstanding this, it has been our experience that some states have interpreted this language to permit them to continue to define, and thereby proscribe or sanction, conduct that, though considered by the state to be "dishonest" or "unethical," does not rise to the level of fraud or deceit (e.g., many states proscribe the borrowing or loaning of money as dishonest or unethical conduct). The Institute strongly encourages the participants at this year's Section 19(c) Conference to discuss this issue in detail.

## **II. Ongoing Joint Commission/NASAA Investment Management Initiatives**

There are two final issues on the proposed agenda relating to investment advisers on which the Institute would like to comment: the proposed electronic filing system for investment advisers and proposed revisions to the investment adviser filing forms. The Institute would welcome innovation in both of these areas. Indeed, we believe that updating current forms and filing systems would make the current registration process more effective and efficient. However, we strongly encourage the Commission and the members of NASAA, in addition to working with each other on these projects, to actively involve representatives of industry in the process—and to do so early on. We note that the brokerage industry has actively participated with NASD Regulation, Inc. in the redesign of the Central Registration Depository and we believe such involvement will result in a more effective and useful system. We believe similar benefits would result from the Commission and the states involving industry in the ongoing discussions relating to revising the investment adviser filing forms and developing an electronic filing system for investment advisers. Moreover, eliciting the participation and support of the industry in this process should help ensure that the revised forms and the filing system are user friendly, and facilitate their acceptance by the industry in the future. With respect to the investment adviser filing forms, industry participation in the process also may help the Commission and NASAA eliminate some of the "disclosure creep" that pervades the existing forms. As a result, such forms would elicit only information that is relevant to regulators and investors and omit information that is superfluous, redundant, or outdated.

## **III. Investor Education Initiatives**

The Institute would like to commend the Commission and the states for working together on the recent national public awareness campaign, "Facts on Savings and Investing Campaign," which was very well received throughout the United States. The Institute was

pleased to have the opportunity to participate in this most worthwhile program. We believe that initiatives of this type better enable the investing public to make knowledgeable and prudent decisions about their investments and their investment professionals and leave investors less vulnerable to unscrupulous scams and scam operators. During the upcoming Section 19(c) Conference, we strongly encourage the Commission and the states to discuss planning similar future initiatives and to consider how the industry can effectively assist with and participate in such efforts.

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The Institute greatly appreciates the opportunity to comment on the issues to be discussed during this year's Section 19(c) Conference. We would be happy to provide whatever assistance the Commission, NASAA, and the individual states require in order to achieve our shared objective of an effective federal-state regulatory partnership and the continued protection of mutual fund investors.

Sincerely,

Tamara Cain Reed  
Associate Counsel

cc: The Honorable Arthur Levitt, Chairman  
The Honorable Isaac Hunt, Commissioner  
The Honorable Norman Johnson, Commissioner  
The Honorable Paul Carey, Commissioner  
The Honorable Laura Unger, Commissioner  
U.S. Securities and Exchange Commission

#### **ENDNOTES**

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,987 open-end investment companies ("mutual funds"), 437 closed-end investment companies, and 9 sponsors of unit investment trusts. Its mutual fund members have assets of about \$4.747 trillion, accounting for approximately 95% of total industry assets, and over 62 million individual shareholders. The Institute also represents the interests of investment advisers. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 488 associate members which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.