The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

February 10, 1997

Comment Letter on Proposed Investment Adviser Rules, February 1997

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

Re: Rules Implementing Amendments to the Investment Advisers Act of 1940
(File No. S7-31-96)

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to comment on the Commission's proposal to adopt rules under the Investment Advisers Act of 1940 (the "Advisers Act") to implement provisions of the Investment Advisers Supervision Coordination Act ("Coordination Act") that reallocate regulatory responsibilities for investment advisers between the Commission and the states.[2] The Institute commends the Commission for the thoroughness of its proposed rules and for their expeditious release. Our specific comments on the proposals are set forth below.

As a general matter, the Institute believes that in order for the Coordination Act to be implemented successfully, it is critical that the division of regulatory responsibility for investment advisers between the Commission and the states be clearly defined and understood by all parties. For this reason, we are pleased that the Commission's Release provides detailed commentary addressing many of the issues that have arisen since the Act was enacted last fall regarding the Commission's and the states' new responsibilities.

Of particular importance is the discussion in the Release on the scope of the Coordination Act. We strongly concur with the Commission that Section 203A(b) of the Advisers Act "preempts not only a state's specific registration, licensing, or qualification requirements, but all regulatory requirements imposed by state law on such investment advisers relating to their advisory activities or services, except those provisions that are specifically preserved by the Coordination Act."[3] A different interpretation or any attempt by a state to adopt or enforce laws that impose substantive regulation upon Commission-registered

advisers under the guise of its anti-fraud authority would be inconsistent with Congressional intent for such advisers to be regulated exclusively by the Commission.4 In this regard, the Institute recommends that the Commission clarify that the scope of the preemption includes all provisions of state law that apply to Commission-registered advisers (except those expressly preserved by the Coordination Act), even if they do not arise under provisions concerning registration of advisers (i.e., do not "flow from" an adviser's status as a state registrant). For example, several states impose requirements on principal transactions involving investment advisers, which are not limited to advisers registered in the state.5 Congress clearly did not intend to preserve this kind of duplicative regulation.6

I. Summary

Overall, the Institute is very supportive of the adoption of the Commission's proposed rules. We do have several comments, however; the most significant of these are noted below.

The Commission should clarify that suspension of Form ADV-S relieves registered advisers from all of the reporting requirements thereunder and that the updating requirements as set forth in Form ADV are still in effect.

The Commission should extend the grace period proposed in Rule 203A-1 from 90 to 120 days and permit an adviser to amend its Schedule I if it again becomes eligible for Commission registration during the grace period.

The Commission should amend the criteria for determining which advisers that are affiliated with Commission-registered advisers may register with the Commission. In particular, we recommend elimination of the "same address" criterion.

In defining "investment adviser representative," we recommend that the Commission: exclude sophisticated investors in determining whether the representative conducts a substantial portion of its business with retail investors; eliminate the asset test in determining whether a substantial portion of the representative's business is with retail clients; and exclude registered representatives of broker-dealers.

For purposes of the definition of "investment adviser representative," the Institute recommends that the Commission clarify that "place of business" is not intended to include locations merely visited by a representative.

Finally, the Commission should clarify that solicitors of Commission-registered advisers that are "supervised persons" of such advisers would not be subject to state regulation, unless they fall within the definition of "investment adviser representative."

Each of these recommendations is discussed in more detail below.

II. Proposed Form ADV-T and Rule 203A-5

The Commission has proposed a transition rule, Rule 203A-5, and a transition form, Form ADV-T, to assist investment advisers in determining their eligibility for Commission registration as of April 9, 1997. For those advisers that declare their ineligibility for Commission registration, Form ADV-T would serve as the adviser's request for withdrawal from registration as of April 9, 1997. Advisers that do not file Form ADV-T or that fail to voluntarily withdraw from Commission registration (if no longer eligible for such registration) would be subject to a cancellation proceeding under the Advisers Act.

The Institute supports Form ADV-T and Rule 203A-5 as proposed.7 We believe that requiring the filing of Form ADV-T, and using such form to de-register investment advisers, will provide an orderly means for determining which advisers will no longer be eligible for Commission registration and providing for their de-registration.

We believe further that Form ADV-T contains all of the information that would be necessary for a state to convert the existing state registration of a federally registered investment adviser to a notice filing, as contemplated by the Coordination Act, and that its use by the states would provide for an efficient and uniform transition to the regulatory scheme created by the Coordination Act. Therefore, the Institute recommends that the Commission work with the states, either individually or through NASAA, to encourage their use of the Form ADV-T for purposes of providing notice to the states of those advisers that, as of April 9, 1997, would no longer be subject to state registration requirements.

In conjunction with its proposal of these amendments, the Commission announced the immediate suspension of the use of Form ADV-S, the annual report currently required to be filed by all federally registered investment advisers.8 There are two points regarding an adviser's current filing and updating obligations that we request be clarified. First, we recommend that the Commission clarify that the suspension of Form ADV-S relieves registered advisers from all of the reporting requirements thereunder. For example, if a registrant uses a written disclosure statement other than Part II of Form ADV to satisfy the "brochure rule" under the Advisers Act (i.e., Rule 204-3), Item 5 of Form ADV-S requires the adviser to file with the Commission a copy of such disclosure statement. Because there is no analogous requirement on proposed Form ADV-T, we assume that such brochures would not be required to be filed during the suspension of Form ADV-S. Second, we request clarification that the updating requirements as set forth in Instruction 7 to Form ADV are still in effect. Thus, an adviser would be required to amend its Form ADV as appropriate to ensure that the information reported therein remains accurate and current.

III. Advisers With Fluctuating Assets

Under the Coordination Act, in order to be eligible for registration with the Commission, an adviser must have at least $25 million in assets under management, be an adviser to an investment company, or be located in a state that either does not regulate investment advisers or that exempts the investment adviser from registration. To address concerns regarding those advisers that are subject to Commission registration based upon their assets under management and whose assets fluctuate around the $25 million threshold, the SEC has proposed Rule 203A-1. For those advisers whose eligibility for Commission registration will depend upon their assets under management, the proposed rule provides that advisers with $30 million or more in assets under management would be required to register with the Commission; those with less than $25 million in assets under management would be prohibited from registering with the Commission; and advisers with between $25 and $30 million could elect whether to be state-registered or Commission-registered. The Institute supports this approach. We believe the $5 million window is an appropriate amount and will provide sufficient flexibility to alleviate the need for advisers whose assets under management fluctuate around $25 million to continually switch their registration between the Commission and the states.

Proposed Rule 203A-1 would also provide a 90 day "grace period" for investment advisers that, as a result of ineligibility for continued Commission registration, must obtain state registration. During this period, the Commission would not institute proceedings to cancel

such an adviser's registration if the adviser has not voluntarily withdrawn it. The Institute supports the concept of a grace period. We understand, however, that it is not unusual for it to take longer than 90 days for an adviser to obtain state registration.9 Accordingly, because the sole purpose of this grace period is to ensure that there is no gap between the time an adviser's federal registration is terminated and the time its state registration is effective, we recommend that the grace period be increased to 120 days, a period that we believe more realistically reflects the time it may take to obtain state registration.10 Additionally, to ensure that this grace period accomplishes its intended result, we strongly encourage the Commission to work with the states and NASAA to ensure the timely and expeditious processing of applications for registration filed by those advisers that become ineligible for Commission registration.

Finally, the Institute recommends that the Commission permit an investment adviser to amend its Schedule I during the grace period to indicate its continued eligibility for Commission registration if it has once again become eligible (e.g., due to an increase in its assets under management). This would obviate the need for the Commission to commence administrative proceedings to terminate the adviser's registration.11

IV. Exemptions

The Coordination Act authorizes the Commission to exempt persons from the prohibition on Commission registration. Under this authority, the Commission has proposed Rule 203A-2, which would exempt from the prohibition against Commission registration nationally recognized statistical rating organizations ("NRSROs"), certain pension consultants, certain affiliated advisers, and investment advisers with a reasonable expectation of eligibility.

The Institute supports the exemption for NRSROs and certain pension consultants. Additionally, we support an exemption for those advisers with a reasonable expectation of eligibility for Commission registration. We recommend, however, that the proposed 90 period under Rule 203A-2 be increased to 120 days. We believe a 120 day period more realistically reflects the amount of time it might take a newly formed adviser to assume, as anticipated, management of assets sufficient to make it eligible for Commission registration.12

In addition, the Institute strongly supports the proposed exemption for affiliated advisers. Nonetheless, we believe that limiting it to only those affiliates that share a common principal office and place of business with a Commission-registered adviser is unnecessary and inappropriate. We urge that Rule 203A-2(c) be revised to eliminate the "same address" requirement. According to the Release, the exemption in Rule 203A-2(c) is intended to avoid the burdens that would result from subjecting affiliates of Commission-registered advisers to state registration in those instances in which the adviser and its affiliate are centrally managed or "likely to have overlapping operations, similar books and records, and integrated compliance systems."13 The Commission appropriately recognizes that "compliance with separate schemes of regulation may not permit the integration of such systems and therefore would be burdensome for these advisers." Nevertheless, employing a "place of business" test will result in many affiliated investment advisers being subjected to these very same burdens. The locations of the principal offices of affiliated investment advisers often are of little relevance to how their businesses are conducted. Frequently, these locations are based upon extraneous factors, such as tax or corporate law considerations, that are completely unrelated to how the adviser conducts its business or whether the adviser and its affiliates are integrated in their operations. Moreover, with

today’s technology, it is possible for the books and records and compliance systems of an adviser and its affiliates to be integrated and accessible from a single location even though such entities maintain different physical locations.

We believe that the control test proposed by the Commission is, by itself, sufficient to distinguish between those affiliates that should be eligible to register with the Commission and those that should not.14 If, however, the Commission determines that the proposed control test, standing alone, would be overly broad, rather than employing a place of business test, the Commission should adopt a narrower definition of "control." In particular, Rule 203A-2(c) could be amended to define "control" not as the "power to direct or cause the direction of the management or policies of an adviser", but rather as "directing or causing the direction of the management or policies of an adviser."

V. Persons Who Act On Behalf of Investment Advisers

A. Investment Adviser Representatives

The Coordination Act authorizes states to "license, register, or otherwise qualify any investment adviser representative who has a place of business located within that [s]tate." It does not, however, define the term "investment adviser representative." The Institute is pleased that the Commission has proposed to define this term. While many state laws contain a definition of "investment adviser representative," they are not consistent.15 Also, as noted in the Release, many states define the term to include persons who do not provide advice to retail investors (e.g., portfolio managers of mutual funds).16 Moreover, deferring to state law on this issue would allow states to adopt a definition that is equivalent with or even broader than the term "supervised person" as defined in the Coordination Act.17 Such a result would render the definition of "supervised person" in the Act moot and, therefore, be antithetical to the unambiguous language of the Coordination Act. Thus, leaving the term to be defined by the states would frustrate the objectives of Congress in promoting uniformity and establishing an important but limited role for the states in regulating the activities of certain individuals associated with Commission-registered advisers. Finally, as a general matter, we believe the Commission is in the best position, and has been entrusted by Congress with the responsibility, to define and interpret the meaning of terms included in one of its core statutes.

Proposed Rule 203A-3(a) would define "investment adviser representative" to be a "supervised person" (as that term is defined in the Coordination Act) of an investment adviser, if a substantial portion of the business of the supervised person is providing investment advice to clients who are natural persons. The term "substantial portion of the business" is proposed to be defined as providing advice to natural persons if, during the preceding twelve months, more than ten percent of the supervised person’s clients consisted of natural persons, or more than ten percent of the assets under management by the adviser attributable to the supervised person were assets of clients who are natural persons. The Institute believes that the proposed definition should be modified in several respects, which are discussed below.

1. Clients of the Representative

The Institute recommends that the Commission clarify the scope of the term "clients" as used in proposed Rule 203A-3(a). In particular, we recommend that the proposed Rule define those clients that shall be deemed a single client, as is done in proposed Rule 222-2(a) in connection with determining the number of clients an adviser has for purposes

of the national de minimis standard. This recommendation is intended to clarify and ensure consistency in the treatment of spouses and relatives of clients under the Act.[18]

2. "Substantial Portion of the Business"

a. "Retail" Clients
The Congressional committee reports on the Coordination Act provide no guidance as to which persons providing advice on behalf of Commission-registered advisers Congress intended the states to continue to register. As noted in the Release, however, testimony by NASAA in support of preserving state authority over investment adviser representatives, expressed a concern only about those representatives who deal with "retail" investors.[19]

Recognizing the interests of the states in protecting retail investors, the Commission has proposed an appropriately tailored definition under which institutional investors (i.e., investors who are not natural persons) would not be counted among clientele relevant for determining whether an individual is an "investment adviser representative." We suggest, however, that the definition be further refined by also excluding certain wealthy individuals. These investors, like institutions, generally would not be considered "retail" customers. The Institute recommends that the Commission use the criteria set forth in Rule 205-3 under the Advisers Act to identify these clients.[20]

b. Client Test
As proposed by the Commission, a "substantial portion" of a representative's business would be measured by reviewing either the number of clients of the representative or the amount of the managed assets of such clients. The Institute recommends that the measure be based solely upon the number
of clients of the representative. We believe that the number of clients a representative has is a sufficient determinant of whether the representative is doing a retail business and would be easier to monitor and evaluate than an asset test. Including an assets test as an alternative would require advisers to perform two tests on an ongoing basis for each of their representatives, which is unnecessarily burdensome. In any event, it appears that an asset test is unnecessary. Institutional clients are likely to have disproportionately greater assets under the representative's management, and an asset test accordingly would seem to increase coverage very little over a client test.[21]

3. Dually Registered Investment Adviser Representatives

The Commission requested comment on whether an investment adviser representative that is dually-registered as a broker-dealer representative should be excepted from the definition of "investment adviser representative."[22]

The Institute supports such an exception. Presumably, requiring the state registration of investment adviser representatives is intended to provide the state with jurisdiction over such persons and to ensure that those persons dealing with advisory clients have demonstrated their competency and fitness
to render investment advice. These interests, however, are fulfilled by the representative being registered with the state as a representative of a broker-dealer.[23] Accordingly, it would add no public protection nor fill any jurisdictional gap to require such persons to be dually registered with a state both as a broker-dealer representative and as an investment adviser representative. We also note that, consistent with the intent of the National Securities Markets Improvement Act of 1996 ("NSMIA") to promote uniform state and federal regulatory requirements, adoption of this recommendation would provide for

greater uniformity in the registration process inasmuch as broker-dealer representatives, unlike investment adviser representatives, are currently registered in the states using uniform forms and a uniform filing mechanism (i.e., the Central Registration Depository system).24

B. Place of Business

As with the term "investment adviser representative," the term "place of business" is used but not defined in the Coordination Act. To ensure a uniform nationwide interpretation of "place of business," the Commission has proposed to define this term.25 The Institute supports the proposed definition. We strongly concur in the Commission's view that interpreting this term, as used in the Coordination Act, to be the equivalent of "doing business" "would have the effect of nullifying the restriction that the inclusion of the phrase 'place of business' places on a state's authority to regulate investment adviser representatives."26

Nevertheless, the Release appears inconsistent on this point and may be read to employ a "doing business" test in certain circumstances. In particular, according to the Release:

A place of business need not be a formal office, but it cannot be merely an office of an agent for service of process or a mail box. A place of business may, however, include a hotel room, temporarily rented office space, or even the home of a client, if the adviser representative regularly provides advisory services or solicits, meets with, or otherwise communicates to the client at that location.27

Such a standard would include locations not normally considered, either by the adviser or by any of its clients, as a place of business. For example, the fact that an investment adviser representative may meet on a regular basis with a client at either the client's home or at a hotel room should not result in such locations being deemed the representative's place of business. Instead, "place of business" should be limited to a physical location that is held out to the public through a telephone listing, building directory, business card, stationary, advertising, advisory contract, or otherwise, as a location at which the representative regularly conducts advisory services.28 We believe it is inappropriate and inconsistent with both the Coordination Act and common business usage to deem other locations visited by the representative as its place of business.29

Moreover, the approach suggested in the release would raise various practical issues. For example, if the Commission considers a client's home or a hotel room to be the representative's "place of business," does this mean that the representative would have to list these locations on its Form U-4, Uniform Application for Securities Industry Registration or Transfer," in response to Question 8, which requires disclosure of the representative's "office of employment address"?30 Would the representative then expect to receive mail at these locations from state regulators? Because this is clearly an illogical result, the Institute believes that such locations should not be considered a representative's place of business.

Finally, considering a client's home or a hotel room as a "place of business" may have implications beyond triggering the state registration of an investment adviser representative. As aptly noted by the Commission in its Release, a "doing business" test would nullify the national de minimis exemption, which the Coordination Act created in Section 222 of the Advisers Act.31 Treating a client's home as a place of business could, in large part, render the national de minimis exemption moot.

C. Solicitors

According to the Release, the Commission believes that Section 203A(b) of the Advisers Act does not generally preempt state regulation of a solicitor for a Commission-registered adviser. It is not clear from the Release, however, which solicitors the Commission believes would continue to be subject to state regulation.32 The Institute requests that the Commission clarify that solicitors that fall within the category of "supervised persons" of Commission-registered advisers would not be subject to state regulation, unless they fall within the definition of "investment adviser representative." Congress did not choose to distinguish solicitors from other individuals for purposes of determining who would remain subject to state regulation. Consequently, Section 203A(b) does preempt state regulation of employees of Commission-registered advisers,33 as well as third-party solicitors that fall within the definition of "supervised person," unless these persons are subject to state regulation as "investment adviser representatives." For the reasons discussed above in paragraphs A and B of this section, the category of investment adviser representatives should exclude individuals that do not have sufficient contact with retail investors,34 that are registered as broker-dealer representatives by the state in question, or that do not maintain a bona fide physical place of business in the state in question.

The Institute appreciates the opportunity to comment on the Commission's proposed rules that are intended to implement the provisions of the Coordination Act. If you have any questions regarding our comments above, please contact the undersigned at 202/326-5810.

Sincerely,

Paul Schott Stevens
Senior Vice President and General Counsel

cc: The Honorable Arthur Levitt, Chairman
The Honorable Stephen M.H. Wallman, Commissioner
The Honorable Isaac Hunt, Commissioner
The Honorable Norman Johnson, Commissioner
Barry P. Barbash, Director, Division of Investment Management
Robert E. Plaze, Associate Director, Division of Investment Management

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. 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 461 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.

2 Release No. IA-1601 (December 20, 1996) (the "Release").

3 Release at p. 9.

4 The importance of the Commission's statements in the Release was recently underscored last week when Neil Sullivan, the Executive Director of the North American Securities Administrators Association ("NASAA"), reportedly stated that he was troubled by the

language in the Release that, "States may not... indirectly regulate activities of Commission-registered advisers by enforcing state requirements that define ‘dishonest’ or ‘unethical’ business practices unless the prohibited practices would be fraudulent absent the requirements." BNA Securities Regulation & Law Report, SEC Proposal Takes Wrong Approach to States’ Antifraud Authority, NASAA Says, Vol. 29, No. 5, pp. 129-130 (Jan. 31, 1997).

5 E.g., § 25235, California Corporations Code.

6 Indeed, Congress determined that, "The states should play an important and logical role in regulating small investment advisers whose activities are likely to be concentrated in their home state. Larger advisers, with national businesses, should be registered with the Commission and subject to national rules." S. Rep. No. 293, 104th Cong., 2d Sess. p. 4 (1996) (emphasis added).

7 The Institute requests, however, that the Commission clarify that the requirement in proposed instruction 7(a) to Form ADV-T to exclude "cash and cash equivalents" for determining whether a client’s account is a "securities portfolio" does not cover money market instruments or shares of money market funds, which are typically treated as "securities" in the marketplace and do not appear to be the type of "cash equivalents" that the Commission intended to exclude.

8 Release No. IA-1602 (December 20, 1996).

9 In fact, under Florida law, the state has 90 days from the time an application is deemed complete to either approve or deny the application. It is our understanding that an application is rarely deemed complete upon initial receipt. In such instances, the Florida securities division has up to 30 days to notify an applicant of any deficiencies. The applicant, in turn, has up to 60 days to correct such deficiencies. Once corrected, the state could take the full 90 days to act on the application. See § 120.60(1), Florida Statutes.

10 Because of unique state registration requirements, even 120 days might not provide an adviser sufficient time to become state registered. We assume that where an adviser has demonstrated a good faith effort to become state-registered but has been unsuccessful by the end of the grace period, the Commission would be willing to extend the period.

11 According to the Release, such proceedings would not be commenced until after the expiration of the grace period. At that time, the adviser "would be given notice and an opportunity to show why its registration should not be canceled (i.e., because since the time the adviser has filed its Schedule I to Form ADV, its amount of assets under management had grown)." Release at p. 20.

12 Additionally, a 120 day period would conform to the Institute’s recommended change to the grace period under proposed Rule 203A-1(c).

13 Release at p. 24.

14 We would also note that the use of a control test would be consistent with the test recently proposed by the Commission under the Regulatory Flexibility Act for determining when a "small business" or "small organization" is "affiliated" with a large investment adviser. See Release Nos. 33-7383, 34-38190, IC-22478, and IA-1609 (January 22, 1997). Specifically, Rule 0-7 under the Advisers Act would be amended to deem a small adviser "affiliated" with a large firm if the small adviser "controls, is controlled by, or is under

common control with a large firm." For purposes of Rule 0-7, "control" would "mean the right to vote 25 percent or more of the voting securities of another person, to receive 25 percent or more of the net profits of the other person, or otherwise to direct the person's management or policies."

15 For example, the states of Arkansas, Connecticut, Delaware, Florida, Hawaii, Nevada, New Hampshire, New Mexico, Oklahoma, Oregon, Pennsylvania, and Texas do not define investment adviser representatives consistently with the definition in the Uniform Securities Act.

16 See Release at p. 31.

17 Indeed, the term "investment adviser representative" is defined in the 1986 NASAA Model Amendments to the Uniform Securities Act as:

...any person, officer, director of (or a person occupying a similar status or performing similar functions) or other individual employed by or associated with an investment adviser, except clerical or ministerial personnel, who (1) makes any recommendations or otherwise renders advice regarding securities, (2) manages accounts or portfolios of clients, (3) determines which recommendation or advice regarding securities should be given, (4) solicits, offers or negotiates for the sale of or sells investment advisory services, or (5) supervises employees who perform any of the foregoing.

18 This could be accomplished by adding a new subparagraph to paragraph (a)(2) of the proposed Rule to define the term "client" for purposes of the paragraph (a)(1) of the Rule.

19 Throughout the pendency of the federal legislation that was ultimately enacted as the NSMIA, NASAA consistently expressed a concern with preserving state registration authority over persons that deal with retail investors. For example, in its discussion of investment adviser representatives in its Senate Testimony, NASAA stated, "NASAA recommends that all retail-oriented sales activities be regulated [by the states]. . . Adoption of [NASAA's recommendation for requiring the registration of investment adviser representatives] would insure that an [investment adviser] with a primarily retail clientele would continue to be licensed by the states and the [investment adviser's representatives] employed by the [investment adviser] would continue to have some regulatory oversight." See "Statement of Dee Harris, Director, Division of Securities, Arizona Corporation Commission, President, NASAA, Before the Banking, Housing and Urban Affairs Committee, U.S. Senate, S. 1815, the 'Securities Investment Promotion Act of 1996'" (June 5, 1996) (Emphasis added). Also, the "Sample Letter to Send to the Two Senators of Your State Regarding S. 1815", which NASAA provided to its members to express the state's concern with S. 1815, included the following: "With a greater emphasis on individual responsibility for planning for the future, this bill needs to ensure that investment adviser employees who provide point of sale advice to retail customers satisfy appropriate testing, educational or other standards." (Emphasis added.) Finally, in "NASAA's Recommendations Relating to S. 1815 and H.R. 3005", with respect to state regulation of investment adviser representatives, NASAA states, "NASAA recommends . . . requiring all supervised persons that provide advice to retail clients to be licensed with the states regardless of the size of their [advisory] firm. Supervised persons would be exempt from state licensure if they do not solicit retail business nor hold themselves out as providing investment advice to a retail clientele." (Emphasis added.)

20 Rule 205-3 under the Advisers Act governs those clients with whom an adviser may

enter into an advisory contract that provides for performance based compensation. Under this Rule, the client must be a natural person who has at least $500,000 under management of the investment adviser or who has a net worth that exceeds $1,000,000.

21 In the event that the Commission does not adopt a client test as recommended above, we urge that the test be only an asset test rather than an alternative asset/client test, as proposed. A "one prong" test would be more desirable because of the compliance burdens noted above that are associated with alternative tests under which an adviser would need to monitor both its "retail" assets and its "retail" clients.

22 Release at p. 34.

23 Several states (e.g., Arizona) already have this sort of regulatory scheme in that they do not require an investment advisory firm and/or its representatives to be registered so long as the firm and/or its representatives have fulfilled the broker-dealer registration requirements.

24 In contrast to the uniform forms and procedures used by all states to register broker-dealer representatives, several states continue to require investment advisers and investment adviser representatives to file unique forms with the state for the adviser or its representatives to obtain or maintain registration.

25 As proposed in Rule 203A-3(b), "place of business" would mean "a place or office from which the investment adviser representative regularly provides advisory services or otherwise solicits, meets with, or communicates to clients, unless the investment adviser representative does not regularly provide advisory services or otherwise solicit, meet with, or communicate to clients at any place or office, in which case the place of business of such investment adviser representative will be the residence of each client."

26 Release at p. 36. We similarly concur with the Commission’s view that the Coordination Act not be interpreted to permit a state to require every investment adviser representative to establish a place of business in the state as a condition of doing business in such state.

27 Release at p. 35.

28 The indicia listed correspond to those generally used by the Commission to determine whether an investment adviser qualifies for the exemption from registration under Section 203(b)(3) of the Advisers Act. Under this exemption, an investment adviser is exempt from registration with the Commission if it has had fewer than fifteen clients during the preceding twelve months, does not advise specified entities, and does not hold itself out generally to the public as an investment adviser.

29 The Institute understands the concerns expressed by the Commission with those representatives that may claim to have no place of business. In such instances, we believe that it would be appropriate for the representative’s place of business to be the adviser’s place of business.

30 The Form U-4 is the form most often used by states to register investment adviser representatives. According to the instructions to Item 8 of the Form, the "Office of Employment Address" is "the address at which the applicant is physically located for business purposes."

31 Release at p. 36.

32 We are not aware of any state that currently defines the term "solicitor." Instead, those states that regulate solicitors do so by including them within the definition of "investment adviser representative." In view of the fact that the Commission intends to adopt a definition of "investment adviser representative," which as proposed does not include solicitors, these states may revise their regulations to define "solicitor." States that do not currently regulate solicitors might do so in the future, which would require them to adopt such a definition. Without guidance from the Commission regarding the scope of state authority in this regard, we are concerned that states may define "solicitor" as broadly as possible.

33 The definition of "supervised person" in Section 203A(b) plainly includes all employees, regardless of whether they provide investment advice on behalf of the adviser; the clause "who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser" relates only to "other persons" (i.e., persons who are not a "partner, officer, director..., or employee of an investment adviser"). Any other reading would be illogical; it would not make sense, for example, for the clause "subject to the supervision and control of the adviser" to apply to a partner, officer or director of an investment adviser. Moreover, we note that the predecessor legislation to the Coordination Act, which did not include a definition of "supervised person," nevertheless preempted state regulation of all investment adviser employees. [See proposed amendments in Section 103 of S. 1815.] The term "supervised person" was subsequently added to the legislation to clarify that an independent contractor who provides advice on behalf of a Commission-registered adviser would be treated the same as an employee of an adviser under the legislation. Finally, exempting solicitors who are employees of an adviser appears to be consistent with the discussion in the Release, which states, "Investment advisers frequently engage others to solicit clients on their behalf." (Release at p. 37; emphasis added.)

34 The "ten percent retail client" test, however, would need to be revised in light of the fact that solicitors do not typically have on-going relationships with the investors whom they refer to an adviser and therefore do not have "clients."
