Securities Industry Association
120 Broadway, New York, NY 10271-0080 • (212) 608-1500, Fax (212) 608-1604 • info@sia.com, www.sia.com

April 17, 2003

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549 – 0609

Re: Compliance Programs of Investment Advisers and Investment Companies (Release Nos. IC-25925, IA-2107: File No. S7-03-03)

Dear Mr. Katz:

The Investment Adviser, Investment Company and Self-Regulation and Supervisory Practices Committees (the "Committees") of the Securities Industry Association (SIA)[1] welcome the opportunity to comment on the rule proposals and concept release described in the above referenced SEC release ("the "Release").

While we will offer some observations regarding compliance programs for investment companies, the major focus of this letter will be on investment adviser compliance programs, and most specifically on such programs in the context of advisers who are dually registered as broker-dealers and members of the New York Stock Exchange Inc. ("NYSE") and/or NASD.

As a general matter, the Committees believe that the utilization of written compliance procedures developed and supervised by qualified compliance professionals, and the periodic review of such procedures to assure continued viability, are critical components of any effective compliance program. Furthermore, regardless of whether a client has a brokerage or advisory

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs more than 700,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2002, the industry generated $214 billion in U.S. revenue and $285 billion in global revenues. (More information about SIA is available on its home page: www.sia.com .)

relationship with a firm, he or she is equally entitled to the protections that such programs provide.

A. BACKGROUND

All SIA members are members of the NASD, and a substantial percentage are also NYSE members. As such, they are all subject to the jurisdiction of at least one, and often multiple self-regulatory organizations ("SROs")[2].

Nearly all SIA members are dually registered broker-dealer/investment advisers. In virtually all dual registrant situations, our members utilize integrated compliance programs which provide unified oversight of both broker-dealer and investment advisory activities. From a policy standpoint most compliance procedures have equal applicability to both types of activities.

Additionally, NYSE rules require member firms to designate a qualified compliance official to oversee its compliance programs,[3] and the NASD, while not requiring an individual to be designated as a chief compliance officer or official, does require its members to designate principals responsible for supervision of each component of its business[4].

B. DISCUSSION OF RULE PROPOSAL

We recommend that any adopted rule clarify that dual registrants with integrated compliance programs may rely on these programs, and the compliance professionals charged with administering the programs, to satisfy the rule's requirements. We also recommend that any adopted rule include a safe harbor from supervisory liability for these compliance professionals where they have reasonably performed their duties.

As referenced in the rule proposal, broker-dealers have long been required to develop and implement compliance procedures.[5] As a result, the compliance programs employed to comply with SRO rules relating to broker-dealers also establish the compliance framework for overseeing the vast majority of investment adviser activities. In the relatively few instances where investment adviser regulation has unique characteristics, dual registrants supplement their integrated procedures accordingly.[6]

With respect to the nine specific areas identified in the rule proposal[7], almost without exception, all are already addressed in the integrated compliance procedures of dual registrants.

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[2] These would include a variety of securities and options exchanges.
[3] NYSE Rule 342.13(b).
[4] NASD Conduct Rule 3010(a) (2).
[5] Proposing Release at pg. 5.
[6] Examples would include procedures for monitoring compliance with the principal trading restrictions of Section 206(3) of the Investment Advisers Act of 1940, and procedures to insure that annual offers of Form ADV, Part 2 are made in accordance with Rule 204-3 of the Advisers Act.
[7] See Proposing Release at pgs. 5-6. Among other things, this includes personal trading, allocation practices, disclosure, recordkeeping and safeguarding of customer assets.

Indeed, dual registrants would not be in compliance with applicable SRO rules unless they had written procedures addressing each of these areas, as well as any other areas that relate to their businesses.[8]

Similarly, dual registrants already have in place personnel responsible for administering compliance policies and procedures. Any adopted rule should make clear that a firm's chief compliance officer could continue to oversee both the broker-dealer and investment advisory procedures. With respect to the standards applied to compliance professionals, the Committees recommend that a safe harbor provision be included in any adopted rule. This safe harbor should contain the same type of protection currently afforded to broker-dealer compliance professionals to the extent they may be deemed supervisors under Section 15(b)(4)(E) of the Securities Exchange Act of 1934 (i.e., procedures were established that would reasonably prevent and detect violations and responsible persons reasonably discharged the duties and obligations incumbent upon them).

In light of all of the above, the Committees believe that any final rule should clarify that with respect to dual registrants, they may rely on their integrated compliance programs to satisfy SEC requirements. To do otherwise would lead to a bifurcated and less effective compliance regime.

C. DISCUSSION OF CONCEPT RELEASE

1. Formation of Additional SROs or Other Private Sector Involvement

In recent years there has been an increasing awareness of the costs and confusion often engendered as the result of the layering of tiers of regulation and self-regulation on the securities industry. Even in areas where self-regulation has worked reasonably well, such as with respect to NYSE and NASD regulation of broker-dealers, it has become necessary to develop a coordinated examination program to eliminate duplication of effort. Also, at the urging of the SEC, the NYSE and NASD conducted a survey of members last summer to identify inconsistencies between SRO rules that cause operational inefficiencies. In a comment letter to the SROs, SIA identified 19 significant areas in which NYSE and NASD rules were inconsistent or even contradictory[9]. This list was not all-inclusive, and did not identify areas in which these or other SRO rules and regulations might also be inconsistent with those of the SEC. Thus, formation of one or more additional SROs would run counter to a pre-existing, SEC-supported effort toward consolidating and unifying the regulatory structure.

It is noteworthy that the North American Securities Administrators Association ("NASAA"), which had previously endorsed the formation of an investment adviser SRO, voted earlier this month to rescind that endorsement. In so doing, it noted that the division of labor concerning investment adviser oversight between NASAA and the SEC following adoption of The National Securities Markets Improvement Act of 1996 has been working well. It also

[8] See NASD Conduct Rule 3010(b).

[9] See letter to Barbara Sweeney, Office of the Corporate Secretary, NASD and Donald Van Weezel, Vice President, Regulatory Affairs, NYSE, from Michael H. Stone President, SIA Compliance & Legal Division and Christopher Franke, Chairman, SIA Self-Regulation and Supervisory Practices Committee; August 19, 2002.

expressed concern that an adviser SRO could result in unnecessary and overlapping regulation and potentially become a burden on small business. NASAA's view that the current allocation of regulatory responsibilities is functioning well, is particularly significant because it is state regulators that examine the smaller advisers who are less likely to have comprehensive compliance programs. Since the states believe they are providing effective oversight of the thousands of smaller advisers for whom the SEC no longer has examination responsibility, and the SEC will be receiving substantial additional funding, a portion of which could be utilized to enhance its examination capabilities of large advisers, we believe that the current oversight regime will protect fully the interests of investors.

We also note that a significant percentage of all investment advisory activity is effectuated through broker-dealers, either in their capacity as dual registrants, or custodians. Therefore, clients receiving these services would derive the collateral benefit of the applicable panoply of broker-dealer compliance oversight required under NYSE and/or NASD rules, including the nine core areas articulated in the proposing release.

There would be a similar collateral benefit with respect to investment company transactions, since broker-dealers are the primary distributors of mutual fund shares and the NASD has delegated authority from the SEC to regulate mutual fund advertising[10], and also has oversight responsibility for mutual fund sales practices of broker-dealers.

Given the significant impact which existing SROs thus have on investment advisory and investment company activities, there would be little, if any value added by creating more SROs. The Committees would similarly oppose third-party compliance examinations and expanded audits because concerns such as the lack of uniformity of such reviews and additional costs would seem to outweigh any potential benefits.

2. Fidelity Bonding Requirement For Investment Advisers

In its discussion in the Release, the SEC observes that investment advisers are among the only financial service providers handling client assets that are not required to obtain fidelity bonds[11]. Broker-dealers are subject to such requirements under NYSE Rule 319 or NASD Conduct Rule 3020[12]. The fidelity bond which meets these requirements is referred to as a Standard Form 14 Brokers Blanket Bond, and it is generally similar to fidelity bonds of other financial institutions that custody client assets[13]. By virtue of the broker-dealer SRO rules, dually registered broker-dealer/investment advisers already maintain fidelity bonds covering their advisory activities, and many affiliated investment advisers of broker-dealers maintain fidelity bonding coverage as named insureds on the broker-dealer's fidelity bond. We believe there is no reason why an unaffiliated investment adviser should not be required to maintain similar fidelity bonding coverage.

[10] NASD Conduct Rule 2210.
[11] See proposing release at p.11.
[12] See proposing release, footnote 74.
[13] Banking institutions, for example, carry a Standard Form 24 Bankers Blanket Bond, the terms of which are virtually identical to the Form 14 bond.

D. RECOMMENDATIONS AND CONCLUSION

The Committees support the proposal to require written investment adviser compliance procedures, and to periodically review same, provided it is clarified that dual registrants may rely on integrated written procedures and may conduct periodic reviews of such procedures to satisfy the requirements of any adopted rule.

The Committees believe that given the substantial percentage of advisory and fund activities that are conducted through broker-dealers already subject to extensive SRO regulation, there is little added value to creating an additional SRO layer, or imposing additional reviews by third-parties, which will result in additional cost and create further opportunities for confusion and regulatory inconsistency.

Finally, the Committees would support an investment advisory fidelity bonding requirement, provided it conformed to the requirements to which dual registrants are already subject with respect to their broker-dealer operations.

Thank you for the opportunity to comment. If you have any questions regarding this letter, or if we can otherwise be of assistance, please contact SIA Vice President and Associate General Counsel Michael D. Udoff at (212) 618-0509 or mudoff@sia.com.

Sincerely,

Eileen Ryan
Chair
SIA Investment Adviser Committee

Stuart R. Strachan
Chair
SIA Investment Company Committee

John Polanin, Jr.
Chair
SIA Self-Regulation and Supervisory Practices Committee

cc: Paul F. Roye, Esq.
Cynthia M. Forelli, Esq.
Robert E. Plaze, Esq.