

**Securities Industry Association**

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January 15, 1998

Jonathan D. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street N.W., Stop 6-9
Washington, D.C. 20549

**Re: Proposed Exemption to Allow Investment Advisers to Charge Fees
Based Upon a Share of Capital Gains Upon or Capital Appreciation of
a Client's Account. (Release No. IA-1682, File No. S7-29-97)**

Dear Mr. Katz:

The Investment Adviser and Investment Company Committees ("the Committees") of the Securities Industry Association ("SIA")¹ are taking this opportunity to comment on the above proposed exemption which is designed to liberalize certain of the provisions currently applicable to the use of performance fees, as well as eliminating the provisions that prescribe contractual terms and require specified disclosures.

OVERVIEW

The Committees strongly support and appreciate the Commission's efforts to liberalize Rule 205-3 to permit performance fee arrangements to be customized for individual investors. Certainly, the elimination of required contractual terms that cause administrative burdens to advisers is a step in the right direction. The Committees also note that aside from the net worth requirements for performance fee clients, the disclosures provided under other provisions of the Advisers Act and the Securities Exchange Act of 1934, coupled with the ever increasing level of investor education initiatives, are more than adequate to insure that public investors entering into performance fee arrangements are fully capable of understanding the risks and benefits involved.

Having indicated the Committee's support for liberalization of the provisions relating to contractual provisions and disclosure, we would nonetheless respectfully suggest that given the lack of a history of abuse regarding performance fee arrangements, it may not be necessary to raise the threshold net worth requirements, regardless of inflation. Additionally, it may be appropriate for the Commission to consider making performance fee arrangements also available to some less affluent investors, but retaining some of the contractual and disclosure

requirements with respect to such investors.

DISCUSSION

As noted in the SEC Release, Congress enacted the prohibition against performance fees in 1940 to protect against client advisory fee arrangements that might encourage advisers to take undue risks with client funds, in order to increase advisory fees.² While a potential conflict may still remain, we believe that in today's investment environment, extensive information is broadly available to, and understood by, public investors, particularly those of high net worth or other indicia of investment sophistication, so as to enable them to properly evaluate compensation arrangements.

Also, investors are protected by an extensive body of law under the Advisers Act, related SEC rules and regulations, and state fiduciary laws, among others, which prohibit advisers from engaging in actions which are inconsistent with an investors investment objectives or the stated investment style of the adviser. In particular, section 206 of the Advisers Act is a general anti-fraud provision. These laws, rules and regulations apply regardless of the nature of the compensation arrangement between the adviser and the client. In light of the current availability of information and regulatory oversight, the Committees' strongly support Commission initiatives to eliminate burdensome and unnecessary contractual provisions. We also suggest that performance fee arrangements may well be beneficial to some less affluent investors and that the Commission may wish to consider making such arrangements available to such investors, but retain certain of the contractual and disclosure requirements with respect to them. This might be a desirable alternative to totally depriving such investors of access to performance fee arrangements.

In recent years, general inflation, as well as strong market performance has made performance fee arrangements available to more investors under the existing thresholds of Rule 205-3. By increasing the threshold, as proposed, and possibly indexing it to inflation in the future, the Commission would be reversing this trend, and perpetuating the denial of performance fee arrangements to smaller but still significant investors. Therefore, we urge the Commission not to take this step, but rather to consider the retention of the current threshold.

We support the Commissions' proposal to apply the "qualified purchaser" standard as defined in Section 2(a) (51) (A) of the Investment Company Act as an alternative "test" for performance fee arrangement eligibility. However, we are uncertain it will significantly expand the pool of investors who may avail themselves of such arrangements, as many qualified purchasers already meet the \$750,000/\$1,500,000 proposed threshold.

CONCLUSION

The Committees welcome the Commission's efforts to simplify rules relating to performance fee arrangements. Additionally, the Committee's believe that the Commission should consider allowing at least some less affluent investors to participate in such arrangements, subject to retention of certain contractual and disclosure requirements.

If you have any questions regarding this comment letter or we can be of assistance to the Commission regarding the matters addressed herein, please contact the undersigned or Mike Udoff, Staff Adviser to the Committees, at 212-618-0509.

Sincerely,

Burton M. Fendelman
Chairman, Investor Adviser Committee

Lawrence H. Kaplan
Chairman, Investment Company Committee

cc:

Barry P. Barbash
Robert A. Plaze
Stuart J. Kaswell

Footnotes

¹ The Securities Industry Association is the trade association representing more than 780 securities firms headquartered throughout North America. Its members include securities organizations of all types investment banks, brokers, dealers, specialists, and mutual fund companies. SIA members are active in all markets, and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of investment services and account for approximately 90% of the securities industry's revenue in the United States.

² Release IA-1682, Footnote 3