| asset management group

August 7, 2018

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 4889 (April 18, 2018)
File No. S7-09-18

Dear Mr. Fields:

The Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide our comments to the Securities and Exchange Commission ("SEC" or "Commission") on the Commission's proposed interpretation regarding the standard of conduct applicable to investment advisers, Investment Advisers Act Release No. 4889 (Apr. 18, 2018) (the "Proposed Interpretation").

SIFMA AMG is the voice for the buy-side within the securities industry and broader financial markets, which serve millions of individual and institutional investors as they save for retirement, education, emergencies, and other investment needs and goals. Our members represent U.S. asset management firms whose combined global assets under management exceed $34 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

The Proposed Interpretation is one of three sets of proposals that the Commission has issued that focus on the standards of conduct applicable to investment professionals and helping retail investors understand the differences between investment advisers and broker-dealers. The package of proposals includes proposed Regulation Best Interest, which would establish a standard of conduct for broker-dealers when making recommendations of securities transactions or investment strategies to retail customers,[1] and proposed disclosure requirements and forms, including a brief relationship summary, intended to help retail investors understand the

---

[1] *See* Regulation Best Interest, Exchange Act Release No. 83062 (Apr. 18, 2018), available at https://www.sec.gov/rules/proposed/2018/34-83062.pdf.

differences between investment advisers and broker-dealers, including the standards of conduct applicable to each, and help alleviate retail investor confusion about different types of financial professionals.[2] The Commission issued the Proposed Interpretation, stating that in light of the comprehensive nature of its proposed set of rulemakings, it believed "it would be appropriate and beneficial to address in one release and reaffirm – and in some cases clarify – certain aspects of the fiduciary duty that an investment adviser owes to its clients under section 206 of the [Investment Advisers Act of 1940]" (the "Advisers Act").[3]

SIFMA AMG welcomes the leadership role taken by the SEC to enhance the standards of conduct for broker-dealers and investment advisers to foster a regulatory system that best serves the interests of retail investors.[4] As the principal federal regulator of broker-dealers and investment advisers, the SEC is the proper agency to update the regulatory framework that has served investors for decades. The SEC and its staff have been working on the issues underlying these proposals for many years.[5] The SEC's jurisdiction extends broadly and encompasses retirement as well as non-retirement accounts. Navigating the complex landscape is not an easy task and we commend the SEC and the staff for their work over many years to thoughtfully develop an approach that can ensure investor choice.

While SIFMA AMG applauds SEC efforts to enhance the protections afforded to retail investors and clarify the roles of and standards of conduct applicable to different types of investment professionals, we do not believe that the proposed interpretation or the suggested areas for enhanced regulatory requirements are necessary or appropriate for investment advisers with respect to institutional advisory clients. Our members are concerned that the Proposed Interpretation inappropriately departs from existing precedent in describing the fiduciary duties of investment advisers towards their institutional clients. Our members also are concerned that the three areas suggested by the Commission for possibly adding new federal regulatory requirements for investment advisers will unnecessarily add to their regulatory burdens without

---

[2] Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, Exchange Act Release No. 83063 (Apr. 18, 2018), available at https://www.sec.gov/rules/proposed/2018/34-83063.pdf.

[3] Proposed Interpretation at 5.

[4] Chairman Clayton has emphasized the importance of the concerns of retail investors in this endeavor. *See* Statement at the Open Meeting on Standards of Conduct for Investment Professionals, Apr. 18, 2018 (Statement of SEC Chairman Jay Clayton), available at *https://www.sec.gov/news/public-statement/clayton-statement-open-meeting-iabd-041818*; *see also* Jay Clayton, SEC Chairman, "Statement on Public Engagement Regarding Standards of Conduct for Investment Professionals Rulemaking" (Apr. 24, 2018), available at https://www.sec.gov/news/public-statement/public-engagement-standards-conduct-investment-professionals-rulemaking (regarding the entire rulemaking package, stating that "[t]his rulemaking is designed to serve our Main Street investors").

[5] *See, e.g.,* Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 2011) available at *www.sec.gov/news/studies/2011/913studyfinal.pdf* (SEC staff recommended that the SEC engage in rulemaking to adopt a uniform fiduciary standard of conduct for broker-dealers and investment advisers); Angela A. Hung, et al., RAND Institute for Civil Justice, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers (2008), available at *https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf* (SEC-sponsored study concluded that many retail investors did not understand key differences between broker-dealers and investment advisers).

adding meaningful protections for institutional clients. We also believe that the suggested enhancements also will have a disproportionate effect on smaller advisers and make the formation of new advisers more difficult and costly.

INVESTMENT ADVISERS' FIDUCIARY DUTY

The Proposed Interpretation. In the Proposed Interpretation, the Commission proposed an interpretation of the standard of conduct for investment advisers under the Advisers Act. The Commission stated that the Proposed Interpretation is not intended to be the exclusive resource for understanding an investment adviser's fiduciary duty.

The Proposed Interpretation states that "[t]he Advisers Act establishes a federal fiduciary standard for investment advisers. This fiduciary standard is based on equitable common law principles and is fundamental to advisers' relationships with their clients under the Advisers Act."[6] Drawing from cases such as *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180 (1963) (*"Capital Gains"*), as well as secondary sources, the Proposed Interpretation states that although the federal fiduciary duty is not specifically defined in the Advisers Act or the rules thereunder, it is imposed under the Advisers Act and made enforceable by the antifraud provisions of Section 206 of the Advisers Act based on the nature of the relationship between an investment adviser and a client and the desire to eliminate the abuses that led to the enactment of the Advisers Act in 1940.

The Proposed Interpretation summarizes the fiduciary duty of investment advisers as consisting of the duty of care and the duty of loyalty. Focusing on the duties arising when an investment adviser provides personalized investment advice to clients, the Commission states that an investment adviser's duty of care consists of three separate duties:

- The duty to act in the client's best interest;
- The duty to seek best execution of trades for the client; and
- The duty to provide advice and monitoring over the course of a relationship with the client.

The Proposed Interpretation states that to fulfill the duty to act in a client's best interest, an investment adviser must gather and update information about the client that will form the basis for determining whether the advice given is suitable for and in the client's best interest based on the client's "investment profile." The Proposed Interpretation also discusses the importance of the costs of recommended actions associated with investment advice. The Commission notes that the suitability obligations of an investment adviser can vary depending upon the client's sophistication and goals. The Proposed Interpretation also recognizes that although an investment adviser's fiduciary duty does not require the adviser to recommend the lowest cost investment product or strategy, it would be contrary to an adviser's fiduciary duty for the adviser to select a higher cost product if the lower cost product was otherwise identical.

[6] Proposed Interpretation at 6.

Regarding the duty to seek best execution, the Proposed Interpretation notes that an investment adviser must consider "the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness" to the adviser. The Proposed Interpretation also notes that the duty to provide advice and monitoring over the course of a relationship may be circumscribed by contract in some circumstances, such as financial planning.

In discussing an investment adviser's duty of loyalty, the Proposed Interpretation emphasizes that an investment adviser must not favor its own interests over those of a client. An investment adviser also must not unfairly favor some clients over other clients when allocating investment opportunities. The Commission notes that an investment adviser has a duty to disclose to its clients all material facts relating to the advisory relationship.

SIFMA AMG's Comments. While SIFMA AMG understands the Commission's desire to summarize in one document its views and those of the courts and other authorities as to the fiduciary duty of investment advisers as a counterpart to its other proposals, we have several concerns about the Proposed Interpretation. One concern we have is that while the Proposed Interpretation purports to set forth interpretations that are "generally consistent with investment advisers' current understanding of the practices necessary to comply with their fiduciary duty under the Advisers Act," certain statements made in the release appear to go beyond current requirements.

The core principle of the Advisers Act is that an adviser must seek to avoid conflicts of interest, or at least fully disclose them to clients, and put the clients' interest ahead of the adviser's interest.[7] For this reason, disclosure has always been the key to complying with the fiduciary duties imposed under the Advisers Act. As SEC Chairman Clayton said in recent testimony,

> With respect to an investment adviser's fiduciary duty, let me be clear, because I believe there is substantial confusion in the marketplace. An investment adviser must seek to avoid conflicts of interest *and at a minimum make full and fair disclosure of material conflicts. But it misstates the law and could mislead investors to suggest that investors currently have a legal right to conflict-free advice from an investment adviser.* [emphasis added][8]

We are concerned that the Proposed Interpretation departs significantly from the reliance upon disclosure that is the hallmark of investment adviser regulation. Specifically, in the

---

[7] *See Capital Gains,* 375 U.S. at 191-2.

[8] Testimony before the Financial Services and General Government Subcommittee of the House Committee on Appropriations, Apr. 26, 2018 (testimony of SEC Chairman Jay Clayton), available at https://www.sec.gov/news/testimony/testimony-financial-services-and-general-government-subcommittee-house-committee.

discussion of conflicts of interest, the Commission suggests that there may be circumstances when it is not enough to disclose the existence of a conflict. While our members strongly believe in the necessity of clear, understandable disclosure, we believe that the suggestion that some conflicts are too complex for an investment adviser to be able to fulfill its fiduciary duty through disclosure is not supported in the law. Including the suggestion that full, clear and understandable disclosure may, in some circumstances, not be sufficient is likely to increase the risk of litigation for our members.

In connection with the discussion of when disclosure may not be enough, the Proposed Interpretation states that "where full and fair disclosure and informed consent is insufficient, we expect an adviser to eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed."[9] This statement does not reflect the general understanding of the law as our members and the bar understand it. When an investment adviser has provided full and fair disclosure to a client about a conflict of interest, whether the client is a retail or institutional client, such as disclosing the conflict in Part 2A of the adviser's Form ADV, and the client has entered into or continued a relationship with the adviser following such disclosure, the investment adviser should be able to infer that the client has consented unless applicable law or regulations or the investment advisory agreement provide otherwise. We respectfully request that the Commission remove this statement from the final interpretation.

Our members are concerned about certain inconsistencies in how the elements of fiduciary duty are described in the Proposed Interpretation. For example, in discussing an investment adviser's duty of loyalty, the Proposed Interpretation first states that it "requires an investment adviser to put its client's interests first,"[10] while elsewhere the Proposed Interpretation describes the duty as a duty not to "subrogate its clients' interests to its own"[11] or to "subordinate its clients' interests to its own."[12] The assertion that an investment adviser must put clients' interests "first" is very different from saying that they may not "subordinate" or "subrogate" clients' interests, and is inconsistent with how the duty of loyalty has been applied in the past. For example, an obligation to put client interests first could be read as forbidding an investment adviser from aggregating trades for client accounts and accounts in which the adviser or its personnel have an interest. However, many investment advisers have adopted policies and procedures based on the SEC staff's position that an investment adviser may aggregate trades for client accounts and accounts in which the adviser or its employees have an interest, provided the adviser discloses its policies regarding trade aggregation and follows appropriate procedures to ensure clients are treated fairly.[13] Accordingly, we respectfully request that the Commission consider revising the Proposed Interpretation to eliminate this and other discrepancies in how the fiduciary duties are described.

---

[9] Proposed Interpretation at 19.
[10] *See id.* at 15.
[11] *See id.* at nn. 10, 18, 38 (citations omitted).
[12] *See id.* at 7, 16.
[13] *See* SMC Capital, Inc., SEC No-Action Letter (Sept. 5, 1995), available at https://www.sec.gov/divisions/investment/noaction/1995/smccapital090595.pdf.

The Proposed Interpretation is inconsistent in its discussion of the ability of an investment adviser and a client to define the scope of their relationship and the adviser's duties by contract. On the one hand, the Proposed Interpretation states that an investment adviser and its client may shape their relationship via contract when the client receives full and fair disclosure and provides "informed consent."[14] Yet, the Commission then states that an investment adviser cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary duty.[15] SIFMA AMG is concerned that the discussion of the limits on and additional requirements for how an investment adviser and its client may contractually define the scope of the adviser's services and duties is confusing and may unnecessarily increase the risk of litigation for our members. We respectfully request that the Commission clarify these comments and reaffirm the ability of an investment adviser and its client to contractually agree to terms that modify the scope of services and duties of the adviser, provided the client is given full and fair disclosure.[16]

Certain of the issues that are of concern to our members arise because the Proposed Interpretation does not distinguish between fiduciary duties owed to retail and institutional or other sophisticated clients. The Proposed Interpretation states at note 4 that "[a]n investment adviser has a fiduciary duty to all of its clients, whether or not the client is a retail investor," which seems to suggest that an investment adviser must treat sophisticated and non-sophisticated clients the same in rendering its services and structuring the relationship. SIFMA AMG respectfully suggests that this is an over-simplification of the duties that have been articulated vis-à-vis different types of clients. Statements in the Proposed Interpretation about the adequacy of disclosure and the ability to negotiate the scope of an investment adviser's duties appear to be aimed more at investment advisers' interactions with retail clients.

Another example of this is the Proposed Interpretation's broad statement that an investment adviser must not unfairly favor some clients over other clients when allocating investment opportunities.[17] Read together with the statement about investment advisers being unable to negotiate or disclose away their fiduciary duties, this suggests that an investment adviser always must allocate investment opportunities *pro rata*. Yet it is not uncommon for investment advisers with institutional clients to negotiate with such clients (or their representatives) regarding certain investment opportunities that could result in the client receiving a proportionally smaller allocation or an allocation based on a different agreed-upon methodology. Where there is full and fair disclosure of the material facts surrounding the proposed transaction and the parties are sophisticated investors, this sort of transaction should not be deemed a violation of fiduciary duty on the part of the investment adviser. Such a result

[14] *See* Proposed Interpretation at 8.
[15] *Id.*
[16] In this regard, we note that the SEC staff has previously taken the position that an investment adviser and its client may define the nature of their relationship, including by including a "hedge clause" in their investment advisory contracts limiting the adviser's liability to acts involving gross negligence or willful malfeasance, provided the client is not led to believe that he or she has waived nonwaivable rights of action against the adviser in violation of section 206 of the Advisers Act. *See* Heitman Capital Management (SEC No-Action Letter) (Feb. 12, 2007), available at https://www.sec.gov/divisions/investment/noaction/2007/heitman021207.pdf ("Heitman").
[17] *See* Proposed Interpretation at 16-17.

would restrict institutional investors' access to desired limited investment opportunities, especially in private investments.

Many of SIFMA AMG's members are investment advisers whose clients often work with consultants or other financial professionals who are sophisticated and knowledgeable about the investment advisory services they receive. The SEC staff in the *Heitman Capital* letter,[18] said that the sophistication of the client or the involvement of a sophisticated intermediary assisting a client would be a factor in considering whether a hedge clause was misleading in violation of an investment adviser's fiduciary duty, and the SEC and its staff have similarly distinguished between the duties owed to institutional or other sophisticated clients and retail clients.[19] Accordingly, we respectfully request that the SEC clarify its views on the important role played by the sophistication of a client, or the involvement of a sophisticated intermediary, in determining whether an investment adviser has fulfilled its fiduciary duty under all of the facts and circumstances.

More broadly, our members are concerned that, unlike the situation with Regulation Best Interest, where the Commission is seeking to raise the bar by establishing a new federal standard of conduct for broker-dealers, the Proposed Interpretation suggests that the Commission is merely restating the law and not breaking any new ground. In the view of our members, the basic requirements for an investment adviser to fulfill its fiduciary duty are well-known to the investment management community, having been articulated over the course of decades in case law, previous SEC rulemaking and other recognized authorities. Nevertheless, SIFMA AMG believes that if a general statement summarizing the fiduciary duty of investment advisers is needed, the SEC would be the proper agency to issue such an interpretation, since it has the expertise and experience to appreciate the nuances involved in determining what is consistent with an investment adviser's fiduciary duty. We respectfully suggest that if the SEC decides to adopt a broad interpretation of such a fundamental precept as the fiduciary duty of investment advisers, which very likely will be viewed by the public and the industry as having significant authority, it should be founded on a stronger, more direct connection to relevant court cases and other authoritative sources of the law than that presented in the Proposed Interpretation.[20]

We also are concerned that the proposal to adopt Regulation Best Interest, particularly the requirements relating to disclosing conflicts and mitigating, or eliminating, conflicts relating to

---

[18] *See* Heitman, *supra* note 16.
[19] *See, e.g.,* Advisers Act Rule 205-3 (investment advisers permitted to enter into agreements with "qualified clients" providing for compensation based on a share of capital gains or capital appreciation of the client's assets); Credit Suisse First Boston, LLC, SEC No-Action Letter (Aug. 31, 2005) (investment adviser permitted to rely on global consents, rather than transaction-by-transaction consents, for certain principal transactions with high net worth individuals and institutional clients); Investment Company Institute, SEC No-Action Letter (Sept. 23, 1988) (adviser's presentation of gross performance results without showing results net of fees would not be misleading if made in one-on-one presentations to sophisticated investors, provided sufficient disclosure is made and clients given opportunity to ask about fees).
[20] *Cf.* SEC Commissioner Michael S. Piwowar, *Statement at Open Meeting on Form CRS, Proposed Regulation Best Interest and Notice of Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers (Proposed Rule)*, Apr. 18, 2018, *available at* https://www.sec.gov/news/public-statement/statement-piwowar-041818.

financial incentives, will be presumed applicable to investment advisers. As fiduciaries, registered investment advisers do, of course, disclose conflicts of interest in Part 2A of Form ADV. If the proposed Regulation Best Interest requirement is adopted, we respectfully request that the Commission clarify that it will not form a baseline against which investment adviser conduct will be judged.

REQUEST FOR COMMENT REGARDING AREAS OF ENHANCED INVESTMENT ADVISER REGULATION

In addition to the discussion of fiduciary duty, the Commission discussed three areas where it is considering imposing new regulatory requirements on investment advisers. The Commission framed this discussion as intended to further the harmonization of regulation as between investment advisers and broker-dealers and to enhance the investor protections provided to investment advisory clients. SIFMA AMG appreciates the opportunity to comment on these areas.[21]

General Comments. As we noted earlier in the letter, we are writing on behalf of SIFMA AMG members that are investment managers to institutional clients. Since the three areas the SEC focuses on are issues of concern for investment advisers to retail clients, we respectfully request that if regulatory action is to be taken with respect to any of these matters, the SEC give serious consideration to limiting their applicability accordingly.

SIFMA AMG members are concerned about layering on additional requirements for investment advisers simply because the requirements are similar to the broker-dealer regulations. SIFMA AMG respectfully suggests that if the Commission were to pursue any of these additional regulatory requirements, the Commission should articulate a need related to investor protection and apply those rules to the relevant types of investment advisers. Since retail and institutional clients often have different needs and present different issues, SIFMA AMG believes that harmonizing the regulations applicable to broker-dealers and investment advisers is primarily an issue of importance to retail clients, and that imposing these types of requirements on investment managers with respect to their institutional clients will not add materially to the protection of those clients. [22]

SIFMA AMG members also are concerned about the impact that adding these new regulations will have on competition, and particularly the ability of new firms to enter the market

---

[21] This comment letter expresses the views of SIFMA AMG's members as investment managers to institutional (versus retail) clients. With respect to regulatory harmonization, these views are separate and distinct from those expressed in SIFMA's separate comment letter submitted on behalf of its broader membership (both broker-dealer and investment adviser), which focuses more on issues of concern to retail clients.

[22] We also note that these additional requirements would not serve to enhance investor protections in the context of the provision of investment advisory services to retail clients of sponsors of the different types of wrap programs that are available in the marketplace. For instance, client assets are held by a custodian designated by the program sponsor; clients receive quarterly statements from the program sponsor; and program clients typically have no direct contact with the investment manager. Accordingly, we believe that such scenarios should be excluded from any prospective rulemaking in this area.

to offer investment advisory services. We expect that such new requirements also will present cost issues that will have a greater impact on smaller advisers. In light of the likely impact that these costs would have on the market for investment advisory services, we respectfully request that any effort to impose these types of regulations on investment advisers be conducted through a notice and comment rulemaking process that will consider the costs and economic impact of the proposals. We also respectfully request that any such rulemaking be targeted at areas that will respond to a real investor protection need, and not be simply about eliminating regulatory differences between investment advisers and broker-dealers. If the Commission were to proceed with rulemaking in any of these areas, we request that investment advisers be given at least 24 months to come into compliance with any new requirements that are eventually adopted.

Licensing and Continuing Education. One of the areas about which the Commission asked for comment is whether investment adviser personnel should be subject to licensing and continuing education requirements under the Advisers Act. The Commission noted that most states require investment adviser representatives who have a place of business in the state to be registered, licensed or meet certain other qualifications.

Since the states already have adopted comprehensive requirements for investment adviser representatives, we urge the SEC not to adopt a duplicative federal licensing and continuing education requirement for investment adviser personnel, particularly for personnel who service institutional clients. We respectfully submit that licensing and continuing education requirements will do little to enhance investor protection. Rather, it will increase costs for investment advisers and erect another barrier to entry for individuals. We urge the SEC to consider whether the lack of a federal licensing and continuing education requirement is causing problems.

We note that the Advisers Act and the rules thereunder already contain a number of provisions that keep bad actors out of the investment advisory business, including the requirement for investment advisers to disclose legal and disciplinary events on Form ADV. The SEC has the power to bar bad actors from involvement with investment advisers under Section 203 of the Advisers Act.[23] Proposed new Form CRS also will direct retail investors to information about any legal and disciplinary information about investment advisers and their personnel. In light of these existing protections, we respectfully submit that adding a federal licensing and continuing education requirement for investment advisers seems unlikely to materially deter bad actors and seems unnecessary for good actors.

If, notwithstanding these various concerns, the Commission were to go ahead with a federal licensing and continuing education requirement, we would urge the SEC to limiting the applicability of any eventual requirements to investment advisers and their personnel who provide investment advisory services to retail clients (*e.g.,* persons currently within the definition

[23] Similarly, "bad actors" are barred from involvement in private securities offerings relying on Rule 506 under the Securities Act of 1933. *See* 17 C.F.R. 230.506. The disqualification provisions apply to investment managers of pooled investment vehicles that make such offerings, as well as their directors, executive officers, and other officers participating in the offering, among others.

of "investment adviser representative" in Rule 203A-3 under the Advisers Act). We know of no evidence suggesting that a lack of licensing or continuing education requirement for personnel who provide investment advisory services to institutional clients has been the cause of any issues. This limitation also would be consistent with the Commission's overarching concern to enhance the protections for retail investors through this and the other proposals.

We also request that the Commission consider the fact that many states that already have licensing and continuing education requirements provide exceptions for individuals who have achieved certain levels of education or experience or who have attained certain designations (e.g., Chartered Financial Analyst). We urge the SEC to consider carving these persons out of any eventual federal requirements.

SIFMA AMG is further concerned about how a federal licensing and continuing education program will be administered. We respectfully request that the SEC carefully consider whether it has the resources and experience to administer such a program.

Account Statements. Another area the Commission indicated it was considering adding new requirements for investment advisers is whether to require registered investment advisers to send periodic account statements to their clients. The SEC noted that under Advisers Act Rule 206(4)-2, an investment adviser with custody of client funds or securities must have a reasonable belief that the qualified custodian sends the client an account statement at least quarterly, and that in separately managed account programs relying on Rule 3a-4 under the Investment Company Act of 1940, clients must receive a statement at least quarterly from the sponsor or another person designated by the sponsor.

SIFMA AMG's members generally provide investment advice to institutional clients, and they usually are required to provide statements under the terms of their investment advisory contracts. In addition, a client's prime broker and custodian also issue statements providing the client with information about asset values and expenses. Requiring investment advisers to provide similar statements to these clients would be duplicative and unnecessary. Accordingly, we believe that this issue, and the associated costs and regulatory burden, is more likely to have an impact on retail investment advisers and smaller advisers. We respectfully urge the Commission to give full consideration to these added burdens and costs and the impact that they would have on barriers to entry, should the Commission decide to proceed, and limit the applicability of any requirements to clients not already receiving statements from their custodians or prime brokers.

Financial Responsibility Requirements. Finally, the Commission asked whether registered investment advisers should be subject to financial responsibility requirements, such as requirements to maintain minimum capital, obtain a fidelity bond, obtain an annual audit and file audited financial statements with the SEC. SIFMA AMG believes that these sorts of requirements are inappropriate for investment advisers that serve institutional clients and would oppose them, as institutional clients have the experience and expertise needed to understand the risks involved in retaining an investment adviser and are able to take steps to protect themselves.

Requiring registered investment advisers to meet financial responsibility requirements would be a significant departure from the general approach to regulating investment advisers under the Advisers Act, which always has emphasized disclosure. The SEC has in place a number of relevant disclosure requirements. Thus, many registered investment advisers, including investment advisers that have discretionary authority to manage client assets, already are required to disclose on Form ADV Part 2A (Item 18) any financial condition that is reasonably likely to impair their ability to meet contractual commitments to clients. A registered investment adviser is required to disclose in its brochure if it has been the subject of a bankruptcy petition at any time during the previous ten years and the current status of the matter. In addition, registered investment advisers that require or solicit prepayment of more than $1,200 in fees per client, six months or more in advance, are required to include a balance sheet for their most recent fiscal year with their brochure.

Financial responsibility requirements of the type imposed on broker-dealers are inappropriate for investment advisers because the services provided and risks posed by those services are so very different. Investment advisers provide advice. There is no guarantee that a client will not lose money resulting from the advice. Investment advisers do not hold their clients' assets, even for short periods of time.[24] Instead, client assets are held at a qualified custodian. Therefore, even if the client's investment adviser were to become insolvent, the client would still have access to his or her assets at the custodian.[25] In appropriate cases, such as when the investment adviser is a "related person" of the custodian, the investment adviser must comply with the custody rule, Advisers Act Rule 206(4)-2, which provides substantial protection to clients.[26] Many brokers, on the other hand, do hold client assets, so the risks to those assets are much higher in those cases. We believe that the risks of a registered investment adviser or its personnel absconding with client assets are adequately addressed through the requirements of the custody rule.

We respectfully submit that the broker-dealer net capital rule is not a good model for the sorts of protections needed for investment advisory account assets. The Commission suggested that a minimum capital requirement could be useful to help ensure clients are made whole in the event of wrongdoing by an investment adviser. However, the broker-dealer net capital rule does not serve the purpose of making clients whole in the event of wrongdoing by the broker. Its purpose is to ensure that the broker has sufficient capital to be able to cover its operating expenses and to ensure that it can be wound down in an orderly fashion if necessary. This is not the concern that the SEC expressed in suggesting this requirement for advisers.

---

[24] In order to avoid having custody under Rule 206(4)-2, an investment adviser must return any client assets that it receives within three business days. Staff Responses to Questions About the Custody Rule, Question II.1 available at https://www.sec.gov/divisions/investment/custody_faq_030510.htm.
[25] We note that in the event that the investment adviser is a dual registrant and also serves as the qualified custodian, the dual registrant would already be subject to financial responsibility requirements. *See infra* n.26.
[26] The custody rule requires that investment advisers keep all client assets with a qualified custodian, Rule 206(4)-2(a)(1). In order to be a qualified custodian, the entity must be a bank, broker-dealer, futures commission merchant or foreign financial institution that customarily holds financial assets for customers. Rule 206(4)-2(d)(6). Each of these entities is already subject to stringent financial responsibility requirements.

It is unclear how a minimum capital requirement based on the amount deemed necessary to compensate clients in the event of wrongdoing that resulted in losses would be calculated. We believe that this could dramatically increase costs for registered investment advisers, and make it extremely difficult for smaller investment advisers to survive. A minimum capital requirement also may have significant tax implications for investment advisers that are taxed as limited partnerships. We urge the SEC to consider these impacts if it decides to proceed with these types of requirements.

The Commission also asked for comment about whether a fidelity bonding requirement should be imposed on registered investment advisers. Since many SIFMA AMG members provide investment advice to retirement plans that are subject to the requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"), they already have fidelity bonds complying with applicable ERISA requirements. A fidelity bond requirement will increase costs and barriers to entry for smaller investment advisers and other advisers that, for one reason or another, do not already have a fidelity bond in place.

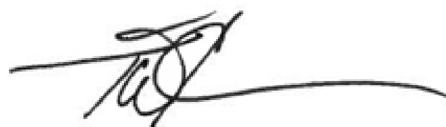
SIFMA AMG also objects to requiring that registered investment advisers obtain an annual audit and submit audited financial statements to the SEC. Here again, such a requirement will add significant costs and barriers to entry for participants in this industry and provide little, if any, benefit to clients. Moreover, we note that members of SIFMA AMG that are members that are privately held treat this information as very sensitive and confidential information. Being required to submit the information to the SEC, whether with Form ADV or otherwise, raises significant privacy concerns for privately held firms, and therefore we would urge the SEC not to impose such a requirement.

* * * * * *

CONCLUSION

SIFMA AMG sincerely appreciates the opportunity to comment and your consideration of these views. We stand ready to provide any additional information or assistance that the Commission might find useful. Please do not hesitate to contact either Timothy Cameron at 202-962-7447 or tcameron@sifma.org or Lindsey Keljo at 202-962-7312 or lkeljo@sifma.org with any questions.

Sincerely,



Timothy W. Cameron, Esq.
Asset Management Group – Head
Securities Industry and Financial Markets Association

Lindsey Weber Keljo, Esq.
Asset Management Group – Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

cc: The Honorable Jay Clayton
The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce

Dalia Blass, Director, Division of Investment Management