August 15, 2017

Craig S. Phillips
Counselor to the Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Re: Executive Order 13772

Dear Mr. Phillips:

The Investment Adviser Association[1] (IAA) appreciates the opportunity to provide comments as the Department of Treasury considers asset management issues in developing its reports pursuant to Executive Order 13772, "Core Principles for Regulating the United States Financial System."[2] Consistent with the Core Principles, we support ways to empower Americans to save for retirement and build individual wealth, make the regulation of SEC-registered investment advisers more efficient, effective, and appropriately tailored, advance American interests internationally, restore public accountability within Federal financial regulatory agencies, and rationalize the regulatory framework for SEC-registered investment advisers.

The IAA is the leading organization dedicated to advancing the interests of SEC-registered investment advisers. The IAA's more than 640 member firms reflect the broader investment advisory industry and range from many of the world's largest asset managers to the small and medium-sized firms that reflect the core of the investment management industry. Collectively, our members manage more than $20 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. Our members play an important role in helping individuals meet their financial goals, including investing for retirement, home ownership, or education. Indeed, investment advisers are dedicated to helping "Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth" (Core Principle (a)). Further, our members' investments on behalf of clients in businesses large and small help those companies grow and create jobs. The asset management industry itself is a strong contributor to our economy, steadily adding firms, jobs,

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms registered with the U.S. Securities and Exchange Commission (SEC). For more information, please visit www.investmentadviser.org.

[2] Executive Order 13772, *Presidential Executive Order on Core Principles for Regulating the United States Financial System* (Feb. 3, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states.

and investors.[3] And, as the "buy-side," our members are critical to the vibrancy of our leading capital markets.

The IAA previously has made recommendations to the SEC, CFTC, and the Department, as well as to Congress, on how to make a number of current and proposed regulations more efficient, effective, and appropriately tailored to the stated objective while maintaining robust investor protection. This letter summarizes at a very high level for the Department's consideration those recommendations that reflect many of our most critical policy priorities. We attach more detailed analyses and would be pleased to provide any additional information that may be helpful in the Department's review. The Department's upcoming report will play an important role in addressing the cumulative effect on our members of an ever-increasing and duplicative array of regulations from domestic and international regulators.

I. Systemic Risk and Stress Testing

We understand that the Department will address the Financial Stability Oversight Council (FSOC) and its designation process in a separate report but we take this opportunity to emphasize our view that prudential regulation of asset managers is inappropriate. As we have stated in numerous comments, some of which are attached, asset managers do not present systemic risk and are fundamentally different from banks. In fact, far from being a source for creating or exacerbating systemic risk, the asset management industry engages in activities and performs functions that consistently moderate such risks.

FSOC/SIFIs—Core Principle (f)—efficient, effective, and appropriately tailored; Core Principle (g)—public accountability and rationalizing regulatory framework. We oppose the designation of any individual asset manager or fund as a systemically important financial institution (SIFI) by FSOC. Indeed, we support repeal of FSOC's authority to designate an asset manager as a SIFI. Short of repeal, we urge FSOC to recognize that the SEC is in the best regulatory position to assess and, if necessary, address any risks in the asset management industry. FSOC should allow the results of the SEC's recent regulatory initiatives to play out before making any further recommendations with respect to the asset management industry. We also stress the importance of obtaining and evaluating good data, and thoroughly understanding asset management products and services, before forming any potential regulatory responses.

In addition, as the Department reviews the FSOC determination and designation process pursuant to a recent Presidential Memorandum, we support efforts to bring much-needed

[3] The recently-released *2017 Evolution/Revolution: A Profile of the Investment Adviser Profession (Evolution/Revolution Report)*, a joint study by the IAA and National Regulatory Services, shows the number of SEC-registered investment advisers grew to 12,172, a net increase of 2.7%. Investment advisers now manage more than $70 trillion in assets as fiduciaries for their clients. The industry employs more than 778,000 non-clerical employees, more than 400,000 of whom provide investment advisory services, including research. Findings are based on Form ADV, Part 1 data filed by all SEC-registered investment advisers as of April 10, 2017. (See **Exhibit A** for the *2017 Evolution/Revolution Report.)*

transparency and due process to FSOC's work.[4] These steps will help restore accountability within Federal financial regulatory agencies, consistent with Core Principle (g).

(See **Exhibit B** for the joint comment letter dated March 25, 2015 submitted by the IAA and the Asset Management Group of the Securities Industry and Financial Markets Association to FSOC on its notice seeking public comment on whether asset management products and activities may pose potential risks to the U.S. financial system.)

FSB/Structural Vulnerabilities from Asset Management Activities—Core Principle (e)—advance American interests internationally; Core Principle (f)—efficient, effective, and appropriately tailored. We have also commented on relevant systemic risk issues in response to the Financial Stability Board (FSB) consultation on proposed policy recommendations to address structural vulnerabilities from asset management activities. As we told the FSB, we believe that the International Organization of Securities Commissions (IOSCO) is in the best position to encourage local securities regulators in each jurisdiction, such as the SEC, to develop appropriate approaches for each particular jurisdiction. We also think that the FSB's recommendation that IOSCO develop a single simple way to measure leverage in funds will prove to be very difficult on a worldwide basis and that IOSCO's time and energy would be better spent on a comprehensive survey on that topic.

(See **Exhibit C** for the IAA's letter to the FSB dated September 21, 2016.)

Stress Testing—Core Principle (f)—efficient, effective, and appropriately tailored. We support repeal of section 165(i) of the Dodd-Frank Act to the extent it requires the SEC to adopt rules requiring large funds and large advisers to conduct stress tests. In the alternative, we urge the SEC to refrain from rulemaking in this area. Such a rulemaking is unnecessary given the nature of investment advisory firms (which traditionally operate with little or no leverage, do not bear the market risk of their clients' investments, and do not actually hold their clients' assets), and the SEC's adoption of new rules designed to promote effective liquidity risk management by mutual funds.

II. SEC Rules

The IAA recently sent a letter to SEC Chairman Jay Clayton highlighting the many regulatory challenges affecting investment advisers and offering to work with the SEC as it looks for ways to make its regulatory oversight of asset managers more efficient and effective. We also urged the SEC to apply more robust and comprehensive cost-benefit analyses to regulations, both new and old, consider alternative approaches to regulation, and factor in the cumulative impact of all regulations affecting investment advisers. (See **Exhibit D** for the IAA's letter to Chairman Clayton dated May 10, 2017.)

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[4] *Presidential Memorandum for the Secretary of the Treasury* (April 21, 2017), *available at* https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-memorandum-secretary-treasury.

We respectfully request that the Department consider the following recommendations we made to the SEC in light of Core Principle (a) – to "empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth" – Core Principle (f) – to "make regulation efficient, effective, and appropriately tailored" – and Core Principle (g) – to "restore public accountability" within the SEC and "rationalize the Federal financial regulatory framework."

1. Review, modernization, and streamlining of existing regulations under the Investment Advisers Act of 1940 (Advisers Act)—*Core Principle (a)—informed choices, save for retirement, and build wealth; Core Principle (f)—efficient, effective, and appropriately tailored; Core Principle (g)—public accountability and rationalizing regulatory framework.* The principles-based regime established under the Advisers Act has proven to be robust in protecting investors while allowing the profession to grow to the benefit of clients and the capital markets. However, the investment management landscape has evolved significantly over the last 77 years, led by dramatic changes in technology and communications. It is therefore appropriate for the SEC to initiate retrospective reviews of certain core regulations governing investment advisers to ensure that they are effective, efficient, tailored, and appropriately targeted to protecting investors and fostering capital formation. As part of its retrospective review of existing regulations, the SEC should consider changes in the following areas:

   a. *Small Business Impacts.* The SEC should conduct a more realistic assessment of the impact of regulations on smaller advisers and better tailor its rules to such firms. Indeed, the SEC should change how it defines "small business" for purposes of analyzing the economic impact of its rules – the current definition is meaningless. (In addition to the IAA's letter to Chairman Clayton, see **Exhibit E** for the IAA's letter to the Senate Banking Committee dated April 14, 2017)

   b. *Advertising Rule.* The Advertising Rule, which has not been substantively amended since 1961, has not kept pace with technology, social media, and other communications developments. The SEC should modernize the Advertising Rule by eliminating the prohibitions on testimonials and past specific recommendations and streamlining existing guidance.

   c. *Custody Rule.* We support the investor protection goals of the Custody Rule. However, the Rule is overly complex and burdensome and has caused unnecessary confusion and costs. Further, recent staff guidance issued without notice and comment has generated significant concern and uncertainty in the industry. The SEC should immediately revise or withdraw its guidance to address these concerns and then proceed to rationalize and streamline the Rule holistically.

   d. *Pay-to-Play Rule.* We recommend that the Commission review the efficiency and effectiveness of the Advisers Act rule governing political contributions by

investment advisers. The IAA strongly agrees with the SEC's goals in preventing investment professionals from "buying business" through campaign contributions. However, the Pay-to-Play Rule is unnecessarily complex, costly, and burdensome and should be more narrowly tailored to its intended purpose. For example, we have recommended that the SEC rethink the way the Pay-to-Play Rule currently imposes draconian penalties for even the most minor violations or "foot faults," among many recommendations in the attached letter.

e. *Electronic Delivery.* We strongly recommend that the SEC take action to facilitate electronic delivery of required disclosures. The electronic delivery rules have not been updated in more than 15 years and the use of the Internet has changed significantly since then. Electronic delivery should be the default option, while clients should retain the opportunity to request receipt of disclosures and reports on paper.

f. *Private Offerings.* The SEC should promote capital formation and empower Americans to build wealth by reassessing certain rules relating to private offerings, such as the definition of accredited investor. The SEC should also review and revise the definition of "qualified institutional buyer."

2. Certain outstanding SEC proposed rules—*Core Principle (a)—informed choices, save for retirement, and build wealth; Core Principle (f)—efficient, effective, and appropriately tailored.*

a. *Adviser Business Continuity and Transition Plans*. We strongly recommend that the SEC withdraw its proposed rule on adviser business continuity and transition plans and consider whether interpretive guidance for business continuity only would be an appropriate alternative. This approach would more effectively and efficiently achieve the SEC's goals, while allowing for a principles-based, and thus appropriately tailored, approach to business continuity planning. We also believe that no further SEC action is warranted or appropriate relating to transition planning by advisers.

b. *Use of Derivatives by Registered Investment Companies and Business Development Companies*. We recommend that the SEC withdraw its rulemaking and reconsider the imposition of portfolio limits. The use of portfolio limits represents a significant change in the SEC's approach to regulating funds' use of derivatives, and would supersede decades of guidance, so much so that the SEC states that it would cause some currently operating funds to cease operating as registered investment companies. In our view, portfolio limits are unnecessary to protect investors or appropriately limit leverage in fund portfolios, and ultimately will reduce investor access to certain types of funds and portfolio strategies—including some that serve to mitigate investment risk—that are beneficial to investors. Portfolio limits

could also have a negative impact on capital formation, market participation, and market efficiency.

3. Ongoing regulatory debates involving investment advisers where there is a potential for additional regulation. Although they are not currently the subject of specific rulemaking, we note that there are other potential issues for which the SEC should adhere to certain of the Core Principles. Two primary examples are: (a) considering the appropriate standard of care for broker-dealers and (b) SEC oversight and examinations of investment advisers.

a. *The Importance of Maintaining the Existing Fiduciary Duty of Investment Advisers—Core Principle (a)—informed choices, save for retirement, and build wealth; Core Principle (f)—appropriately tailored*. The IAA strongly supports the fiduciary standard and has long advocated that financial professionals providing investment advice about securities to clients be required to act as fiduciaries in the best interest of their clients. Investment advisers are already subject to this standard. In considering appropriate rulemaking in this area, we urge the SEC to focus on the standard of care for brokers and refrain from rulemaking with respect to the robust fiduciary principles already embodied in the Advisers Act. We recommend that the SEC promulgate a principles-based "best interest" standard of conduct for brokers under the Exchange Act of 1934 that is as stringent as the Advisers Act fiduciary duty.

Given our core belief regarding the importance of fiduciary duty, we support the goals underlying the Department of Labor (DOL) fiduciary rule. We also have commented that the DOL fiduciary rule as adopted and interpreted should be more appropriately tailored to discretionary investment advisers, which already are fiduciaries under the Advisers Act and under ERISA.

(See **Exhibit D** for the IAA's letter to Chairman Clayton; **Exhibit F** for the IAA's letter to the DOL dated July 21, 2015; and **Exhibit G** for the IAA's letter to the DOL dated August 7, 2017.)

b. *SEC Oversight and Examinations of Investment Advisers—Core Principle (g)—public accountability.* Effective oversight of the advisory profession is critical to investor protection as well as investor confidence. We believe that the SEC – an experienced and accountable governmental regulator – should retain its primacy in investment adviser regulation. This is consistent with Core Principle (g), which calls for accountability of federal financial regulators. Given the importance of governmental accountability, we have long advocated against subjecting advisers to either self-regulatory organization (SRO) or third-party oversight. SRO oversight of advisers would

impose a costly and unnecessary additional layer of regulation and bureaucracy on advisers without providing a commensurate benefit to investor protection.

The SEC has considered requiring advisers to engage third parties to perform a compliance assessment to augment the SEC's adviser oversight program. We have not supported this concept because we strongly believe that examinations are inherently a government function and because of its many other drawbacks. For example, the SEC would have to address a number of serious concerns about the standards, scope and frequency of any such third-party reviews; the confidentiality of any work product generated; the qualification process for third parties; and the ability of the SEC to oversee the third parties. We also have significant concerns regarding the costs that could be imposed on investment advisers, particularly smaller firms which constitute the vast majority of investment advisers.

(See **Exhibit D** for the IAA's letter to Chairman Clayton.)

III. Treasury Rules—*Core Principle (f)—efficient, effective, and appropriately tailored*

The IAA recently commented on the Department's request for information on regulations for possible repeal, replacement, or modification in order to reduce burdens and in furtherance of Executive Orders 13771 and 13777. We outlined our previous comments on two proposed Treasury regulations that, if adopted, could require investment advisers to incur significant new compliance expenses. Most notably, we have: (1) asked the Financial Crimes Enforcement Network (FinCEN) to reconsider the scope of its proposal relating to anti-money laundering (AML) compliance requirements for investment advisers; and (2) expressed concerns to FinCEN about revised regulations regarding Reports of Foreign Bank and Financial Accounts (FBAR).

(See **Exhibit H** for the IAA's letter to Treasury dated July 28, 2017.)

IV. CFTC Rules

1. Overlapping Regulation by the SEC and CFTC—*Core Principle (f)—efficient, effective, and appropriately tailored; Core Principle (g)—public accountability and rationalizing regulatory framework.* As a result of CFTC amendments in 2012 unrelated to the Dodd-Frank Act, SEC-registered investment advisers have been subject to dual registration and overlapping and often conflicting regulation by the SEC and CFTC for providing the same services to clients. This duplicative regulation and registration imposes costly compliance burdens which provide little benefit to investors.

The IAA makes the following recommendations to address this duplicative, costly, and fragmented regime:

a. *Regulation 4.5 Reform.* Prior to 2012, Regulation 4.5 contained an exclusion from the definition of CPO for investment companies registered under the Investment Company Act of 1940. The IAA recommends the CFTC reinstate the exclusion from the definition of commodity pool operator (CPO) in Regulation 4.5 as it existed prior to 2012, but at the very least, that it exclude from the CFTC's definition of CPO and commodity trading advisor any SEC-registered investment adviser to the extent it advises a registered investment company (or its subsidiary) that trades in financial commodity interests.

b. *Restoration of Exemption from CPO Registration*. We support restoration of the exemption from commodity pool operator (CPO) registration under CFTC Regulation 4.13(a)(4) which contained a broad registration exemption from most of the requirements of the Commodity Exchange Act (CEA) for SEC-registered advisers to private funds. The rescission of Regulation 4.13(a)(4) in 2012 was neither mandated by Dodd-Frank nor required for the CFTC to be able to fulfill its mandate to regulate commodity interest markets.

c. *Substituted Compliance*. At the very least, we recommend the CFTC adopt a substituted compliance regime for CPOs and CTAs that are dually-registered with the SEC and subject to SEC rules. Such an approach would rationalize the financial regulatory framework for these entities.

d. *Merger of SEC & CFTC*. Unless the SEC and CFTC can appropriately coordinate regulation of investment advisers as recommended above, the most effective way to rationalize the regulatory regime for affected financial markets and intermediaries would be to merge the SEC and the CFTC.

(See **Exhibit I** for the IAA's letter to the CFTC dated April 12, 2011. See also, **Exhibit J** for the IAA's letter to the CFTC dated April 24, 2012.)

2. Other CFTC – Regulation Automated Trading (Reg AT)—*Core Principle (efficient, effective, and appropriately tailored).* While we support the CFTC's goals of ensuring the safety and oversight of trading on U.S. designated contract markets, we have recommended that the CFTC reconsider its complex and overly prescriptive Reg AT proposal to regulate "automated trading" by all market participants and to instead consider ways to leverage its current oversight of market participants.

(See **Exhibit K** for the IAA's letter to the CFTC dated May 1, 2017.)

V. Other Asset Management Policy Matters Implicated by Core Principles

Tax Reform/Retirement Savings—Core Principle (a) – retirement savings. The IAA supports tax reform to simplify the corporate tax system and the taxation of financial products. We oppose a financial transaction tax and any further increases to the dividend and capital gains

rates. We also oppose efforts to force small businesses currently allowed to use cash accounting (which includes advisory firms) to switch to the accrual method. The IAA supports efforts to expand the options and incentives for voluntary retirement savings. We have concerns about tax proposals that would impose new limits on incentives for Americans' retirement savings. We are a member of the Save Our Savings Coalition, an alliance of advocates and businesses dedicated to protecting Americans' retirement savings and working to ensure that Americans will continue to have access to the private sector retirement system and to meaningful savings incentives.

Protection for Senior Citizens from Financial Abuse—Core Principle (a)—empowered and informed investors. The IAA supports S.223, the "Senior$afe Act," legislation that would provide a safe harbor from civil liability for employees of investment advisers, banks, credit unions and broker-dealers who report suspected elder financial abuse to regulatory, crime enforcement, and adult protective authorities. Under the legislation, both the employee and the institution would be protected from liability resulting from the reporting of any instance of elder exploitation as long as the employee received proper training from the employer on identifying these instances.

Cybersecurity—Core Principle (f)—efficient, effective, and appropriately tailored. The growing threat of cyber attacks has created a need for more cooperation and collaboration within the private sector and between the private and public sectors, and the IAA supported the recent enactment of legislation that facilitates cybersecurity information sharing, both among companies and between companies and law enforcement agencies. We also support establishment of a national data breach notification system that would make it easier for affected companies to comply with the law while ensuring that clients and customers are protected.

We agree with the recommendation in the June 12 Report issued by the Department on the U.S. depository system that regulators coordinate with respect to cybersecurity regulation. We also note Secretary Mnuchin's June 12, 2017 testimony to the House Appropriations Committee in which he called for Congress to empower FSOC to coordinate financial regulators when it comes to cybersecurity. In so doing, we strongly urge the Department to tailor any cybersecurity framework to the asset management industry and permit advisers to take into account the size and nature of their business. The vast majority of investment advisory firms are small businesses and their cybersecurity risk profiles may differ in certain respects from large firms.[5] Therefore, rather than take a "one size fits all" approach to cybersecurity rules for all financial institutions, the Department should make clear that a small firm with limited resources should not be expected to address every cybersecurity element or to the same degree as a very large firm.

[5] In 2017, 56.8% (6,911) of advisers registered with the SEC reported having fewer than ten non-clerical employees and 87.4 percent (10,641) reported employing 50 or fewer individuals, with a median number of nine employees. *See* the *2017 Evolution/Revolution Report*, at 27-28, at **Exhibit A**.*)*

International Processes and Standard-Setting Bodies—Core Principle (e)—advance American interests internationally. To advance American interests and global competitiveness, we fully agree with the Department's recommendations in its first report on the U.S. depository system that "improved inter-agency coordination should be adopted to ensure the best harmonization of U.S. participation in applicable international forums," and that "international regulatory standards should only be implemented through consideration of their alignment with domestic objectives and should be carefully and appropriately tailored to meet the needs of the U.S. financial services industry and the American people." We urge the Department to make similar recommendations with respect to cross-border issues relating to asset management as well.

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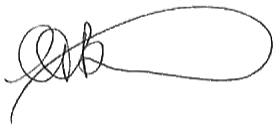
We appreciate the opportunity to meet with the Department and its staff and would be happy to provide any additional information. Please contact the undersigned at (202) 293-4222 with any questions.

Respectfully submitted,



Gail C. Bernstein
General Counsel

Attachments

IAA Letter dated August 15, 2017 to Craig S. Phillips re: Executive Order 13772

List of Exhibits

Exhibit A
2017 Evolution Revolution: A Profile of the Investment Adviser Profession (IAA, NRS), attached and available here

Exhibit B
Joint comment letter dated March 25, 2015 submitted by the IAA and the Asset Management Group of the Securities Industry and Financial Markets Association to FSOC on its notice seeking public comment on whether asset management products and activities may pose potential risks to the U.S. financial system, attached and available here

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