ICAA

Investment Counsel Association of America

1999 ICAA Comments & Statements

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SUMMARY – ICAA AMENDMENTS

1. *Extend national de minimis standard to federally registered advisers.* Amend Section 203A of the Investment Advisers Act to clarify that the national *de minimis* standard (currently Section 222(d) of the Investment Advisers Act of 1940) also applies to federally registered investment advisers on a self-executing basis. Currently, only four states do not extend the *de minimis* standard to federally registered advisers: Nebraska, New Hampshire, Texas, and Vermont. The requested clarification is fully consistent with the intent of the Coordination Act to achieve uniform treatment of federally registered advisers. No arguments or policies have been advanced to justify disparate treatment of federally registered advisers in this area.

2. *Prohibit state notice filing and fee requirements imposed on investment adviser representatives of federally registered investment advisers with no place of business in the state.* Amend Section 203A of the Investment Advisers Act to clarify that states may not impose any filing or fee requirements on investment adviser representatives of federally registered investment advisers who do not have a place of business in the state. Only two states – Texas and Oklahoma – impose filing and fee requirements on investment adviser representatives associated with federally registered investment advisers where the representative has one or more clients in the state but does *not* have a place of business in the state. The proposed amendments are consistent with the intent of the Coordination Act to eliminate duplicative regulation of investment advisers and to permit state authority over investment adviser representatives only if they have a place of business in the state.

3. *Restrict state notice filings to Form ADV and amendments thereto.* Amend Section 203A of the Investment Advisers Act to clarify that states may require federally registered investment advisers to notice file *only* Form ADV and any schedules and amendments thereto filed with the SEC. The law currently provides that states may require federally registered advisers to notice file "*any* documents filed with the Commission pursuant to the securities laws . . ." (emphasis added). Thus, under current law, states could require federally registered advisers to "notice file" documents in addition to Form ADV, such as Form 13F and Schedules 13D and 13G filed with the SEC under provisions of the Securities Exchange Act of 1934. Form ADV – which is being revised and updated by the SEC – is the basic registration and disclosure document for federally registered advisers and contains all the information states need for notice purposes. Further, because these documents are or will be made publicly available via EDGAR or other electronic means, "notice filing" such documents with the states is duplicative and unnecessary.

4. *Require states to participate in one-stop filing system.* Amend Section 203A of the Investment Advisers Act to require any state that wishes to impose notice filing or fee requirements on SEC-registered investment advisers or their employees to participate in the one-stop filing system currently being designed by the SEC and the North American Securities Administrators Association (NASAA) pursuant to Section 203A(d) of the Investment Advisers Act. The one-stop filing system would permit federally registered advisers to register with the Commission and notice file with the states and pay any related fee simultaneously. Importantly, investors would be able to use the electronic system to find any disciplinary history of an investment adviser. Such a system is most useful only if all of the states participate. The proposed amendments would ensure uniformity and maximum efficiency of the filing depository being developed by the Commission and NASAA.

Background and Need for the Legislation

Enactment of the Investment Advisers Supervision Coordination Act in 1996 represented the greatest change in the laws authorizing regulation of investment advisers since passage of the Investment Advisers Act in 1940. As the name of the law implies, Congress sought to create a new and improved scheme of regulation that *coordinates* regulation of investment advisory firms and their employees by allocating responsibility for larger firms to the SEC and allocating responsibility for smaller firms and individual financial planners to the states. This overriding legislative intent was well summarized in the SEC's proposed rules to implement the law:

> The reallocation of regulatory responsibilities grew out of Congress' concern that the Commission's resources are inadequate to supervise the activities of the growing number of investment advisers registered with the Commission, many of which are small, locally operated, financial planning firms. Congress concluded that if the overlapping regulatory responsibilities of the Commission and the states were divided by making the states primarily responsible for smaller advisory firms and the Commission primarily responsible for larger firms, the regulatory resources of the Commission and the states could be put to better, more efficient use.
>
> Congress also was concerned with the cost imposed on investment advisers and their clients by overlapping, and in some cases, duplicative, regulation. In addition to the Commission, forty-six states regulate the activities of investment advisers under state investment adviser statutes. States generally have asserted jurisdiction over investment advisers that "transact business" in their states. Consequently, many large advisers operating nationally have been subject to the differing laws of many states. Compliance with differing state laws had imposed significant regulatory burdens on these large advisers. *Congress intended to reduce these burdens by subjecting large advisers to a single regulatory program administered by the Commission.* (emphasis added)[1]

The Coordination Act prohibits an investment adviser from registering with the SEC unless it has more than $25 million in assets under management or is an adviser to a registered investment company or fits within another exemption. To effectuate the Act's central purpose of reducing regulatory redundancy, Section 203A(b)(1) of the Advisers Act provides that "[n]o law of any State or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser or a supervised person of an investment adviser shall apply . . ." to any federally registered adviser or supervised person thereof. This preemption of state authority over federally registered advisers is the key component in the allocation of regulatory responsibility between the SEC and the states.

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[1] *SEC Proposed Rules Implementing Amendments to the Investment Advisers Act of 1940, December 20, 1996, Release No. IA-1601, File No. S7-31-96.* Since enactment of the Coordination Act, the states of Colorado, Iowa, and Ohio have enacted investment adviser laws; thus, the State of Wyoming is the only state without an investment adviser statute.

The Coordination Act carves out only four narrow exceptions for state authority over federally registered advisers and their employees:

1. *Investment adviser representatives who have a place of business in the state.* The Act allows states to "license, register, or otherwise qualify an investment adviser representative who has a place of business in the state."[2]
2. *Enforcement actions for fraud and deceit.* The Act preserves state authority to investigate and bring enforcement actions "with respect to fraud or deceit against an investment adviser or person associated with an investment adviser."[3]
3. *Notice filings.* The Act preserves state authority to require "the filing of any documents filed with the Commission pursuant to the securities laws solely for notice purposes, together with a consent to service of process and any required fee."[4]
4. *Fees.* The Act preserves the ability of states to impose and collect "filing, registration, or licensing fees . . ."[5]

The ICAA strongly supports the intent of the Coordination Act. The patchwork of inconsistent and varying state provisions that existed prior to the Coordination Act created unnecessary regulatory costs, burdens, and inefficiencies without enhancing investor protection. As outlined below, we believe the Coordination Act's allocation of regulatory responsibility between the SEC and the states enhances investor protection, provides for more efficient use of limited regulatory resources, and reduces burdensome and unnecessary regulatory costs.

With a few notable exceptions, we believe the Coordination Act has worked well. Certainly there can be no doubt that the SEC's regulatory, inspection, and enforcement activities with respect to investment advisers have increased dramatically during the past two years. Collectively, these efforts represent a revolution in the treatment of investment advisers by the SEC:

- When the Coordination Act was enacted in 1996, there were approximately 22,500 advisers registered with the SEC. Today, that number is between 7,500 and 8,000 and it will shrink further after smaller investment advisers in Colorado, Iowa, and Ohio are deregistered during the next few months. Obviously, this means that the SEC can concentrate its resources on a much smaller universe of advisers.
- At the same time, the SEC has devoted increased regulatory resources to the investment adviser area. In 1997, the SEC for the first time created the Task Force on Investment Adviser Regulation. During its short existence, the task force already has completed a number of rules adopted by the Commission, including various regulations implementing the Coordination Act, new rules governing performance fees, and rules requiring the filing of Year 2000 readiness reports by advisers. We understand that the task force intends to review and revise virtually every regulation

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[2] Section 203A(b)(1)(A), Investment Advisers Act of 1940.
[3] Section 203A(b)(2), Investment Advisers Act of 1940.
[4] Section 307(a), Investment Advisers Supervision Coordination Act.
[5] Section 307(b) and (c), Investment Advisers Supervision Coordination Act.

governing investment advisers, as well as take the lead on new initiatives such as pay-to-play regulations governing advisers in the public pension area. Some of the major regulatory issues expected to be addressed during the next 1-2 years include: a major overhaul of Form ADV, implementation of a centralized database for advisers, and revisions to rules pertaining to books and records, custody, and personal trading.

- The SEC's inspection activities of investment advisers have increased dramatically. At the time the Coordination Act was being debated, the SEC estimated that the average cycle for routine adviser inspections was once every 15-30 years. Today, the SEC's regional offices have implemented plans to inspect every registered investment adviser at least once every 4-5 years and to inspect new advisers within their first year of business. Since enactment of the Coordination Act, the SEC also has stepped up its targeted inspections or "sweeps" of advisers on particular issues of concern, including the 1997 soft dollar sweep of 280 investment advisers, a sweep of advisers on performance issues, and last year's visits to nearly 60% of advisers nationwide regarding Year 2000 readiness.
- Statistics also indicate that in recent years the SEC has brought more enforcement cases involving violations of the Investment Advisers Act of 1940, the penalties imposed in these actions have been harsher, and more cases have been litigated.

In conclusion, the record is indisputable that the SEC has exceeded expectations in beefing up its programs governing the investment adviser industry since enactment of the Coordination Act.

With respect to the states, the results are mixed. Since passage of the Coordination Act, we have communicated regularly with the North American Securities Administrators Association (NASAA) and various states in an effort to achieve uniform implementation of the law and accompanying regulations. As early as November 20, 1997, we reported to NASAA that "a majority of states appear to be complying with both the spirit and the letter of the Coordination Act," while noting that the actions of a minority of states "may threaten these positive efforts."[6] Our primary concerns have focused on laws or regulations in a few states that run counter to the provisions and purposes of the Coordination Act, including those that: (1) require the filing of documents and other materials that are not required to be filed with the SEC, (2) require the filing of documents and/or payment of fees by investment adviser representatives who do not have a place of business in the states, (3) impose an additional layer of regulation on federally registered investment advisers and their supervised persons[7]; and (4) otherwise interfere with uniformity.

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[6] *Letter from ICAA Executive Director David G. Tittsworth to NASAA Executive Director Neal E. Sullivan, November 20, 1997.*

[7] We have not proposed amendments in this area, because we believe the language of the Coordination Act is unambiguous. For example, the SEC's release proposing rules to implement the Coordination Act, *supra, Note 1,* stated: "States may not, however, 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." In providing technical assistance to Senate personnel drafting the Coordination Act, the SEC staff stated that the provision "limiting the [states'] authority to bringing enforcement actions [for fraud and deceit] *precludes a state securities commission from re-regulating advisers by issuing anti-fraud rules.*" Memorandum dated May 16, 1996

As the 106th Congress reviews the results of the Coordination Act, the ICAA submits that the following clarifying modifications to the Act will help in achieving the original goals of the legislation:

- The ICAA supports amendments to clarify that the national *de minimis* standard set forth in section 222(d) of the Advisers Act applies to federally registered advisers on a self-executing basis. Section 222(d) preempts the application of state adviser laws if the adviser does not have a place of business in the state and has fewer than 6 clients who are residents of the state. But the provision has been interpreted by some to apply only to state registered advisers; thus, a few states still require notice filings and payment of fees from federally registered advisers that have only one client in the state. The ICAA is unaware of any justification for not extending the national *de minimis* standard to federally registered advisers.
- The ICAA supports amendments to clarify that states may not require notice filings and impose fees on investment adviser representatives of federally registered advisers when the representative does not have a place of business located in the state.[8] Currently, only two states continue to require the filing of documents and payment of fees for investment adviser representatives doing business – but with no place of business – in the state. The impetus for these state requirements appears to be collection of additional revenue rather than additional investor protection. This "doing business" requirement imposes a heavy burden on large advisers to monitor the movements of hundreds of employees and to analyze each state's requirements. Considering that the overwhelming majority of states do not impose such filing or fee requirements, we submit that this clarification is appropriate and necessary, and fully consistent with the intent of the Coordination Act.[9]
- The ICAA supports amendments to provide that states may require federally registered investment advisers only to notice file Form ADV and schedules and amendments thereto (that is, *registration* documents), instead of "any documents filed with the Commission pursuant to the securities laws." This amendment will help to avoid any unnecessary and burdensome state requirements that go beyond notice filing purposes while providing appropriate information to the states about federally registered investment advisers. The amendment also would help achieve greater uniformity and certainty in state filing requirements.
- The ICAA supports amendments to ensure the development of a uniform and comprehensive centralized database and filing system for investment advisers. Such

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from the Division of Investment Management to the Senate Securities Committee Staff, File Docket No. F7-98 (emphasis added).

[8] Section 307 of the Coordination Act permits states to collect "filing, registration, or licensing fees." Other sections of the Coordination Act, however, prohibit states from imposing filing, registration, or licensing requirements on investment adviser representatives employed by federally registered advisers with no place of business in the state. Thus, the Act does not permit states to levy a "doing business" fee on these individuals.

[9] The Coordination Act permits a state to license, register, or qualify only those investment adviser representatives who have a place of business in that state. Congress enacted this compromise provision specifically to address states' concerns about monitoring representatives operating out of local branch offices. States should not be permitted to circumvent this provision by imposing filing and fee requirements on investment adviser representatives who are merely doing business (*e.g.* have one client) in the state.

a system should permit a federally registered adviser to file Form ADV and any amendments in only one place, which would in turn be transmitted efficiently to the SEC and those states with which the adviser must notice file. The database should permit investors to check on the disciplinary history of investment advisers (both state- and SEC-registered) in one simple step. The proposed amendments will assist to ensure the participation of all states in the filing system/database in a prompt and uniform manner.

The proposed amendments will help to achieve uniform treatment by the states of federally registered advisers and their employees and are fully consistent with the stated purposes of the Coordination Act.

*   *   *   *   *

The ICAA is a national not-for-profit association that consists exclusively of federally registered investment adviser firms. Founded in 1937, the ICAA today consists of more than 240 firms that collectively manage in excess of $1.8 trillion for a wide variety of institutional and individual clients.

March 24, 1999

DRAFT

To clarify provisions of the Investment Advisers Supervision Coordination Act and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Short Title.

This Act may be cited as the "__________________________________."

Section 2. State and Federal Responsibilities.

(a) CONTINUED STATE AUTHORITY. - Section 203A of the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) is amended by inserting the following new subsections:

"(f) PRESERVATION OF FILING REQUIREMENTS. – Nothing in this title prohibits the securities commission (or any agency or office performing like functions) of any State from requiring the filing of any Form ADV, including schedules and amendments thereto, filed with the Commission pursuant to this title solely for notice purposes ("Notice Filing"), together with a consent to service of process, and any Notice Filing fee that is not prohibited by subsection (g) of this section; provided that:

(1) the State permits such Notice Filing, consent to service, and payment of fees to be made through the entity designated by the Commission pursuant to subsection (d) of this section; and

(2) the Notice Filing fee requirement of any State does not directly or indirectly require investment advisers to maintain or submit records of investment adviser representatives or supervised persons who do not have a place of business located within that State.

"(g) NATIONAL DE MINIMIS STANDARD. – No law of any State or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser shall require an investment adviser or supervised person of an investment adviser to register, pay fees, notice file, or submit to licensing by the securities commissioner of the State (or any agency or officer performing like functions), or otherwise to comply with such law or regulation (other than any provision thereof prohibiting fraudulent conduct) if the investment adviser or supervised person –

(1) does not have a place of business within the State; and

(2) during the preceding 12-month period, has had fewer than 6 clients who are residents of that State."

(b) CONFORMING AMENDMENTS. –

(1) Section 307 of the Investment Advisers Supervision Coordination Act, Title III of the National Securities Markets Improvement Act 1996, Public Law 104-290, is amended –

(a) by striking subsections (a) and (b).

(2) Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) is amended by striking subsection (d).

(3) Section 203A(b)(1)(A) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) is amended by inserting ", provided that the State permits any filing or fee requirements related to such licensing, registration or qualification to be made through the entity designated by the Commission pursuant to subsection (d) of this section" after "within that State".

Section 3. Effective Date.

(a) The amendments made by this Act shall take effect ___ days after the date of enactment of this Act.

April 5, 1999

Donald J. Reis, Chair
NASAA Investment Adviser Competency
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Re: Examination Waivers for Chartered Investment Counselors

Dear Messrs. Reis, Cortese, and Kahl, and Mss. Struck and Cahill:

Thank you for your letter of March 25, 1999 requesting information about waivers that should be considered in implementing the revised Series 65 and 66 examinations.

As you know, the Investment Counsel Association of America[1] has been involved in discussions about the new exams with the Project Group, NASAA, and other interested parties since November 1997. In addition to ICAA staff, several individuals from ICAA member firms have participated actively in the process of developing the revised Series 65 examination. We have attempted to cooperate and lend our assistance to NASAA in this effort and hope to continue to do so in the future as the various states proceed to implementation.

We have repeatedly voiced two major concerns during the development of the new examinations. First, we strongly support *uniform* implementation of the new exams.

[1] The ICAA is a national not-for-profit association that exclusively represents SEC-registered investment adviser firms. Founded in 1937, our membership consists of approximately 240 investment advisory firms that collectively manage funds in excess of $1.8 trillion for a wide variety of institutional and individual clients.

The current patchwork of state qualification requirements for investment adviser representatives is confusing, burdensome, and inefficient and does not enhance investor protection. We therefore request NASAA to recommend *one single set of standards*, including appropriate waivers, grandfathers, and other provisions regarding the exams, and to work diligently to achieve *uniform* implementation among all states of such standards.

Second, the ICAA strongly supports both the granting of examination waivers for persons who have appropriate designations, charters or experience, and the grandfathering of current investment advisory personnel in appropriate circumstances. In this regard, the ICAA respectfully requests that the Project Group include our designation, Chartered Investment Counselor (CIC), in the list of designations for which the proposed examinations will be waived and grandfathered.

The ICAA established the CIC program in 1975 so that knowledge and experience in the investment counsel profession might be better recognized. We have enclosed a CIC brochure and application, which set forth the procedures and requirements for a person to be granted the CIC charter. As you will see from those materials, becoming a CIC requires substantial experience, professionalism, and knowledge.

The CIC program was initially developed in cooperation with the Institute of Chartered Financial Analysts. Today, a key component of the program is the requirement that candidates must pass the CFA examination (all three levels) and hold the CFA charter before submitting an application to become a CIC. As noted in AIMR's letter to you dated July 10, 1998, the CFA examination is extremely rigorous, far exceeding any notion of an entry-level competency test. We refer you to AIMR's materials for additional details about the CFA examination and program, but suffice it to say that the CFA charter encompasses not only every component listed on the first page of your letter, but also every topic of importance both to investors and to NASAA.

In addition to successful completion of the CFA examinations, CIC candidates must be employed by an ICAA member firm and must demonstrate a minimum of *five years* of work experience in one or more *eligible occupational positions*. An *eligible occupational position* means a position in which the primary responsibility of the candidate's duties consists of some combination of both investment counseling and portfolio management services. The term "*investment counseling*" is predicated on the candidate's ongoing and continuous contact and professional relationship with the client and involvement with rendering investment advice oriented to the client's investment goals. The term "*portfolio management*" means the authority, selection, supervision and responsibility to make specific investment decisions for a client's portfolio, based on the client's investment goals. In other words, CIC charter holders are professional investment counselors with ongoing client relationships – not solicitors, marketers, wrap fee consultants, administrators, or the like. Charter holders therefore must demonstrate substantial professional experience far beyond a minimum entry-level position in the investment adviser industry.

With respect to ethical requirements, CIC candidates must provide several work and character references evidencing good moral character. The candidate also must specifically endorse the ICAA's *Standards of Practice*[2] and complete a professional ethical questionnaire.[3] Thereafter, on an annual basis, each CIC charter holder must certify to the ICAA that he or she (a) continues to be employed in an eligible occupational position; and (b) has not been the subject of disciplinary proceedings of any nature arising from such person's professional conduct.

With respect to educational and securities law knowledge requirements, please note that all CIC charter holders receive the ICAA's monthly newsletter, which discusses relevant legal and regulatory developments in a timely and educational manner. While the ICAA does not impose a continuing education regime on CICs, the Association invites all CICs to its legal and compliance workshops and seminars, as well as to conferences discussing developments in the field of investment counseling and portfolio management. Many CICs avail themselves of these opportunities.

A total of 1,024 charters have been issued since the inception of the CIC program in 1975. Today, there are 617 active CIC charter holders.

Recognizing the extensive degree of knowledge, experience, and ethical conduct represented by the CIC charter, approximately half of the states accept the CFA, the CIC, or both in lieu of examination. In addition, we understand that some states that provide for waivers on an *ad hoc* basis consider the CIC as a factor in their decision. As you requested, we have included a chart listing the waivers accepted by each state for your information.[4] We would appreciate your informing us if you believe any of the entries on the chart to be incorrect.

The ICAA appreciates the opportunity to work with the Project Group and NASAA on these important issues. *If implemented in a uniform manner by all the states*, the ICAA believes the revised Series 65 and 66 examinations will represent a significant and positive step forward and we pledge our continuing support to achieve uniform implementation of standards developed by the Project Group.

We also appreciate your consideration of recommending a waiver for Chartered Investment Counselors. Given the level of testing, experience, and conduct required of

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[2] The ICAA has always prescribed certain principles of conduct to be endorsed by member firms in the practice of their profession. The Association's principles of conduct were originally set forth in its Code of Professional Practice in 1937 and later in its statement of Function and Principles. Over the years, many of these principles have been used by Congress and the Securities and Exchange Commission as the basis for legislation and regulations governing the conduct of investment advisers and by the United States Supreme Court in defining the standards of fiduciary conduct applicable to all investment advisers.

[3] These requirements are over and above the ethical and professional components a candidate must already have met in order to attain the CFA charter.

[4] Per your request, we will send the chart only to the NASAA Corporate Office.

CIC charter holders, we strongly believe that CICs far exceed the qualifications of entry level investment adviser representatives and thus should receive a waiver from the new examinations.

We would be pleased to meet with you to discuss the CIC program, as well as our views generally on waivers, grandfathering, and the examination itself. Please do not hesitate to call me or Karen Barr, ICAA General Counsel, if you have any questions or require any additional information concerning these matters.

Sincerely,

DAVID G. TITTSWORTH
Executive Director

cc: Peter Hildreth, NASAA President
Melanie Senter Lubin, Investment Adviser Section Chair

NOTE: A similar letter was sent to all other state securities administrators.

May 20, 1999

Mr. W. Mark Sendrow
Securities Division
Arizona Corporation Commission
1300 West Washington St., 3rd Floor
Phoenix, AZ 85007-2996

Re: Uniform Implementation of Revised Adviser Competency Exam

Dear Mr. Sendrow:

On behalf of the Investment Counsel Association of America, I am writing to urge the State of Arizona to adopt rules that implement all provisions of the sample rule recently developed by NASAA's Investment Adviser Competency Examination Project Group.

The ICAA commends the Project Group for its work in this important area, both in terms of its substantive recommendations and the process that produced such recommendations. During the past 18 months, we have been in regular communication with NASAA and members of the Project Group. (See enclosed letter dated April 5, 1999.) Additionally, several representatives from ICAA member firms participated in the process of modifying the Series 65 and Series 66 exams.

The ICAA strongly supports adoption of the modified Series 65 and Series 66 exams by Arizona and all other states. As a not-for-profit association that exclusively represents federally registered investment adviser firms, the ICAA believes firmly that investment adviser representatives should be subject to uniform competency requirements no matter where they are registered. We urge you to ensure that Arizona implements the Series 65 and Series 66 exams by the issuance of an order, promulgation of a rule, or adoption of legislation that mirrors the NASAA sample rule. Obviously, the exam's fundamental goal of a uniform national competency standard for investment adviser representatives can be achieved only if the states implement the NASAA sample rule uniformly.

The sample rule addresses three areas: examination requirements, grandfathering, and waivers. The ICAA has an interest in the recommended waiver for individuals holding the Chartered Investment Counselor (CIC) designation that is awarded by the ICAA. Enclosed is a recent letter from the ICAA to the Project Group detailing the history and requirements of the CIC program, as well as ICAA's participation in the development of the newly developed adviser competency exams. The ICAA is pleased that Arizona already provides a waiver for CICs[1] and believes that this waiver policy should continue to be reflected in regulations incorporating the new competency exam requirements.

If you would like to discuss the CIC program or any other aspect of this issue, please contact me.

Sincerely,

RACHEL S. WITMER
Counsel

Enclosure

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[1] Arizona currently provides such a waiver at Regs. of Ariz. Corp. Commission, Title 14, Ch.4, Art. 1, Sec. R14-6-204.

May 20, 1999

Mr. Joel Seligman
The University of Arizona College of Law
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Re: NCCUSL Drafting Committee to Revise Uniform Securities Act

Dear Mr. Seligman:

It was a pleasure to renew our acquaintance at the March meeting of the NCCUSL Drafting Committee. The Investment Counsel Association of America truly appreciates the opportunity to participate as an observer to the Committee's efforts to revise the Uniform Securities Act. Over the years, NCCUSL has been an important force in promoting uniformity among the states and improving outdated state laws and we welcome NCCUSL's review and improvement of the Uniform Securities Act.

The ICAA is a national not-for-profit association that consists exclusively of federally registered investment adviser firms.[1] Founded in 1937, the Association has always prescribed standards of practice that emphasize the fiduciary duty owed by advisers to their clients. Over the years, many of the principles embodied in our *Standards of Practice* have been used by the Congress, regulators, and the United States Supreme Court in defining the obligations of investment advisers. Today, the ICAA's membership is comprised of approximately 240 firms that collectively manage in excess of $1.8 trillion in assets for a wide variety of institutional and individual clients.

Virtually all ICAA members have a multi-state or national business; thus the Drafting Committee's objectives of conforming the Uniform Securities Act to the National Securities Markets Improvement Act of 1996 ("NSMIA"), promoting efficient coordination of federal and State securities regulation, and achieving uniformity of state law are of paramount concern to our members.[2] The ICAA has been an active and consistent supporter of uniformity in the treatment of SEC-registered advisers by the various states and regulators. We strongly encouraged Congressional efforts to enact the Investment Advisers Supervision Coordination Act ("Coordination Act") in 1996 as part

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[1] Because we represent only federally registered advisers, we are limiting our comments to provisions of the Uniform Securities Act that would affect such advisers.

[2] Seligman J., *Introduction to the Uniform Securities Act* (March 12, 1999), at p. 42.

of NSMIA[3] because of the needless burdens and inefficiencies associated with duplicative and overlapping regulation of our industry by both the Commission and the states.

The ICAA has worked constructively with NASAA and the individual states on issues related to implementation of the Coordination Act. We have commended NASAA and the vast majority of the states for their efforts to enact implementing rules and regulations in a timely and uniform manner. There are, however, several outstanding issues that have prevented the Coordination Act from achieving true uniformity and elimination of duplicative regulation for federally registered advisers, including the following:

- A number of states do not apply the national *de minimis* standard to federally registered advisers;
- A few states impose requirements on investment adviser representatives who do not have a place of business in the state;
- Several states require federally registered advisers to make filings for third party solicitors;
- Some states have imposed substantive regulations on SEC-registered advisers; and
- States do not have a uniform set of requirements for notice filings.

We respectfully request that the Drafting Committee consider these impediments to uniformity and effective regulation in its current efforts to revise the Uniform Securities Act.

National *De Minimis* Standard

The national *de minimis* standard set forth in the Coordination Act prohibits a state from regulating advisory firms that do not have a place of business in the state and have had fewer than 6 clients who are residents of the state during the past 12 months.[4] The vast majority of states have applied this provision to both state-registered and SEC-registered advisers. However, some states have interpreted the *de minimis* provision to apply only to state-registered advisers. These states still require notice filings and payment of fees from federally registered advisers that have only one client in the state.[5] We see no justification for treating state-registered and federally registered advisers differently in this regard. In addition, a few states' laws contain a *de minimis* provision, but require filings from advisers to claim the exemption (*i.e.*, the *de minimis* is not self-executing). We therefore suggest that the Uniform Securities Act be revised to provide a clear self-executing *de minimis* standard for both state- and SEC-registered advisers.

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3 Title III, National Securities Markets Improvement Act of 1996, Public Law 104-290 (1996).

4 Investment Advisers Act of 1940, Section 222(d), 15 U.S.C. 80b-18a (1999) ("Advisers Act").

5 These states include Nebraska, New Hampshire, Texas, and Vermont.

Investment Adviser Representative Issues

Under NSMIA, states are permitted to license, register, or qualify "investment adviser representatives" who have a "place of business" located within the state.[6] Congress enacted this compromise specifically to address states' concerns about monitoring representatives operating out of local branch offices. The Coordination Act does not allow states to impose any requirements on investment adviser representatives who are merely doing business in the state. A few states nonetheless require filings and fees from investment adviser representatives that do not have a *place of business* in the state, but are merely *doing business* there (*i.e.*, they have one or more clients in the state).[7]

This "doing business" requirement imposes a heavy burden on large advisers to monitor the movements of hundreds of employees and to analyze each state's requirements for investment adviser representatives (as opposed to analyzing only the law of the state in which the employee has a place of business). These non-conforming requirements undermine the Coordination Act's goal of reducing overlapping regulatory burdens through "regulatory clarity, certainty and uniformity."[8] We suggest that the Uniform Securities Act be revised to provide that a state may only require filings and fees related to investment adviser representatives who have a place of business in the state.

Third Party Solicitor Issues

There appears to be much confusion surrounding the registration of solicitors of federally registered advisers.[9] The Coordination Act preempts state laws only with respect to an "investment adviser or supervised person of an investment adviser." Many third party cash solicitors used by SEC-registered advisers do not meet the definition of "supervised person," and thus state laws are not preempted as to these solicitors. However, these third party solicitors do meet many states' definitions of "investment adviser representative," and states may require them to register in every state in which they have clients or prospective clients – again generating the ubiquitous 50-state survey. The ICAA is pleased that NASAA's model "investment adviser representative" definition limits registration requirements to those solicitors who have a place of business located within the state, but this language has not been uniformly adopted. We therefore request that the Committee include the "place of business" requirement for registration of third

[6] Advisers Act, Section 203A(b)(1)(A).

[7] These states are Texas and Oklahoma.

[8] Letter dated April 25, 1997 to SEC Chairman Arthur Levitt from Phil Gramm (R-Tex) and Christopher J. Dodd (D-Conn), at p. 2.

[9] To provide additional information about this subject, we have enclosed a sample letter that the Society of Asset Allocators and Fund Timers, Inc. sent to several states, as well as NASAA's materials discussing its model rule definition of "investment adviser representative."

party solicitors of federal covered advisers in any statutory language it proposes related to this subject.

In addition, a number of states place the burden on a federally registered adviser to file registration and other paperwork related to its third party solicitors -- even when the solicitor is already registered as a representative of a state-registered adviser or other state-registered entity. This runs counter to the Coordination Act, pursuant to which states may require SEC-registered firms to file only those documents filed with the SEC. The SEC does not require firms to file documents related to solicitors and, therefore, the states are not permitted to require such filings. States are certainly entitled to register solicitors, but the burden of registration should be placed squarely on the solicitor.[10]

Even the states that place registration and filing burdens on the solicitor do not use appropriate forms to handle these filings; the Form U-4 generally used for investment adviser representatives does not make sense when used for third party solicitors. We understand that these problems -- particularly the Form U-4 issue -- are more readily addressed by rule than by statute. We do, however, suggest that the Drafting Committee, where appropriate, include provisions clarifying that any filing or notification requirements for investment adviser representatives and solicitors of federal covered advisers are the responsibility of the representative or solicitor, not the firm.[11]

Duplicative Regulation of Federally Registered Advisers

Under the Coordination Act, states retain the authority to investigate and bring enforcement actions for "fraud or deceit" against an investment adviser or person associated with an investment adviser.[12] Many states, however, have gone beyond this limited exception to preemption by applying their "dishonest and unethical practices" provisions to federal advisers and their employees. Most of these states have tried to finesse the preemption issue by adding a sentence to the "dishonest and unethical practices" provision stating (redundantly) that the provision only applies to federal advisers "to the extent permitted by NSMIA." A few states have gone even further by attempting to apply specific regulations (outside their "dishonest and unethical practices") to federal advisers or their employees.

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[10] The same is true, of course, for investment adviser representatives of federally registered firms. However, requiring federal firms to register for third party solicitors is more inappropriate and unfounded, given that these individuals are not employees of or under the control of the advisory firm.

[11] *See, e.g.,* Securities Act of Kentucky, Section 292.330(10) (1998) ("When an investment adviser representative begins or terminates a connection with an <u>investment adviser</u>, the *investment adviser representative and the investment adviser* shall promptly notify the commissioner…When an investment adviser representative begins or terminates a connection with a [federal] <u>covered adviser</u>, the *investment adviser representative* shall notify the commissioner…") (emphasis added); Maryland Securities Act, Section 11-402(4), (5) (1998) (substantially similar); Iowa Uniform Securities Act, Section 502.301(4) (substantially similar).

[12] Advisers Act, Section 203A(b)(2).

As you know, the Coordination Act is designed to eliminate overlapping and duplicative regulation of large advisers by the Commission and the states by *dividing* regulatory responsibilities. The plain language of the Coordination Act unequivocally prohibits states from imposing a second layer of regulation on SEC-registered advisers (even where the second layer mimics the SEC's rules).[13] Thus, states may not apply their "dishonest or unethical practices" provisions or other specific substantive regulations to federal advisers, their investment adviser representatives, or other employees. To implement the Coordination Act's "fraud or deceit" exception to preemption, the Uniform Securities Act should be revised to reflect that federal advisers are subject only to states' general anti-fraud provisions, similar to those set forth in sections 206(1) and 206(2) of the Advisers Act.

One-Stop Filing System/Central Depository

The Coordination Act permits states to require federal advisers to file with the states "any documents filed with the Commission pursuant to the securities laws solely for notice purposes, together with a consent to service of process and any required fee."[14] Under this provision, advisers should be able simply to make copies of Form ADV and any amendments and mail them to the relevant states. In practice, however, this provision has resulted in a lack of uniformity in notice filing requirements, generating the need for yet another 50-state survey.[15]

Many of these problems may well be corrected when the SEC and NASAA create and implement the anticipated one-stop filing system/central registration depository for advisers. We hope that the SEC and NASAA can agree on a uniform method of notice filing using electronic filing. NASAA has expressed concern, however, that certain state statutes currently do not allow participation in the proposed electronic filing system. This system will be fully effective only if all states participate. We therefore request that NCCUSL work with NASAA and the states to implement revisions necessary to attain full state participation in the one-stop filing system and depository for advisers.

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[13] We would be pleased to provide legislative history and other documentation if the Committee has any questions on this point.

[14] Coordination Act, Section 307(a).

[15] For example, some states have required an annual filing of complete Form ADV. Some states have required an initial filing of complete Form ADV, then an annual filing of page 1 of Form ADV, plus Schedule I. Some states require a newly executed Form ADV in lieu of consent to service of process (even though, per the Coordination Act, the Form ADV filed is the last one filed with the SEC, not an updated version as of the time it must be filed with the state). Other states require a consent to service of process, but do not require an original execution on Form ADV. Some states literally require "all documents" filed with the SEC (including Forms 13F, 13D, and 13G), not simply registration documents providing notice of the adviser's activities. Finally, contrary to the Coordination Act, some states require submission of varying forms (not filed with the SEC), along with Form ADV.

Additional Considerations

During the Drafting Committee's March 1999 meeting, some participants raised the issue of whether NASAA is or should be allowed to amend the Uniform Securities Act. Though we do not always agree substantively with NASAA's recommendations, we believe that NASAA's prompt actions to fill in regulatory gaps have been generally helpful in promoting uniformity. Given the infrequency of NCCUSL's activities in this area, we believe that NCCUSL should seriously consider formal recognition of NASAA's actions under certain conditions. NASAA should establish in writing an open and defined process for considering statutory amendments and rules, including the opportunity to submit written comments on proposals and to review submissions from other interested parties. If so, the ICAA likely would support NASAA's taking a leading role to provide a forum where amendments to the Act could be duly proposed, considered, and implemented. NCCUSL could then continue to review and revise periodically the entire Act and NASAA amendments.

Finally, we recognize that, as a practical matter, revising the Uniform Securities Act to conform to NSMIA does not guarantee uniformity, as some states may choose to adopt the Act with modifications or may not adopt the Act at all. Congressional action may be necessary to achieve true uniformity. To that end, we recently submitted proposed legislation to the United States Senate Banking Committee which is currently drafting a bill intended, among other things, to remedy NSMIA-related problems. For your information, we have attached a copy of our proposal addressing many of the issues discussed above.

* * * * *

We appreciate your consideration of our comments regarding revisions to the Uniform Securities Act, and would be pleased to offer technical drafting assistance regarding the issues outlined above. Please do not hesitate to call me with any questions or comments at (202) 293-4222. Thank you for involving us in this important initiative.

Sincerely,

Karen L. Barr
General Counsel

cc: Richard B. Smith, Esq.
Drafting Committee Chair

May 27, 1999

The Honorable Phil Gramm
Chairman
Committee on Banking, Housing
and Urban Affairs
370 Senate Russell Building
Washington, D.C. 20510

Dear Mr. Chairman:

Earlier this year, the ICAA submitted legislative proposals to your staff that would amend certain aspects of the Investment Advisers Supervision Coordination Act (Title III of the National Securities Markets Improvement Act of 1996). We sincerely appreciate your continuing efforts to address issues of regulatory clarity and efficiency. As you know, the ICAA strongly supported the leadership role you and Senator Dodd assumed in crafting investment adviser provisions in NSMIA that enhance investor protections while reducing regulatory duplication and inefficiency. Our recent legislative proposal is intended to clarify provisions of the Coordination Act to deal with problem areas that have been identified since enactment of NSMIA. Other groups also have submitted legislative proposals and we have provided our preliminary analysis of many of those proposals to Senate staff.

We are writing to express our concern about the legislative proposal recently submitted by the Securities Industry Association. As you know, aspects of the SIA's proposal have been criticized by various groups and officials, including the North American Securities Administrators Association, the Investment Company Institute, and the Securities and Exchange Commission. The ICAA is concerned that inclusion of these controversial provisions will bog down efforts to enact appropriate legislation during this Congress.

Additionally, we believe that certain proposals of the SIA are more appropriate for consideration and resolution by the SEC pursuant to its rulemaking and exemptive authority under both the Advisers Act and the Investment Company Act. For example, the SIA proposal includes provisions to amend the restrictions contained in section 206(3) of the Investment Advisers Act, primarily relating to principal transactions, as well as section 17(a) of the Investment Company Act.

The ICAA strongly believes that a rulemaking conducted by the SEC – not legislation – is the appropriate forum for resolution of issues involving principal transactions. In his April 13, 1999 speech at the SIA's Legal and Compliance Seminar, SEC Chairman Levitt indicated that "this is the right time to consider whether it might be appropriate to provide an exemption from the restrictions on principal trading" and that the SEC's Division of Investment Management "will develop amendments to the rule that strike a balance" among competing considerations. Particularly in light of the fact that the SEC has stated unambiguously that it will conduct a rulemaking in this area, we believe it would be inappropriate to enter into a legislative debate on the same issues. Given the complexities of the issues involved, the need to carefully weigh the delicate considerations involving potential conflicts of interest, and the SEC's extensive experience in this area, an SEC rulemaking would be the best manner to consider exemptions from current statutory restrictions.

Similar considerations argue against the inclusion of the 17(a) proposal by SIA. In this regard, we agree with recent statements made by Paul Roye, Director of the SEC's Division of Investment Management. In his May 21, 1999 speech, Roye voiced his personal opposition to the proposal, arguing that it could "open the door to overreaching, self-dealing, and other abusive practices" and that "any problems that are posed by Section 17(a) can be addressed administratively by the Commission through its broad exemptive authority."

We truly appreciate your continuing leadership to craft and enact bipartisan legislation during this Congress that will further the goals of investor protection and regulatory efficiency and we stand ready to assist you and your staff in achieving this mission. While we would not object to a hearing to develop an initial record on some of the controversial issues raised by SIA and other groups, we sincerely hope the Committee's efforts will focus on the development of bipartisan legislation that can be enacted during this Congress.

Sincerely,

DAVID G. TITTSWORTH
Executive Director

Cc: The Honorable Paul S. Sarbanes
The Honorable Rod Grams
The Honorable Christopher J. Dodd
The Honorable Arthur Levitt
Mr. Marc E. Lackritz
Mr. Matthew P. Fink
Mr. Philip A. Feigin

July 29, 1999

The Honorable Phil Gramm
Chairman
Committee on Banking, Housing
and Urban Affairs
534 Dirksen Office Building
Washington, D.C. 20510

The Honorable Paul S. Sarbanes
Ranking Member
Committee on Banking, Housing
and Urban Affairs
534 Dirksen Office Building
Washington, D.C. 20510

The Honorable Rod Grams
Chairman
Subcommittee on Securities
534 Dirksen Office Building
Washington, D.C. 20510

The Honorable Christopher J. Dodd
Ranking Member
Subcommittee on Securities
534 Dirksen Office Building
Washington, D.C. 20510

Dear Senators Gramm, Sarbanes, Grams, and Dodd:

On behalf of the Investment Counsel Association of America, Inc.,[1] we are writing to offer comments on various proposals that have been submitted regarding the proposed Securities Markets Enhancement Act. Given the fact that our membership is comprised of federally registered investment adviser firms, these comments are focused on proposals that directly amend the Investment Advisers Act of 1940,[2] the primary law that governs the activities of our member firms.

The ICAA strongly supported the efforts of Senators Gramm and Dodd and others in enacting the Investment Advisers Supervision Coordination Act in 1996.[3] As our March 24, 1999 submission to Committee staff indicates (attached), the Coordination Act represents the greatest change in laws governing the regulation of investment advisers since passage of the Investment Advisers Act in 1940. The evidence to date indicates that, with a few notable exceptions, the law is working as intended. By allocating primary regulatory responsibility to the SEC for advisers with more than $25 million in assets under management and authorizing exclusive regulatory authority to the states for advisers that manage less than $25 million, the Coordination Act has resulted in greater regulatory efficiency and reduced regulatory duplication and overlap.

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[1] The ICAA is a national association that exclusively consists of federally registered investment adviser firms. Founded in 1937, the ICAA's membership today is comprised of more than 240 investment adviser firms that collectively manage approximately $2 trillion in assets for a wide variety of institutional and individual clients.

[2] 15 U.S.C. 80b-1, *et seq*. The ICAA will provide comments to the Committee on other proposals at a later date if we determine that any such issues directly and significantly affect our membership.

[3] Title III of the National Securities Markets Improvement Act, P.L. 104-290.

Following are our comments on proposals amending the Investment Advisers Act of 1940, as listed in the June 28, 1999 letter from Senators Gramm, Grams, and Dodd:

1. Authority to deny or revoke registration based on state (and other governmental) administrative actions. The ICAA does not object to this proposal, as submitted by SEC staff.

2. Bars on persons associated with investment advisers. The ICAA does not object to this proposal, as submitted by SEC staff.

3. Enhance public disclosure over the Internet. This proposal was included in written submissions from the SEC staff and NASD. While the ICAA has supported the establishment of a centralized investment adviser registration system for many years, we have raised two major issues with respect to the proposed system. First, we wrote a letter to SEC staff last year (attached) to voice our serious misgivings about NASDR's potential involvement, based upon our strong opposition to the creation of a self-regulatory organization for our industry and the fact that NASDR might view its involvement with the centralized adviser system as an opportunity to extend its regulatory reach over our industry. SEC staff subsequently provided assurances that NASDR's role in the centralized system will be *solely* limited to ministerial functions and that the SEC's designation of NASDR to operate the database in no way implies that NASDR will be empowered to serve as a self-regulatory organization for SEC-registered investment advisers. However, based on statements by NASD and NASDR officials during the past year, we continue to have serious concerns about NASDR's involvement. We also remain concerned about the costs of the new system. The proposed amendment would authorize the SEC to impose fees on investment advisers "to pay reasonable costs" associated with the system, as well as authorize NASDR to recover costs from any person, other than individual investors, for responding to inquiries. As we stated in our August 20, 1997 letter to NASAA officials (attached): "We assume NASAA shares our view that one of the virtues of such a system is its potential to increase efficiencies while *reducing* costs associated with the current scheme. At a minimum, we hope the SEC and NASAA will work together to create a database and filing system without imposing additional fees on investment advisers. Our support for a one-stop filing system thus is conditioned on learning more about whether there will be substantial costs that could outweigh the benefits of the system." We hope NASDR will promptly establish an advisory group to allow for full participation and consultation with the ICAA and other interested parties as the centralized system is designed and implemented so that these and other concerns may be appropriately considered and addressed.

4. Extend national de minimis standard to federally registered advisers. The ICAA strongly supports a national self-executing de minimis standard that applies to all advisers. Please note that we have submitted revised statutory

language regarding our proposal (attached) that has been developed and approved in cooperation with the Institute of Certified Financial Planners, the International Association for Financial Planning, and the National Association of Personal Financial Advisors.

5. Prohibit state notice filing and fee requirements on certain investment adviser representatives. The ICAA strongly supports this proposal, as set forth in our March 24 submission to Committee staff.

6. Vestigial provisions in Investment Advisers Act. The ICAA supports this proposal, as submitted by SEC staff.

7. Restrict state notice filings to Form ADV and amendments thereto. The ICAA strongly supports this proposal, as set forth in our March 24 submission to Committee staff. We understand that some states may believe that our proposed amendment, as drafted, may be too restrictive and we stand ready to work with them to craft a provision that will provide greater certainty to federally registered advisers with respect to state notice filings while ensuring appropriate notification to the states.

8. Require states to participate in one-stop filing system. The ICAA strongly supports this proposal, as set forth in our March 24 submission to Committee staff.

9. Investment adviser books and records. With respect to the proposal submitted by the financial planning groups regarding examinations, the ICAA strongly supports uniformity in state examination requirements for investment adviser representatives. We supported NASAA's efforts during the past three years to develop the newly revised Series 65 and Series 66 examinations and we recently wrote to all states urging uniform adoption of the examinations and the sample rule issued by NASAA's working group in April.

10. Definition of "place of business." While the ICAA generally agrees with the SIA's proposed definition of "place of business," we instead support the proposal submitted by SEC staff (modeled on section 3(b) of the Exchange Act) that would amend the Advisers Act to provide explicit authority to the Commission to define various terms.

11. Limitation on state regulation of federally regulated persons. The ICAA commends the Committee for withdrawing this proposal from consideration, as submitted by the SIA.

12. Streamlining procedures for registering state-regulated investment advisers. The ICAA commends the Committee for withdrawing this proposal from consideration, as submitted by the SIA.

13. Limitation on state notice filings and fees for federally registered investment advisers. We assume that this item refers to one of the proposals submitted by the SIA. As indicated in items 4 and 5, above, the ICAA strongly supports the proposals included in our March 24 submission to Committee staff relating to notice filings, fees, and a self-executing national de minimis provision.

14. Transactions by investment advisers. The ICAA strongly opposes these proposals, as submitted by the SIA and the Bond Market Association. As indicated in our May 27, 1999 letter to Senator Gramm (attached), we believe that issues relating to section 206(3) of the Investment Advisers Act of 1940 involve complexities and sensitivities that extend well beyond the scope of the proposed legislation. Particularly in light of the burgeoning trend of brokers offering fee-based advisory services, as evidenced by Merrill Lynch's dramatic announcement last month, we are of the view that consideration of any changes in this area require extreme caution and deliberation. Section 206(3) of the Investment Advisers Act forbids advisers – both state and federal registrants – and their affiliates from knowingly selling any security to or purchasing any security from an advisory client on a principal basis, without disclosing this capacity to the client in writing before the completion of the transaction and obtaining the client's consent (principal transactions). It also imposes disclosure and consent requirements on an adviser who, while acting as a broker for a person other than a client, knowingly effects a sale or purchase of a security for a client's account and, where the adviser or affiliate recommends the trade to both sides of the transaction, the notice and consent must occur on a case-by-case basis (agency cross transactions). Section 206(3) was enacted by Congress because of serious concerns about potential overreaching and self-dealing by investment advisers at the expense of clients. The provision is similar to section 17(a) of the Investment Company Act. As noted in the April 28, 1999 letter from the Investment Company Institute (ICI) to the SIA regarding SIA's proposal to amend section 17(a), the statutory restriction on affiliated transactions – as well as section 206(3) of the Advisers Act – was enacted in 1940 in response to a wide array of abuses that occurred in the 1920's and 1930's. The ICAA believes that it is essential to maintain the core protections of section 206(3). While we acknowledge that SEC Chairman Levitt has indicated an interest in conducting a rulemaking in this area, we remain firmly convinced that any relaxation of rules in this area should be carefully considered and understood, especially because of the "migration" of broker-dealers toward fee-based advisory services. We hope that the Committee will not include this proposal in any legislation and would welcome the opportunity to discuss this issue at greater length with Committee staff.

15. Internet related firm exclusion. The ICAA is unaware of the genesis of this proposal or any suggested legislative language pertaining to it and thus takes no position on this proposal.

16. <u>SEC review of Advisers Act.</u> The ICAA is unaware of the genesis of this proposal or any suggested legislative language pertaining to it. Nonetheless, the ICAA opposes the concept of this proposal, as described in the June 28 letter from Senators Gramm, Grams, and Dodd. The fact of the matter is that the SEC's Division of Investment Management – and its Task Force on Investment Adviser Regulation – is currently doing what the proposed amendment contemplates. As described in the background section of our proposal, the SEC staff is reviewing virtually every investment adviser regulation on the books. The Commission already has issued a number of important rules since the enactment of the Coordination Act, including regulations implementing the 1996 law, a new rule regarding performance fees, and regulations requiring Year 2000 reports from investment advisers. The Task Force is actively engaged in drafting a major overhaul of Form ADV, as well as working with NASAA on an investment adviser registration system and database. Other rule revisions, covering books and records requirements, advertising rules, and other adviser regulations are also contemplated. Ironically, the proposed study would shift scarce Commission resources away from these important rulemakings and would delay implementation of needed revisions.

We truly appreciate the opportunity to submit these comments for your consideration and trust that you will not hesitate to contact us if we may answer any questions or provide any additional information. We look forward to working with you, the SEC, and other interested parties in crafting bipartisan legislation that will be enacted during this Congress.

Sincerely,

DAVID G. TITTSWORTH
Executive Director

Attachments:

1. ICAA legislative proposal (March 24, 1999).
2. Joint submission of ICAA, ICFP, IAFP, and NAPFA re: national self-executing de minimis provision.
3. ICAA letter to SEC re: investment adviser registration system (September 23, 1998).
4. ICAA letter to NASAA re: investment adviser registration system (August 20, 1997).
5. ICAA letter to Senator Gramm (May 27, 1999).

Cc: The Honorable Arthur Levitt (SEC)
Ms. Mary L. Schapiro (NASD Regulation, Inc.)
Mr. Philip A. Feigin (NASAA)

Investment Adviser Responsibilities in Nasdaq Class Action
by Karen L. Barr*

The ICAA has received numerous calls from members regarding an investment adviser's obligations on behalf of its clients with respect to the Nasdaq Market-Makers Antitrust Litigation. The ICAA has considered this issue carefully and provides the following information to its members.

The Nasdaq Market-Makers Antitrust Litigation

The Nasdaq Market-Makers Antitrust Litigation began in 1994, when the U.S. District Court for the Southern District of New York eventually consolidated more than thirty separate antitrust actions against more than 35 defendants. The complaint alleged that the defendants (market-makers with respect to certain securities traded on Nasdaq) conspired to increase and fix the spreads paid by plaintiffs and other investors (*i.e.* members of the class) in Nasdaq securities transactions.

The plaintiffs settled with all of the defendants for a total settlement fund of more than $1 billion. The Court approved the settlements and preliminarily approved a Proposed Plan of Distribution. The Court approved a class definition of all persons and entities who bought or sold "class securities" on Nasdaq, directly or through agents, trading with the defendants, during the period May 1, 1989 through July 17, 1996. Claim forms and a Notice dated June 11, 1999 were sent to potential class members. In addition, in an attempt to ensure broad notice, the plaintiffs' counsel in some cases sent copies of the forms and Notice to agents of the class members, including investment advisers, and multiple copies of the form to members under different account names and spellings. *The deadline to submit the proof of claim forms is December 8, 1999*.

Investment advisers have been receiving numerous inquiries from their clients and, in some cases, proof of claim forms in the Nasdaq litigation. Neither the Securities and Exchange Commission nor the Department of Labor has issued rules or guidelines for advisers to follow in the class action context. Over the years, advisers have followed different practices: some advisers filed proofs of claim for their clients in a class action, some simply provided the backup documentation to clients, and others forwarded the information to custodians for the custodians to handle. The Nasdaq litigation is quite different from a typical class action with only one issuer involved. Advisers thus may be overwhelmed by the scope and potential cost and burden associated with providing client information pertaining to the Nasdaq litigation. Many advisers are unsure whether following their past practices in other class actions is required or operationally possible in the Nasdaq litigation. Others note the uncertainty of the amount of money to be recovered by each client and wonder whether a significant effort is warranted. In light of this confusion, the ICAA offers the following guidance.

Filing Proofs of Claim for Clients

There is "no accepted fiduciary duty to litigate or pursue claims" on behalf of clients, though an adviser sometimes considers whether pursuing litigation is necessary to protect client interests. <u>Unlike the typical class action, however, the Nasdaq litigation has a specific answer to whether advisers should file proofs of claims on behalf of clients: No.</u> The Claim Form Instructions (paragraph 36) in the June 11 Notice and the Frequently Asked Questions section of the Nasdaq litigation web site (www.nasdaqlitigation.com) specifically state that asset managers who "wish to assist their customers in filing claims may transmit data to their customers for inclusion by the customers in the customers' claims, but should not submit such data directly to the Claims Administrator." The Nasdaq materials do permit custodians to file proofs of claim and include a form specifically designed for bank custodians to submit claims for their clients.

Contractual Issues

Even in a typical class action, the contract between a client and adviser may specify what role, if any, an adviser will play in a class action. The ICAA's specimen advisory contract, revised this year, now includes such a sample clause. Currently, most advisory contracts do not provide the adviser with sufficient authority or power of attorney to file claims for clients in a legal proceeding. Further, in a typical class action, the decision whether to participate in a legal proceeding may involve legal judgments, which advisers are not necessarily well suited to make (*see ICAA Newsletter*, Compliance Corner, December 18, 1998). *At a minimum, advisers should carefully review their contracts to determine whether they owe a contractual duty to their clients to submit proofs of claim or provide data relating to class action litigation generally.* Advisers may also wish to consult with counsel in considering whether they have developed a long-term pattern or practice of handling class actions for clients that may have created any legal obligations.

Providing Documentation to Clients

The most overwhelming and expensive aspect of the Nasdaq litigation for advisers is providing documentation to support client proofs of claim. Some advisers have provided such documentation to their clients in typical class actions, though no specific rule or duty requires it. We are unaware of any controlling precedent addressing this issue. Nor do the ICAA *Standards of Practice* specifically address class actions, including whether to provide information about specific transactions in such suits.

The ICAA *Standards*, however, emphasize an adviser's fiduciary duty and responsibility to render professional, continuous, and unbiased investment advice. In that light, *we discourage advisers from disregarding or ignoring the Nasdaq class action notice.* Advisers should inform their clients of the Nasdaq class action and notify clients that the adviser is not able to submit proofs of claim on their behalf. Additionally, where the client cannot obtain the information through other means, advisers should provide available information about specific securities transactions. As long as the adviser makes an effort, through any reasonable means its chooses, to determine that its clients may obtain the required claim information, the adviser has satisfied any duty it may have in this regard.

The following are examples of reasonable methods that some of our members have used to address these matters in the Nasdaq litigation. Please note that they all are predicated on the assumption that the adviser does not owe a *contractual* duty to the client to provide information regarding the litigation. Also note that the following examples are *not* the only reasonable ways to proceed:

1. Send a letter or other communication to clients informing them of the class action, stating that the adviser cannot file claims for clients, and referring them to their custodian as the best source of information. As noted above, custodians are specifically permitted to file proofs of claim on behalf of their clients; the Nasdaq claim form procedures provide a special document for custodians to submit in this regard.

2. Send a letter to each client's custodian, discussing the class action and stating that the adviser assumes the custodian will gather the relevant documents. This letter is copied to the client.

3. Send a letter to clients informing them of the class action, perhaps transmitting the Notice or other information received, stating that the adviser cannot file claims for the clients, and offering to provide all available supporting documentation necessary for the clients to file the claims. The letter should note the limitations of any information provided, including the SEC's five-year record retention rule, and that the clients may have traded through other advisers, etc.

4. Send the above letter, but also offer to actually fill out the proof of claim form and send it to the clients for signature.

5. If the adviser receives a *preprinted* proof of claim form for a client, send a letter to the client transmitting the form and stating that the adviser does not confirm the accuracy or completeness of the preprinted data, and that the client should check with its custodian for such confirmation.

In all circumstances, we suggest that members coordinate with their clients' custodians as necessary. There is certainly no requirement to reinvent the wheel. The custodian is often the natural coordinator for clients, particularly clients that employ more than one adviser. We understand that many custodians are already gathering the relevant documents for all of their clients. Some members are taking the lead in this effort (*i.e.* examples 3 and 4 above), while others are communicating with custodians who have taken or should take the lead (*i.e.* examples 1 and 2 above). All of these approaches are reasonable, as long as the adviser communicates with clients, takes a consistent approach with respect to similarly situated clients, and provides an opportunity for clients to request specifically that the adviser provide the information needed.

If you would like additional information about the ICAA's views on this subject, please contact our office. We also strongly suggest that you consult your legal counsel regarding these questions.

* *Karen L. Barr is the General Counsel of the ICAA. This article is for general information purposes only and does not constitute legal advice as to any particular set of facts.*

November 1, 1999

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

Re: Release IA-1812, File No. S7-19-99, Political Contributions by Certain Investment Advisers

Dear Mr. Katz:

The Investment Counsel Association of America[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposed new rule under the Investment Advisers Act of 1940 regarding political contributions by certain investment advisers, known as "pay-to-play." The proposal would prohibit investment advisers from providing advisory services for compensation to a government pension plan for two years after the adviser or any of its partners, executive officers, or solicitors make a contribution to certain elected officials or candidates related to the plan. The proposal also would require registered advisers with government clients to maintain records of political contributions made by the adviser or any of its partners, executive officers, or solicitors.

The ICAA strongly opposes any attempts by investment professionals to "buy business" through campaign contributions. We agree with SEC Chairman Arthur Levitt's public pronouncements denouncing pay-to-play practices in the securities industry, including his statement that:

> Pay-to-play harms fund beneficiaries and taxpayers. It breeds cynicism of government officials, and contempt for the political process. It brings discredit on the businesses and professionals who participate in the practice. … Competition, transparency, trust and integrity become casualties of the political process when public funds are used as a means to an end.[2]

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[1] The ICAA is a national not-for-profit association that exclusively represents federally registered investment adviser firms. Founded in 1937, our membership consists of about 250 investment advisory firms that collectively manage funds in excess of $2 trillion for a wide variety of institutional and individual clients. For further information, please see www.icaa.org.

[2] Remarks by Chairman Arthur Levitt, *In the Best Interests of Beneficiaries: Trust and Public Funds*, at the 1999 Annual Meeting of the Council of Institutional Investors (March 30, 1999).

Since its inception in 1937, the ICAA has promoted standards of conduct for the investment advisory profession. Over the years, many of these principles have been used by Congress and the Commission as the basis for legislation and regulations governing the conduct of investment advisers and by the U.S. Supreme Court in defining the standards of fiduciary conduct applicable to all investment advisers.[3] Our current *Standards of Practice* emphasize that an investment adviser is a fiduciary who has the responsibility to render professional, continuous, and unbiased investment advice oriented to the investment goals of each client. Additionally, our *Standards* state that investment managerial personnel should be individuals of experience, ability, and integrity. We believe that campaign contributions made for the intended purpose of influencing the selection or retention of an investment adviser run counter not only to our *Standards of Practice*, but are contrary to an adviser's fiduciary duties. *Buying business by making inappropriate political contributions has no place in our profession and these practices should be prohibited.* Accordingly, the ICAA supports reasonable measures that are specifically tailored to prevent and eliminate abuses that may exist in this important area.

At the same time, we are mindful that prohibiting specified campaign contributions – *without regard for the intent underlying such contributions* – involves sensitive constitutional issues that should not be swept away without due regard for and consideration of an individual's right to participate fully in our political processes. One can easily imagine a range of legitimate considerations that are wholly separate from a desire to influence the selection of an adviser – including political, religious, and other personal reasons – that may compel individuals employed by investment advisory firms to make political contributions to various public officials described in the proposed rule. The proposed rule limits the rights of certain advisory personnel to make *any* campaign contributions, without regard for the intent underlying the contribution or even the amount of the contribution. In fact, it is somewhat puzzling that the proposed rules do not include a meaningful discussion of the countervailing constitutional rights that certainly will be compromised by adoption of the proposal, although the staff recognizes that the Commission must tailor its rules narrowly to serve a compelling government interest.[4]

Because of the extremely harsh penalty involved – a two-year ban on an adviser receiving compensation if there is a violation of the proposed rule – the Commission also should be mindful of the fact that investment adviser firms will err on the side of ensuring that no prohibited contributions will be made, *e.g.*, by adopting procedures that cover employees who have *any* potential nexus to a public pension plan client (current or prospective) or by banning all contributions. Thus, adoption of the proposed rule may very well result in the investment adviser adopting policies and procedures that further restrict what otherwise would be lawful and appropriate contributions by investment adviser employees and their families. The bottom line is that this proposed rule requires the Commission to engage in a serious and delicate balancing act – weighing the

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3 *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 190 (1963).

4 *See Blount v. Securities and Exchange Commission*, 61 F.3d 938, 943 (D.C. Cir. 1995).

protection of public plan clients from undue influence that may result from certain political contributions against the individual's established constitutional right to participate in the political process.

We also believe that consideration of the proposed rules should be gauged against the background and factual basis underlying the alleged need for the rules. The proposal explicitly states that it is premised upon Rule G-37, adopted by the Municipal Securities Rulemaking Board in 1994 to address pay-to-play concerns in the municipal securities area. But there are significant differences between the municipal securities industry and the investment adviser profession, as well as the facts and circumstances that led to Rule G-37 and the subject proposal. Unlike municipal dealers, investment advisers have a *fiduciary* relationship with each of their clients – including public pension plan clients. The investment adviser/client relationship is predicated on providing continuous, ongoing, and independent investment advice, whereas the municipal security business generally is transaction-oriented.

The potential ramifications of a Rule G-37-type ban for investment advisers could be extremely disruptive to the client – and ultimately to the beneficiaries of the plan – even for minor violations that have nothing to do with pay-to-play abuses. Termination of a longstanding, ongoing fiduciary relationship is a much harsher result for both client and adviser than a time-out on transactional business. Indeed, the penalty for violating the proposed rule is tantamount to a death penalty for an advisory relationship. It is extremely unlikely that a public pension plan would endure the hardships and disruptions created by a violation of the rule, go through the process of identifying and hiring a replacement adviser, and then return to the original adviser after the two-year ban ends. In all likelihood, the so-called "two-year ban" will operate as a *de facto* permanent ban.

We also understand that, unlike the municipal bond business where one official (often the treasurer) has significant influence over the award of a contract, the public pension process generally is more open and involves more decision-makers, including representatives of plan participants and consultants. Presumably for this reason, the Commission has decided not to extend its exception for a competitive bidding process set forth in G-37 to the investment adviser pay-to-play proposal. Because competitive bidding accounts for much of the municipal securities business, this proposal, if adopted, would apply to significantly more firms and individuals than does G-37.

The Commission should also be mindful of the fact that there is significant evidence that state and local laws and regulations are working to curb pay-to-play abuses in cases involving public pension plans, unlike the evidence that existed in the municipal securities area earlier this decade. The recent situation involving a former Connecticut state treasurer appears to be such a case.[5] In fact, there is no indication that the proposed pay-to-play ban would have had any significant effect in dealing with the allegations of fraud and wrongdoing that are now being prosecuted under state law in that case. In the time since Rule G-37 was released, many state and local governments have mandated

[5] *See, e.g.,* The New York Times, *Ex-Treasurer in Connecticut Pleads Guilty* (Sept. 24, 1999).

restrictions or disclosures designed to deter pay-to-play practices. According to our members, many investment advisers already have policies and procedures in place to avoid pay-to-play issues. Further, some clients request investment advisers to disclose contributions during the bidding process. Given the laws and procedures that are in place, the Commission must carefully consider whether its proposed rules are the best approach, particularly where they effectively prohibit otherwise lawful and appropriate behavior.

Indeed, these considerations make disclosure a more meaningful and appropriate approach than a two-year ban on business. A disclosure regime is more consistent with the Investment Advisers Act and other securities laws than is a prohibition. Some of our member firms believe that, in lieu of the current proposal, the Commission should consider adopting an anti-fraud rule under the Investment Advisers Act to prohibit contributions that are made with the intent to influence the selection of an investment adviser to manage the funds of a government entity. The SEC could bolster this approach by requiring advisers to disclose any political contributions to relevant officials of government clients or potential clients on a regular basis. The adviser would also be required to maintain records of certain political contributions for SEC inspection.

Finally, we trust the Commission will seriously consider whether adoption of the proposed rule will disproportionately disadvantage the investment adviser profession by imposing regulatory burdens that do not apply to other similarly situated market participants. Banks, bank holding companies, certain broker-dealers, and others enjoy an exemption from the Investment Advisers Act and thus would not be covered by the proposed rule.[6] Many banks, for example, are in the business of providing discretionary investment management services to public pension plans and others, and include some of the largest advisory entities in the business. These firms compete directly with federally registered investment advisers for public pension plan business but would not be restricted by the proposed rule. Other persons who have relationships with public pension plans, including many consultants who play a significant role in the selection of investment advisers, are not regulated by the Commission and, therefore, their activities would fall outside of the proposed rule.[7] In considering the subject proposal, we hope the Commission will carefully consider the fiercely competitive environment investment advisers confront. In keeping with its statutory mandate to maintain orderly markets, the Commission must ensure that a level playing field is maintained among investment advisers, their competitors, and other market participants. The Commission must avoid

[6] *See, e.g.,* Section 202(a)(11), Investment Advisers Act of 1940. For example, the Commission's binders of "evidence" related to this proposal contain numerous mentions of an entity that may be exempt from registration as a subsidiary of a bank. In addition, this rule does not address pay-to-play practices by custodians, brokers, and other regulated entities or vendors that provide public pension plans with services other than discretionary asset management.

[7] *See "Paying to Play" Pensions & Investments,* May 17, 1999: "The Securities and Exchange Commission, in proposing to ban pay-to-play at public pension funds, missed tackling a huge related issue. It also should look at the power of consultants and the subtle pay-to-play they generate in the investment management community through money managers buying services from them."

the imposition of burdensome regulatory requirements that solely affect the investment advisory profession, while permitting others to compete without such burdens.

Whatever approach the Commission ultimately adopts, the ICAA strongly believes that particular aspects of the current proposal must be clarified and should be more narrowly tailored to support the Commission's objectives. We therefore submit the following specific comments in an attempt to narrow the reach of the rule to areas where abuse may be more likely to exist, while continuing to serve the SEC and public interest in eliminating any impropriety or appearance of impropriety:

1. <u>Definition of Partners, Executive Officers, and Solicitors. (Release at pp. 25-26)</u>[8]

Although we recognize that the Commission has attempted to apply the rule to a limited group of persons, we respectfully submit that the proposed rule still reaches too broadly, potentially requiring investment advisory firms to maintain records and monitor the contributions of the vast majority of their employees. The proposed application of the rule to "partners, executive officers, and solicitors" should be more narrowly tailored to investment adviser personnel who are most likely to be in regular contact with existing and prospective public pension plan clients.

Partners. The definition of "partners" is too broad in the context of limited partnerships, in which most limited partners have little or no involvement in the operations of the adviser and may have a relatively insignificant investment in the adviser. A more appropriate definition would simply apply to "general partners." Alternatively, the definition could apply only to partners with a significant ownership interest (*e.g.,*10 %) in the adviser and who have a functional role in the operations of the adviser. Moreover, it is unclear whether the Commission means to include "shareholders" in the definition of "partners." If so, the Commission should explicitly state that shareholders are covered and limit the definition to 10% shareholders who have a functional role in the operations of the adviser.[9]

Executive Officers. We believe the definition of "executive officer" in the proposed rule requires further clarification. For example, the term "vice president" in some firms could encompass dozens of individuals, including persons who have no significant relationship or nexus to public pension plan clients. Other persons covered by the rule – such as any person "who performs…policy-making functions for the investment adviser" – may in fact have little or no contact with existing or prospective government clients. Moreover, certain terms in the proposed definition (*e.g.*, "principal function" and "policy-making function") are somewhat unclear and could result in

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[8] Where the Commission has requested comment on a specific subject, we have referenced the release page number in the subject heading. *See Political Contributions by Certain Investment Advisers*, 64 Fed. Reg. at 46822 (August 27, 1999), Release No. IA-1812 (August 4, 1999) ("Release").

[9] We assume that by including the term "partners" in the proposal, the Commission does not intend to impose requirements related to control persons or affiliates or their employees. *Accord* Release at p. 26 (stating that contributions by employees of control persons or affiliates do not trigger the rule's prohibitions).

inconsistent interpretation and uncertainty. We therefore propose defining executive officer to mean "the president, CEO, or any officer in charge of a principal business unit or division related to portfolio management, client relations, sales, or marketing." This definition includes the types of personnel more likely to be involved with existing or prospective public pension plan clients. It would exclude officers in charge of administrative, accounting, technical, or legal units, who are unlikely to solicit such clients.

Solicitors. The proposed definition of "solicitor" is susceptible to broad and varying interpretations and should be clarified and narrowed.[10] For example, "solicitor" may be interpreted to include a portfolio manager who makes just one presentation at one meeting with one client. It appears to include any employee who even once refers a client to the employee's firm or affiliated adviser for no additional compensation.[11] The purpose of the rule would be served by more narrowly defining "solicitor" as "any employee whose primary function includes soliciting or referring clients to an investment adviser." This definition principally would apply to an adviser's marketing personnel, on whom the SEC should focus its concerns.

The release states that the proposed rule applies to third-party solicitors. It is very difficult to monitor and enforce rules regarding independent third parties. We strongly believe that it is quite harsh to hold an investment adviser fully accountable for the actions of third parties over whom the adviser has minimal control. To ensure absolute compliance with the proposed rule, a firm may even have to try to ban contributions by each and every person who does business with the firm. We understand the reasons underlying the Commission's inclusion of third-party solicitors in its definition of "solicitor": the Commission does not have direct statutory authority over third-party solicitors, yet third-party solicitors may have a financial incentive to pay-to-play and investment advisers may benefit from such payments.

The Commission's proposal, however, is not workable. Logistically, adviser firms will find it burdensome – if not impossible – to monitor continuously and keep detailed records regarding third parties. Further, as the Commission recognized in the proposed exemption provision, it is unfair and unproductive to ban firms from participating in a client relationship when the firm did not know of, or play any role in, a third party's contribution. If the firm instructs a third party to make a contribution to

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[10] The proposed rule defines solicitor as "any person who, *directly or indirectly*, solicits any client for, or refers any client to, an investment adviser." (emphasis added). Release p. 40.

[11] Although the Commission's proposed definition is the same as that used in the cash solicitation rule (Rule 206(4)-3), the purpose of the cash solicitation rule is very different from the purpose of the pay-to-play proposal. In the Rule 206(4)-3 context, the "solicitor" definition is of no consequence unless there is an arrangement for cash compensation in exchange for the referral/solicitation. Even where cash is involved, an employee (as opposed to third party) solicitor need only identify himself/herself to the prospective client (which, even without the rule, would be done by any firm's marketing department). Thus, although it seems on the surface beneficial to use consistent definitions, the "solicitor" definition in Rule 206(4)-3 should not apply and is not relevant to a context in which no additional compensation is involved.

obtain business, the firm already would be culpable under proposed rule 206(4)-5(a)(2) for soliciting a contribution and may be subject to the two-year ban on compensation for making an "indirect" contribution.

We believe it is unnecessary to include third-party solicitors in the rule at all, because any abuse would be covered by proposed rule 206(4)-5(a)(2). However, we also propose the following alternative, consistent with the structure of the Advisers Act. Third-party solicitors currently are governed by Rule 206(4)-3, the cash solicitation rule. We suggest that the Commission amend Rule 206(4)-3 to require a solicitor who is a natural person to disclose in writing to the adviser and government entity client or prospective client any contributions the solicitor has made to an official of the government entity within the past two years.[12] The solicitor should also certify that he or she will make no contributions in the future to any official of that government entity. The disclosure should be made in the separate written disclosure document mandated by Rule 206(4)-3(b), which the adviser is required to maintain under Section 204-2(a)(15) of the Advisers Act. The SEC inspection staff would have full access to these disclosure documents.

2. Definition of "Official of Government Entity"

Because the consequences of violating proposed Rule 206(4)-5 are so draconian, it is crucial that investment advisers have a very clear understanding of who is and who is not an "official" of a "government entity." The proposed definition of "official" is vague and could be quite broad.[13] Under the proposal, an investment adviser must decide on its own whether an office is "directly or indirectly responsible for, or can influence the outcome of, the use of an investment adviser by a government entity" or an office with the authority to appoint such a person. Government entities are not required to assist investment advisers by providing a list of officials covered by the rule. Because the definition is tied to an "office" rather than a particular "official" and includes persons who can appoint such officials, investment advisers cannot simply assume that the person with whom they are in contact is the relevant "official." Relevant officials could be many layers removed from the plan. Quite possibly, an adviser might have to hire a law firm for an opinion on the vagaries of local law before the adviser can even begin to think about contacting a potential client. Alternatively, an adviser could ban *all* contributions to *all* state and local officials nationwide for *all* covered employees – an outcome that would have obvious unfortunate implications on the ability of employees to participate fully in the political system and an outcome which we presume the Commission does not intend.

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[12] We suggest that the rules apply to natural person solicitors because some firms retain solicitors that constitute a large corporate entity, such as a full-service broker-dealer firm. Under the current proposal, it is ambiguous whether a contribution made by one employee of a huge brokerage firm could disqualify an investment adviser to whom the brokerage firm referred a government client – a result we believe the Commission did not intend. A rule that applied to entities may similarly discourage internal referrals among affiliated entities, perhaps another unintended result of the proposal.

[13] Proposed Rule 206(4)-5(e)(4).

We suggest that "official" be defined as a person who is *directly* involved in selecting the investment adviser. Moreover, we believe it is unfair and unduly burdensome for each investment adviser to try and ascertain all officials to whom the rule may apply. To this end, we strongly urge the SEC to coordinate with state and local organizations to compile a single list of "officials" on which all investment advisers may rely for purposes of the rule. At a minimum, the Commission should publish publicly a list of state "officials" and indicate those officials who are also candidates for federal office.

3. Definition of "Contribution"

The Commission proposes to define "contribution" as "any gift, subscription, loan, advance, or deposit of money or anything of value made for the purpose of influencing any election…payment of debt incurred in connection with any such election; or … transition or inaugural expenses…."[14] On its face, the proposal seems to apply only to election-related payments or gifts and would not apply to ordinary and usual business entertainment, such as meals, sporting events, theater tickets and similar items "of value," which are not otherwise prohibited or restricted under state or local law. It is our understanding that these types of gratuities generally are not made for the purpose of influencing an election and do not relate to debt, transitional, or inaugural expenses. Additionally, the consequences of making an inadvertent mistake in the burdensome process of policing meals, tickets, and related items would be disproportionately severe. Therefore, we respectfully request that the final rule confirm our understanding of the definition of "contribution" in this regard.[15]

Similarly, many officials of clients or prospective clients solicit investment advisers and their employees to make a wide array of contributions involving a charity. We assume these types of contributions in response to a solicitation are not covered by the proposed rule. If our understanding is incorrect, we would appreciate clarification in the final rule release.[16] Finally, we would appreciate confirmation that a covered employee's volunteer time for a political campaign is not a "contribution," unless employer resources (such as providing office space for the campaign) are used.[17]

4. *De Minimis* Exception (Release at pp. 26-27)

The ICAA respectfully requests that the *de minimis* exception be revised to permit an employee to make contributions of $1,000 or less to *any* candidate, not merely those

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[14] Proposed Rule 206(4)-5(e)(1).

[15] *Accord* MSRB Rule G-37 and Rule G-38 Handbook at 10, confirming that such gratuities are not covered by the rule.

[16] *Id.* (MSRB confirms that charitable donations are not covered).

[17] *Id.* at 9, 13 (MSRB confirms same).

for whom the employee could vote, if registered.[18] In today's economy, the reality is that $1,000 for any candidate is not going to buy a contract or an opportunity to be considered for a contract **–** it would not even buy a seat at the table. Increasing the exception to $1,000, however, would permit citizens to feel they are participating more fully in determining the quality of life in their communities.[19] In many cases, an investment adviser employee lives in one voting district and works in another. These individuals often take a great interest in their workplace location and they should have the freedom to participate fully in supporting officials who will make decisions affecting them.[20]

Further, limiting contributions to candidates for whom an employee can vote is inconsistent with the national goals of various legitimate groups or PACs, which sometimes name particular government officials in their contribution materials. For example, certain groups solicit contributions earmarked for specific female or minority candidates around the country or specific candidates who believe in particular platforms. In our democracy, no one should be prohibited from expressing support for these causes through contributions; as it is, even a $250 limit would significantly limit the ability of individuals to make a meaningful statement of support for particular candidates for legitimate reasons. For example, if the proposed rules were in effect today, Republicans who would like to be considered for public pension plan business in Texas or New York would not be permitted to provide any meaningful support to George W. Bush or Mayor Rudolph Giuliani. Democrats wishing to support Hilary Clinton, however, could proceed unfettered. Clearly, the rule would hamper candidates for federal office who are currently state or local officials, while effectively benefiting candidates who already hold a federal office.

Finally, we understand that certain Federal Election Commission officials have expressed concern that the SEC's proposal may conflict with the Federal Election Campaign Act of 1971 (FECA).[21] Increasing the *de minimis* to $1,000 would make the SEC's rules more consistent with FECA, which in 1974 established a $1,000 limit on individual contributions.[22]

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[18] We strongly urge the Commission to permit individuals to make **some** contribution to candidates for whom they are **not** eligible to vote, even if the Commission should decide upon a different *de minimis* amount than the $1,000 we suggest.

[19] We understand that $250 is the *de minimis* amount under Rule G-37. We submit, however, that such amount was established more than five years ago, when $250 presumably was a more meaningful contribution. We also understand that the more extensive record of abuses in the municipal securities industry may have led the Commission to impose a relatively low *de minimis* amount.

[20] For example, employees and owners of businesses in Baltimore City may reside in Baltimore County or other locations. Such employees and business owners, however, may care deeply about issues affecting Baltimore City, where they work daily. Similar issues are raised when Maryland and Virginia residents would like to contribute meaningfully to their workplace environments in Washington, D.C.

[21] *See, e.g., SEC "Play-to-Pay" [sic] Rules: Its Impact with Respect to FECA,* Memorandum to The Federal Election Commission from Lawrence M. Noble, General Counsel, *et al.* (Sept. 20, 1999).

[22] *See id.* p. 2. Indeed, some have suggested that the proposed rule may encourage use of "soft money," which some political participants would like to discourage.

5. <u>The "Look Back" Requirement (Release at pp. 27-28)</u>

The look-back proposal presents a number of difficulties. Firms will have to question potential job applicants regarding their specific contributions and require new hires to sign a representation regarding such contributions. Currently, this query is not made of most candidates in the investment advisory profession and would inhibit advisers' competition for talent and the ability of advisory personnel to change jobs. Moreover, advisers have every reason to be concerned about potential liability in questioning applicants regarding their political contributions; such questions may elicit information from these individuals about their political, religious, sexual orientation, racial, or other views or affiliations.[23] In essence, this provision is an invitation to lawsuits by job applicants, whether legitimate or not.

We propose that the Commission eliminate the look-back provision. Eliminating the provision will in no way compromise the Commission's goals. Officials of relevant government entities are unlikely to "credit" to an advisory firm a contribution previously made by a newly hired employee (as much as two years earlier). Moreover, this provision "punishes" the advisory firm for contributions the individual made while employed at a prior firm. We are aware of no evidence that this type of conduct has occurred. In any event, we believe the "no solicitation" and "directly or indirectly" provisions of the pay-to-play proposal adequately address any illicit contributions made by employees departing a firm.

Should the Commission choose to retain the look-back provision, we respectfully submit that the time period be limited to six months and that the Commission obtain from Congress some liability protection for advisory firms for asking employees and potential employees specific questions about their history of political contributions.

6. <u>The SEC's Authority to Grant Exemptions (Release at pp. 31-32)</u>

Because the proposed sanctions are so severe, the exemption process established by the Commission is a crucial element of the proposal. First and foremost, the exemption process must provide for a *prompt* response. This is simply a matter of fundamental fairness. Delays in the exemptive process will harm the adviser, the plan, and beneficiaries of the plan. We therefore suggest requiring a response to an exemptive application within 30 days. To achieve this result, we suggest that the Commission delegate to its staff authority to grant exemptions. Because of the potential for a significant number of innocent or inadvertent problems, we strongly believe that the rule

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[23] *See, e.g.,* District of Columbia Human Rights Act of 1977, Title 1, Chapter 25, Subchapter II, Section 1-2512 (prohibiting employment discrimination based on, among other classes, race, color, religion, gender, sexual orientation, or *political affiliation*) (emphasis added).

should provide that an application not acted upon within 30 days would be automatically granted.[24]

Second, because of the severity of the sanctions, the Commission should set forth specific criteria, which, if established, would result in the automatic issuance of an exemption. For example, an automatic exemption should issue if the applicant can establish that the contribution was made inadvertently or without the intent, purpose, or actual effect of influencing the selection or consideration of the adviser.[25] Similarly, if employees or solicitors of the adviser who communicate with the government client had no knowledge of a contribution made by an employee who has no contact with the client, an exemption should issue.

Third, the Commission should factor in the differences between the municipal bond business and the investment adviser profession in fashioning exemptions. The municipal bond business is transaction-based. Forced termination of an ongoing fiduciary relationship is a much harsher result for both client and adviser than a ban on a transactional business. For example, particular types of advisers may fill a specific niche of expertise required by a client. Whether or not a contribution has been made, in many circumstances the adviser chosen by the client may indeed be the most qualified candidate and the selection may be in the best interests of plan beneficiaries. A forced change could result in additional costs – as well as a change in performance and risk – for beneficiaries of government plans.

Fourth, the text of the release states that the Commission "would apply these exemptive provisions with sufficient flexibility to avoid consequences disproportionate to the violation while accomplishing the remedial purpose of the rule."[26] We strongly support this goal, including the proportionality concept. Firms should not be subject to forfeiture of significant revenues or important relationships because of an inadvertent error by one of many employees.[27] We assume that the phrase "conditionally or unconditionally" in the proposed exemption language permits the Commission, through

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[24] *Cf.* General Instructions for Preparing and Filing Form ADV-W ("a notice to withdraw from registration … shall become effective on the 60th day after the filing thereof" unless the SEC has begun proceedings before then).

[25] For example, we understand that there may be private investment companies with respect to which the adviser does not know who the beneficiaries are; only the sponsor or distributor of the fund may know whether a public pension plan is one of the beneficiaries. This is an area in which consideration of intent (or lack thereof) should result in an exemption. Note that in private investment company cases, the adviser would not be able to resign from the relationship; instead the client would have to withdraw its investment in the fund. The SEC exemption process may be able to identify a more logistically suitable sanction in such cases if it finds there was an intent to influence the selection process.

[26] Release at 32.

[27] Indeed, loss of a very significant public pension plan client could result in layoffs or other cutbacks. Further, investment advisers are concerned that these severe consequences would be triggered, for example, where a disgruntled employee spends just $1 on a contribution to an official for whom he is not registered to vote.

its staff, to impose alternate remedies to a two-year ban on business when it appears that a remedy is justified yet a ban is too severe under the circumstances.[28]

Finally, the Commission should make provision for an application for exemption made *in advance* of the contribution for legitimate reasons. For example, an advisory employee, otherwise subject to the rule, may wish to make a contribution outside the *de minimis* to an official for religious reasons. That employee should be able to obtain advance reassurance from the Commission that such contribution would not result in a ban for the firm. Similarly, some investment advisers are currently supporting (both financially and otherwise) legislative proposals that would result in increased government-related investment advisory opportunities, such as IRS Code §529 college savings plans. Having successfully supported such legislation, firms should not then be banned from responding to subsequent RFPs for these plans.[29]

7. <u>Termination of Advisory Contracts Under Proposed Two-Year Ban (Release at p. 23)</u>

Under the current proposal, an adviser and its client appear to have three options when a violation of the rule occurs: (1) the adviser could immediately resign from an account by giving the requisite notice (and not charge fees for the notice period); (2) the adviser could continue to manage plan assets for no compensation for any time period up to two years per an agreement with the client; or (3) the adviser could continue to manage plan assets while applying for an exemption from the SEC.[30]

Virtually all advisory contracts provide a time period for termination. For example, the ICAA's specimen advisory contract provides: "This agreement may be terminated at any time upon __ days' prior written notice by either party." The blank is a term to be negotiated by the parties at the outset of the relationship. By contract, both the government client and the adviser mutually agree to a time period for termination. We believe that leaving the time period to contractual negotiation provides the most flexibility for an adviser and its client. However, government clients often negotiate lengthy periods for termination so that they have significant time to select a new adviser. We therefore strongly recommend that the rule permit compensation to be paid during the time period between notice of termination and until termination or until the client finds a successor adviser. The penalty of losing a significant client – which we believe will be a *permanent* loss of business in most cases – is harsh enough without imposing the additional penalty of uncompensated work for termination periods of up to 180 days under some contracts. Our recommendation would not only benefit the adviser but also the client, who may have legitimate concerns about the adviser's motivation to perform

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[28] We are aware of, and strongly **oppose**, the MSRB's statement that certain inadvertent mistakes are not grounds for an exemption under any circumstances, such as failure to recognize that an individual is an "official" consistent with the Board's interpretation of that term. *See* MSRB Rule G-37 Handbook at 17.

[29] *See, e.g., State-College-Savings Plans Go National, Tax Legislation Broadens Market*, Wall Street Journal, C1 (Sept. 23, 1999).

[30] *See* Release at p. 32 n.101.

during the period between notice and actual termination. Significantly, the MSRB does *not* prohibit the receipt of compensation in analogous situations under Rule G-37.[31]

8. <u>The Proposed Recordkeeping Requirements (Release at pp. 33-34)</u>

The ICAA understands the Commission's need to review records maintained by advisers to prevent pay-to-play practices by their covered employees. We submit, however, that the proposed record-keeping requirements should be more narrowly tailored to meet the Commission's objectives.

Prospective Clients. The proposed rule, in effect, requires firms to keep an ongoing, continuously updated list of prospective government clients.[32] We oppose this proposed provision because we do not see why the required information is necessary. The remedy of a two-year ban on receiving compensation simply does not fit a situation where the adviser fails to obtain the client's business. If an advisory firm is not selected for business, that firm has caused no harm to the plan or its beneficiaries. If an adviser is acting inappropriately, that conduct will be recorded when the adviser is actually chosen by a client. If the firm is never chosen, it certainly will determine that its contribution activities are for naught and will not continue them. Further, it is logistically unclear how a firm should compile this list. Should all letters that are sent to prospective clients be copied immediately to the compliance officer? Should all RFPs received be sent to the compliance officer? Must each solicitor maintain a log of phone calls made to prospective clients and update the compliance officer daily? The burden of continuously compiling this list would be significant, with little or no benefit to the Commission or the public.[33]

Indirect Contributions. As proposed, the rule would require each firm to maintain records of all "direct or indirect" contributions made to "an official, a political party of a State or political subdivision thereof, or a political action committee."[34] How is a firm to determine what is an "indirect" contribution?[35] That determination appears to require a state-of-mind assessment by an employer. The Commission's release states that spouses

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31 MSRB *Interpretation of Prohibition on Municipal Securities Business Pursuant to Rule G-37* (February 21, 1997).

32 Proposed Rule 204-2(l)(1)(ii).

33 If the Commission nevertheless decides to retain this requirement, we strongly recommend that it require the list to be updated on an annual, not a continuous, basis and include only those clients to which a formal, written proposal has been made.

34 Proposed Rule 204-2(l)(1)(iv).

35 Some have suggested (incorrectly we believe) that contributions made using a check from a joint checking account where both names appear on the check should be considered "indirect" contributions. This suggestion is contrary to the MSRB's comment that where a covered employee and another person sign a check drawn on a joint account, only 50% of the contribution is attributable to the employee. MSRB G-37 Handbook at 17.

are not covered by the rule unless they are used to indirectly make a contribution. We strongly agree that spouses should not be covered consistent with a narrowly tailored rule. Spouses should be permitted to continue to participate in the political and civic life of their communities. However, the Commission should provide clearer guidance to firms and employees on this subject. We therefore propose that the Commission clarify the "indirect" provision by stating that it refers to contributions made with the intent, purpose, or effect of influencing an official of a government entity.[36]

For similar reasons, the Commission also should make clear that an investment adviser may rely on self-reporting or certifications by covered employees, who could be asked to list their contributions and certify that they have not made any indirect contributions. The adviser should not have to conduct continuous expansive, invasive (and expensive) investigations of a covered employee, as well as the employee's friends and family. Indeed, we suggest that the Commission rephrase the provision to require the investment adviser to keep annual reports submitted by covered personnel (similar to the annual reports now required by the personal trading rule under the Investment Company Act).

Political Action Committees. We do not understand why investment advisers are required to keep records regarding contributions made to a "political party" or "political action committee." The proposed rule prohibits contributions to an "official of a government entity." The Commission itself has stated that "[c]ontributions to political parties would not trigger the proposed rule's prohibitions, unless the contribution is earmarked or known to be provided to an official."[37] We assume, and the Commission should clarify, that the same statement applies to political action committees or similar organizations. If contributions to a party or PAC do not trigger the rule's prohibitions, there is no compelling need to maintain records of such contributions. Any contribution made to a party or PAC for the purpose of obtaining business from a certain official would be covered by the requirement to report indirect contributions and by the Commission's statement that the contribution must not be earmarked for a particular official.

Payments. Although the prohibitions of the rule apply only to "contributions," the record-keeping provisions apply to either "contributions or payments." Unlike the definition of "contribution," the term "payment" is *not* limited to situations involving an attempt to influence elections.[38] It is unclear why the Commission needs records of payments that are unrelated to elections if they do not violate the rule. And, as discussed

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36 *See* Release at p. 26, which states: "Contributions by other employees of the adviser or other persons (such as spouses, control persons and affiliates) would not otherwise trigger the rule's prohibitions unless the adviser … used the person to indirectly make a contribution." At a *minimum*, the phrase "with the intent, purpose, or effect of influencing an official of a government entity" should be added at the end of that sentence.

37 Release at p. 25 n.81.

38 Proposed Rule 204-2(l)(3)(ii).

above, if the term "payment" includes ordinary and usual business entertainment expenses that are not otherwise prohibited, these record-keeping requirements will be very burdensome and difficult to follow. Moreover, such an interpretation would render completely erroneous the Commission's assumption that the proposal involves "no substantial additional burdens" in addition to records internally required for compliance with the rule.[39] We therefore request that the Commission strike the word "payment" from the proposed amendments to Rule 204-2.

Total Ban on Employee Contributions. Advisory firms may attempt to avoid the burdens imposed by the record-keeping requirements and the possible imposition of the "death penalty" for violations of the rule by simply banning all employees or all covered employees from making political contributions. If an investment adviser wishes to take this path, it should be permitted simply to obtain a signed statement each year from each covered employee certifying that he/she has complied with the ban. This annual certification should be permitted in lieu of the records required by Rule 204-2(l)(1)(ii)-(iv) and (2).

9. <u>A Transition Period (Release at p. 34)</u>

The ICAA respectfully submits that some investment advisory firms will need a significant amount of time to develop internal procedures to comply with the proposed rule. In order to ensure that (1) procedures are in place, (2) appropriate personnel have been hired and trained, (3) all relevant employees have been informed properly of the rule and procedures, and (4) any necessary legal opinions have been obtained, we propose a transition period of 180 days.

* * * *

The ICAA opposes any practice by which investment professionals try to gain access to business through political contributions. We commend the Commission for attempting to eradicate pay-to-play practices in the financial services industry. The ICAA stands ready to assist the Commission in any way needed to craft an effective rule that is tailored to eliminate pay-to-play practices without unnecessarily infringing on free speech rights or imposing unnecessary burdens on the investment advisory profession.

We truly appreciate your consideration of our comments and trust that you will not hesitate to contact us if we may provide additional information regarding these or any other issues.

Sincerely,

David G. Tittsworth
Executive Director

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[39] Release at p. 34.

cc: The Honorable Arthur Levitt
The Honorable Isaac C. Hunt, Jr.
The Honorable Norman S. Johnson
The Honorable Paul R. Carey
The Honorable Laura Unger
Paul F. Roye, Esq.
Robert E. Plaze, Esq.

November 24, 1999

Mr. Joel Seligman, Dean
Washington University School of Law
One Brookings Drive
St. Louis, MO 63130

Re: NCCUSL Drafting Committee Proposal to Revise Uniform Securities Act

Dear Dean Seligman:

We again thank you for providing the Investment Counsel Association of America the opportunity to participate as an observer to the Committee's efforts to revise the Uniform Securities Act. We appreciate the enormous task you have undertaken in revising the Act and found your first discussion draft to be an excellent basis for achieving uniformity in accordance with the spirit and intent of the National Securities Markets Improvement Act of 1996 (NSMIA).[1]

To more completely conform the draft circulated in October 1999 to NSMIA, we provide the following comments in the order in which the relevant provisions appear in the draft. To a large extent, these comments simply confirm in writing certain points that we and other parties made during the NCCUSL meetings on October 22-24, 1999:

1. Definition of Investment Adviser (p. 8)

As discussed at the October 23 meeting, we strongly recommend excluding "federal covered investment advisers" from the definition of "investment adviser" in proposed subsection (j) of the definitions. Such a structure would facilitate a plain reading of the rest of the Act and eliminate other changes that otherwise would have to be made. For example, if federal covered advisers were excluded from the definition of "investment adviser," the coverage of Section 16 regarding post-registration provisions would be appropriate as proposed. If such advisers continue to be included in the "investment adviser" definition, the provisions of Section 16 would have to be amended to cover only "registered" investment advisers.[2] We understand that both the SEC and NASAA concur in this recommendation.

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[1] Because we represent only federally registered advisers, we are limiting our comments to provisions of the Uniform Securities Act that would affect such advisers.

[2] *See* ICAA letter to the Reporter, Joel Seligman dated May 20, 1999, discussing NSMIA's pre-emption of substantive state regulation of federally-registered investment advisers.

2. <u>Definition of Investment Adviser Representative of Federally Registered Investment Adviser (pp. 9-10)</u>

Based on the October 23 meeting, there appeared to be general consensus that the term "investment adviser representative of a federally covered investment adviser" should be inserted in subsection (k) of the definitions. We strongly concur and, subject to reviewing the details in writing, we support the definition proposed by SEC staff at the October 23 meeting.

3. <u>Reorganization of Sections 13-15 (p. 63, et seq.)</u>

At the October 23 meeting, you indicated that you might reorganize proposed Sections 13-15 on a functional basis. That is, there would be separate provisions integrating the necessary information (requirements, exemptions, and procedures) for each category of registrant or notice-filer: brokers, agents, state-registered advisers, federally registered advisers, and investment adviser representatives. We believe this approach would improve significantly a person's ability to read and understand his or her obligations and we strongly support this concept.

4. <u>Use of Registration Terms for Notice Filers (pp. 64, 73)</u>

Under NSMIA, states are not permitted to impose registration requirements on federally registered advisers. States may, however, require these advisers to file documents filed with the SEC "solely for notice purposes." Sections 13 and 15 of the proposed Uniform Securities Act use the terms "renewal," "expire," and other phrases that evoke the notion of a registration system. These terms are often used in current state statutes and in the NASAA models for notice filers, presumably because states are familiar with registration concepts and notice filing has no precedent. This fresh Uniform Securities Act is a great opportunity to introduce a new and more appropriate model to the states for notice filing.

We recommend that instead of registration-type provisions, the Act provide for the periodic filing of documents and payment of annual fees without continuing the now-inappropriate concepts of "renewal" and "expiration."[3] This will be easier when the Act is functionally reorganized as discussed above. For example, current Section 15(c) could be revised to read: "Except with respect to federal covered investment advisers whose only clients in this state are those described in section 14(c) of this Act, a federal covered investment adviser shall file with the [Administrator] such documents as have been filed with the Securities and Exchange Commission as the [Administrator], by rule or order, may require. On an ongoing basis, a federal covered investment adviser shall file such documents when they are filed with the Securities and Exchange Commission." Similarly, the brackets in Section 15(d)(3) should use the word "annual" instead of

[3] The ICAA and other associations currently are making similar comments regarding this issue to the SEC, NASAA, and the NASDR, which is creating the investment adviser database for one-stop filings.

"initial or renewal." We understand that staff of the SEC's Division of Investment Management agrees with this approach.[4]

5. Definition of Place of Business (pp. 68-70)

As discussed at the October 23 meeting, we strongly urge the Drafting Committee to include the SEC's definition of "place of business" in the Uniform Securities Act. The "place of business" definition was hotly debated at the time of creation, but at this point has been accepted (reluctantly or otherwise) by both the profession and NASAA. Inclusion of the definition in the statute would solidify the uniform use of this term after its initial period of debate. Although the phrase determines which investment adviser representatives the states may register under federal preemption law whether or not a state chooses expressly to include the SEC's definition in its statute or rules, a uniform definition would provide more certainty and acceptance for both states and individuals.

We suggest including the SEC's definition of "place of business" in Section 2 separately. In addition, we recommend inserting the term "place of business" into the definition of "investment adviser representative of a federal covered investment adviser." For example, the definition could read in relevant part: "Investment adviser representative of a federal covered investment adviser means any individual with a place of business located within this state who is …" This would simply the other provisions in the Act regarding such investment adviser representatives, eliminating the need to add "with a place of business" in various other sections.

6. Notice Filing Provision (p. 72)

There has been some confusion, especially among first-line registration officials of various states, regarding which types of documents a federal covered adviser should file with the state. Although certain documents are not specifically required in writing by any state, some of these officials informally have interpreted the phrase "such documents as have been filed with the Securities and Exchange Commission" to include literally *all* documents, including Form 13F and Schedules 13D and G. Advisers are sometimes required to make these federal filings pursuant to the Securities Exchange Act of 1934. Before NSMIA, states did not require these types of filings; they generally required only Form ADV with its schedules and amendments. It was not within the intent of NSMIA to change the filings typically required.

Other forms have caused confusion among state officials and notice filers, such as Form ADV-Y2K.[5] We understand, however, from informal discussions that NASAA may be hesitant to use the term "Form ADV" or "registration documents" in a statute.

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4 *See* Letter from Robert E. Plaze, Associate Director, SEC Division of Investment Management to the Honorable Ed Perlmutter, Colorado State Senator, dated March 10, 1998 (copy attached).

5 The SEC required advisers to file this form on two specific occasions to report Year 2000 progress to the SEC. Some state officials required the form to be "notice filed" by SEC-registered advisers and others did not so require.

We will continue to work with NASAA to develop appropriate language. In the meantime, we suggest that, at a minimum, the phrase "pursuant to the Investment Advisers Act of 1940" be inserted after "Securities and Exchange Commission" to clarify these requirements.

7. Notice Filing Fee Provision (p. 73)

We note that proposed Section 15(d)(3) should be clarified to apply only where the federal covered adviser does not meet the *de minimis* exemption and therefore has to notice file. We recommend conforming the provision to Section 15(c), which requires notice filings "except with respect to federal covered investment advisers whose only clients in this state are those described in section 14(c) of this Act." We understand that other participants in the October 23 meeting concur with this approach.

8. Criminal Penalties (p. 99)

Proposed Section 27, entitled Criminal Penalties, would subject to criminal penalties any person who violates any provision of the Uniform Securities Act.[6] Under a plain reading of the proposal, such violations would include failure to notice file and pay fees. We object to imposing criminal penalties on firms federally registered with the Securities and Exchange Commission that simply fail to notice file and pay the accompanying fees. The provisions of NSMIA that preserve notice filing and fees were the result of a last-minute compromise to assure the states that they could still collect fees from SEC-registered firms and have some notice of firms doing business in their state above a certain *de minimis* level. The primary intent of NSMIA, however, was to *divide* regulatory responsibility between the SEC and the states. The states no longer have substantive authority over federally registered firms. The Uniform Securities Act should not criminalize an action that simply provides duplicate notice to states (and will be even more plainly repetitive after the electronic one-stop filing is implemented). We therefore request that Section 27 be amended to provide: "(a) Any person who willfully violates any provision of this Act except Sections 22 and [insert] (currently sections 13(f) and 15(c)), or who…"

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[6] We recognize that the proposal uses the term "willfully violates." As you are aware, however, some federal and state courts may interpret "willfully" rather loosely to include concepts of recklessness or gross negligence, and to exclude defenses based on misunderstanding or ignorance of these technical legal requirements.

We appreciate your consideration of our comments regarding revisions to the Uniform Securities Act. Please do not hesitate to call me with any questions or comments at (202) 293-4222. Thank you for involving us in this important initiative.

Sincerely,

Karen L. Barr
General Counsel

cc: Richard B. Smith, Esq.
Drafting Committee Chair