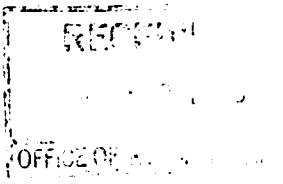
DF - IX - Enhanced Exam



December 24, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Sections 913 and 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Ms. Murphy:

Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") requires the Securities and Exchange Commission (the "Commission") to evaluate the effectiveness of the current standards of care applicable to brokers, dealers, investment advisers and their respective associated persons when providing personalized investment advice and recommendations to retail customers. Section 914 of the Act requires the Commission to analyze the need for enhanced examination and enforcement resources for investment advisers and to determine the extent to which having Congress authorize the Commission to designate one or more self regulatory organizations ("SROs") to augment the Commission's efforts in overseeing investment advisers would improve the frequency of examinations of investment advisers.

Members of the Association of Institutional Investors ("Institutional Investors")[1] discussed Sections 913 and 914 with Commission staff at a meeting held on October 25, 2010. At that meeting, members of Institutional Investors expressed their view that the same fiduciary standard that applies to investment advisers when managing all categories of client accounts should apply to brokers when providing personalized investment advice to retail customers. Further, with respect to Section 914, members were strongly of the view that the effectiveness of the Commission's ability to oversee and examine investment advisers would not be enhanced by the establishment of an SRO.

Institutional Investors continues to believe that the Commission should retain exclusive oversight of all registered investment advisers. Institutional Investors is pleased to provide the Commission with its views concerning regulation of investment advisers, should the Commission conclude, for resource or other reasons, that Congress should authorize an SRO for advisers. In such event, Institutional Investors urges the Commission to distinguish between investment advisers who predominantly provide investment advice to accredited investors (an "institutional adviser") and advisers who provide personalized investment advice to non-accredited investors (a "retail adviser").

[1] Institutional Investors is an association of some of the largest and oldest investment advisers in the United States who primarily provide services to institutional clients, such as registered investment companies, public and private pension plans, and foundations.

Institutional Investors believes that the Commission should retain exclusive examination authority over institutional advisers. For purposes of our proposal, Institutional Investors recommends that: (1) "accredited investor" be defined as it is currently defined in Regulation D under the Securities Act of 1933 (17CFR §230.501); (2) "institutional adviser" be defined as a registered investment adviser, whose annual gross revenues earned from providing advisory services to accredited investors represent 85% or more of the annual gross revenues earned from providing advisory services to all clients of the registered investment adviser;[2] and (3) "retail adviser" be defined as any registered investment adviser who is not an institutional adviser.

Institutional Investors believes that the distinction between institutional advisers and retail advisers should be drawn at the entity level in order to avoid duplication of regulatory oversight. The examination program for financial advisers should recognize the fundamental differences between accredited investors and non-accredited investors and between the activities of institutional advisers and retail advisers by not forcing a single examination process on all advisers with attendant consequences to such different classes of clients and activities.

Institutional Investors requests that the Commission provide clarification on the scope of services which would be classified as "personalized investment advice to retail clients" under Section 913 of the Act for the purpose of determining which advisers should be classified as "institutional advisers." In keeping with the above definition, Institutional Investors believes that an adviser's activities related to the manufacture and management of pooled investment products (such as mutual funds) should be considered institutional in nature for the purposes of the institutional adviser definition above, even if the ultimate purchasers of those products may be non-accredited investors. In addition, Institutional Investors believes that to the extent that an adviser supplies investment research or model strategies to other advisers for such advisers' use with end clients, but does not have investment discretion or direct contact with the non-accredited customer, such activities should be considered institutional in nature, and should not be categorized as providing "personalized investment advice to retail clients" for the purpose of determining whether the adviser should be considered an institutional adviser.

Many institutional advisers are affiliated with a limited purpose broker dealer whose business activities are limited to supporting the sale of shares of registered investment companies or private funds that are sponsored by the institutional adviser. Those services include the distribution of shares of those funds either to other broker dealers (who in turn sell the shares to the end investor), or to institutional investors or broker dealers to be included in their "wrap account" offerings. The hallmark of the sales activities of representatives of limited purpose brokers is that they are sales to institutional investors. Institutional Investors requests the Commission to consider whether the limited nature of such broker dealer activities, and the integrated activities of such broker dealers with the business of institutional advisers, warrant a separate regulatory structure from that applicable to full service broker dealers or broker dealers that engage with retail customers and whether the regulation and examination of such limited purpose broker dealers should be consolidated with the regulation and oversight of institutional advisers.

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[2] The proposed definitions of institutional advisers and limited purpose broker use the same standards used in Section 102(a) (6) of the Act to define "predominantly engaged."

The Act and the federal securities laws differentiate between the levels of protection provided to accredited investors versus non-accredited investors. Accredited investors are allowed to invest in various investment products, such as unregistered investment companies, 144A offerings, and privately placed securities that are simply off-limits to retail investors. Certain accredited investors are permitted to agree to performance-based fee structures that are unavailable to retail investors. Permitting accredited investors the freedom to invest in these products is appropriate because accredited investors are able to understand complex financial matters and assess risks far better than the typical retail investor.

In our experience, accredited investors are more proactive and self-reliant in overseeing the institutional advisers they hire. Almost all registered investment companies have independent boards and counsel, and most clients of institutional advisers either have their own staff or consultants that perform extensive due diligence on the institutional adviser's investment process and business operations and receive regular detailed reports on the performance of their portfolio.

Non-accredited investors are not similarly equipped. The relationship between a non-accredited investor and a retail adviser is better suited to prescriptive-rule based regulation than the relationship between an accredited investor and an institutional adviser.

We are concerned that if an SRO is created using FINRA as a model, it will not provide the flexibility needed by accredited investors because the rules based system that is applied to broker-dealers is ill-suited for the institutional market. A rules-based system reduces freedom of choice by requiring the same treatment of clients regardless of differences clients and facts and circumstances. This model was designed to protect less sophisticated clients that are unable to make well-informed decisions on complicated financial products. It sacrifices choice for an acceptable conduct standard. It is more reasonable for less sophisticated clients than it is for institutional clients. The Commission's staff has recognized how the facts and circumstances surrounding an adviser's relationship with a client will inform whether the contract terms between them are acceptable.[3] [4] That same recognition should lead the Commission to different regulatory structures based on the classes of customers the Commission is seeking to protect.

Additionally, many institutional advisers include registered investment companies among their clients, either on a direct advisory or sub-advisory basis. As noted above, the regulation of registered investment companies is intertwined with the regulation of their advisers. If the Commission retains its examination authority over registered investment companies, it will be very inefficient to separate this retained examination authority from the examination of institutional advisers and risk inconsistent interpretations of the Investment Company Act of 1940 (the "40 Act").

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[3] Heitman Capital Management, LLC, SEC No-Action Letter (pub. avail. February 12, 2007).

[4] The European Union's Markets in Financial Instruments Directive ("MIFID") similarly distinguishes between various categories of clients. Under MIFID there are two main categories of clients—retail and professional—to allow for the tailoring of regulatory requirements according to the knowledge and experience of clients. Professional clients are considered to possess the experience, knowledge and expertise to make their own investment decisions and assess the risks inherent in their decisions. (Financial Services Authority, Implementing MIFID's Client Categorisation Requirements (August 2006)).

By limiting the reach of an adviser SRO to only retail advisers who provide personalized investment advice to retail clients, the Commission will avoid many of the drawbacks that a SRO poses to the institutional market. [5]

An SRO style prescriptive rule book is ill suited to the institutional market. By exempting institutional advisers the Commission will preserve the principles-based regulatory structure for institutional advisers and their clients, and thereby permit the institutional adviser and its client to manage the relationship as best suits their needs. Exempting institutional advisers from a SRO will also reduce the risk of inconsistent interpretations and application of the '40 Act to those advisers that advise registered investment companies.

Second, by diverting oversight of retail advisers to a SRO, the number of advisers to be examined by the Commission will be greatly reduced. The Commission should have adequate resources to examine and supervise the remaining institutional advisers subject to their jurisdiction.

Third, the Commission's other important responsibilities, including maintaining fair, orderly, and efficient markets, will be better served if the Commission retains examination responsibility over institutional advisers. Institutional advisers play a unique role in the market. How they manage assets is influenced by regulatory oversight and interpretation of complex, and at times, ambiguous laws and regulations. We believe the agency that is charged with the responsibility of maintaining fair, orderly and efficient markets should have the benefit of the knowledge it acquires through its oversight of institutional advisers and the ability to influence institutional advisers through the examination process.

In 1965, the Commission implemented a Securities and Exchange Commission Only ("SECO") program relating to the regulation of broker dealers that traded only in over-the-counter derivatives ("OTC"). The Commission eliminated the program in 1983 concluding that a direct regulatory program was not the best use of the Commission's resources. The SECO program is not analogous to the continued regulatory oversight of institutional advisers here advocated for by Institutional Investors.

First, SECO was developed as an alternative to compulsory membership in a SRO at a time when certain classes of broker dealers were first becoming subject to such regulation. To implement SECO, the Commission needed to develop a regulatory program to take on SRO responsibility. Here, the Commission has been responsible for examining institutional advisers for 70 years. A SRO for institutional advisers would disrupt this 70 years of experience and practice. Unlike broker-dealers,

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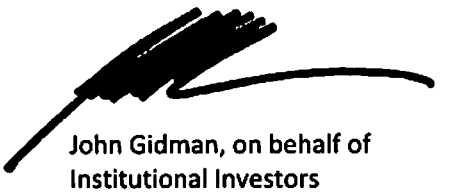
[5] By way of background, the SRO system that was put into place to govern broker-dealers represented an incremental change to a system that predated the federal securities laws. As the former Director of the Commission's Office of Compliance Inspections and Examinations, Lori Richards, noted in 2000, "[t]he Securities Exchange Act of 1934 created the SEC and codified the existing self-regulatory system for broker-dealers. The SROs retained primary authority to regulate their members. Former Commission Chairman and later Supreme Court Justice William O. Douglas famously described the SEC's oversight role as akin to keeping a "shotgun, so to speak, behind the door, loaded, well-oiled, cleaned, and ready for use but with the hope it would never have to be used." (Self-Regulation in the New Era (Remarks by Lori Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission), NRS Fall 2000 Compliance Conference, Scottsdale, Arizona, September 11, 2000).

investment advisers were never members of an SRO. Therefore, requiring investment advisers to be subject to an SRO would amount to an unnatural graft on the existing regulatory structure.

Additionally, the SECO program involved different oversight programs based on trading activity rather than differences in the types of relationships that institutional and retail clients have with their advisers. Mandating a SRO for institutional clients will force changes onto those relationships in ways that the elimination of the SECO program did not. Finally, Institutional Investors' proposal will greatly reduce the number of advisers subject to the Commission's examination, thereby reducing the needed resources and enhancing the Commission's oversight of the advisers that remain exclusively subject to Commission examination.

Institutional Investors does not support the creation of a SRO for investment advisers, but if one is to be appointed Institutional Investors urges the Commission to recognize the fundamental ways in which the activities of institutional advisers differ from those of retail advisers. Institutional Investors urges the Commission to acknowledge those differences by retaining exclusive regulatory and examination authority over institutional advisers. Representatives of Institutional Investors would be pleased to meet with Commission staff to further discuss this proposal.

Very truly yours,



John Gidman, on behalf of
Institutional Investors