August 7, 2018

Via Electronic Submission

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles

File No. S7-08-18

Dear Mr. Fields,

The Loan Syndications and Trading Association ("**LSTA**")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "**SEC**") package of proposals (the "**Proposal**")[2] regarding the standards of conduct for investment advisers and the delivery of a client relationship summary ("**Form CRS**") to clients of investment advisers. The LSTA is a not-for-profit trade association consisting of a broad and diverse membership involved in the origination, syndication, and trade of commercial loans. More than a third of our more than 440 members are SEC-registered investment advisers. We recognize the importance of investor protection and education and strongly support the SEC's vital role in achieving these objectives. In this comment letter, we express our agreement with the comment letters submitted to the SEC by the Investment Adviser Association ("**IAA**"). In addition, we urge the SEC to exempt investment advisers from the Form CRS requirement if their only advisory clients are "qualified clients" as defined in Rule 205-3 ("**Rule 205-3**")[3] under the Investment Advisers Act of 1940, as

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1 The LSTA is a not-for-profit trade association that is made up of a broad and diverse membership involved in the origination, syndication and trading of commercial loans. The more than 440 members of the LSTA include commercial banks, investment banks, investment advisers, broker-dealers, hedge funds, mutual funds, insurance companies, fund managers and other institutional lenders, as well as law firms, service providers and vendors. The LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans. Since 1995, the LSTA has developed standardized practices, procedures and documentation to enhance market efficiency, transparency and certainty.

2 *See* Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, 83 Fed. Reg. 21,416 (May 9, 2018) (hereinafter *Proposal*).

3 *See* 17 CFR 275.205-3.

amended ("**Advisers Act**"). In the alternative, we respectfully request that the SEC consider adopting an exemption from the Form CRS requirement for those investment advisers whose client base is limited to "qualified purchasers" as defined in the Investment Company Act of 1940, as amended (the "**Investment Company Act**") and the rules thereunder.

I. We Concur with the Comment Letters Submitted by IAA.

The LSTA concurs with and supports the analyses, commentary and recommendations in the IAA's comment letters dated August 2, 2018 and August 6, 2018. We believe that the recommendations in the IAA's letters strike an appropriate balance between the concerns of the investment adviser industry and the SEC's essential goals of protecting and educating investors. We respectfully request that the SEC take into consideration the IAA's recommendations when adopting its final rules.

II. Investment Advisers with Only Qualified Clients Should Not Be Subject to the Form CRS Requirement.

While we generally concur with the IAA's comment letter, we also wish to make an additional recommendation with respect to the Proposal's definition of "retail investor." The Proposal would require registered investment advisers to deliver a Form CRS to all "retail investors." As proposed, "retail investor" means "a client or prospective client who is a natural person (an individual). This term includes a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust."[4] As a reason for this definition of "retail investor," the Proposal states that: "[w]e believe that this definition is appropriate because section 913 of the [Dodd-Frank Wall Street Reform and Consumer Protection Act of 2011 ("**Dodd-Frank Act**")[5]] defines 'retail customer' to include natural persons and legal representatives of natural persons without distinction based on net worth, and because financial literacy studies report deficiencies in financial literacy among the general population. While studies also report variability in financial literacy among certain sub-sections of the general population, we believe that all individual investors would benefit from clear and succinct disclosure regarding key aspects of their advisory and brokerage relationships."[6]

In the Proposal, the SEC requested comment on whether the definition should "include all natural persons, as proposed" or should "instead exclude certain categories of natural persons based on their net worth or income level, such as accredited investors, qualified clients, or qualified purchasers."[7]

We welcome the SEC's request for comment on this issue. We believe sophisticated, high net worth individuals do not need the information in Form CRS. Specifically, for the reasons set forth below, we believe that "qualified clients" as defined in Rule 205-3[8] should not be deemed

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4 *Proposal* at 21,548 (text of proposed Rule 204-5(d)(2)).

5 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2011) (hereinafter *Dodd-Frank Act*).

6 *Proposal* at 21,420 (citations and footnotes omitted).

7 *Id.* at 21,422–23 (footnotes omitted).

8 In 1985, the SEC adopted what was effectively the precursor to today's Rule 205-3. *See* Exemption To Allow Registered Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account, 50 Fed. Reg. 48,556 (Nov. 26, 1985) (hereinafter *1985 Release*). In 1998,

"retail investors" for purposes of Form CRS. Therefore, we respectfully request that, in adopting final rules, the SEC exempt from the Form CRS requirement those registered investment advisers whose only clients are qualified clients.[9] (In the alternative, we respectfully request that the SEC consider adopting an exemption from the Form CRS requirement for those investment advisers whose client base is limited to qualified purchasers under the Investment Company Act and the rules thereunder.)

A. Section 913, Which Authorizes the Form CRS Requirement, Does Not Support the Proposed Retail Investor Definition.

We recognize the SEC's concerns about the financial literacy of the general population and commend the SEC's focus on protecting and educating retail and other investors through, among other initiatives, adequate disclosure. We appreciate that these concerns led the SEC to define "retail investor" in materially the same way as "retail customer" is defined in Section 913 of the Dodd-Frank Act ("**Section 913**"). However, we respectfully submit that Dodd-Frank Act Section 913 does not support using this definition of "retail investor" for purposes of Form CRS.

Section 913(g) amended the Advisers Act to incorporate two distinct rulemaking authorizations for the SEC. One provision, added as Advisers Act Section 211(g)(1), authorizes the SEC to promulgate rules on "the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the [SEC] may by rule provide" ("**Section 211(g)(1)**").[10] The second provision, added as Advisers Act Section 211(h), addresses "Other Matters" and mandates that the SEC:

> shall (1) [f]acilitate the provision of simple and clear disclosures *to investors* regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and (2) [e]xamine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the [SEC] deems contrary to the public interest and the *protection of investors*[11] [("**Section 211(h)**")].

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the SEC amended Rule 205-3 to incorporate the term "qualified client." *See* Exemption To Allow Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account, 63 Fed. Reg. 39,022, 39,027–28 (July 21, 1998) (hereinafter *1998 Release*). For ease of understanding, we use the term "qualified clients" in this comment letter to refer to eligible investors whom the SEC deemed did not need the protections of Advisers Act Section 205(a)(1)'s general prohibition on performance-based fees, whether as defined in the 1985 rule or the current version of Rule 205-3.

9 We believe that "qualified clients" should not be included in the definition of "retail investor" for Form CRS purposes, and this comment letter sets forth our reasoning for this conclusion. However, we limit our request to an exemption from Form CRS for registered investment advisers who serve qualified clients. We submit that a registered investment adviser who provides advice to both qualified clients and non-qualified clients would be obligated to prepare a Form CRS for its non-qualified clients regardless and therefore would not face substantial additional burden in transmitting a Form CRS to its qualified clients as well.

10 *See Dodd-Frank Act* § 913(g)(2).

11 *Id.* (emphasis added).

In the Proposal, the SEC indicated that the Form CRS requirement is statutorily authorized by, among other provisions, Section 211(h).[12] The SEC staff's *Study on Investment Advisers and Broker-Dealers*, which was mandated by Section 913 (the "**913 Study**"), also cites Section 211(h) as a basis for its disclosure-related recommendations.[13]

Section 211(g)(1) specifically uses the Section 913 definition of "retail customer." In fact, Section 913 amended the Advisers Act to explicitly add the "retail customer" definition "for purposes of this subsection [211(g)]."[14] However, at the same time, Congress deliberately did not include the "retail customer" definition for use with Section 211(h) even though it certainly could have done so. In Section 211(h), Congress instead used the more general term "investors."[15] Section 913 therefore neither mandates nor suggests that "retail customer," or a substantially similar term, be used in the SEC's disclosure-related rulemaking.

We recognize that Section 913(f) of the Dodd-Frank Act—which authorizes the SEC to engage in rulemaking "to address the legal or regulatory standards of care for brokers, dealers, [and] investment advisers"—uses the term "retail customers"[16] and that the SEC views Section 913(f) as one of the statutory bases for the Form CRS disclosure.[17] However, this should have no effect on the intentional difference in the legislative language between Section 211(g) and Section 211(h), which effectively provides the SEC greater flexibility in developing disclosure-related rules. As the SEC itself noted in the Proposal, it has the authority to incorporate carve-outs from the "retail investor" definition as it determines appropriate and therefore requested comments on whether the final rule should include carve-outs based on investor sophistication.[18] In our view, the absence of the "retail customer" definition in Section 211(h) reflects a recognition on the part of Congress that while an investment adviser (or broker or dealer) standard of conduct should apply equally to all retail customers, the same may not apply with respect to the need for informational disclosures.

The SEC staff itself appears to have appreciated this point in its 913 Study, which the SEC cites heavily in the Proposal in support of the Form CRS requirement. In the very section of the 913 Study that recommends that the SEC "explore the utility and feasibility of a summary disclosure document," the 913 Study suggests that not all retail customers suffer the same deficiency in financial literacy and thereby require protective disclosure, noting that "retail customers *do not always* understand the roles of investment advisers and broker-dealers, and *may be* confused by financial legal terms."[19] Elsewhere the 913 Study states that "retail customers *may not*

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12 *See Proposal* at 21,546.

13 *See* SEC STAFF, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 116 (2011) (hereinafter *913 Study*) (citing *Dodd-Frank Act* § 913(g)).

14 *Dodd-Frank Act* § 913(g)(2).

15 We note that the use of "investors" in Section 211(h) should not be interpreted conversely as mandating a disclosure requirement for all "investors" rather than simply "retail customers." If that were the case, the SEC would have proposed the Form CRS disclosure requirement as applicable to all investors rather than being limited to retail investors.

16 *Dodd-Frank Act* § 913(f).

17 *See Proposal* at 21,546.

18 *See id.* at 21,422–23 (footnotes omitted).

19 *913 Study* at 116 (emphasis added) (citations and footnotes omitted).

necessarily have the sophistication, information, or access needed to represent themselves effectively in today's market and to pursue their financial goals."[20]

Moreover, the SEC staff's Study Regarding Financial Literacy Among Investors ("**Financial Literacy Study**"), which is cited in the Proposal as support for the "retail investor" definition, notes that "[w]hen we [the Staff] refer to 'retail investors' in discussing the quantitative research results, we are extrapolating those results to the general population of retail investors in the United States."[21] The Financial Literacy Study engaged in extrapolations and generalizations to make a recommendation to the SEC about the need for disclosure. It was not intended to reach the conclusion that *all* individuals, regardless of their financial sophistication and experience, require the information of the type set forth in Form CRS. As an extreme example, the Financial Literacy Study could not reasonably be read to support the proposition that an individual such as Warren Buffett needs Form CRS.

The foregoing supports the notion that certain retail investors may be excluded from the Form CRS requirement. We believe that it would be reasonable and appropriate for the SEC to adopt a standard for doing so by analogizing to existing SEC rules and guidance. As discussed below, we believe that qualified clients or qualified purchasers would not need the information in Form CRS. From a policy perspective, we believe it would be consistent with the SEC's mandate in Section 913 (and the SEC's prior announcements relating to investor sophistication) for the SEC to exempt from the Form CRS requirement registered investment advisers whose only clients are qualified clients or qualified purchasers.

B. The SEC Historically Has Considered Qualified Clients as Sophisticated Investors, and It Would Be Consistent from a Policy Perspective for Advisers with Only Qualified Clients to Be Exempt from the Form CRS Requirement.

The SEC Has Concluded that Qualified Clients Do Not Need the Protections of the Advisers Act Prohibition on Performance-Based Fees. For over three decades, Rule 205-3 has set forth the SEC's conclusion that certain investors—qualified clients[22]—are sufficiently sophisticated

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[20] *Id.* at 101 (emphasis added).

[21] SEC STAFF, STUDY REGARDING FINANCIAL LITERACY AMONG INVESTORS (xvii) (2012).

[22] "Qualified client" means:

(i) A natural person who, or a company that, immediately after entering into the contract has at least $1,000,000 under the management of the investment adviser; (ii) A natural person who, or a company that, the investment adviser entering into the contract (and any person acting on his behalf) reasonably believes, immediately prior to entering into the contract, either: (A) Has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than $2,000,000. For purposes of calculating a natural person's net worth: (1) The person's primary residence must not be included as an asset; (2) Indebtedness secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time the investment advisory contract is entered into may not be included as a liability (except that if the amount of such indebtedness outstanding at the time of calculation exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess must be included as a liability); and (3) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the residence must be included as a liability; or (B) Is a qualified purchaser as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 at the time the contract is entered into; or (iii) A natural person who immediately prior to entering into the contract is: (A) An executive officer, director, trustee, general partner, or person serving in a similar capacity, of the investment adviser; or (B) An employee of the investment adviser (other than an employee performing solely clerical, secretarial or administrative functions with regard to

and thus do not require the protection of Advisers Act Section 205(a)(1),[23] which generally prohibits registered investment advisers from charging clients performance-based fees ("**Performance Fee Prohibition**").

While the investor eligibility and other provisions of Rule 205-3 have been amended over the years, the SEC's rationale for its conclusion has stood unchanged. When it first adopted Rule 205-3 in 1985, the SEC stated that "it is consistent with the protection of investors and the purposes of the [Advisers] Act to permit clients who are financially experienced and able to bear the risks associated with performance fees to have the opportunity to negotiate compensation arrangements which they and their advisers consider appropriate."[24] The SEC noted that, in adopting Rule 205-3, the SEC had "presumed that these clients . . . are less dependent on the protections" of Advisers Act Section 205(a)(1) "[b]ecause of their wealth, financial knowledge, and experience."[25] The SEC thus determined that qualified clients not only possess the wealth necessary to bear the risks of performance-based fees, but also the financial sophistication necessary to evaluate such risks and potentially even negotiate performance-based fees with their advisers.

Consistent with the foregoing, the SEC amended Rule 205-3 in 1998 to eliminate specific contractual and disclosure requirements that had been included in an earlier version of the rule, concluding that qualified clients did not need such protections. These requirements, among other things, included specific mandated contractual provisions and disclosures and required that each adviser reasonably believe that its client contract represented an arm's length agreement.[26] Nonetheless, the SEC determined in 1998 that additional contract disclosures required by the original version of Rule 205-3 were unnecessary.[27]

The SEC Has Concluded that Qualified Clients Are Not Retail Investors and Do Not Need the Protections of State Regulations on Investment Adviser Personnel. The SEC has also concluded that qualified clients do not need the protection offered by state licensing and qualification requirements. The National Securities Markets Improvement Act of 1996

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the investment adviser) who, in connection with his or her regular functions or duties, participates in the investment activities of such investment adviser, provided that such employee has been performing such functions and duties for or on behalf of the investment adviser, or substantially similar functions or duties for or on behalf of another company for at least 12 months. 17 CFR 275.205-3.

The $2,000,000 net worth threshold has been adjusted to $2,100,000 by SEC order. *See* Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205–3 Under the Investment Advisers Act of 1940, 81 Fed. Reg. 39,985, 39,985–86 (June 20, 2016).

23 *See* 15 U.S.C. 80b-5(a)(1).

24 *1985 Release* at 48,558 (footnote omitted).

25 *1998 Release* at 39,023.

26 *See* generally *1985 Release* at 48,561-62. The original version of Rule 205-3 required that the advisory contract disclose (1) that a performance fee arrangement may create an incentive for the adviser to make riskier or more speculative investments; (2) the fact (if applicable) that the adviser may receive increased compensation based on both unrealized appreciation and realized gains; (3) the periods that will be used to measure investment performance and their significance in the computation of the performance fee; (4) the nature and significance of any index used as a comparative measure of investment performance and why the index is appropriate; and (5) if the performance fee is based on unrealized appreciation of securities for which market quotations are not readily available, how the adviser will value such securities and the extent to which the value will be determined independently. *1985 Release* at 48,562.

27 *1998 Release* at 39,023–24.

("**NSMIA**")[28] preempted a substantial portion of state regulatory authority over federally registered investment advisers and their personnel. NSMIA, however, preserved states' authority to regulate "investment adviser representatives" of SEC-registered investment advisers, although it left that term undefined. In 1997, over the protests of many state securities regulators,[29] the SEC adopted a rule defining "investment adviser representative" generally to mean a supervised person of a federally registered adviser if a substantial portion of the person's business is providing investment advice to a number of natural person clients over specified numerical and percentage thresholds.[30] For purposes of calculating the thresholds, the SEC excluded qualified clients.

In creating this carve-out, the SEC drew an explicit distinction between retail and non-retail investors. Specifically, the SEC examined testimony that the North American Securities Administrators Association offered to Congress in connection with NSMIA, which "urged Congress to permit states to establish qualification standards for investment adviser representatives to protect 'retail' investors."[31] The SEC "assumed that this testimony persuaded Congress to preserve state authority over such persons" and sought to define "the term investment adviser representative in a manner consistent with the policy concerns expressed in the testimony."[32]

This congressional history led the SEC to conclude that qualified clients "similarly do not need the protections of state qualification requirements."[33] According to the SEC, "[b]ecause of the historical treatment of wealthy and sophisticated individuals under the federal securities laws, Congress reasonably could have expected these persons not to be considered retail investors."[34]

In view of the foregoing, we do not believe that qualified clients raise the financial literacy concerns that Form CRS was specifically designed to address. In fact, the SEC's longstanding pronouncements with respect to qualified clients strongly support the conclusion that they should not be treated as "retail investors" for Form CRS purposes. Consequently, we respectfully submit that the SEC, in its final rules, adopt an exemption from the Form CRS requirement for registered investment advisers that provide investment advice only to "qualified clients." Such an exemption would be fully consistent with, and supported by, the SEC's historic policy judgment, including the SEC's prior interpretation of congressional intent in NSMIA, that qualified clients are not retail investors.

D. An Alternative Standard – "Qualified Purchasers" Under the Investment Company Act

If, notwithstanding the foregoing, the SEC determines that qualified clients require the information that would be provided by Form CRS, we respectfully request that the SEC instead

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28 National Securities Markets Improvement Act of 1996, Pub. L. No. 104–290 (1996).

29 *See* Rules Implementing Amendments to the Investment Advisers Act of 1940, 62 Fed. Reg. 28,112, 28,113, 28,120 (1997) (hereinafter *IAR Release*) (noting that the SEC received comment letters from twenty-six state securities regulators opposing the adoption of any SEC definition).

30 *See id.* at 28,120; *see also* 17 CFR 275.203A-3 (1997).

31 *IAR Release* at 28,121 (citation omitted).

32 *Id.* (footnote omitted).

33 *Id.* at 28,122.

34 *Id.* (footnote omitted).

consider an exemption from the Form CRS requirement for registered investment advisers whose only clients are "qualified purchasers" as defined in Section 2(a)(51) of the Investment Company Act and the regulations thereunder. The "qualified purchaser" standard includes a far higher asset threshold for individuals ($5 million in "investments" as defined by the SEC,[35] compared to $2.1 million in net worth for qualified clients[36]) and is viewed as a higher investor qualification standard than the "qualified client" under Rule 205-3. In fact, qualified purchasers are deemed qualified clients under Rule 205-3.[37]

In addition, the SEC has concluded that qualified purchasers do not require certain important disclosures. Specifically, the instructions to Part 2A of Form ADV state that registered investment advisers do not need to include a description of how they are compensated, fee schedules, or whether their fees are negotiable in a Form ADV brochure that is delivered only to qualified purchasers.[38] To the extent that the SEC does not find the qualified client standard as discussed above in Part II.B to be a sufficient basis for an exemption, we believe it would reasonable for the SEC to conclude that a registered investment adviser that deals only with qualified purchasers need not provide a Form CRS, which would be consistent with the SEC's prior determination with respect to Form ADV.

III. Conclusion

We respectfully request that in adopting final rules, the SEC take into consideration the IAA comment letter and that the SEC expressly exempt from the Form CRS requirement investment advisers whose only clients are qualified clients. Qualified clients are sufficiently sophisticated and do not require the information in Form CRS. Adopting our recommended exemption is fully consistent with the SEC's prior pronouncements and would not in any way adversely affect the SEC's commendable goals of investor protection and education. In the alternative, we respectfully request that the SEC consider adopting an exemption from the Form CRS requirement for those investment advisers whose client base is limited to qualified purchasers.

We appreciate your consideration of our comments to this very important Proposal. We trust that you will not hesitate to contact us if we may provide any additional information or assistance to you during this process. Please feel free to contact me at [redacted] if you have any questions regarding our comments.

Respectfully,

Elliot Ganz
General Counsel

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35 *See* 15 U.S.C. 80a-2(a)(51)(A)(i); *see also* 17 CFR 270.2a51-1.
36 *See supra* note 22.
37 *See id.*
38 *See* General Instructions for Part 2 of Form ADV (SEC 1707 (07-17)), at *7.