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May 27, 2011

Elizabeth M. Murphy, Esq.
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Incentive-Based Compensation Arrangements
File Number S7-12-11

Dear Ms. Murphy:

We represent The Private Investor Coalition, Inc. ("Coalition"), an entity all of whose members are single family offices. The Coalition is submitting this letter to express its views on the nature and scope of the rule that the Commission must adopt to implement the authority granted to it in Section 956 ("Section 956") of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") regarding incentive-based compensation. As you know, the proposed rule contained in Securities Exchange Act Release No. 64140 (March 29, 2011) ("Release") would require a "covered financial institution" to provide reporting on incentive-based compensation arrangements and prohibit certain incentive-based compensation arrangements.

The Coalition appreciates this opportunity to comment on the proposed rule ("Proposed Rule") contained in the Release. The Coalition takes no position on the merits of the public policy behind Section 956 or the merits of the Proposed Rule.

Comments

1. Definition of "Covered Financial Institution"

The key term in the Proposed Rule is the definition of a "covered financial institution." The Coalition believes that the definition, as drafted, is overly-inclusive and respectfully requests that the Commission interpret the term "investment adviser" to include only persons who are registered or required to be registered under the Investment Advisers Act of 1940 ("Advisers Act.")

2. Legal Analysis

Definition of "Investment Adviser"

The Release at page 21174 in the Federal Register states that the Proposed Rule will apply to a "covered financial institution" and reports that, with respect to the SEC, this means an investment adviser as such term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 ("Advisers Act"). Footnote 10 explains further the definition of "investment adviser" is the operative term, regardless of whether the firm is registered as an investment adviser. Footnote 10 goes on to explain that banks and bank holding companies are generally excluded from the definition of "investment adviser." Although these very few sentences are critically important to determining which investment advisory entities are "covered financial institutions," they leave unanswered several interpretive questions that the Coalition believe should be clarified when the Proposed Rule is adopted.

First, the clause that precedes subsection (A) -- and therefore subsections (B) through (H) -- to Section 202(a)(11) is "does not include." In plain English, the phrase "does not include" should be read to mean "exclude," and as the last sentence of footnote 10 correctly points out subsection (A) thereof does exclude banks and bank holding companies from the definition of "investment adviser." And subsection (B) excludes any lawyer, accountant, engineer, or teacher, whose investment advice is solely incidental to the practice of his profession, subsection (C) excludes any broker or dealer whose investment advice is solely incidental to the practice of his profession and who receives no special compensation therefore, subsection (D) excludes the publisher of any bona fide newspaper, subsection (E) excludes any person whose advice relates to no securities other than obligations of the U.S. government, subsection (F) excludes any nationally recognized statistical rating organization, subsection (G) excludes any family office, as defined by the Commission, and subsection (H) excludes such other persons not within the intent of Section 202(a)(11) as the Commission may designate by rules and regulations or order. In short, although footnote 10 isolates just one subsection for commentary in the Release, each of the eight subsections in Section 202(a)(11) provides an identical exclusion from the definition of "investment adviser," and therefore as a matter of law any entity that may properly rely on an exclusion from the definition of "investment adviser" will not be a "covered financial institution" as that term is used in the Proposed Rule.[1]

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[1] The Coalition understands and acknowledges that a similar interpretive scheme exists in the Investment Company Act of 1940 ("Investment Company Act"), the companion legislation to the Advisers Act. An entity that is an investment company as defined in Section 3(a) of the Investment Company Act may otherwise be excluded from the definition by a provision in Section 3(b) or Section 3(c), or by one or

There is no public policy reason of which the Coalition are aware that would justify distinguishing between the first six exclusions, each of which is self-executing in nature, and the last two exclusions, each of which will be available solely as a result of an action that must be taken by the Commission. More specifically, the term "family office" is not defined in the Advisers Act, and the Commission has proposed Rule 202(a)(11)(G)-1 which contains a definition of "family office." The fact that the operative term "family office" in subsection (G) is the result of a rule to be adopted by the Commission does not change the fact that, whatever the term "family office" may be defined to mean, subsection (G) of Section 202(a)(11) unequivocally excludes such an entity from the definition of "investment adviser." The same argument applies equally to subsection (H). Historically, the Commission has entertained applications under subsection (H) [and its predecessors, then-subsections (F) and (G)] in which the entity filing the application seeks an order, based on the authority in subsection (H), that it is not a person within the intent of the paragraph. Again, the operative term is "not a person within the intent of this paragraph" and such a person is identified by the Commission as the result of the issuance of an order; the fact that the person is identified by the issuance of an order does not change the fact that subsection (H) excludes such a person from the definition of "investment adviser."

For the reasons set forth in the two preceding paragraphs, the Coalition respectfully requests that the Commission make clear in the release adopting the Proposed Rule that any person who is excluded from the definition of "investment adviser" by any one or more of the eight subsections in Section 202(a)(11) is not a "covered financial institution."

Second, Section 956(e)(2)(D) provides that the term "covered financial institution" means "an investment advis[e]r, as such term is defined in the section 202(a)(11) of the []Advisers Act []…." As the Commission knows, Section 203(a) of the Advisers Act requires

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more of the exemptive rules that have been adopted by the Commission. *See* Rules 3a-1 to 3a-8. Each of those rules was adopted by the Commission through the exercise of its exemptive authority, and each expressly excludes an entity properly relying on that Rule from all of the provisions of the Investment Company Act. The Coalition believes that an entity that has been excluded from the definition of "investment company" is in no different position than an entity that is properly relying on an exemptive rule: in each instance, such an entity is not subject to any of the provisions of the Investment Company Act. It makes no difference as a matter of law, and thus should make no difference as a matter of public policy, that in the first instance Congress made the decision to exclude the entity and in the second instance the Commission, based on its experience in administering the Investment Company Act, used the exemptive authority given to it by Congress to adopt a rule that achieved the identical result.

that an investment adviser register with the Commission before it is permitted to make use of the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser. Section 203(b) of the Advisers Act states that the "provisions of subsection (a) shall not apply to" a number of entities. In plain English, the phrase "shall not apply to" should be read to mean "except," and as a consequence entities that can properly rely on subsections (1) through (7) of Section 203(b) are excepted from registration with the Commission.[2] It is understood that it is the Commission's position that, notwithstanding the exception from registration, any entity relying on a subsection of Section 203(b) is still an "investment adviser" for purposes of some portions of Section 206 of the Advisers Act.[3] For example, seven of the eight rules adopted pursuant to the rulemaking authority in Section 206(4) expressly apply only to an investment adviser that is registered or required to be registered under the Advisers Act. *Contrast* Rule 206(4)-8 *with* Rule 206(4)-1 to 206(4)-7. The public policy reason for excluding certain unregistered investment advisers, *i.e.*, investment advisers that are excepted from registration, from the operation of these rules would be that (a) those investment advisers are not otherwise subject to the Commission's jurisdiction and it would be an unfair burden to keep current and comply with rules that are part of a statutory scheme as to which they are not otherwise subject, and (b) it would be unfair to hold the Commission responsible for the actions of legally unregistered investment advisers who are not otherwise subject to the Commission's jurisdiction, including its authority to conduct regular inspections or examinations.

With respect to Section 203(b) and Sections 203(l) and (m), the entities excepted from registration are:

- Subsection (1), any investment adviser, other than an investment adviser who acts as investment adviser to any private fund, all of whose clients are residents of the state within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;

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[2] Similarly, Section 203(l) provides an exception from the registration provisions of the Advisers Act to an investment adviser that acts as an investment adviser solely to one or more venture capital funds, and Section 203(m) provides an exception from the registration provisions of the Advisers Act to an investment adviser to private funds that has assets under management of less than $150 million. *See* Sections 407 and 408 of Dodd-Frank Act.

[3] 1 Anderson, Bagnall & Smythe, Investment Advisers: Law and Compliance § 3.04 (2009).

- Subsection (2), any investment adviser whose only clients are insurance companies;
- Subsection (3), any investment adviser that is a foreign private adviser;
- Subsection (4), any investment adviser that is a charitable organization;
- Subsection (5), any plan described in Section 414(e) of the Internal Revenue Code of 1986;
- Subsection (6), any investment adviser that is registered with the Commodities Futures Trading Commission as a commodity trading advisor whose business does not consist primarily of acting as an investment adviser; and
- Subsection (7), any investment adviser, other than an entity that has elected to be regulated as a BDC pursuant to Section 54 of the Investment Company Act of 1940 who solely advises SBICs.
- An investment adviser solely to one or more venture capital funds.
- An investment adviser to private funds that has less than $150 million in assets under management.

To the extent that there is a common organizing principle to each of these nine exceptions, it is that there is no Federal interest in requiring registration under the Advisers Act because the entity is not engaging in investment activities at the national level or international level, or there is another functional regulator or regulatory framework that more appropriately governs the investment activities of the entity.

Section 956 itself does not explicitly require that the term "covered financial institution" also include entities that, although within the definition of "investment adviser," are not required to be registered under the Advisers Act. Whether an entity is excluded from the definition of "investment adviser" or excepted from registration as an investment adviser, at the end of the day such an entity is essentially not subject to the Commission's jurisdiction. By contrast, each of the other entities that is a "covered financial institution" has a Federal regulator – the Office of the Comptroller of the Currency, the Federal Reserve Board, the FDIC, the Office of Thrift Supervision, NCUA, or FHFA – and is subject to that Federal regulator's full supervisory authority. None of the other Federal regulators is seeking to apply the Proposed Rule to entities that are not fully subject to their jurisdiction and supervision. For example, the Federal Reserve Board has not sought to apply the Proposed Rule to entities, often referred to as "non-bank

banks," that are excluded from the definition of "bank" in the Bank Holding Company Act and thus the parent organization is not required to register as a bank holding company. There are no obvious public policy reasons for why the Commission ought to extend the Proposed Rule to investment advisers that are excepted from registration while at the same time those entities are free to engage in investment advisory activities, well within the Commission's acknowledged area of regulatory expertise, without any oversight from the Commission. In the case of the "foreign private adviser," it would seem particularly anomalous to subject an entity that is subject to the investor protection laws of another country to the Proposed Rule. It cannot be good public policy for the Commission to take the position that entities that are otherwise excepted from registration under the Advisers Act must nonetheless be a "covered financial institution" and be subject to the requirements of the Proposed Rule, especially where that interpretation is not required by a literal reading or a fair reading of Section 956(e)(2)(D).

For the reasons set forth in the two preceding paragraphs, the Coalition respectfully requests that the Commission make clear in the release adopting the Proposed Rule that any person who is excepted from registration as an "investment adviser" by any one or more of the seven subsections in Section 203(b) or Sections 203(l) or (m) is not a "covered financial institution."

Conclusion

For all of the reasons set forth above, the Commission should interpret the term "an investment advis[e]r, as such term is defined in the section 202(a)(11) of the []Advisers Act []…" in Section 956 to mean an investment adviser that is registered or required to be registered with the Commission under the Advisers Act. It is in everyone's best interests to craft a rule that does not burden investment advisers that Congress or the Commission has deemed -- either (i) by exclusion or exemption from the definition of investment adviser or (ii) by exception from the requirement to be registered -- to not be within the Commission's jurisdiction to oversee. The Coalition stands ready to work with the Commission and its staff to achieve a final rule that fulfills the mandate from Congress in Section 956. Thank you again for this opportunity to express the Coalition's comments.

Sincerely,

Martin E. Lybecker