FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT BROKER-DEALERS
AND INDEPENDENT FINANCIAL ADVISORS

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VIA ELECTRONIC MAIL

January 24, 2011

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

RE: File Number S7-36-10 – Rules Implementing Amendments to the Investment Advisers Act of 1940

Dear Ms. Murphy:

On November 19, 2010, the Securities and Exchange Commission (SEC) held an open meeting in which the SEC Commissioners voted to propose new rules and rule amendments under the Investment Advisers Act of 1940 ('40 Act) to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[1] The SEC published two releases addressing these proposed rules and amendments under the '40 Act. The first release solicits comment on '40 Act registration and reporting requirements, including the switch from federal to state jurisdiction for mid-size investment advisers with assets under management between $25 and $100 million (Proposed Amendments).[2] Among other things, the Proposed Amendments will require the adoption of new rules and amendments to existing rules and forms to give effect to section 410 of the Dodd Frank Act.

The Financial Services Institute (FSI)[3] welcomes this opportunity to comment on the Proposed Amendments. We are pleased to see that the SEC has set out a well-developed plan for the "switch" in jurisdiction for certain mid-size advisors. However, we are concerned with several aspects of the Proposed Amendments. Specifically, we believe that the Proposed Amendments are offered prematurely given contemporaneous relevant studies that were recently completed by the SEC. We also believe that the Proposed Amendments do not properly define terms that are essential to the "switch," and do not provide advisors with notice and an opportunity to cure deficiencies. Moreover, we believe that the Proposed Amendments do not provide for an adequate transition time, and do not provide for an appropriate buffer for advisors on the cusp of registration with the SEC and/or states. These concerns are addressed in more detail below.

Background on FSI Members

FSI represents independent broker-dealers (IBD) and the independent financial advisors that affiliate with them. The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No: 111-20, *available at* http://docs.house.gov/rules/finserv/111_hr4173_finsrvcr.pdf.

[2] See the Proposing Release at http://sec.gov/rules/proposed/2010/ia-3110.pdf.

[3] The Financial Services Institute is an advocacy organization for the financial services industry – the only one of its kind – FSI is the voice of independent broker-dealers and independent financial advisors in Washington, D.C. Established in January 2004, FSI's mission is to create a healthier regulatory environment for their members through aggressive and effective advocacy, education and public awareness. FSI represents more than 120 independent broker-dealers and more than 15,000 independent financial advisors, reaching more than 15 million households. FSI is headquartered in Atlanta, GA with an office in Washington, D.C.

financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 financial advisors – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.[4] These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[5] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments on the Proposed Rule

As stated above, FSI is pleased to see that the SEC has set out a well-developed plan for the "switch" in jurisdiction for certain mid-size advisors. However, we are concerned with several aspects of the Proposed Amendments. These concerns are discussed below:

- **Premature Nature of the Proposed Amendments** – The Proposed Amendments require the adoption of new rules and amendments to existing rules and forms to give effect to the provisions of section 410 of the Dodd Frank Act. This section requires the SEC to delegate to the states the responsibility for oversight of certain mid-size registered investment advisers. While we are aware and sensitive that this "switch" in jurisdiction is

[4] Cerulli Associates at http://www.cerulli.com/.
[5] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.

required to take place on or before July 21, 2011,[6] we believe that the SEC should have an opportunity to carefully review and digest the results of recently released SEC studies related to sections 913 and 914 of the Dodd-Frank Act.

Section 913 of the Dodd-Frank Act directs the SEC to study the obligations and standards of care of broker-dealers and investment advisers providing personalized investment advice about securities to retail investors. Section 914 of the Dodd-Frank Act directs the SEC to study the issue of enhancing investment adviser examinations, including the possibility of creating a Self Regulatory Organization (SRO) for investment advisors. The results of these studies were sent to Congress on January 21, 2011 and January 20, 2011, respectively.

FSI supports the adoption of a clearly stated universal fiduciary standard of care, plainly articulated conduct rules, effective customer disclosures, and balanced regulatory supervision efforts. The fiduciary standard of care should be applicable to all Financial Advisors[7] who offer personalized investment advice to retail customers. This universal fiduciary standard of care must be carefully designed to promote universal access to advice, preserve investor choice, and enhance investor protection. FSI supports a universal fiduciary standard of care that would require a Financial Advisor providing personalized investment advice concerning securities to a retail customer to:

1. Act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice;
2. Disclose material conflicts of interest, avoid them when possible, and obtain informed customer consent to act when such conflicts cannot be reasonably avoided; and
3. Provide the advice with skill, care, and diligence based upon information that is known, or should be known, about the customer's investment objectives, risk tolerance, financial situation, and other needs.

Moreover, FSI supports the creation of an industry-informed, self-funded regulatory authority for all registered investment advisers dedicated to effective supervision, timely examination, and vigorous enforcement. We commend the SEC on reigning in, and requiring the registration of certain "private funds"[8] as call for under the Dodd-Frank Act, and as proposed in the related release. We believe that FINRA is well suited to act as the SRO for all entities regulated under the '40 Act. Emphasizing examination and supervision of all investment advisers will benefit investors by contributing to the transparency, effectiveness, and efficiency of the financial services regulatory structure. Therefore, it is an essential part of any serious effort to enhance investor protection.

Given the significant impact these studies can have on the industry, and the potential for other substantial amendments to the '40 Act, and other securities rules, regulations and forms to carry forward the results of the studies, FSI urges the SEC to delay issuing final rules related to the Proposed Amendments until it has sufficient time to carefully review the results from the sections 913 and 914 studies, and to wait for Congressional guidance on these reports.

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[6] *See,* section 419 of the Dodd-Frank Act.

[7] The term Financial Advisor refers to a broker, dealer, investment adviser, affiliated registered representative, or investment adviser representative.

[8] Private funds include hedge funds, private equity funds, and other types of pooled investment vehicles that are excluded from the definition of "Investment Company" under the Investment Company Act of 1940.

- **Definition of "Subject to Examination"** – Section 7 of the Proposed Amendments notes that the Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "subject to examination" by a particular state securities authority.[9] The Proposed Amendments try to address this issue by explaining how to define this term.

  In subsection B of section 7 of the Proposed Amendments, the SEC indicates that it does not intend to either review or evaluate each state's investment adviser examination program. It provides that "[i]nstead, we will correspond with each state securities commissioner (or official with similar authority) and request that each advise us whether an investment adviser registered in the state would be subject to examination as an investment adviser by that state's securities commissioner (or agency or office with similar authority)." The SEC believes that the states are the most familiar with their own circumstances, and are in the best position to determine whether advisers in their state are subject to examination. Using the responses that it receives, the SEC will identify for advisers the states in which the securities commissioner did not certify that advisers are "subject to examination."

  FSI believes that this is a flawed approach that is poorly designed to prevent investor harm. We believe that the SEC should take a more proactive approach in determining whether an investment adviser is "subject to examination" by a state securities authority. Specifically, we believe that the SEC should expressly define what it means to be "subject to examination" by a state securities authority, and should evaluate each state's investment adviser examination program to ensure compliance with the definition of what it ultimately defines "subject to examination" to be. We believe that the definition of "subject to examination" should, at a minimum:

  1) Indicate that each state has a uniform or risk based routine examination process, and
  2) Ensure that the routine examination process mirrors the frequency of broker-dealer examination by FINRA and the SEC.[10]

  Routine examination of state registered advisors is essential to ensuring that investors are adequately protected, and that advisors registered with the states do not fly under the examination radar. Currently, approximately eight state securities authorities do not conduct routine examinations of investment advisers or broker-dealers under their jurisdiction.[11] The remaining 42 states that do conduct routine examinations have significant resource and budget constraints that prevent them from completing robust and comprehensive examinations. Moreover, each state securities authority has a different frequency on how often the advisors under their jurisdiction are examined. Approximately half of the states have routine examinations designed to examine advisors under their jurisdiction on a 1-3 year exam cycle, and the other half are on a cycle of six

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[9] The '40 Act defines the term "state" to include any U.S. state, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. '40 Act section 202(a)(19).

[10] Currently, the SEC and FINRA examine more than half of the registered broker-dealer firms subject to their jurisdiction each year. Rick Ketchum, Chairman & CEO of FINRA, before the NAVA Government & Regulatory Affairs Conference (June 8, 2009), available at http://www.finra.org/Newsroom/speeches/Ketchum/P118889. FINRA's examination cycles ranges from every 12 months for complex brokerage operations, to between 18 months to 48 months for less involved business operations.

[11] Elizabeth MacBride, *It's looking official: Advisors switching to state oversight to face many more audits,* RIABiz.com, September 28, 2010, *available at http://www.riabiz.com/a/2323150.*

years or less.[12] Consistency in routine examination at the state level is essential to the success of ensuring that mid-size advisers are properly supervised by the state securities authorities. Accordingly, we urge to the SEC to adopt a definition of "subject to examination" that takes into account the two aforementioned guiding principles.

- **Notice and Opportunity to Cure** – The SEC is proposing new rule 203A-5, which would require each investment adviser registered with the SEC on July 21, 2011 to file an amendment to its Form ADV no later than August 20, 2011, 30 days after the July 21, 2011 effective date of the amendments to section 203A, and to report the market value of its assets under management determined within 30 days of the filing. The Proposed Amendments describe this filing as "the first step by which an adviser no longer eligible for Commission registration would transition to state registration."[13] This would require each investment adviser to determine whether it meets the revised eligibility criteria for SEC registration, and would provide the SEC and the state regulatory authorities with information necessary to identify those advisers required to transition to state registration. An adviser no longer eligible for Commission registration would have to withdraw its SEC registration by filing Form ADV-W no later than October 19, 2011 (60 days after the required re-filing of Form ADV).

  We believe that the SEC's plan on identifying advisors that are required to deregister with the SEC and register with their state regulatory authority is sound in terms of process, time, and operation. However, we take issue with the Proposed Amendments plan to "cancel the registration of advisers that fail to file an amendment or withdraw their registrations in accordance with the rule."[14] We believe that each advisor that fails to file an amendment to its Form ADV by August 20, 2011 should receive notice that its failure to file an amendment will result in cancelation of its registration with the SEC. This will provide all advisors with adequate notice of the "switch" in the event that they do not comply with the aforementioned registration provisions.

- **Transition Period Too Short** – Page 11 of the Proposed Amendments provides the following:

  > "We are proposing a 90-day transition process, which is shorter than the 180-day transition period that our rules currently provide for advisers switching from SEC to state registration, in order to promptly implement this Congressional mandate and accommodate the processing of renewals and fees for state registration and licensing via the IARD system, while allowing for an orderly transition."

  We believe that keeping the 180-day transition period will assist advisers who are impacted by the switch in jurisdiction. There does not appear to be a compelling reason to shorten this period. We urge the SEC to keep the 180-day transition period intact under the Proposed Amendments.

- **Elimination of the Registration Buffer** – Page 24 of the Proposed Amendments provides the following:

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[12] *Id.*
[13] See the Proposing Release at http://sec.gov/rules/proposed/2010/ia-3110.pdf, 10.
[14] *Id.*

> "We propose to amend rule 203A-1 to eliminate the $5 million buffer for advisers having between $25 million and $30 million of assets under management, but to retain the ability of an adviser to avoid the need to change registration status based upon intra-year fluctuations in its assets under management for purposes of determining its eligibility to register with the Commission. The current buffer seems unnecessary in light of Congress's determination generally to require most advisers having between $30 million and $100 million of assets under management to be registered with the states. Moreover, at this time, we believe it is not necessary to increase the $100 million threshold in order to provide a similar buffer for advisers crossing that threshold and becoming registered with the Commission under the amended statutory provisions. We believe that the requirement that advisers only assess their eligibility for registration annually and the grace periods provided to switch to and from state registration will be sufficient to address the concern that an investment adviser with assets under management approaching $100 million or affected by changes in other eligibility requirements will frequently have to switch between state and federal registration."

Currently, Rule 203A-1 contains means of preventing an adviser from having to switch frequently between state and SEC registration because of changes in the value of its assets under management or the departure of one or more clients. Rule 203A-1 provides for a $5 million buffer that permits an investment adviser having between $25 million and $30 million of assets under management to remain registered with the states and does not subject the adviser to cancellation of its SEC registration until its assets under management fall below $25 million. If an adviser is no longer eligible for SEC registration, the rule provides a 180-day grace period from the adviser's fiscal year end to allow it to switch to state registration.

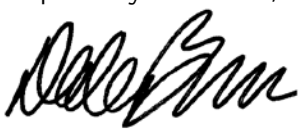
We believe that a buffer should be incorporated into the Proposed Amendments. As explained above, the current buffer under Rule 203A-1 is $5 million. Because the registration requirements have been increased by four times (from $25 million to $100 million), we believe that the buffer should also be increase four times (from $5 million to $20 million). Investors and advisors benefit from having a buffer in place because it reduces the cost associated with re-registration for advisers with assets under management in this buffer zone – a cost that will be passed along to investors. If the buffer were eliminated, mid-size advisers may have to switch between registration with the states and the SEC on an annual basis if their assets under management go below or above the registration thresholds. This cost will ultimately be passed on to the retail customer, in one form or another. As such, we urge the SEC to create a registration buffer of $20 million for advisors having assets under management of $100 to $120 million.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to in creating the rules implementing amendments to the Investment Advisers Act of 1940.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 202 379-0943.

Respectfully submitted,



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