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Filed Electronically

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549

Re: *Rules Implementing Amendments to the Investment Advisers Act of 1940; S7-36-10; and Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, S7-37-10*

Dear Ms. Murphy:

Pickard and Djinis LLP appreciates the opportunity to comment on the above-referenced proposals to implement the changes to the Investment Advisers Act of 1940 (Advisers Act) made by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[1] Though informed by our work on behalf of registered investment advisers, these comments reflect the views of our firm, and not necessarily those of our clients. We start with two primary issues.

Form ADV Questions Regarding Custody

The Commission proposes several changes to the custody-related questions on Form ADV. For the reasons explained herein, we believe that as proposed, the amended Form uses terminology that will confuse advisers and fail to elicit meaningful information for the regulators.

Rule 206(4)-2, as it was amended in 2009,[2] (the "custody rule") uses the term "custody" to refer to physical possession of funds and securities (hereafter referred to as

[1] Investment Advisers Act Rel. Nos. 3110 and 3111 (November 19, 2010) (respectively, "Implementing Release" and "Exemptions Release").

[2] Investment Advisers Act Rel. No. 2968 (December 30, 2009). The amended version of the rule became effective on March 12, 2010.

"physical" custody); the authority to obtain physical possession of funds and securities ("constructive" custody) and physical or constructive custody through a related person ("imputed" custody).[3] Different requirements are imposed on advisers depending the type of custody involved.

As it exists today, Item 9 of Form ADV, Part 1A uses the terms "custody" (*i.e.,* physical custody, constructive custody and imputed custody) and "qualified custodian" (a term indicating physical custody)[4] in a way that creates confusing gaps and overlaps. Unfortunately, instead of eliminating this confusion, the revised Form continues to trip over the terminology in several respects.

For example, proposed Section 7.A. of Part 1A, Schedule D asks for information about an adviser's financial industry affiliations. Question 3 of this section asks whether a related person that is a bank, broker-dealer or futures commission merchant acts as a qualified custodian for the registrant's clients in connection with its advisory services. If so, the question goes on to ask whether the registrant is "operationally independent" of its affiliate as that term is defined in the custody rule.[5] If operational independence is established, the registrant is relieved of the obligation to obtain a surprise examination of its clients' funds and securities in the custody of its affiliate.[6]

It is unclear why this item is limited to physical custody, since the custody rule also imposes surprise exam obligations on an adviser whose affiliate has constructive custody of the adviser's clients' assets. Likewise, the operational independence relief is available for imputed constructive as well as imputed physical custody. If the purpose of the Schedule D custody questions is to identify circumstances in which an industry affiliation has custody rule implications for the registrant, it would appear that Question 3 should be amended to cover both kinds of imputed custody.

Similar problems appear in the proposed revisions to Item 9 of Part 1A. The instructions to 9.A.(1) (an item that asks whether the registrant has custody of client assets) state that an adviser can answer "No" if the adviser's related person acts as a

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[3] Rule 206(4)-2(d)(2).

[4] The custody rule requires physical possession of managed assets to be maintained with a "qualified custodian," as that term is defined in the rule. Rule 206(4)-2(a)(1).

[5] Rule 206(4)-2(d)(5).

[6] Rule 206(4)-2(b)(6). On the other hand, operational independence does not eliminate an adviser's duty to obtain from its related party an internal control report where the related party acts as a qualified custodian (*i.e.,* has physical custody). Rule 206(4)-2(a)(6).

qualified custodian for the adviser's clients' assets *and* the adviser and its related person are operationally independent. As noted above, both the concept of imputed custody and the operational independence exemption apply with equal force to physical and constructive custody. The instructions to Item 9.A. should be broadened to account for that fact.

For the same reason, the instructions to Item 9.A.(2) should refer to a related person's having *custody* as opposed to *serving as a qualified custodian.* Leaving these instructions as proposed would lead to double counting of assets as to which a registrant has imputed constructive custody. This is so because the instruction removes from 9.A.(2) only those assets as to which a related party has physical custody, while Item 9.B.(2) seeks information as to all assets as to which a related party has any type of custody. In other words, constructively custodied assets are reported both in A.(2) and B.(2).

Another negative ramification of the proposed language shows up in Item 9.C.(3). This item asks whether an independent public accountant conducts an annual surprise exam of client assets as to which either the registrant or its related person has custody. As explained above, an adviser who is operationally independent of a related person who has constructive custody would have to answer Item 9.A. in the affirmative, even though the adviser would be exempt from the custody rule's surprise exam requirements. Such an adviser's failure to indicate in 9.C.(3) that its clients' assets undergo an annual surprise exam could mislead SEC staff into thinking that the adviser has violated that rule, when that is not the case.[7]

Finally, Item 9.D., which asks whether the registrant or its related person acts as a qualified custodian for the registrant's clients' assets, could result in the double counting of certain custodial relationships. This is so because acting as a qualified custodian (*i.e.*, having physical custody) is already picked up in Items 9.A. and 9.B. To avoid painting a misleading picture of investment adviser custody practices, we suggest that the Commission distinguish between physical and constructive custody and use separate, clearly worded questions to elicit information about each category.

Treatment of Proprietary and Non-Paying Accounts

The instructions to the current version of Form ADV give investment advisers the option of including or not including family, proprietary and non-paying accounts in their calculation of assets under management.[8] This approach is consistent with the one used

[7] The same risk could arise in connection with Item 9.E.

[8] Form ADV, Instructions for Part 1A, instr. 5.b.

for purposes of determining which supervised persons of federally registered advisers may be subject to state licensing requirements,[9] and the one used in defining the term "client" for purposes of NSMIA's national *de minimis* standard.[10] The Commission proposes to eliminate this flexibility and to require advisers to include family, proprietary and other assets managed without compensation as part of their "regulatory assets under management" reported in Item 5 of Part 1A.[11] The response to this item would dictate whether an adviser meets the assets-under-management test for federal registration under NSMIA, as that test has been amended by the Dodd-Frank Act.[12]

The Commission also proposes to change other Advisers Act rules relating to the treatment of non-paying clients. In this regard, the Commission proposes moving the client-counting safe harbor currently found in Rule 203(b)(3)-1[13] to a new Rule 202(a)(30)-1, but eliminating the provision allowing advisers not to count clients from whom they receive no compensation.[14] The replacement safe harbor would be incorporated into the rule defining "investment adviser representative" for state licensing purposes.[15] It also would be incorporated into the rule relating to the national *de minimis* standard under NSMIA, although in that context, advisers' ability not to count *gratis* clients would be preserved.[16]

While we are sympathetic to the Commission's stated goals of promoting consistency among advisers, managing systemic risk and enforcing the line the Dodd-

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[9] Advisers Act Rule 203A-3(a)(4). This rule, in turn, refers to Advisers Act Rule 203(b)(3)-1, which provides a safe-harbor definition of "client" for purposes of the private adviser exemption that was eliminated by Section 403 of the Dodd-Frank Act. *See* Rule 203(b)(3)-1(b)(4) ("You are not required to count as a client any person for whom you provide investment advisory services without compensation").

[10] Advisers Act Rule 222-2.

[11] Implementing Release at 17-18.

[12] *See* proposed Rule 203A-3(d); Dodd-Frank Act, § 410.

[13] As explained in note 9 above, this rule pertains to the private adviser exemption that was repealed by the Dodd-Frank Act. That exemption was replaced by a more limited "foreign private adviser" exemption. The term "foreign private adviser" is defined in new Advisers Act Section 202(a)(30).

[14] Exemptions Release at 73, 119-20.

[15] Proposed amended Rule 203A-3(a)(4).

[16] Proposed amended Rule 222-2.

Frank Act has drawn between federal and state advisers,[17] we are concerned that the proposed approach may exceed the Commission's authority and produce anomalous results.

Advisers Act Section 202(a)(11) defines an investment adviser as a person who, *for compensation*, engages in the business of advising *others* about securities. When an adviser does not charge for its services, it is not rendering investment advice "for compensation," and when it manages proprietary accounts, it is not "advising others." Regardless of whether such asset management activities are of national concern, they are simply not subject to regulation under the Advisers Act.

In addition to potentially requiring an adviser to register with the SEC because of activities that fall outside the scope of Section 202(a)(11), the Commission's proposals also could lead to the anomalous situation in which an employee of a federally registered adviser might have to register as an investment adviser representative in a state in which his only managed accounts are his own or those of his family and friends who do not pay for his services.

For these reasons we urge the Commission not to require advisers to include family, proprietary and other non-paying accounts in calculating regulatory assets under management for purposes of Form ADV, Part 1A, Item 5. We also urge the Commission to include in Rule 202(a)(30)-1 a provision confirming that an adviser is not required to count as a client any person for whom the adviser provides investment advisory services without compensation.[18]

Miscellaneous

In addition to the foregoing:

- We support the adoption of new Rule 203A-5 as proposed to assist mid-sized advisers[19] in transitioning from federal to state registration.

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[17] Implementing Release at 17, 18.

[18] If this language is added to Rule 202(a)(30)-1, the proviso at the end of proposed Rule 222-2 should be eliminated.

[19] Mid-sized advisers are those with between $25 and $100 million in assets under management. Section 410 of the Dodd-Frank Act generally raised the threshold for federal registration established by the National Securities Markets Improvement Act of 1996 (NSMIA) from $25 to $100 million.

❍ We support the proposal to defer to the states on the issue of investment adviser examinations, in connection with the implementation of the mid-sized adviser provisions of the Dodd-Frank Act.[20]

❍ We support the proposal to amend Rule 203A-2(a) to eliminate the exemption that allows nationally recognized statistical rating organizations (NRSROs) to register with the SEC. Ten credit rating agencies are currently registered with the Commission as NRSROs pursuant to Section 15E of the Securities Exchange Act of 1934. None of these firms is also still registered as an investment adviser. To the extent IARD data indicate that someone is using this category to claim federal registration eligibility,[21] the continued availability of the exemption must be causing confusion. Paragraph (a) of Rule 203A-2 therefore should be removed.

❍ We support the proposal to increase the federal registration threshold for pension consultants in Rule 203A-2 from $50 million to $100 million;

❍ We support the proposal to adjust the multi-state adviser registration exemption in Rule 203A-2 from 30 to 15 states for both small and mid-sized advisers.

❍ We ask the Commission to add a new exemption to Rule 203A-2 for proxy advisory firms. In its recent Concept Release on the U.S. Proxy System, the Commission recognized that such firms meet the definition of investment adviser when they, for compensation, engage in the business of issuing reports or analyses concerning securities and advising others as to the value of securities.[22] The Commission also recognized that without sufficient assets under management, proxy advisers are not able to register at the federal level unless they qualify as pension consultants under Rule 203A-2(b).[23] Because proxy advisory firms have the kind of impact on the national securities markets that the NSMIA exemptions were designed to address, we believe that the Commission should create a new exemption for such firms and add a new category to Form ADV, Part 1A, Item 2.A.. Likewise, we believe that a new category for "Proxy advisory services" should be added to Item 5.G of the Form.

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[20] Implementing Release at 34 - 35.

[21] Implementing Release at 26.

[22] Investment Advisers Act Rel. No. 3052 (July 14, 2010) at 110.

[23] *Id.* at 112-113. Once the NRSRO exemption is eliminated, the pension consultant provision will be renumbered as Rule 203A-2(a).

❍ We do not support any acceleration of the updating requirements for Form ADV. More than half of federally registered advisers have 5 or fewer non-clerical employees.[24] Complying with the Advisers Act and the panoply of related regulations can be enormously burdensome for small firms. Shortening the current 90 day period from the end of the fiscal year for filing an annual update to Form ADV would impose an additional burden on advisers without a sufficient offsetting gain.

❍ For the same reason, we do not believe that advisers should be required to update their assets under management reported on Form ADV more than once a year.

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We appreciate the opportunity to comment on these important proposals. Please contact the undersigned if you need further information on any of the matters discussed in this letter.

Respectfully submitted,

Mari-Anne Pisarri

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
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[24] Investment Adviser Association and National Regulatory Services, *Evolution Revolution 2010 -- A Profile of the Investment Adviser Profession* at 10.