S7-20-04

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ICAA

December 27, 2001

The Honorable Harvey L. Pitt
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Exemption for Thrift Institutions under the Investment Advisers Act

Dear Chairman Pitt:

The Investment Counsel Association of America[1] wishes to take this opportunity to express our views about a new exemption the Commission is contemplating that would allow thrift institutions to avoid the regulation to which they are currently subject under the Investment Advisers Act of 1940.

Background

Historically, the definition of "investment adviser" in section 202(a)(11) of the Advisers Act has specifically excluded all "banks" and "bank holding companies." As a result, banks and bank holding companies conducting investment advisory activities have not been subject to Commission regulation. The term "bank" does not encompass savings associations and other thrift institutions.[2] Therefore, thrift institutions have always been subject to Commission regulation under the Advisers Act when they provide advice regarding securities for compensation.[3]

Pursuant to the Gramm-Leach-Bliley Act[4] enacted in 1999, banks are now included in the definition of "investment adviser," but only to the extent that they act as

[1] The Investment Counsel Association of America, Inc. is a not-for-profit organization that represents the interests of SEC-registered investment advisory firms. Founded in 1937, the ICAA's membership today consists of about 300 federally registered advisory firms that collectively manage in excess of $3 trillion for a wide variety of individual and institutional clients. For more information about the Association, please see our web site at www.icaa.org.

[2] *See, e.g., Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934*, Release No. 34-44291; File No. S7-12-01 (May 11, 2001) ("Interim Final Rules") at n.246.

[3] In 1983, the SEC issued a notice requesting comment on granting an exemption from the Advisers Act to thrifts. *Status of Savings and Loan Associations Under the Federal Securities Laws*, Rel. No. IC-13666, 49 Fed. Reg. 6383 (Dec. 19, 1983). The SEC did not take further action on this notice.

[4] Pub. L. No. 106-102, 113 Stat. 1338 (1999).

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investment advisers to investment companies.[5] Banks that do not advise investment companies continue to be excluded from the definition of "investment adviser." The Gramm-Leach-Bliley Act did not change the application of the Advisers Act to thrifts.

We understand that since enactment of Gramm-Leach-Bliley, thrift institutions have urged the SEC to treat thrifts identically to banks for purposes of exemption from the Advisers Act. The requested exemption – and rationale therefore -- was described in a speech delivered earlier this year by Paul F. Roye, Director of the SEC's Division of Investment Management:

> The Gramm-Leach-Bliley Act (GLB) contains a number of provisions that affect the investment management business. GLB amended various terms in both the Investment Company Act and the Investment Advisers Act, and gave the SEC new regulatory authority to enable the SEC to address issues presented by greater involvement of banks in the investment management business. For example, the Investment Advisers Act currently excludes banks from the definition of "investment adviser." GLB amended the definition of "investment adviser" to include a bank within the definition of investment adviser, if it acts or serves as an investment adviser to a registered investment company. A bank may register its entire corporate structure as an investment adviser or it may choose to register only a separate division or department of the bank. Consequently, for the first time the SEC will be able to inspect bank advisers to registered investment companies. Previously, the Commission had authority only to inspect the registered investment company's records.
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> The Investment Company Act definition of "bank" was amended in such a way that now thrift institutions can sponsor common and collective trust funds, exempt from registration under the Investment Company Act. However, the definition of bank in the Investment Advisers Act was not amended to exempt thrifts from the Advisers Act. *We recognize that to place thrifts on a level playing field with banks regarding offering common and collective trust funds, that it seems appropriate to use our rulemaking authority to exempt thrifts from the Advisers Act, to the extent that they engage in bona fide fiduciary activity. Consequently, we have been working on an exemptive rule for thrifts in this area.*[6] (emphasis added)

We also note that the Commission issued interim final rules in May that provide exemptions for banks, savings associations, and savings banks under the Securities Exchange Act of 1934.[7] The rules grant an exemption from the definitions of "broker"

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[5] Investment Advisers Act, Section 202(a)(11).

[6] "Managing the Revolution," Keynote Address of Paul F. Roye at the Third Annual Compliance Summit sponsored by the ICAA and *IA Week*, Washington, D.C. (March 26, 2001). *See also*, Keynote Address of Paul F. Roye at the Glasser LegalWorks Fifth Annual Investment Advisor Compliance Conference, New York, New York (May 4, 2001).

[7] Interim Final Rules, *supra* note 2.

and "dealer" for savings associations and savings banks on the same terms and conditions that banks are excepted or exempted from broker-dealer registration.

Issues and Concerns

The ICAA believes that a broad new exemption for thrifts may run contrary to legislative provisions and Congressional intent, may create an ill-advised loophole under the Advisers Act contrary to functional regulation, and may create unfair competition among thrifts and registered investment advisers, all without compelling public benefit.

1. *The contemplated exemption for thrifts is not consistent with provisions of the Gramm-Leach-Bliley Act.* When Congress passed the Gramm-Leach-Bliley Act, it amended various provisions of the securities laws, including the Investment Advisers Act of 1940. As noted in the Commission's proposed exemption for banks, savings associations, and savings banks, the GLB Act was landmark legislation that marked the culmination of more than three decades of deliberation.[8] In revising numerous provisions of the securities laws, Congress had more than ample opportunity to consider an exemption for thrifts similar to that enacted for banks under the Advisers Act. In fact, the GLB Act explicitly amended the definition of "investment adviser" in section 202(a)(11) of the Advisers Act to require registration of banks that serve as advisers to investment companies. Yet the final legislation is silent with respect to thrifts. If Congress had intended to grant similar treatment of thrifts as with banks, it could have done so.[9] We respectfully submit that the Commission should be extremely cautious in imposing its judgment on policy issues that were the subject of extensive Congressional deliberations and final action. In effect, the Commission will be legislating issues that are properly within the purview of Congress.

2. *The exemption may be inconsistent with functional regulation and create an unwise loophole.* Significantly, Congress *added* banking entities to the Commission's jurisdiction in enacting the GLB Act in order to strive for functional regulation. Pursuant to the GLB Act, for the first time Congress subjected banks that advise mutual funds to investment adviser regulation and for the first time subjected banks to broker-dealer regulation with a number of exceptions. These provisions addressed Congressional concern that banks had been permitted "to engage in securities activities without being subject to the provisions of the federal securities laws that were designed to protect investors."[10] Granting an exemption for thrifts from Advisers Act registration – particularly an exemption of the type and scope accorded banks in the Advisers Act – may create an unnecessary and potentially troublesome gap in regulatory coverage under

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[8] Interim Final Rules, *supra* note 2, at 5-6.

[9] *See AmeriFed Federal Savings Bank* no-action letter (pub. avail. Jan. 18, 1990). In *AmeriFed*, the SEC staff refused to grant relief from the securities laws to a savings bank wishing to maintain a collective tru fund, stating "[n]or do we believe that we should, by administrative interpretation, eliminate the distinct that Congress has drawn in the federal securities laws between banks and thrifts." Congress – not the Commission – subsequently changed the *AmeriFed* result in the GLB Act.

[10] Interim Final Rules, *supra* note 2, at n. 22-23 and accompanying text.

the Advisers Act. If the Commission approves a broad exemption for thrift institutions, any entity that wishes to avoid registration and regulation under the Advisers Act could do so simply by organizing itself as a thrift. Such an approach would be contrary to the Commission's longstanding support for functional regulation, as well as the GLB's endorsement of functional regulation.[11] The Commission should use caution in allowing thrifts to perform activities that otherwise would subject them to registration and regulation as an adviser to ensure that any such exemption does not undermine the integrity of the Advisers Act and is consistent with the Commission's functional regulatory approach.

3. *The exemption may create an unlevel playing field for investment advisers and thrift institutions.* The primary argument in support of the thrift exemption is that such an exemption is necessary to create a level playing field between banks and thrifts. However, the exemption instead may create an unlevel playing field between thrifts and investment advisers. By exempting thrifts from registration, the Commission would allow thrifts to engage in identical activities as investment advisers while avoiding the regulatory structure of the Advisers Act. As noted in the Commission's interim rule exempting banks, savings associations, and savings banks from provisions of the Exchange Act:

> The federal securities laws provide a comprehensive and coordinated system of regulation of securities activities. They are specifically and uniquely designed to assure the protection of investors through full disclosure concerning securities and the prevention of unfair and inequitable practices in the securities markets. *The securities laws also have as a goal fair competition among all participants in the securities markets.*[12] (emphasis added)

Creating an exemption for thrifts may unfairly disadvantage investment advisers that are subject to registration and regulation under the Investment Advisers Act. Investment advisers owe a fiduciary duty to their clients, are required to comply with various statutory and regulatory restrictions, and are subject to rigorous oversight by the Commission.[13] Exempting thrifts from requirements of the Advisers Act may enable them to perform the same functions as investment advisers while remaining outside of the legal and regulatory scheme Congress has mandated and may result in an unfair competitive advantage for thrift institutions.

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[11] "The GLBA codified the concept of functional regulation – that is, regulation of the same functions, or activities, by the same regulator, regardless of the type of entity engaging in those activities. Congress believed that, given the expansion of the activities and affiliations in the financial marketplace, functional regulation was important to building a coherent financial regulatory scheme." Interim Final Rules, *supra* note 2, at 16.

[12] Interim Final Rules, *supra* note 2, at 16-17.

[13] For a discussion of issues related to the Investment Advisers Act, *see* Statement of David G. Tittsworth, Executive Director, Investment Counsel Association of America, Inc., SEC Roundtable on Investment Adviser Regulatory Issues (May 23, 2000).

4. *The Commission should evaluate whether there is a compelling public or investor protection benefit that justifies exempting thrifts from Advisers Act registration and regulation.* The rationale that has been advanced to support the thrift exemption is that banks and thrifts should be treated the same. However, this rationale may not amount to a compelling public or investor protection benefit that justifies the Commission's use of its exemptive authority under the Advisers Act. The Commission is charged with the protection of investors. Granting an exemption to thrifts from Advisers Act registration and regulation potentially may harm investors because thrifts will not be subject to the panoply of legal and regulatory requirements governing the investment adviser profession.[14] For example, one of the most significant investor protections in the Advisers Act is the requirement that advisers provide their clients *prior to or at the time of* engagement a brochure that describes the adviser's business, services, fee structures, and all material actual or potential conflicts of interest.[15] In addition, extensive information about the business, services, and disciplinary history of each SEC-registered investment adviser is available on the SEC's web site.[16] We know of no similar information posted by banking agencies.

In closing, we strongly urge you to consider fully the views outlined above if and when the Commission decides to consider granting an exemption for thrifts. If an exemption is to be granted, it should be crafted narrowly in order to encompass only those traditional trust activities that have long been considered to be outside the core functions of an investment adviser. We would be pleased to discuss this matter with you or Commission staff and trust that you will not hesitate to contact us if we may provide any additional information to you regarding this or any other matter of mutual concern.

Sincerely,

David G. Tittsworth

DAVID G. TITTSWORTH
Executive Director

Cc: The Honorable Laura S. Unger
The Honorable Isaac C. Hunt, Jr.
Paul F. Roye
Cynthia M. Fornelli
Robert E. Plaze

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[14] For example, in our comment letter on the pending rule regarding the broker-dealer exception under the Advisers Act, we noted that there are at least four aspects of the Advisers Act and accompanying laws that differ significantly from those governing broker-dealers: fiduciary duty, restrictions on principal trading, disclosures, and prohibition of testimonials. Letter to Jonathan G. Katz from David G. Tittsworth, ICAA Executive Director re: *Release Nos. 34-42009; IA-1845; File No. S7-25-99; Certain Broker Dealers Deemed Not To Be Investment Advisers* (January 12, 2000). Such aspects, as well as a desire to avoid the costs of complying with Advisers Act regulation, may be relevant to the proposed thrift exemption.

[15] Investment Advisers Act, Section 204 and Rule 204-3 thereunder.

[16] *See* www.adviserinfo.sec.gov, the SEC's web site that posts all current Form ADV, Part 1 filings by investment advisers.