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August 11, 2015

Submitted Electronically – rule-comments@sec.gov

Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Amendments to Form ADV and Investment Advisers Act Rules,
Release No. IA-4091, File No. s7-09-15, RIN 3235-AL75

Dear Mr. Fields:

Charles Schwab & Co., Inc. (Schwab) is a dually-registered broker-dealer and investment adviser and serves as wrap sponsor for managed account programs. On behalf of itself and its affiliated advisers,[1] and as a broker-dealer custodian for almost 7,000 independent investment advisers and their clients, Schwab is pleased to provide comments on the U.S. Securities and Exchange Commission (SEC or Commission) proposed amendments to Form ADV published on May 20, 2015.[2] Our comments relate to three areas: (i) registered investment advisers reporting derivatives and borrowing under the asset categories on separately managed accounts or "SMAs," (ii) minimizing unnecessary burdens on smaller advisers, and (iii) providing additional guidance for reporting "custody" under Item 9 to resolve longstanding ambiguities.

I. Reporting Derivatives and Borrowings in Schedule D

The Proposing Release would require all advisers that manage SMAs to report annually in new Section 5.K.(1) of Schedule D the approximate percentage of SMAs on an aggregate basis in ten broad asset categories, such as exchange-traded equity securities, securities issued by registered investment companies and derivatives. We support the SEC's efforts to collect additional data seeking to minimize

[1] Charles Schwab & Co., Inc. ("CS&Co"), Charles Schwab Investment Management, Inc. ("CSIM"), Charles Schwab Investment Advisory, Inc. ("CSIA"), Windhaven Investment Management, Inc. ("Windhaven") and ThomasPartners, Inc. ("ThomasPartners") are affiliates and are each wholly-owned subsidiaries of The Charles Schwab Corporation.

[2] Amendments to Form ADV and investment Advisers Act Rules, Release No. IA-4091 (May 20, 2015), available at http://www.sec.gov/rules/proposed/2015/ia-4091.pdf (the "Proposing Release").

as much as possible the burden on regulated entities and the investors they service while helping the SEC to enhance their ability to conduct risk-based examinations of advisers. In support of those goals, we recommend that certain clarifying instructions are made including Proposed Form ADV, Part 1A, Schedule D, Section K in an effort to ensure the information requested is readily available to advisers to allow for reporting.

Schwab's affiliated registered investment advisers and its independent RIA clients provide investment advisory services to SMAs. Many invest in exchange-traded equity securities or securities issued by registered investment companies (RICs). One affiliated adviser, Windhaven Investment Management, Inc. (Windhaven), invests $14.8 billion primarily in unaffiliated ETFs. This is a fast-growing segment of the managed-account universe with 700 investment strategies that typically have more than 50% of portfolio assets invested in ETFs spread across over 150 firms with total assets of $86 billion through March 2015.[3]

The Proposing Release clearly identified ten broad asset categories, such as exchange-traded equity securities and securities issued by RICs, asking advisers to report approximate percentages in SMAs. Depending on an adviser's regulatory assets under management (RAUM), an adviser will need to report the: (i) approximate percentage of derivatives and borrowings, (ii) number of accounts advised according to the net asset value (NAV) of account, gross notional exposure, and weighted average borrowings as a percentage of NAV, and (iii) gross notional exposure for six categories of derivatives. For advisers like Windhaven, the vast majority of assets would be identified as exchange-traded equity securities which is an asset category separate and apart from derivatives. These same advisers may, depending on the ETFs in which they invest, provide risk disclosure related to derivatives and borrowings in its Part 2A. The Proposing Release asks, whether "advisers readily have access to the data and information requested by these proposed changes?"[4] The exercise for advisers may be difficult, if not impossible, in the event the SEC is requesting advisers to look-though to the underlying holdings of ETFs, RICS or Pooled Investment Vehicles for purposes of reporting obligations under new Section 5.K.(2) and 5.K.(3) of Part 1A.

In the past, the SEC has provided guidance to advisers whether RICs need to "look through" to underlying securities for purposes of compliance with different sections within the Investment Company Act of 1940, as amended (1940 Act)[5]. The SEC has provided relief from other 1940 requirements for "fund of funds" (FOF) to expanding the investment abilities of such funds, including the ability to invest in non-fund securities and codifying a number of exemptive FOF arrangements.[6] Other regulators, such as the Commodity Futures Trading Commission, have also provided relief from requiring FOF to look

[3] Ling-Wei Hew, *Morningstar ETF Managed Portfolios Landscape Q1 2015* (May 2015).

[4] Proposing Release at 21.

[5] *See, e.g.*, Investment Company Names, Release No. IC-24828 at n.13 "an investment company *may* "look through" a repurchase agreement to the collateral underlying the agreement" [emphasis added]; *See, e.g.*, Treatment of Repurchase Agreements and Refunded Securities as an Acquisition of the Underlying Securities, Release No. IC-25058.

[6] *See, e.g.*, Fund of Funds Investments, Release No. 33-8713.

through all of the underlying funds in which a FOF invests to determine whether a FOF may avail itself of the CPO registration exemption provided in either Regulation 4.5 or 4.13(a)(3).[7] The CFTC recognized the "lack of visibility"[8] that a FOF may have regarding the positions of the underlying funds, "in many instances such opaqueness may not allow [a FOF] operator to perform the direct calculations required to determine whether it satisfies the requirements."[9] Here, the Commission should provide clarifying instructions in Part 1A, Schedule, that advisers are not required to look through to the underlying holdings of the ETFs, RICs or securities issued by pooled investment vehicles for purposes of reporting any derivatives exposure and borrowing in proposed Schedule D, Section K(1) to help ensure advisers have access to the data and information requested by the proposed changes. The additional clarification would also be helpful in the event questions arise around derivatives or similar risk disclosure in the adviser's Form ADV, Part 2A.

II. Minimizing Burdens on Smaller Advisers

We support the SEC's efforts to gather additional data to make more informed risk assessments with respect to SMAs and their investment advisers which will help the SEC staff conducting more targeted risk-based examinations of advisors. As noted above, Schwab serves as the broker-dealer custodian for almost 7,000 independent investment advisers and their clients. Most independent advisers are small businesses with limited staff and resources. Accordingly, we appreciate the Commission's additional goal to minimize as much as possible the burden on RIAs.

To this end, we support the Investment Adviser Association's recommendation that the Commission increase the threshold for reporting use of borrowings and derivatives in SMAs from $150 million to $500 million. The vast majority of small advisers use little leverage and derivatives in their SMAs. The slight risk assessment and monitoring benefit the Commission gains in subjecting this small RIA segment to this requirement should be balanced against the meaningful cost and resource burden these small businesses would incur. This includes establishing a documented system to categorize accounts and assets, calculate the relevant amounts, and record and report the results. Increasing the threshold in this manner would be consistent with the "burden-tiering" approach the Commission is taking in other parts of the proposed amendments to Form ADV.

III. Clarifying Custody Instructions in Form ADV Part 1A, Item 9

The Commission asks "whether there are any ambiguities or concerns" that it should address in Form ADV, the instructions or the Glossary.[10] We think there are when it comes to reporting custody under Item 9. Based on our experience as a qualified custodian for over 7,000 advisers, we believe that advisers do not have enough guidance from the Commission to answer the Item 9

[7] CFTC No-Action Letter No. 12-38 (Nov. 29, 2012) ("Letter 12-38").

[8] *Id.* at 2.

[9] *Id.* at 2.

[10] Proposing Release at 43.

questions in a consistent manner when it comes to the limited money movement authority the vast majority of RIAs receive from their SMA clients as a basic aspect of their money management service.

To enable efficient management of client accounts, RIA clients commonly grant RIAs limited authority to transfer client funds in the future either to an identically registered account held by the client at the same or another custodian, or to a third party account or payee specifically identified by the client. The Commission staff in the past has provided, through FAQs, excellent guidance on many matters relating to interpretation and application of the Custody Rule. Unfortunately, as the March 4, 2013 Office of Compliance Inspections and Examinations National Exam Program Risk Alert, "Significant Deficiencies Involving Adviser Custody and Safety of Client Assets" points out, the failure by advisers to recognize they have custody remains one of the biggest areas of concern. The Risk Alert, however, did not address the very common adviser authority to transfer client funds. There remain open questions whether a client's direction to a custodian like Schwab to allow the client's agent, the RIA, to move funds according to the client's grant of authority is "custody." In a nutshell, some RIAs report this as custody, while others do not.

It is in the interest of both the Commission and advisers to have advisers accurately and consistently report custody under Item 9. Reasonably construing "custody" for Item 9 reporting purposes as excluding limited money movement authority (to an identically registered account, or to a third party account as indicated by the client to the custodian) would enable the Commission staff to better consider custody as a true risk-based factor in assessments of individual advisors and would enhance the Commission's overall monitoring of the industry. It would also enable individual advisors to accurately and in good faith report custody without needlessly taking on the additional burdens of the Custody Rule. Meanwhile, Schwab will continue to work with the Investment Adviser Association and other major custodians to resolve this uncertainty with the Commission staff.

IV. Closing

We hope the foregoing is helpful to the Commission and would be happy to provide any additional information. Should you have any questions, please contact the undersigned.

Very truly yours,

/s

Christopher Gilkerson
Senior Vice President and General Counsel
Charles Schwab & Co., Inc.
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