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12 March 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street NW
Washington DC 20549-0609

Re: File No. S7-04-04

Dear Mr. Katz:

Thank you for giving us the opportunity to comment on these proposed rules.

Any new regulation imposes burdens on firms. Regulations are, by their nature, anti-competitive because they reduce the number of firms that are able to comply with them and thus create barriers to entry. In this light, new regulations should be held at a minimum.

Rationale for new regulations is, of course, valid if it addresses recurring violations which harm clients. In the absence of such, we submit that additional regulations are not desirable in that they constrain the open market for investment services which benefit clients.

There are certain very significant differences between small and large investment advisory firms, differences that should be considered in imposing new regulations.

The small advisory firm, typically, is launched by one or more entrepreneurs who invests capital and time with the hope of profits, typically individuals with a new investment idea, and who likes to serve clients. Small firms get much of their new business from recommendations from existing clients. They often serve clients they see attending church or synagogue, at social and civic clubs, and at other local activities. The client/adviser relationship is often personal as well as professional. It is not in the best interest of small advisory firms to take advantage of these clients.

Small firms with only one office know their personnel, have daily contact with members of the firm, and are in a better position to prevent and correct violations than are managers of sprawling, mega-managers with hundreds or thousands of employees. The principals at small firms, such as ours, typically invest mostly in mutual funds that they manage, if such funds exist.

Large firms, on the other hand, are frequently owned by absentee investors. Some are publicly owned and traded. Their management and key personnel are paid employees, and sometimes they have minimal client contact, and might lack the client focus so important to the small firm. The client/adviser relationship can be much more remote.

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In small firms, the principals of the firm typically wear many, many hats. Their principal focus should most properly be on achieving top results for clients, communicating with clients, and serving them properly. But in addition to the advisory function, principals are responsible for the administration of the firm including all personnel, planning, marketing and financial matters relating to the firm, as well as compliance. The burden of additional regulations falls mostly on these key personnel in small firms. Extensive compliance requirements soak up time which would otherwise be used to improve client positions. These small firms are most often not in a financial position to consult with attorneys on a frequent basis.

The proposed rule dealing with the need for compliance with laws as an element in a code of ethics is unnecessary; responsible citizens should understand they need to comply with laws.

Adding a provision requiring "supervised persons to comply with all applicable laws and regulations" may also be considered unfairly broad. The key word is *applicable*, which could be a matter of interpretation. Large advisers with armies of lawyers could spend years in court debating the word, small advisers would be easily bankrupt by such an impossible expense.

The provision to limit access to non-public information is also unnecessary for small firms. Firms with less than $2 billion in assets under management are generally unlikely to be able to buy or sell enough shares to significantly influence the market. These firms generally do not act as custodian or broker. As soon as the first order to buy or sell a security is placed with a broker, such information is necessarily transmitted to others outside the firm. There are no real market secrets in a business that depends on so many "outside" people to execute, settle and custody trades.

A buy list for such a small firm might consist of 50 to 100 securities, and it's not easy to predict which of these would rise or fall in price. Some research has suggested that securities most recommended by Wall Street tend to do the worst. Access to the buy list would hardly grant assured advantage to anyone who had the information.

You ask for comments on whether computer files containing nonpublic information should be identified and segregated. Many firms, such as ours, consider all of our client information nonpublic! Our total employment, including part time and full time personnel, is fewer than 20. Most of these people are involved in analysis, portfolio management, statement reconciliation or client service. Each of them must have access to client records. Requiring segregated computer files would accomplish nothing other than higher expenses and more difficult working conditions.

Like many small firms, we currently are regulated under 17j-1 as we advise a small investment company. The proposed section 204A-1 adds an additional burden by considering an investment advisor's officers and directors to be access persons. The proposed regulation defines access person as "a supervised person who has access to non-public information to clients' purchase or sale of securities, is involved in making securities recommendation to clients or who has access to such recommendations that are non-public". Directors and Trustees at most small firms meet quarterly at most and are almost never involved in any of the activities described in the above definition. In any true sense of the word, they are not access persons. Additional reporting and pre-clearing burdens on them will only significantly reduce the available pool of individuals willing to serve as a director or trustee, and would provide no benefit to the investor.

Access persons currently report transactions on a quarterly report. Some types of transactions are exempt from the pre-clearing/reporting policy. Other than those cited on the SEC web site, non-voluntary trades, such as the exercise of an option, should be exempt. If an employee has written a covered call and that option is eventually exercised, no front running claim should be made. It is logical that stock gifts and dividend reinvestment should also be exempted from pre-clearing requirements.

Exempting activities involving stocks of larger market capitalization companies (above $500 million) would significantly reduce the record keeping and reconciliation burden but not increase risk to clients because these larger company stocks are not subject to manipulation by small advisers. A small adviser can't buy or sell enough shares to move the market on large company stocks. Employee transactions that aggregate less than $100,000 a quarter in a large capitalization issuer are benign and should also be exempt

The release asked for comment as to whether the rule to require that access persons obtain the adviser's approval before investing in an initial public offering or private placement should also prohibit access persons from making these investments for their personal accounts. We suggest that prior approval would be sufficient guard for clients. Regardless, it is extremely important that **whatever rule is finally adopted, small advisers must still have a mechanism to add capital to their companies.** This is currently often done through the issuance of additional shares or debentures, both private placements. These transactions are not likely to harm clients, but adding capital to the firm can be helpful.

The proposed regulation that personal holdings and transaction reports must be electronically available is an especially burdensome process for small firms. The difficulty is that non-client security transactions often do not use normal client Depository Trust Company (DTC) settlement process, but are handled on an individual basis, since they are often purchase orders for mutual funds under a small firm's supervision. Every transaction must be determined and entered by hand. For the rule to have meaning, these transactions would need to be input as soon as the information is received – not batched and done when/if time is available.

Furthermore, these securities pay capital gains distributions, interest and dividends. To maintain accurate positions and records, these transactions need to be ascertained and entered by hand. This amounts to a tremendous burden of extra work. If each of the "access" person's portfolios had to be handled in this way, small firms would have to hire additional people to handle this burden, and most such firms are not in a good position to do so. Suggesting that the adviser can require its employees to submit their forms on a spreadsheet assumes the employees each have expertise and will do this on their own time and if away from work, on their own computers. This is both unrealistic and unfair to the employee. Shifting the cost does not eliminate the cost. The provision also requires that a review process be established to make sure the employees have correctly and completely entered the data. The spreadsheets would have to be reconciled against the monthly brokerage statements. Updating such a spreadsheet would be both costly and burdensome. Perhaps that rule would be appropriate for firms with more than 50 or 100 employees, but certainly not for a small company.

The cost analysis discussed in the Proposed Rule on the SEC's Web Site identifies estimated average times for access persons to complete each report required under 204A-1. It does not, however, include any time for the firm employees and Compliance Officers to retrieve these reports from the access people, monitor compliance with the policy, and reconcile the personal transaction logs (or spreadsheets) with the access person's monthly broker statement. This is where the burden is greatest to small advisers. Someone has to maintain, retain and verify these records.

The cost benefit analysis on the web site suggests there would actually be a drop in the required number of hours spent under 201A-1 because they are "easier to understand than the complex provisions currently contained in 204-2(a)(12) and (13)." I most respectfully request this analysis be reviewed again. I would suggest that 204-2(a)(13) is irrelevant to many small advisers as it applies to advisers who are primarily engaged in a business or businesses other than advising an investment company or other advisory client. In addition, we understand that requirements of 204-2(a)(12) can be met simply by receiving and retaining a broker confirm for each transaction by an access person. That is considerably less complex than the requirements of 201A-1.

I respectfully suggest the commission exempt smaller firms, those with assets under management of less than $2 billion, from the provisions we have highlighted above, unless there exists overwhelming data showing such firms have been guilty of repeated violations which harm their clients, and such violations would have been prevented by initiating these changes.

Thanks you again for giving us the opportunity to comment on the proposed rules and regulations.

Sincerely,

F. E. James, Ph.D.
President