ICAA

July 9, 2004

Via Electronic Filing

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Certain Thrift Institutions Deemed Not To Be Investment Advisers, Release Nos. 34-49639, IA-2232; File No. S7-20-04

Dear Mr. Katz:

The Investment Counsel Association of America[1] appreciates this opportunity to comment on the proposed new rule[2] that would exempt certain thrift institutions from the Investment Advisers Act of 1940. As set forth below, we believe the proposed rule is inconsistent with the Commission's well-established views relating to functional regulation. Further, we do not believe that any compelling evidence has been demonstrated that would justify allowing thrift institutions to avoid regulation to which they are currently subject under the Advisers Act.

Background

Historically, the definition of "investment adviser" in section 202(a)(11) of the Advisers Act specifically has excluded all "banks" and "bank holding companies." Because of this exclusion, banks and bank holding companies conducting investment advisory activities generally have *not* been subject to Commission regulation and in fact are specifically excluded from the protections afforded to investors under the Investment Advisers Act.[3]

[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 more than 300 federally registered advisory firms that collectively manage in excess of $4 trillion for a wide variety of individual and institutional clients. Additional information about the ICAA is available on our web site: www.icaa.org.

[2] *Certain Thrift Institutions Deemed Not To Be Investment Advisers*, Release Nos. 34-49639, IA-2232; File No. S7-20-04 (Apr. 30, 2004).

[3] We believe the exclusion for banks and bank holding companies is at odds with the overarching goals of the Investment Advisers Act and inconsistent with the Commission's stated support for functional regulation. There is no compelling justification for excluding banks from the provisions and protections of the Advisers Act when bank activities fall squarely within the definition of "investment adviser" and when the bank (or some part thereof) is holding itself out as an investment adviser. The historic exclusion for

The term "bank," however, does *not* encompass savings associations and other thrift institutions.[4] Therefore, thrift institutions historically have always been subject to Commission regulation under the Advisers Act if their activities fall within the definition of "investment adviser," *i.e.*, if they are engaged in the business of providing advice regarding securities to others for compensation.[5]

In 1999, Congress enacted the Gramm-Leach-Bliley Act.[6] Certain provisions of this law amended the Investment Advisers Act to require registration of banks and bank holding companies that serve or act as an investment adviser to a registered investment company.[7] Banks and bank holding companies that do not advise investment companies continue to be excluded from the definition of "investment adviser." Notably, the Gramm-Leach-Bliley Act did *not* change the application of the Advisers Act to thrifts.

Since enactment of Gramm-Leach-Bliley, the thrift industry has stepped up its efforts, urging the SEC, as well as Congress, to afford identical treatment to thrifts as banks for purposes of the Investment Advisers Act.[8] The requested exemption – and rationale therefore – was described in a speech delivered in 2001 by the 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

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banks and bank holding companies is best explained as the result of political and jurisdictional clout rather than substantive public policy.

[4] *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.

[5] *See* Investment Advisers Act of 1940, § 202(a)(11). *See also, Investment Advisers Act Release No. 1092* (Oct. 8, 1987).

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

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

[8] In fact, the issue of whether thrifts should be excluded from Advisers Act coverage has been previously raised by the thrift industry. For example, 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). After due consideration, however, the SEC did not take further action on the notice.

> 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.*[9] (emphasis added)

We also note that the Commission issued interim final rules in 2001 that provide exemptions for banks, savings associations, and savings banks under the Securities Exchange Act of 1934.[10] The rules grant an exemption from the definitions of "broker" 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

While we recognize that the Commission has attempted to draft a rule that is tailored to specific activities conducted by thrifts, we nonetheless conclude that the proposed rule is contrary to legislative provisions and Congressional intent, will create an ill-advised loophole under the Advisers Act contrary to functional regulation, will result in unfair competition among thrifts and registered investment advisers, and will open the door to other ill-advised exemptions from the Investment Advisers Act – all without any justifiable or compelling public benefit.

1. *The proposed rule for thrifts is not consistent with provisions of the Gramm-Leach-Bliley Act.* When Congress passed the Gramm-Leach-Bliley Act (GLB 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.[11] In revising numerous

[9] "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. (Mar. 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).

[10] Interim Final Rules, *supra* note 4.

[11] Interim Final Rules, *supra* note 4, at 5-6.

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.[12] We respectfully submit that the Commission should not substitute its judgment on policy issues that were the subject of extensive Congressional deliberations and final action. In effect, the Commission now is proposing to deal with issues that already have been settled by Congress.

2. *The proposed rule is inconsistent with functional regulation and will create an unwise loophole.* Significantly, Congress *added* banking entities to the Commission's jurisdiction in enacting the GLB Act in order to achieve more functional regulation. Under the GLB Act, Congress for the first time 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."[13] Granting the proposed exemption for thrifts from the protections of the Advisers Act will create an unnecessary and potentially troublesome gap in regulatory coverage under the Advisers Act. Such an approach also is contrary to the Commission's longstanding support for functional regulation, as well as the GLB Act's endorsement of functional regulation.[14]

3. *The proposed rule will create an unlevel playing field for investment advisers and thrift institutions.* The primary argument in support of the proposed rule by the thrift industry is that an exemption from the Advisers Act is necessary to create a level playing field between banks and thrifts. We are concerned, however, that the exemption instead may create an unlevel playing field between thrifts and investment advisers. By exempting certain thrift activities from registration and regulation under the Advisers Act, the Commission would allow thrifts to engage in essentially identical activities as investment advisers while avoiding the regulatory structure of the Advisers Act. As

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[12] *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 trust fund, stating "[n]or do we believe that we should, by administrative interpretation, eliminate the distinction that Congress has drawn in the federal securities laws between banks and thrifts." Congress – not the Commission – subsequently changed the *AmeriFed* result in the Gramm-Leach-Bliley Act.

[13] Interim Final Rules, *supra* note 4, at n. 22-23 and accompanying text.

[14] "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 4, at 16.

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.*[15] (emphasis added)

Creating an exemption for thrifts – albeit a limited exemption – 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.[16] 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.

For example, under the proposed rule, thrifts will be allowed to manage collective trust funds without being subject to the provisions and protections of the Advisers Act.[17] We believe this is a vivid case in point of a situation where a thrift is clearly engaging in activities that fall within the Advisers Act, where the protections of the Advisers Act are appropriate and necessary, and where granting an exemption creates a clear disparity between thrifts and other investment advisers.

4. *There is no compelling public or investor protection benefit that justifies the proposed exemption for 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 does not amount to a compelling public or investor protection benefit that justifies the Commission's proposed rule. The Commission is charged with the protection of investors. Granting an exemption to thrifts from Advisers Act registration and regulation under certain circumstances potentially may harm investors because thrifts will not be subject to the panoply of legal and regulatory requirements governing the investment adviser profession.[18] For example, one

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[15] Interim Final Rules, *supra* note 4, at 16-17.

[16] 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).

[17] The proposing release states that the proposed rule "would except a thrift institution from the Advisers Act to the extent it provides investment advisory services to its collective trust funds that are excepted from the definition of 'investment company.'" Release, at 8.

[18] 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,

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.[19] In addition, extensive information about the business, services, and disciplinary history of each SEC-registered investment adviser must be filed electronically and is then made publicly available by the SEC.[20] We know of no similar requirements currently required of thrift institutions under any provision of law or legal theory.

5. *The proposed rule opens the door to other ill-advised exemptions from the Investment Advisers Act.* We submit that adopting the proposed exemption for thrifts constitutes a slippery slope that potentially could erode investor protection by narrowing the reach of the Investment Advisers Act. If the Commission approves the proposal, arguably it will be easier for other entities to claim that the protections of the Advisers Act should not apply to them. For example, we note that certain commenters already have urged a significant expansion of the proposed exemption for thrifts, arguing that the scope of the exception also should "include thrifts when they act as agent for accounts that have a fiduciary purpose."[21] We believe an exemption of this magnitude is clearly unwarranted and would result in a potentially wholesale avoidance of the important investor protections provided under the Advisers Act for entities that fall within the definition of "investment adviser."

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disclosures, and prohibition of testimonials. *See* 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* (Jan. 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 rule relating to thrifts.

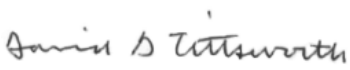
[19] Investment Advisers Act, Section 204 and Rule 204-3 thereunder.

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

[21] *See Letter from Christian G. Heilmann, Merrill Lynch Trust Company, FSB to Jonathan Katz* (June 25, 2004). The letter urges the Commission to expand the proposed thrift exemption in other ways, *e.g.* by including *all* revocable trusts in the category of accounts having a fiduciary purpose, and eliminating the requirement that thrifts covered by the Advisers Act must make available for examination all trust department records and not just those pertaining to the covered accounts.

For the foregoing reasons, we urge the Commission to reject the proposed rule. 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
Executive Director

Cc: The Hon. William H. Donaldson
The Hon. Cynthia A. Glassman
The Hon. Harvey J. Goldschmid
The Hon. Paul S. Atkins
The Hon. Roel C. Campos
Paul F. Roye