

August 10, 2007

Via Electronic Mail

Mr. Robert E. Plaze, Associate Director
Ms. Jennifer Sawin, Senior Special Counsel
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Comprehensive Review of Investment Adviser Recordkeeping Rules

Dear Mr. Plaze and Ms. Sawin:

In several recent speeches at industry conferences and meetings, SEC staff have indicated that the Division is undertaking a “comprehensive review and wholesale rethinking” of the recordkeeping requirements for investment advisers.¹ The Investment Adviser Association² commends the staff for addressing these important issues. We agree that the recordkeeping requirements, as set forth primarily in Rule 204-2 under the Investment Advisers Act of 1940, are in need of modernization to provide clarification, to eliminate outdated references, and to better reflect current business practices and technologies.

This letter is intended to assist in the staff’s review of the recordkeeping requirements by highlighting some of the IAA’s concerns regarding potential revisions to the rules. We welcome the opportunity to continue our discussions regarding these issues in greater detail with you and your colleagues.

¹ See, e.g., Andrew J. Donohue, “Remarks Before the IA Week and the Investment Adviser Association 9th Annual IA Compliance Best Practices Summit 2007,” (Mar. 22, 2007), available at <http://www.sec.gov/news/speech/2007/spch032207ajd.htm> (“The Division is currently undertaking a comprehensive review and wholesale re-thinking of the advisers’ recordkeeping requirements.”) See also, Andrew J. Donohue, “Keynote Address at 2007 Mutual Funds and Investment Management Conference,” (Mar. 26, 2007), available at <http://www.sec.gov/news/speech/2007/spch032607ajd.htm>.

² The IAA is a not-for-profit association in Washington, DC that represents the interests of SEC-registered investment adviser firms. Founded in 1937, the Association’s current membership consists of about 500 firms that collectively manage in excess of \$8 trillion in assets for a wide variety of institutional and individual clients. For more information about the IAA, please visit our web site: www.investmentadviser.org.

The IAA understands that the staff is considering various options with respect to rule revisions, ranging from retaining the current framework of Rule 204-2 to completely revising the rule. We also understand, based on conversations with staff and statements made by staff at industry conferences and meetings, that the SEC staff is seriously considering requiring investment advisers to follow the “business as such” standard for recordkeeping currently applicable to communications sent or received by broker-dealers, as set forth in Rule 17a-4(b)(4) under the Securities Exchange Act. This rule requires a broker-dealer to maintain “all communications received and copies of all communications sent by such member, broker, or dealer (including inter-office memoranda and communications) relating to [its] business as such.”

Some industry observers have posited that harmonization of the broker-dealer and investment adviser recordkeeping rules is desirable, that a “business as such” standard would provide clear guidance with respect to the recordkeeping requirements, and/or that a “business as such” recordkeeping standard would be an easy standard for investment advisers to apply. Based on the reasons set forth below, we do not agree.

1. Harmonization Of The Broker-Dealer And Investment Adviser Recordkeeping Requirements Is Neither Necessary Nor Desirable

Although harmonization with the broker-dealer recordkeeping requirements has conceptual appeal, it would affect only a small number of investment advisers, while burdening the rest. Of the 10,446 investment advisers registered with the SEC as of April 6, 2007, only a small percentage (6%) are dually registered as broker-dealers and only a slightly larger percentage (9%) are registered representatives of a broker-dealer or have employees who are registered representatives of a broker-dealer.³ Accordingly, the overwhelming majority of registered investment advisers are neither dually registered nor registered representatives of a broker-dealer.

In addition, most investment advisers (75%) are not affiliated with broker-dealers. Further, we understand that many of the 25% of investment advisers that are affiliated with broker-dealers are operated as separate businesses with completely separate broker-dealer and investment adviser operations and likely have little or no overlap in recordkeeping practices. Also, the percentage of investment adviser firms affiliated with broker-dealers has been steadily declining over the course of the past three years: investment adviser firms affiliated with broker-dealers declined by 3% last year and 2% in each of the prior two years.

Given that the vast majority of registered investment advisers are not dually registered and a decreasing percentage of investment advisers are affiliated with broker-

³ Statistical information has been compiled from IARD data gathered in conjunction with the 2007 *Evolution/Revolution* report published by the IAA and National Regulatory Services. The report is available on our web site: www.investmentadviser.org.

dealers,⁴ there is no need to harmonize the recordkeeping requirements with respect to communications because most investment advisers operate independently from broker-dealers. Harmonization of the recordkeeping rules would create no efficiencies for most investment advisers and broker-dealers and would provide no added benefit to investors. In addition, investment advisers that are dual registrants have not sought harmonization of the rules. Any dual registrants that prefer harmonization of the broker-dealer and investment adviser recordkeeping rules, however, can keep additional records voluntarily.

From a regulatory policy standpoint, the inherent differences between the business of investment advisers and broker-dealers support different recordkeeping regimes. Harmonization for its own sake simply does not make sense. Broker-dealers interact with customers in a sales process intended to result in a securities transaction. They have custody of client assets, execute trades, and typically are more retail focused than investment advisers. Broker-dealers have a high degree of interconnectivity with market centers, underwriters and other entities and may have one or more branch offices, which call for more internal communications and supervision.

2. “Business As Such” Would Not Provide Clear And Precise Guidance To Investment Advisers

The IAA fully supports staff efforts to modernize Rule 204-2 to provide clarification, to eliminate outdated references, and to reflect current business practices and technologies. Notwithstanding the dramatic technological changes that have taken place over the past decade, however, we think that the current framework of the rule - which sets forth requirements regarding the retention of broad categories of records - provides a useful clarity and certainty with respect to the required retention of documents that has served all constituencies well. On the other hand, the “business as such” framework, if broadly applied without specifically excluded categories of documents, would not provide the same clear guidance for investment advisers, leading to uncertainty in its application.

Indeed, the “business as such” standard has not brought clarity to the broker-dealer universe. This uncertainty is reflected in several letters that the Securities Industry and Financial Markets Association has sent to the SEC staff over the course of the past few years seeking clarification of the “business as such” recordkeeping standard, particularly as it pertains to e-mail. For example, a February 4, 2005 SIA letter stated:

While most of the SEC’s books and records rules identify specific documents that must be kept, the standard for the Business as Such rule is vague and subject to varying interpretations, especially as it

⁴ We recognize that, as a result of the D.C. Circuit’s decision vacating Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (*Financial Planning Ass’n v. S.E.C.*, 2007 WL 935733, C.A.D.C. (March 30, 2007)), some broker-dealers may elect to register as investment advisers in order to continue to offer fee-based accounts.

relates to email communications. The applicable SEC rule (enacted in 1939 in the context of record keeping rules) states that communications are subject to retention if they relate to the firm's "business as such." This highly subjective standard does not lend itself to a hard and fast compliance solution since each communication would theoretically have to be reviewed to determine if it relates to the firm's "business as such" before being archived. Moreover, the lack of SEC guidance exposes firms to unnecessary regulatory risk since a broker-dealer's good faith attempt to define "business as such" in its retention policy could be found to be lacking by enforcement staff with a different interpretation.⁵

Although we recognize that a few subsections of the current recordkeeping rule incorporate a "business as such" standard, use of that term in those contexts is largely superfluous. Investment advisers are required to retain "all bills or statements (or copies thereof), paid or unpaid, relating to the *business* of the investment adviser *as such*;" "all trial balances, financial statements, and internal audit working papers relating to the *business* of *such* investment adviser;" and "all written agreements (or copies thereof) entered into by the investment adviser with any client or otherwise relating to the *business* of *such* investment adviser *as such*."⁶ Given that bills, financial statements, and written agreements with clients are often critical to an adviser's operations, are easily identifiable, and are not typically voluminous documents, it is often more efficient for an adviser to maintain all such documents, rather than to determine, on a case-by-case basis, whether each such document pertains to the adviser's "business as such." Application of the same standard to a much broader and more ambiguous category of documents, on the other hand, would result in confusion, uncertainty, and the unnecessary retention of large volumes of documents.

⁵ Available at http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/4656.pdf. See also, April 7, 2006 SIA letter ("The interpretation of 'business as such' under Rule 17a-4(b)(4) continues to be problematic for SIA members because of the lack of clear, explicit guidance from the SEC on its meaning")(pertaining primarily to e-mail communications) and ("Further, the related issue of what constitutes a 'communication' (particularly in the context of electronic applications) continues to be undefined and subject to a variety of interpretations. In an era of increasingly complex technology, SIA members are without concrete guidance on what constitutes a communication which is required to be saved.") Available at http://www.sifma.org/regulatory/comment_letters/comment_letter_archives/15234.pdf.

⁶ Emphasis added. These recordkeeping requirements are set forth in Rule 204-2(a)(5), (6), and (10) of the Investment Advisers Act of 1940, respectively.

3. The “Business As Such” Recordkeeping Standard Would Lead Many Investment Advisers To Unnecessarily Retain Large Volumes Of Documents And Would Be Burdensome And Expensive

A “business as such” recordkeeping standard would likely lead many investment advisers to retain large volumes of documents, which would be extremely burdensome and would have a substantial negative business impact on most investment advisers. The majority of investment advisers that participated in a recent industry survey⁷ indicated that they retain only records that are required to be maintained under the recordkeeping rules.⁸ Only 38% of survey respondents keep *all* records generated by or received by their business. In addition, many of the advisers that maintain all records do so for office management purposes, which is significantly less burdensome than maintaining documents pursuant to a regulatory obligation.

Although the volume of records maintained under a “business as such” framework would be overwhelming for investment advisers, much of this volume would consist of irrelevant or immaterial information. In addition, given the volume of materials that would be maintained, and the length of time they would have to be maintained (most records must be kept for five to six years under the current rules), the “business as such” framework would be extremely difficult for investment advisers that do not maintain records electronically.⁹ An expanded recordkeeping requirement would also increase costs significantly for investment advisers without any compelling policy justification and without meeting the stated goal of obtaining information in a “more meaningful and less obtrusive manner.”¹⁰

⁷ About 450 compliance professionals participated in the 2007 Investment Management Compliance Testing Survey (“Compliance Testing Survey”), which was co-sponsored by ACA Compliance Group, IM Insight, Old Mutual Asset Management, and the IAA.

⁸ This response excludes e-mail, which was addressed separately in the survey.

⁹ It is very difficult, time-consuming, and costly for investment advisers to convert paper documents to electronic documents. Compliance professionals who participated in the Compliance Testing Survey cited the difficulty in converting paper documents to electronic documents as the biggest obstacle to maintaining more firm records in electronic format.

¹⁰ See, Andrew J. Donohue, “Keynote Address at the Practicing Law Institute Investment Management Institute 2007 (Apr. 12, 2007), available at <http://www.sec.gov/news/speech/2007/spch041207ajd.htm> (“As we go through our analysis, we will look at the purpose behind each requirement and determine whether we can obtain the same information in a more meaningful and less obtrusive manner.”)

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We appreciate the opportunity to provide our views on this important issue. Please do not hesitate to contact us if we may supply additional information or assistance to you regarding this matter.

Sincerely,

A handwritten signature in cursive script that reads "Valerie Baruch".

Valerie Baruch
Assistant General Counsel

Cc: Andrew J. Donohue, Director
Division of Investment Management