June 3, 2022

Via Electronic Filing

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer (Rel. No. 34-94524; File No. S7-12-22)

Dear Ms. Countryman:

The Investment Adviser Association (**IAA**)[1] appreciates the opportunity to comment on the SEC's proposal to amend the definitions of "dealer" and "government securities dealer" under the Securities Exchange Act of 1934 (**Exchange Act**) by further defining what it means to be engaged in dealer activity "as part of a regular business."[2] While we support the proposed exclusion for registered funds and commend the Commission for proposing to carve out certain investment advisers and accounts they manage on a discretionary basis, we are concerned that the over-broad proposal would nevertheless inappropriately bring in scope ordinary-course fiduciary activities of investment advisers as well as certain client accounts managed by advisers in a fiduciary capacity.

We believe that the Commission's proposed approach is inconsistent with Congress' policy decisions in establishing separate regulatory frameworks for investment advisers under the Investment Advisers Act of 1940 (**Advisers Act**) and broker-dealers under the Exchange Act. While we appreciate the Commission's investor- and market-protection goals, we are also concerned, however, that, in an effort to regulate the activities of principal trading firms (**PTFs**) and unregulated market participants and to prevent evasion of regulation by these persons, the Proposal would implement radical changes to the regulation of certain investment advisers without adequate consideration of how these changes would work in practice or affect

[1] The IAA is the leading organization dedicated to advancing the interests of investment advisers. For more than 80 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. The IAA's member firms manage more than $35 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *Further Definition of "As a Part of a Regular Business" in the Definition of Dealer and Government Securities Dealer,* SEC Rel. No. 34-94524, 87 Fed. Reg. 23054 (Apr. 18, 2022) (**Proposal**), available at https://www.govinfo.gov/content/pkg/FR-2022-04-18/pdf/2022-06960.pdf. IAA members would be significantly impacted by the Proposal's potential application of the Exchange Act to their activities.

application of the Advisers Act or advisers' fiduciary relationships with their clients. For the reasons discussed below, we urge the Commission to exclude from any further definition of "dealer" or "government securities dealer" all SEC-registered investment advisers and their clients, including private fund and separately-managed account clients.[3]

I. Background and Executive Summary

The Exchange Act excludes from the definitions of "dealer" and "government securities dealer" a person that buys or sells securities "for such person's own account," but not as "part of a regular business."[4] The Commission proposes to expand the definition and scope of what it means to be a dealer by adopting new definitions of "own account" and "as part of a regular business." In doing so, the Commission would significantly expand the meaning of "own account" by requiring investment advisers, their affiliates, and their clients to aggregate their accounts in certain circumstances, regardless of whether they intend to act as a dealer. The Commission would also significantly expand the meaning of "regular business" with both qualitative and quantitative tests that depart from the historical approach that largely looks to how a person holds itself out to the market. Instead, the Commission would look to whether the person's trading would have "the effect of providing liquidity" to other market participants. The qualitative tests would essentially narrow the so-called "trader" exclusion by narrowing the types of investment strategies in which a person could engage and still be deemed a trader.[5] The quantitative test, which would apply only with respect to the definition of a "government securities dealer," would add a bright-line volume threshold for deemed dealer activity regardless of whether the person meets any indicia of potential dealing activity, including even whether the person is acting on both sides of the market (*i.e.*, buying *and* selling).[6] All four

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[3] Our comments are limited to potential application of the Proposal to SEC-registered investment advisers and their clients. While we focus on these advisers, our concerns are also applicable to state-registered and exempt reporting advisers to the extent they could be captured by the Proposal.

[4] Section 3(a)(5) of the Exchange Act defines a "dealer" as "any person engaged in the business of buying and selling securities (not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants) for such person's own account through a broker or otherwise," but excludes "a person that buys or sells securities … for such person's own account, either in an individual or in a fiduciary capacity, but not as part of a regular business." Section 3(a)(44) of the Exchange Act defines "government securities dealer" to mean "any person engaged in the business of buying and selling government securities for his own account, through a broker or otherwise, but does not include—(A) any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business . . . ." Unless otherwise noted, we use the term "dealer" to include both dealers and government securities dealers.

[5] The Commission views traders as "market participants who provide capital investment and are willing to accept the risk of ownership in listed companies for an extended period of time." According to the Commission, "it makes little sense to refer to someone as 'investing' in a company for a few seconds, minutes, or hours." Proposal at 23059. We note that the statutory definition of dealer uses the terms "buy" and "sell" and not "invest," and does not turn on a particular investment strategy.

[6] We believe that the quantitative test is inconsistent with Congress' intent to apply the same tests to dealers and government securities dealers. The Commission acknowledges in footnote 42 of the Proposal that the term

proposed tests would apply regardless of whether the person is customer facing, otherwise holds itself out as a dealer, or displays any other indicia of intent to act as a dealer.

The Commission's main concern appears to be with market participants, like PTFs, that provide liquidity to the market but are not subject to dealer regulation. But the Proposal is also explicitly intended to capture certain investment advisers and private funds[7] – and, potentially, other advisory clients – if they, alone or aggregated with other advisory accounts, meet any one of the four tests. We strongly oppose application of the Proposal to SEC-registered investment advisers and their clients. We make the following comments:

- The Commission should categorically exclude SEC-registered investment advisers from any further definition of "dealer." Congress intended to regulate the conduct of investment advisers under the Advisers Act and it is ill fitting, inappropriate, and unwarranted to attempt to regulate them as dealers under the Exchange Act. The Proposal also has not considered the impact of dealer regulation on investment advisers or their clients, or on how advisers would continue to comply with their fiduciary and other obligations under the Advisers Act, including how they would manage the conflicts with their clients that dealer regulation would create.

- The Commission should categorically exclude private funds managed by SEC-registered investment advisers from the definition of "dealer." Private funds are pooled investment vehicles, typically managed by registered advisers. They are not and do not behave like operating companies. They are created in order to follow an agreed-upon risk-based investment strategy for the benefit of their investors, which would be significantly harmed if their funds are regulated as dealers.

- Investment advisers' client accounts should not be aggregated either with the adviser's own account or with any other client accounts for purposes of the definition of "dealer." The proposed rules incorrectly and confusingly apply the Exchange Act definition of "control" to an adviser's client accounts and the Commission should make clear that advisers do not control their clients *merely* because they manage those clients' accounts on a discretionary or other basis. Advisers are fiduciaries to each of their clients independently, owing each a duty of care and a duty of loyalty. It is inappropriate to aggregate advisers' client accounts for purposes of the dealer definition even if they are following similar investment strategies. Clients' accounts are segregated from the

"government securities dealer" is intended to "utilize key concepts from the current definitions of 'dealer' and 'municipal securities dealer,'" but it then proposes to treat these categories differently by eliminating the conduct requirement from the proposed "government securities dealer" definition. The Proposal does not point to any legislative history to justify treating identical statutory language this differently. We recommend that the Commission eliminate the quantitative test.

[7] Section 202(a)(29) of the Advisers Act defines "private fund" as an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (**Investment Company Act**), but for section 3(c)(1) or 3(c)(7) of that Act.

adviser's accounts and from one another and no client's account is managed for the benefit of other accounts. The Commission should thus withdraw the part of the Proposal that would require aggregation of an adviser's client accounts.

- The Commission should focus on general anti-evasion principles rather than imposing dealer regulation on advisers and their clients out of concern that some persons could theoretically evade regulation.

We discuss our comments below.

II. Discussion

A. The Commission should categorically exclude SEC-registered investment advisers from the definition of "dealer"

The federal securities laws clearly distinguish between and establish separate regimes for the regulation of investment advisers and dealers. In seeking to capture certain investment advisers and their clients,[8] the Proposal fails to respect the statutory distinctions between advisers,[9] regulated under the Advisers Act, and dealers, regulated under the Exchange Act and FINRA rules, and it undervalues the robust statutory and regulatory requirements with which advisers must comply. The Advisers Act framework is designed to govern an adviser's relationship with and duties to its clients. The Advisers Act and the rules thereunder include a fiduciary duty to act in each client's best interest – which includes both a duty of care and a duty of loyalty – a prohibition on principal trading, and requirements, among other things, to custody client assets at banks or broker-dealers, adopt and implement reasonably-designed policies and procedures to ensure compliance with the Advisers Act and rules thereunder – including, *e.g*., related to portfolio management and trading practices – conduct an annual review, designate a chief compliance officer, maintain books and records, report on Form PF for private fund clients, and submit to SEC examinations.

The dealer regulatory framework is an ill fit for investment advisers. Unlike brokers or dealers, advisers are prohibited from holding client assets or from taking client assets onto their balance sheets. To the extent that advisers trade securities, they do so through a broker or dealer intermediary, generally on behalf of and for the benefit of their clients. Under the Advisers Act, advisers are not permitted to hold themselves out as or act as *de facto* market makers. Dealers trade for their own accounts for their own profit. Advisers provide investment advice for compensation and manage client accounts in the clients' best interest. Imposing a dealer regime on advisers would create untenable conflicts between advisers and their clients which are not

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[8] While the Proposal focuses on advisers' clients that are private funds, it appears to contemplate application to other types of client accounts as well and we thus address advisers' clients more generally.

[9] Section 202(a)(11) of the Advisers Act defines an investment adviser as any person or firm that, for compensation, is engaged in the business of providing advice to others or issuing reports or analyses regarding securities.

addressed in the Proposal, and which would be virtually impossible to manage.[10] Dealers by definition are in the business of trading for their own accounts, standing ready to provide liquidity to the market. By definition, they do not act as agent for the accounts of others, and certainly not as fiduciaries to clients. Advisers, on the other hand, are first and foremost fiduciaries. Their duty is to their clients, not to the market. Moreover, although advisers may trade for their own account, they are prohibited from engaging in principal trading with their clients except with prior transaction-by-transaction consent.[11] The unsuitability of the dealer regime for advisers is highlighted by the inconsistency of an adviser needing to stand ready as a dealer to provide liquidity to, *i.e*., trade as principal with, the market, potentially through its clients' accounts, while being prohibited from acting in that capacity with its clients.[12]

The Commission acknowledges in its cost-benefit analysis that there would be few to no benefits from applying the proposed rules to SEC-registered advisers to private funds because "the regulatory regime that applies to registered private fund advisers already contains similar provisions to the rules that apply to dealers."[13] The Commission also recognizes the costs to advisers of having to register, including "registration and membership fees, costs of record-keeping and reporting, and costs associated with net capital requirements."[14] Advisers would also incur significant costs to modify their systems and develop processes to monitor their activity to determine whether they meet any of the proposed dealer tests. The vagueness and breadth of the proposed qualitative tests would make this even more challenging since there would be so much uncertainty as to whether an adviser would meet any of the tests at any given time.[15] We are concerned that these tests could capture activity that the SEC likely did not intend to capture. The "marginal" or "very small" potential benefits of dealer regulation for advisers would be significantly outweighed by their costs.

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[10] Indeed, the Proposal asks how registered investment advisers would comply with the requirements applicable to dealers (*see* Request for Comment 6, Proposal at 23064), but it does not ask how dealer regulation would affect advisers' relationships with their clients and their ongoing compliance with the statutory regime that Congress adopted explicitly to govern their conduct.

[11] Advisers Act Section 206(3). We thus do not agree with the Commission that "an adviser's proprietary trading is not currently regulated, so the benefits of registering such an adviser would be comparable to the full benefit of registering a PTF." Proposal at 23088. Indeed, this statement is inconsistent with other statements in the Proposal that potential benefits of requiring dealer registration for advisers would be small.

[12] Importantly, we believe that dealer regulation of advisers would be substantially different from regulation of dually-registered broker-dealer/adviser firms in that dual registrants act either in an adviser or broker capacity but not as both an adviser and a broker at the same time. As proposed, advisers would be regulated as dealers for their adviser conduct, which would be an entirely new framework.

[13] Proposal at 23088.

[14] *Id.* While the Proposal recognizes that advisers are regulated under the Advisers Act regime in its cost-benefit analysis, that analysis does not sufficiently consider either the strength of that regulatory regime or the full costs of imposing dealer regulation on advisers.

[15] For example, it would be extremely difficult to determine whether an adviser is "routinely making roughly comparable purchases and sales of the same or substantially similar securities in a day."

The Proposal explains that the Commission considered but rejected excluding registered investment advisers from the dealer definition because it believes that their exclusion would undermine the potential "benefits related to net capital requirements and to transaction reporting."[16] The Commission appears to believe that net capital and transaction reporting by advisers would address concerns about the potential negative effects on creditors, counterparties, market liquidity, and market volatility should an adviser fail. We do not agree. Net capital requirements do not make sense for advisers. The net capital rules are intended to ensure that broker-dealers will be able to liquidate in an orderly fashion by having "adequate liquid assets to meet their customer obligations to investors and liabilities to other creditors."[17] These concerns are not present for advisers, whose client assets are managed on an agency basis and are not held on the adviser's balance sheet. As we have noted to the Commission and the Financial Stability Oversight Council (**FSOC**) in the past, investment advisers are agents for their clients and their core function is to manage assets as an agent on behalf of others.[18] An investment adviser is neither a counterparty to nor a guarantor of its clients' investment risks. Investment advisers are also separate legal entities from their clients, and there is no recourse to the investment adviser in the event of losses in their client accounts. Dealer requirements geared to provide safety to market participants from a dealer stress event are simply inapt for SEC-registered advisers that provide fiduciary investment advice to clients under advisory contracts. Instead, the Commission should recognize that investment advisers are appropriately regulated including with respect to trading activities under the Advisers Act regulatory framework.

We also do not believe that imposing transaction reporting by advisers through dealer regulation is necessary to provide the Commission with a view into market activity. As discussed above, advisers only trade through registered intermediaries – including banks and broker-dealers – that are subject to transaction reporting requirements. The additional information that transaction reporting by advisers would provide does not justify regulating advisers in a new way and the substantial burdens that subjecting them to the comprehensive dealer regulation regime would impose.[19]

We believe that the Commission's concern that, if it excludes advisers from the dealer definition, PTFs will seek to register as private fund investment advisers "in order to escape the

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[16] Proposal at 23095.

[17] *See* Jerry W. Markham and Thomas Lee Hazen, Broker-Dealer Operations Under Securities and Commodities Law (West Group, 2002, supplemented through Supplement 8, Oct. 2008), Vol. 23 Securities Law Series, 4-5, fn. 2. *See also* Michael P. Jamroz, "The Net Capital Rule," 47 Business Lawyer 863 (May 1992).

[18] *See* IAA Letter to FSOC re: Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies (May 10, 2019), available at https://investmentadviser.org/wp-content/uploads/2021/10/May_10__2019_-_FSOC_Comment_Letter_Activities-Based_Approach_FINAL.pdf.

[19] If the Commission believes that it needs to obtain more information through transaction reporting, it should explore more targeted and less burdensome alternatives to achieve this objective, such as expanding transaction reporting.

requirements to report transactions and maintain net capital"[20] is largely unfounded and does not justify the imposition of the dealer regulatory regime on advisers. Advisers, by definition, must advise clients, including private funds, for compensation. Their private fund clients are managed according to an agreed-upon investment strategy designed to maximize value for their investors, not to provide liquidity to the market. Thus, if PTFs were to register as advisers, not only would they need clients, but all the other regulatory requirements of the investor-protective Advisers Act and the rules thereunder would apply as well. We also note the fundamental unfairness of imposing an entirely new regulatory regime on existing advisers that are managing client accounts according to each client's stated strategy out of concern that the entities that the Commission most wants to regulate might choose to become advisers.

B. The Commission should categorically exclude private fund clients of SEC-registered investment advisers from the definition of "dealer"

While the Proposal notes that it would primarily affect PTFs, it states that "potentially some private funds may be affected."[21] The Commission would not exclude private funds from the rules because it believes that some private funds, in particular some hedge funds, "engage in activities that have the effect of providing liquidity in the securities market."[22] Although "private funds' risk-taking may be constrained by their advisers' fiduciary duties," the Commission is concerned that "the average hedge fund is more leveraged than the Net Capital Rule would allow." It acknowledges, however, "the uncertainty around [its] estimate."[23]

Private funds are pooled investment vehicles offered under exclusions from the Investment Company Act and the Securities Act of 1933. Like registered investment companies, private funds issue securities for the purpose of investing commingled funds to maximize the value of their securities for their investors. Private funds with assets under management of at least $150 million are organized and managed by SEC-registered investment advisers, unless an exemption applies. They are designed to engage in risk taking in the capital markets under binding investment strategies governed by limited partnership agreements agreed to by the fund investors. They are organized to follow a specific investment strategy for the purpose of increasing the value of their securities for their investors and not with the intent or to have the effect of providing liquidity to others.[24]

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[20] Proposal at 23095. We also do not believe that the Commission can justify imposing the dealer regulatory regime on investment advisers out of concern that "unregistered market participants" such as PTFs place dealers at a competitive disadvantage because they avoid the compliance and cost burdens on dealers. Proposal at 23087.

[21] Proposal at 23088.

[22] Proposal at 23095.

[23] Proposal at 23086.

[24] The Commission recognizes that private funds are also managed independently and do not coordinate their trading with other funds. They operate for the benefit of their investors and not for the benefit of any other fund. *See* Proposal at 23074 n. 185. We thus believe it would also not be appropriate that separate private funds be aggregated for purposes of the definition of "own account."

As noted above, net capital is intended and operates to guarantee capital stability and facilitate an orderly liquidation for the benefit of customers and creditors. Private funds do not have customers or creditors. They are not and do not function like operating companies and their investors do not function like creditors. Investments in private funds are not guaranteed against loss and investors have no recourse against the fund adviser for investment losses. Indeed, private funds are specifically organized to take agreed-upon risks with the capital of their investors. Not only would the imposition of net capital requirements be entirely inconsistent with the structure and purpose of a private fund, it would also harm private fund investors by changing the bargained-for risk profile of their investment, limit their redemption and liquidity rights, significantly raise the fund's costs, and reduce the value of their investment.

In proposing to exclude registered investment companies from any further definition of "dealer,"[25] which we support, the Proposal explains that it is unclear how these pooled investment vehicles – which have a similar capital appreciation goal as a private fund – would comply with net capital requirements, or even "how they would define net capital."[26] The same is true for private funds. Indeed, if net capital requirements were required for private funds, we would expect fund advisers, as fiduciaries to the fund, to consider restructuring their funds to enable them to continue to maximize value for their investors.

The Proposal also cites the need for transaction reporting as another reason to require private funds to register as dealers. The Commission argues that wider TRACE reporting would have provided more information about the March 2020 instability in the U.S. Treasury securities market.[27] We do not believe that the Commission's desire for additional transaction information justifies the regulation of private funds as dealers. Although private funds do not report their securities transactions to TRACE,[28] the Commission has access to transaction data reported by broker-dealers or alternative trading systems through which private funds trade and can thus monitor trading activity.[29] Moreover, the Commission receives information from private funds through the Consolidated Audit Trail for trades in NMS stocks, OTC equities, and listed options. Discretionary investment managers, if they meet certain thresholds, must also file large trader reports for transactions in NMS stocks on Form 13H under Exchange Act Rule 13h-1. In addition, large hedge funds and all private equity funds are required to file regular reports with the Commission on Form PF for systemic risk and market stability purposes, reporting, among

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[25] Proposed Rule 3a5-4 excludes from the definition of a person's "own account" an account in the name of a registered investment company. Rule 3a5-4(b)(2)(ii)(A) and Rule 3a44-2(b)(2)(ii)(A).

[26] Proposal at 23094.

[27] Proposal at 23087.

[28] Proposal at 23086.

[29] The recent Regulation ATS proposal may capture additional transaction information. *See Amendments Regarding the Definition of "Exchange" and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities*, 87 Fed. Reg. 15496 (Mar. 18, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-01975.pdf.

other things, their investment strategies.[30] Any marginal benefit from additional transaction reporting to TRACE would not be enough to justify the substantial burdens of dealer regulation on private funds and their investors.[31] The Commission should consider other narrower and more targeted ways to obtain additional market data that would not impose an extensive new regulatory regime on private funds.

The Proposal also severely underestimates the negative consequences for private funds of requiring them to register as dealers. In fact, the Commission's own cost-benefit analysis acknowledges a "high degree of uncertainty around private funds and the possible negative effects of requiring some private funds to register as dealers." However, without much support, it states that "not excluding them is more likely to meet the Proposed Rules' objectives."[32]

For these reasons, we respectfully urge the Commission to exclude private funds managed by SEC-registered investment advisers from the definition of dealer in the Proposal.

C. Client accounts managed by the same adviser are not under common control within the meaning of the proposed rules and should not be aggregated

The Proposal defines "own account" for purposes of identifying dealer activity to include any account held in the name of that person or the name of a person over whom the person exercises "control" or with whom the person is under common control.[33] Client accounts would be deemed to be "under common control" of an adviser solely because these accounts are

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[30] The SEC has also proposed amendments to Form PF to require additional private fund information. *See Amendments to Form PF To Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers*, 87 Fed. Reg. 9106 (Feb. 17, 2022), available at https://www.govinfo.gov/content/pkg/FR-2022-02-17/pdf/2022-01976.pdf. The IAA commented on the Form PF proposal. *See* IAA Letter to SEC re: Form PF Amendments (Mar. 21, 2022), available at https://investmentadviser.org/wp-content/uploads/2022/03/IAA-Comment-Letter-on-Proposed-Amendments-to-Form-PF.03.21.22.pdf.

[31] We also note that private fund advisers and their management of private funds are subject to the Commission's examination authority under which advisers are required to make their books and records, including trading information, available to the Commission.

[32] Proposal at 23096.

[33] The proposed rules would define an adviser's "own account" to mean any account (i) held in the name of that person; (ii) held in the name of a person, over whom that person exercises control or with whom that person is under common control; or (iii) held for the benefit of those persons identified in (i) and (ii).

The term "control" under Exchange Act Rule 13h-l(a)(3) means "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of securities, by contract or otherwise. [] any person that directly or indirectly has the right to vote or direct the vote of 25% or more of a class of voting securities of an entity or has the power to sell or direct the sale of 25% or more of a class of voting securities of such entity, or in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the capital, is presumed to control that entity."

managed by the same adviser, if the accounts constitute a "parallel account structure."[34] We urge the SEC to withdraw these provisions from the proposed rules because the use of control in these subsections is inconsistent with how "control" is defined in the proposed rules. In addition, even if these accounts could be deemed to be under common control, it is common for investment advisers to manage different client accounts under similar investment strategies in the ordinary course of the adviser's provision of fiduciary management services. We are concerned that these overbroad provisions would sweep in separately-managed accounts and pooled investment vehicles managed in the ordinary course by the same adviser but that have no relationship with one another other than having the same adviser. It is also unclear to us how dealer regulation in these circumstances would work in practice. We address these concerns below.

i. *The proposed provisions relating to aggregation of an adviser's managed accounts incorrectly apply the concept of control*

The proposed rules would apply to accounts held in the name of a person over whom another person "exercises control or with whom that person is under common control." "Control" would have the same meaning as in Rule 13h-1,[35] under which control means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of securities, by contract, or otherwise. However, the Commission appears to use a different definition of "control" for purposes of proposed Rules 3a5-4(b)(2)(ii)(C) and 3a44-2(b)(2)(ii)(C), *i.e*., client accounts managed by the same adviser would be deemed to be under common control of the adviser simply by virtue of being managed by the adviser. We do not agree that these accounts would be under the adviser's control under a plain reading of the proposed definition of "control."[36]

Being a client of an investment adviser, without more, does not give the adviser the power to vote securities issued by the client or in any way, directly or indirectly, control the management of the client. A client can retain or terminate a relationship with an adviser at its discretion. Moreover, the client controls which assets the adviser will manage and the adviser's

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[34] Proposed Rules 3a5-4(b)(2)(ii)(C) and 3a44-2(b)(2)(ii)(C). A "'parallel account structure' means a structure in which one or more private funds (each a 'parallel fund'), accounts, or other pools of assets (each a 'parallel managed account') managed by the same investment adviser pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions as another parallel fund or parallel managed account."

[35] Proposed Rules 3a5-4(b)(3) and 3a44-2(b)(3).

[36] Indeed, the Commission discussed the distinct concepts of "control" and "investment discretion" in the Rule 13h-1 Large Trader Reporting adopting release. *See Large Trader Reporting*, 76 Fed. Reg. 46960 (Aug. 3, 2011). A large trader is a person, or a person "controlled by" such person, that exercises investment discretion over one or more accounts for which it effects certain NMS stock transactions. Investment discretion, by contrast, is defined as that term is used in Section 3(a)(35) of the Exchange Act. According to the release, it "encompasses a person who is 'authorized to determine what securities or other property shall be purchased or sold by or for the account' as well as a person that 'makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions . . . ." *Id*. at 46964.

authority over those assets is limited by the advisory agreement. This relationship simply does not meet the standard of control as that term is used in Rule 13h-1 and in the proposed rules.[37]

The Commission has not explained why it would look to a different definition of "control" for these purposes than the definition explicitly incorporated into the proposed rules. The answer to the Commission's question whether the aggregation provisions capture activity they should not capture is thus clearly yes.[38] We urge the Commission to withdraw subsection (b)(2)(ii)(C) of both proposed rules and make clear in any adopting release[39] that client accounts of an adviser are not under "common control" solely because they are managed by the same adviser.[40] Because such accounts are *not* under the common control of the adviser, they should not be aggregated regardless of their investment strategies.

ii. The "parallel account structure" concept would sweep in an adviser's client accounts even though they have no relationship with one another

If client accounts are deemed to be under the adviser's common control – which a plain reading of the Proposal indicates that they are not, as discussed above – the Commission should eliminate the parallel account structure concept because it would also capture activities that it should not capture. This concept would potentially sweep in ordinary-course fiduciary management of all types of client accounts even though the Commission has indicated that it is not the intent of the Proposal to do this. The Proposal recognizes that every discretionary client of an adviser "has its own independent investment objectives and strategies, which the registered investment adviser implements as agent for the client" and that an adviser "has a duty to provide investment advice in the best interest of its client, based on the client's investment objectives."[41] This is the case regardless of the strategy the adviser follows. Indeed, advisers often manage

[37] While clients may authorize advisers to vote proxies on their behalf, those proxies are for securities in which the client invests and not, as Rule 13h-1 contemplates, securities that the client *issues*. Moreover, advisers vote their clients' proxies under their fiduciary duty and as part of their investment management services.

[38] Request for Comment 36. Proposal at 23077.

[39] We believe that withdrawal of these provisions and the clarification we request are necessary even if investment advisers are categorically excluded from the definition of "dealer," as discussed above. We are concerned that there is sufficient ambiguity in the Proposal that it could be read to apply to an adviser's clients even if the adviser is excluded. It is unclear how many client accounts would potentially be affected by the Commission's apparent construction of "control" in these provisions. Given the short comment deadline on the Proposal, we have been unable to obtain enough information to provide any estimates. Regardless of the number of potentially affected accounts, however, we ask that our concerns be addressed to eliminate ambiguity and reduce unintended consequences.

[40] We are also concerned that these provisions may be misinterpreted to capture the trading activity of advisers' client accounts where the adviser votes its clients' proxies (*i.e.*, exercises voting authority with respect to client securities owned by the client and held in the client's account over which the adviser has discretionary investment authority). Proxy voting by registered investment advisers is governed by Advisers Act Rule 206(4)-6. Such voting authority also would not be "control" under Rule 13h-1 and we do not believe that the Commission intended to capture these accounts.

[41] Proposal at 23074 n. 185.

different separately managed and pooled accounts under similar strategies for a variety of reasons. For example, clients may want to follow a similar strategy but prefer to invest in separate individual or pooled accounts with different terms and guidelines. Unless accounts are for the benefit of the same persons, they would typically have nothing to do with one another and likely would not even know which other accounts an adviser has.

As noted in the Proposal, a registered investment adviser's clients "are engaged in independent investment objectives and strategies and no individual client is engaged in trading activities for the benefit of any other client."[42] While the Proposal adds the conditional "in many instances" to this statement, this is *always* the case. An adviser's fiduciary duty is owed independently to each of these accounts, for which the adviser typically provides discretionary management. The Advisers Act appropriately requires that each client's account be segregated from the adviser's accounts and from other advisory client accounts. No one client is engaged in trading or other investment activity for anyone's benefit other than its own. We also strongly disagree with the Commission that accounts that follow similar strategies are, "in the aggregate … part of a single trading strategy." We believe that the proposed aggregation of parallel account structures does not accurately capture an adviser's obligations to its clients or the client asset-protection requirements under the Advisers Act. The Commission also has not fully considered or explained how dealer registration would work if unrelated client accounts need to be aggregated.[43] For these reasons, the Commission should eliminate the parallel account structure concept.

D. The Commission should focus on general anti-evasion principles rather than imposing dealer regulation on advisers and their clients out of concern that some persons could theoretically evade regulation

The Commission appears to be proposing application of an entirely new dealer regime on advisers and their clients – including existing advisers and their clients – out of a concern that advisers and other market participants could manipulate their and their clients' legal structures to evade the proposed dealer tests. While we appreciate the Commission's concerns about evasion, we believe that this excessively broad approach, which would capture certain investment advisers acting in the ordinary course of their fiduciary activities as well as certain of their clients, is neither justified nor warranted.[44] We do not agree that SEC-registered advisers that have a fiduciary duty to each of their clients are likely to use client accounts to effect such evasion.[45] We also do not understand how imposing regulation on existing advisers and clients

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[42] Proposal at 23075.

[43] The Proposal asks a series of questions about potential aggregation of accounts, but these questions do not address the practicalities of aggregation of client accounts and dealer registration, the potential effects of dealer regulation on an adviser's ability to continue to manage these accounts in the best interest of each client, or the effect on the clients' assets, among other things. *See, e.g.*, Requests for Comment 33-38.

[44] The Proposal mentions the possibility of evasion or avoidance of dealer regulation close to 40 times, but does not provide support for its theoretical concerns.

[45] *See* Request for Comment 34, Proposal at 23077.

based on a definition of "dealer" that today does not exist would prevent evasion. We believe that the Commission's concerns could be more appropriately and effectively addressed through adoption of a general anti-evasion provision – similar to that in Rule 13h-1(c)(2)[46] – that would work to capture market participants with intent to evade but would not limit the ordinary course activities of persons that have no such intent.

III. Conclusion

For the reasons discussed above, we urge the Commission to categorically exclude all SEC-registered investment advisers and their clients from the definitions of "dealer" and "government securities dealer." We appreciate the Commission's consideration of our comments on this important Proposal and would be happy to provide any additional information that may be helpful. Please contact the undersigned or Associate General Counsel Monique Botkin at (202) 293-4222 if we can be of further assistance.

Respectfully,

/s/ Gail C. Bernstein

Gail C. Bernstein
General Counsel

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Allison Herren Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
William A. Birdthistle, Director, Division of Investment Management
Haoxiang Zhu, Director, Division of Trading and Markets

[46] *See* General Request for Comment 49, Proposal at 23078. Rule 13h-1(c)(2) provides: "Under no circumstances shall a person disaggregate accounts to avoid the identification requirements of this section."