

# NEWS

## SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

(202) 272-2650



Keynote Address

to the

Investment Adviser Operations  
and Regulation Conference

Washington, D.C.

Investment Advisers and The Commission:  
Some Current Issues

June 20, 1984

James C. Treadway, Jr.  
Commissioner

---

The views expressed herein are those of Commissioner Treadway and do not necessarily represent those of the Commission, other Commissioners, or the staff.

## Introduction

Let's imagine for a moment that a mythical investment advisory company is holding its annual shareholders' meeting. Let's also assume that this mythical company is a holding company for every registered investment adviser in the United States. In effect, this mythical company is the investment advisory industry. What remarks would its Chief Executive Officer deliver at the annual shareholders' meeting? They might sound like this.

"Welcome to our 44th Annual Meeting. 1983 was an excellent year. We achieved record results in all areas of operation.

"Our subsidiary registered investment advisory companies increased by 2,049 to 7,816, a 36% increase over 1982. Assets under management increased to \$670 billion, up 49% from \$450 billion a year earlier. Based on our current projections, the number of our advisory subsidiaries will double in less than three years and assets under management will double every 3 1/2 years.

"As you know, your company is subject to the Investment Advisers Act, which requires registration with the Securities and Exchange Commission. The Act and its rules prohibit fraud, declare that we are fiduciaries, prescribe record-keeping requirements and disclosure of adviser qualifications, and provide for SEC inspections. Your company also is subject to detailed regulation at the state level. Thirty-seven states require the registration of investment advisers, and thirteen states require agents of investment advisers to register. Twenty-five states impose an examination requirement; thirteen states have minimum net capital requirements; and nineteen states have bond requirements.

"This two-tiered, non-uniform regulatory structure is burdensome, expensive and -- we believe -- unnecessary for effective investor protection. We are aggressively trying to persuade federal and state policymakers to lessen these burdens. We view this regulatory structure as the single most significant factor inhibiting our growth.

"In addition, certain of our competitors are unchecked by heavy-handed federal and state regulation. This disparity is unfair. We welcome competition, but all players should play by the same rules.

"Your company is well positioned for continued growth. I also can assure you that we will redouble our efforts to seek constructive changes in our regulatory system. The future looks bright. We appreciate your continued support."

### The Growth

This company is mythical, but the growth figures are not. This morning let's discuss the implications of such growth for the regulatory structure the mythical CEO termed so burdensome.

Much of the explosive growth -- the number of advisers and assets managed -- can be attributed to the "financial planner." Ten or fifteen years ago, the "financial planner" was rare. Suddenly, they are everywhere. Large brokerage houses have begun to offer "financial planning," and smaller entrepreneurs are also hanging out financial planning shingles. Three years ago the International Association for Financial Planning had less than 6,000 members. Today it has almost 18,000.

Thousands more individuals are enrolled in various financial planning instructional programs. Many or most will register as investment advisers. \*/ Many large banks are spinning-off their investment advisory services. When they do so, the new entity often must register as an adviser, further increasing the number of registered advisers.

Indeed, the increase in the number of investment advisers is partially responsible for a new industry within an industry: advisers who advise clients which advisers to use. These "money-manager advisers" or "selection advisers" track a manager's performance and compare it with the performance of other managers.

### Commission Initiatives

The increases in advisers has occurred during a time of federal budgetary constraint. That and other factors have prompted the Commission to take certain initiatives.

First, we are seeking to purge inactive advisers from our rolls. Since 1979 the Commission has cancelled the registration of 1,115 advisers who failed to keep their registration current. We are actively pursuing advisers delinquent in filing required annual reports. A monthly delinquency report is being developed, and we plan to proceed against any adviser that does not keep its registration current. In addition, if an adviser cannot be located or appears no longer to be in business, its registration will be cancelled.

---

\*/ In 1981 the Commission issued a release dealing with the circumstances which require financial planners, pension consultants, and other persons to register with the Commission. See Investment Advisers Release No. 770, August 13, 1981.

Another initiative involves inspections. Although the number of registered advisers has increased, the number of Commission personnel conducting inspections has not. In fact, total staff resources devoted to inspections in 1983 were slightly less than in 1979. The number of registered advisers per examiner staff year has doubled from 100 per examiner in 1979 to 200 today.

During the past two years, we have changed examinations in an effort to increase productivity without adversely affecting the quality of the program. For example, we now differentiate between high and low risk inspection candidates to reduce on-site examinations of advisers where the likelihood of substantive violations is demonstrably low. Certain low risk advisory services are inspected by mail, enabling us to increase the number of adviser inspections per staff year by almost 6%. \*/

We also are discussing with the North American Securities Administrators Association (NASAA) the possibility of states' playing a greater inspection role. Currently most states lack even a routine inspection capability. \*\*/ We stand ready to provide a training program for any states that would like to develop adviser examination capabilities and will make personnel available to be trained. These training programs will consist of several days of classroom instruction, followed by a period during which state personnel will accompany Commission examiners on adviser exams. We hope this will encourage states to establish examination programs as a way to deal with the dramatic growth in the number of investment advisers. We cannot afford to let our inspection and enforcement capabilities diminish in this rapidly expanding industry. Too many people and too much money are involved.

In a September, 1983 comment letter, the Investment Company Institute identified a "need for far greater uniformity of federal and state securities laws and regulation." Characterizing this as "a matter of substantial concern and importance," the ICI pleads for a greater effort by the Commission and NASAA to "make this long-neglected area a matter of the utmost priority." I agree, and the federal-state relationship is another Commission initiative. Fellow regulators must communicate on an issue by issue and ongoing basis. The Commission -- particularly our Division of Investment Management under the impressive leadership of Kathie McGrath -- has made that commitment of communication.

---

\*/ From 1979 to 1983 .

\*\*/ Thirteen states do not even require advisers to register.

Going forward, let me highlight a few other areas where progress is being made -- and will be made -- with respect to the federal-state relationship.

- o Uniform Adviser Registration System Based on a Uniform Application Form. The Division of Investment Management is working closely with NASAA's Adviser Committee to develop a uniform adviser registration system based on a uniform form. The NASAA Committee expects to recommend a uniform form, based on the Commission's Form ADV, by next Spring. If adopted by NASAA, the Commission could then adopt the form.
- o CRD and Computer Readable Form. Last Fall, members of the Division met with members of the NASAA Adviser Committee to consider developing a computer readable Form ADV and Commission participation in a central registration depository system for adviser filings patterned on the NASD/NASAA broker-dealer system. Certain improvements in the NASAA draft form were formulated and a revised draft will be circulated for comment soon.
- o More Communications About Commission Rulemaking and Exemptive Orders. The Commission's staff now routinely informs the NASAA Adviser Committee about the substance of staff recommendations when they are sent to the Commission and sends copies of all releases to the NASAA Committee. This encourages states to comment on rule proposals and alerts states to Commission rulemaking actions. In addition, we are developing procedures to increase communications with the states about possible Commission exemptive orders. \*/ This will serve, among other things, to alert the states about Commission exemptive orders involving new products. That will encourage state authorities to call us if they have concerns about any new products which may receive exemptions under federal law.
- o Exchanging Information on Registrants. Our staff sends a computer printout of advisers registered with us by state to the NASAA Committee for dissemination to interested states. We also will send state authorities the names of advisers who (1) withdraw from registration, (2) whose registration is terminated as inactive, and (3) whose past conduct results in denial or revocation of registration by the Commission. We hope for reciprocal assistance from states in locating advisers who are delinquent in annual filings with us or for whom we do not have current

---

\*/ Under the Investment Company of 1940 and the Investment Advisers Act of 1940.

addresses. In fact, the registration rolls of many states may be more current than ours.

- o Dual Registration Issue. Recently our staff met with members of the NASAA Adviser Committee and the NASD to discuss the activities of financial planners and persons who are registered representatives of broker-dealers (agents) and are separately registered as investment advisers. \*/ Our staff has been reviewing how Advisers Act requirements in general, and the Act's disclosure obligations in particular, should be applied to financial planners. This is also an area of concern to states. Some states already have taken action to prevent agents from registering as advisers (Nebraska) or to significantly restrict their ability to do so (Michigan). We hope our discussions with NASAA will identify possible uniform solutions to the problems we and the states have identified.
- o Liaison with the NASAA Adviser Committee on Other Matters. The Commission is trying to maintain liaison with the NASAA Adviser Committee on all the issues the Committee has identified for action.

#### Areas for Further Study

So much for present actions. Let's now shift to the future and two topics in particular.

A recent article in Forbes \*\*/ highlighted the fact that there is no accepted standard for computing an adviser's performance record. I concede that it is difficult to develop such a standard, and I question whether the Commission can or should try. But another point emerges. Those with substantial funds to manage have the power to obtain performance data from advisers. Others lack that influence. The Commission should be sensitive to the needs of all for certain investment data. While private firms track and publish performance results, they rely to a great extent on documents filed with the Commission to obtain the data on which their evaluations are based. Past performance is no guarantee of future results. Yet the Commission, as a disclosure agency, may be able to provide investors with increased disclosure data, thus facilitating comparisons among advisers. At the least, it is an issue for further consideration.

---

\*/ As I mentioned earlier, the greatest increase in adviser registrations involves financial planners, many of whom are also agents of broker-dealers.

\*\*/ Balwin, "Who's Keeping Score," Forbes, June 18, 1984, at 147.

NASAA's Committee on Investment Advisers has organized an Industry Advisory Group composed of representatives of the Investment Company Institute, the Investment Counsel Association of America, the Financial Analysts Federation, the Institute of Chartered Financial Analysts, the Institute of Certified Financial Planners, and the International Association for Financial Planning. This Group recently sent a letter to NASAA's Committee on Investment Advisers expressing their "complete consensus" on a host of matters under debate. They

- o support efforts to revise the SEC's adviser form;
- o oppose any adviser examination requirement;
- o oppose the registration of individual advisory agents;
- o seek to exempt "experienced advisers" from state registration;
- o oppose bonding and net capital requirements; and
- o oppose efforts to establish a code of unethical business practices.

The absolutist approach implicit in those positions seems to be a substantial rejection of governmental regulation and effective self-regulation alike. As a word of friendly caution, I would suggest that when it comes to the handling of the funds of others, a public interest clearly exists. The most effective way to avoid governmental regulation may be to preempt it with effective self-regulation. I would suggest that those who are seriously concerned with the image and professionalism of the adviser industry might find it useful to debate whether these positions are productive in the long run.

### Conclusion

The growth in investment advisers may bring more experience and expertise in managing money to more Americans. But that growth has and will exert more pressure on the Commission and the industry to assess the continued vitality of our present approach to regulation. If the potential for harm appears, a new approach -- perhaps including new regulations or statutory authority -- may be necessary. On the other hand, a strong and thoughtful response by the adviser industry may head off demands for increased government regulation.

Let us not forget the statistics I mentioned at the outset. You are a \$670 billion industry, projected to reach \$1.3 trillion in only 3 1/2 years. You have much public trust in your hands and much responsibility on your shoulders. I hope that we all can work together in a coordinated and thoughtful fashion toward the right solutions.

Thank you.

\* \* \* \* \*