
FINANCIAL PLANNERS

**Report of the Staff of the
United States Securities and Exchange Commission
to the
House Committee on Energy and Commerce's
Subcommittee on Telecommunications and Finance**



The Commission has authorized publication of this report
but has expressed no view on the findings it contains.

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 12, 1988

The Honorable Edward J. Markey
Chairman
Subcommittee on Telecommunications
and Finance
Committee on Energy and Commerce
H2-316 House Office Building
Annex II
Washington, D.C. 20515

The Honorable Matthew J. Rinaldo
2469 Rayburn House Office Building
Washington D.C. 20515

Dear Chairman Markey and Congressman Rinaldo:

I am pleased to transmit Financial Planners: Report of the Staff of the United States Securities and Exchange Commission to the House Committee on Energy and Commerce's Subcommittee on Telecommunications and Finance. The report is a study of the financial planner industry, and is in response to the Subcommittee's July 9, 1986 request. It examines a number of areas relating to the financial planner industry, including: customer demographics, characteristics of planners, and the regulatory program for registering and inspecting planners. The report also evaluates the National Association of Securities Dealers' pilot program to inspect NASD members who are also investment advisers.

The report, which was prepared by the Commission's staff, has not been reviewed by the Commission and does not represent the Commission's views.

Sincerely,

A handwritten signature in cursive script that reads "David S. Ruder".

David S. Ruder
Chairman

Enclosure

cc: The Honorable John D. Dingell
The Honorable Norman F. Lent

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I. INTRODUCTION

The Securities and Exchange Commission ("SEC") staff has prepared this report at the request of the House Committee on Energy and Commerce's Subcommittee on Telecommunications, Consumer Protection and Finance ("Subcommittee"). 1/

The Subcommittee requested the SEC to study further the questions concerning the financial planner and investment adviser industry that were raised during the Subcommittee hearings. 2/ The Subcommittee generally requested a report of the status of the industry, including the "degree of abuse." The Subcommittee also requested specific information on the demographics of planner/advisers, their customers and other characteristics of planner/advisers, including compensation, registration, and oversight by regulators. Finally, the Subcommittee asked for an evaluation of the National Association of Securities Dealers' ("NASD") pilot program to inspect certain NASD broker-dealers also registered as investment advisers with the SEC. The NASD pilot program was intended to test whether the NASD should seek to expand the NASD's jurisdiction to include regulation of some aspects of the investment advisory business of member firms.

This report addresses both the general and specific questions posed by the Subcommittee. Chapter II, Summary, summarizes the findings of the report. Chapter III, Overview, describes the methods used to collect the data used in the report. Chapter IV, Methodology, offers a brief description of the financial planner industry. Chapter V, Findings, responds to the Subcommittee's questions. A subchapter discussing the SEC's enforcement program concerning investment advisers is included in the Findings chapter in response to the Subcommittee's concern about abuse in the planner/adviser industry. Chapter VI, NASD Pilot Project, evaluates the NASD's pilot inspection program. Appendix A,

1/ That request, contained in a July 9, 1986, letter to the Chairman of the SEC from former Subcommittee Chairman Timothy E. Wirth and Ranking Minority Member Matthew J. Rinaldo, is attached as Appendix C. On January 1, 1987 at the inception of the 100th Congress, 1st Session, the name of the Subcommittee was changed to the Subcommittee on Telecommunications and Finance.

2/ Investment Advisers, Financial Planners and Customer Protection: Hearing Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce, 99th Cong., 2d Sess. (1986) [hereinafter Investment Adviser, Financial Planner Subcomm. Hearings].

History of the Investment Advisers Act, presents the history of the Investment Advisers Act of 1940 ^{3/} (the "Advisers Act"). Appendix B, The Operation of the Investment Advisers Act, describes the present statute.

Appendix C is a copy of the letter from former Subcommittee Chairman, Timothy E. Wirth, and Ranking Minority Member, Matthew J. Rinaldo, requesting the report. Appendix D is a glossary of terms. Appendix E is a copy of Form ADV.

^{3/} 15 U.S.C. § 80b-1 et seq.

II. SUMMARY

The report first describes the methodology used to gather data in response to the Subcommittee's questions. Four basic data sources were used. Data derived from the second, third and fourth sources were limited to those financial planners over whom the SEC has regulatory jurisdiction, i.e., those planners who are investment advisers.

- 1) Data found in the literature: A review was made of industry and academic studies, surveys, articles, and news reports concerning financial planners (the "literature"). This source provided information about financial planners generally, and about planners who belong to particular professional associations.
- 2) The SEC's own data: The SEC tapped the computerized database of information investment advisers include in the form used by advisers to register with the SEC (Form ADV), and the computerized database of enforcement matters found in the Case Automated Tracking System ("CATS").
- 3) Data generated specifically for the report: To supplement data already in existence, the SEC a) conducted special inspections of 100 registered investment advisers who were also financial planners; b) specially reviewed all SEC reports of inspections of investment advisers conducted in 1986; and c) specially reviewed a random sample of Form ADV of advisers who were also financial planners and who were registered with the SEC on March 30, 1987.
- 4) The NASD pilot review: The NASD conducted special investment adviser inspections of a selected number of volunteer NASD broker-dealer members who also are registered investment advisers. The SEC reinspected some of the firms to evaluate the NASD's performance.

The findings of the report are presented next. With regard to questions concerning financial planner clientele, the report finds, among other things, that the "typical" client of a financial planner is male, middle-aged, married, working as a business person or a professional, generally college educated, and

relatively well off. With regard to the characteristics of planners, the report finds, among other things, that most financial planners work independently or for small business organizations, that generally they are located in major metropolitan areas, that the average individual planner is male, middle-aged and college educated. There are no federal qualification standards or qualifying examinations for investment advisers or financial planners per se, but many planners are members of trade associations or professions that do have standards or examinations. The report also finds that a significant "other business" of many financial planners is the sale of financial products ^{4/} and that, accordingly, a large percentage of financial planners derive an important part of their income from commissions on sales of financial products. The products found to be most frequently sold are mutual funds, limited partnership interests, and insurance products.

Next, the report describes the registration requirements for financial planners under federal and state law and with self-regulatory organizations. Financial planners have to register with the federal government only if they are investment advisers within the meaning of the Advisers Act, or if they are broker-dealers as defined by the Securities Exchange Act of 1934 ("the Exchange Act"). The same is generally true with respect to state registration requirements. Some states, however, require that individuals register as investment advisers, as well as firms. The federal registration requirement only reaches firms; individuals employed by registered advisers do not have to register separately. The Advisers Act does not provide for the establishment of self-regulatory organizations for investment advisers, but there are a number of trade and professional associations to which advisers may belong.

The report also describes the SEC's program for conducting on-site inspections of registered investment advisers and provides information about the types of deficiencies typically found. The largest number of deficiencies comes from failure to make or maintain accurate books and records, or to keep or provide to clients accurate, timely and adequate registration information. These deficiencies typically are addressed through "deficiency letters" or other internal means, rather than through enforcement actions. The discussion of enforcement actions brought against financial planners by the SEC discloses that the majority of cases charge fraud, with the more serious or

^{4/} If the products sold are "securities" the planner is required to be registered with the SEC as a broker-dealer, or with a securities industry self-regulatory organization as a registered representative of a broker-dealer.

repeating record keeping violations also an important basis for bringing cases.

Finally, the report describes the results of a pilot inspection program conducted jointly by the NASD and SEC inspections staff. The advisers inspected were affiliated with NASD broker-dealer member firms, and had volunteered to be part of the program. The pilot demonstrated both the feasibility and ability of the NASD inspectors to conduct adviser examinations.

The report also includes five appendices. Appendix A provides a review of the history of the federal government's regulation of financial planners. Appendix B offers a description of the present federal regulatory scheme. As is set forth in these Appendices, the federal government has never regulated financial planners per se, but has regulated those planners whose activities meet the definition of "investment adviser" in the Advisers Act or "broker-dealer" in the Securities Exchange Act. ^{5/} Federal regulation of investment advisers began with the 1940 passage of the Advisers Act, and continues to this day. The original statute required little more than a federal registry of investment advisers. The Advisers Act has been amended several times, with the most recent and extensive amendments coming in 1970. The current Advisers Act is far more comprehensive than the original in the scheme it imposes, and contains disclosure, record keeping and antifraud provisions.

The remaining appendices make various sections of the report easier to understand because they contain the particular form or letter often referred to, or they define and give background on the terms or trade association acronyms frequently used. Appendix C is a copy of the letter from former Subcommittee Chairman, Timothy E. Wirth, and Ranking Minority Member, Matthew J. Rinaldo, requesting the report. Appendix D is a glossary of terms, including financial planner trade and professional associations. Appendix E is a copy of form ADV, which advisers that are registered with the SEC are required to complete and which constituted the data base for a significant portion of the information contained within the report.

^{5/} 15 U.S.C. §§ 78a-78jj.

III. OVERVIEW

Before describing the findings of this report, a brief discussion of the financial planning industry's place in the universe of investment advisers, and of the "typical" business environment in which financial planners function, may be helpful.

The term "financial planner" is not a precise term and includes a wide spectrum of advisory activity. An insurance agent may call himself a financial planner; so may a tax accountant, or a securities salesperson employed by a broker-dealer, or indeed anyone who wishes to use the term.

Since the passage of the Advisers Act, 6/ the SEC has regulated those entities in the segment of the financial planning community that meet the definition of "investment adviser" found in the Advisers Act. Investment advisers generally must register with the SEC and are subject to the provisions of the Advisers Act. Registered investment advisers include firms employing thousands of people, as well as small firms, as well as individuals. Broker-dealers must also register with the SEC and are subject to the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The primary focus of this report is an examination of financial planners who are investment advisers.

The definition of "investment adviser" in the Advisers Act 7/ is lengthy, complex and punctuated by exceptions, but generally the Advisers Act defines an investment adviser to be any person who is in the business of giving advice about securities for compensation. Many financial planners fit this definition, 8/ but it is important to emphasize that not all investment advisers are financial planners, and not all financial planners are investment advisers.

The number of investment advisers registered with the SEC has grown in recent years, 9/ perhaps due to the increase in the number of people engaged in financial planning. The SEC is not able to correlate precisely the rise in registrations with the

6/ The Advisers Act was passed in 1940 as Pub. L. No. 76-768, 54 Stat. 847.

7/ Section 202(a)(11), 15 U.S.C. § 80b-2(a)(11).

8/ See Investment Advisers Act Rel. No. 1092 (Oct. 8, 1987).

9/ Table 15 sets forth the registration figures. Chapter V.D, infra.

rise in financial planners because, until 1986, the SEC did not keep separate track in the registration database of investment advisers who identify themselves as financial planners. In addition, the number of advisers that register is only roughly correlated with the number of individuals engaged in the industry, since frequently a firm rather than its individual employees will register. Firms range in size from one individual to thousands of individuals.

People who give personal investment advice may be divided roughly into three groups depending upon the principal type of service they provide to clients. These groups are: discretionary money managers, non-discretionary money managers and financial planners. Some overlap exists among these groups, because an adviser can provide more than one type of service. For example, an adviser can also provide either discretionary or non-discretionary money management services, and many discretionary money managers also provide non-discretionary money management services.

A discretionary money manager's primary activity is to manage on a day-to-day basis a pool of liquid assets provided by a client in accordance with mutually agreed upon investment objectives. Thus, a discretionary money manager will invest and reinvest client assets without obtaining the client's prior approval as to the investment itself, or of the broker selected to effect the transaction, or of the commissions paid to the broker. Mutual funds and pension funds are serviced by discretionary money managers, as may be individual clients. Discretionary money managers usually are compensated on the basis of a percentage of the assets they manage for the client.

A non-discretionary money manager will often provide the same services as a discretionary money manager -- with one important exception: before the non-discretionary money manager may purchase or sell a security for a client's account, the non-discretionary money manager must first obtain the client's consent to effect the transaction.

Unless a money manager is a bank or broker-dealer, the money manager, discretionary or non-discretionary, is almost certainly required to register as an investment adviser under the Advisers Act, because the essence of the activity is to render advice regarding the purchase and sale of securities for compensation.

A financial planner usually does not manage client assets. Instead, the planner's primary service is to prepare a financial plan for the client, and to offer advice as to the purchase or sale of specific financial products appropriate to the implementation of the plan. As the name connotes, the planner's function

includes helping the client plan an investment strategy. 10/ If the advice given by the planner includes advice about securities (including limited partnerships, mutual funds and variable annuities), and if the planner is not exempted from registration under the Advisers Act, 11/ the planner is required to register as an investment adviser under the Act. 12/

The financial planning process is an individualized process that usually starts with an in-person interview of the client in which certain basic information is collected by the planner. The client is then usually given a detailed questionnaire to complete. The questionnaire requests information such as a client's current income, financial position, assets owned, family situation, insurance policies owned, and financial goals. The information from the questionnaire is then usually entered into a computer program, either directly by the planner or by a service bureau. 13/ For those planners who use computer programs, the output from the computer program usually forms the basis of the client's financial plan.

10/ Nothing prohibits a planner from also managing client assets. Of the 7,023 planners registered as investment advisers with the SEC as of October 1, 1987, approximately 700 (or about 10%) said that they provided discretionary money management services, and approximately 1,400 said they provided non-discretionary money management services.

11/ See infra Appendix B, text accompanying notes 26 to 29.

12/ As discussed elsewhere, there are a far greater number of people who are reported to be financial planners than are registered as investment advisers under the Act. The reasons for this discrepancy are discussed infra Chapter V.D.

13/ About 36% of the planners inspected by SEC staff in a random sample of 100 investment advisers registered with the SEC, reported that they prepared their plans without the extensive use of a computer, 60% were found to use an in-house computer to generate the plan, and 4% sent client information to a service bureau. [Hereinafter the data from these inspections is cited as the SEC Special Planner Inspections.] See infra Chapter IV.C.

Once the financial plan has been prepared it is presented to the client, usually in writing, coupled with an oral discussion. 14/

The content of financial plans varies from planner to planner. Most financial plans contain fairly general recommendations regarding the allocation of client assets among various kinds of investments. Seldom are specific securities or other products identified or recommended in the plan.

With some financial planners the process ends with the presentation of a financial plan, for which the planner is compensated by a fee. 15/ In the more typical situation, however, once the client is presented with the plan, the implementation of the plan includes the purchase of investment or insurance products specifically recommended by the planner, often from a product sales organization affiliated with the planner. Thus the planner may be affiliated with a broker-dealer, or with an insurance company, or both. And the planner's remuneration from the client may come more from commissions on the sale of products than from the fees generated by the preparation of the plan. 16/

The client may not always be aware of the product-sales tie-in to the planning activity. The tie-in can be obscure if the relationship is structured in a way that suggests that separate entities are engaged in the recommending and selling activities. Thus, in a hypothetical situation, the financial planning could be conducted by one or two individuals acting through an entity named (for example) "John Jones and Associates." The product sales activity could then be performed by the same individuals

14/ The SEC Special Planner Inspections found that 81% of the planners inspected present the plan in this manner. Another 16% provide an oral presentation only. Three percent provide the plan in writing without an oral discussion.

15/ The compensation of planners is discussed infra Chapter V.C.1.

16/ A study by the Consumer Federation of America of 30 financial planners in the Washington D.C. area found that it was not unusual for the planner to tell clients that investment recommendations could be given in a "free" brief meeting, in return for which the client would implement the planner's recommendations through the planner. The planner's compensation would then come from commissions on the sale of products. B. Roper, Financial Planning Abuses: A Growing Problem 17-18 (1987) (Report of the Consumer Federation of America) [hereinafter CFA Report].

operating under a different name -- "JKL Securities, Inc." The client may be unaware either of the relationship between the two entities or that the planner's remuneration is based on the kind of and number of products sold. 17/

In sum, the financial planning industry includes investment advisers as defined by the Adviser's Act, but does not consist exclusively of investment advisers. Conversely, not all investment advisers are financial planners. Financial planners are less likely than others rendering investment advice to manage customer funds and assets, but some do. Many, but not all, financial planners also sell or are affiliated with organizations that sell, financial products.

17/ The SEC Special Planner Inspections found that 47% of the planners informed prospective clients that they sold financial products, but that 85% actually sold products to clients. For a discussion of the disclosure requirements to which investment advisers are subject see infra Chapter V.C.3. One such requirement is that advisers disclose their financial interest in products they sell, but the disclosure is not always made or made clearly. Misstatements of such information by an adviser could result in charges being brought against it by the SEC pursuant to the disclosure and anti-fraud provisions of the Advisers Act. See infra Chapter V.F. and Appendix B.

IV. DATA SOURCES AND METHODOLOGY

The report used data from a variety of sources as described in this chapter.

Four major information sources were used: 1) published and unpublished reports ("literature"); 2) SEC in-house data, including the SEC's Form ADV database (the "ADV Database"), and a review of adviser deficiencies identified by the SEC's 1986 adviser inspections program (the "SEC 1986 Inspection Report Review"); 18/ 3) SEC inspections of a random sample of 100 registered investment advisers (the "SEC Special Planner Inspections"); and 4) a pilot review of adviser affiliates of NASD member firms conducted by the NASD (the "NASD Pilot Review").

A. Literature Review

The literature review consisted of collecting, examining, and summarizing the available literature on financial planners and investment advisers. The material spans several years, represents widely diverse viewpoints and ranges from the popular press to academic journals.

Surveys conducted by various industry associations proved particularly useful, although somewhat limited in scope because most surveys were confined to the associations' members. 19/ The surveys adduced detailed information about financial planners, their businesses, and, to a lesser extent, their clients. "Non-membership" surveys, *i.e.*, surveys that cut across membership lines, helped to characterize the industry more generally since their scope was not limited to certain memberships. While the surveys taken together provided a wide array of useful material, their results could not easily be compared because each used different questions and different methods of recording the data. For example, one survey might categorize the age of planner clients as being in the "21 to 35 age group", while another might categorize the age group as "25 to 39." However, the survey results can be compared in a general way to provide useful information, both for an understanding of the industry and for comparison with the empirical reviews conducted for this report.

18/ Form ADV is discussed *infra* Appendix B, text accompanying notes 30 to 37. The SEC's inspection program is discussed *infra* Chapter V.E.

19/ A glossary of terms, including financial planner trade and professional associations, is provided in Appendix D.

B. ADV Database

The Act's requirement that advisers register with the SEC on Form ADV is described in Appendix B. 20/ The SEC keeps a computerized and constantly updated database of some of the information contained in the Form ADV. Unless otherwise noted, the ADV figures cited in the report are current as of September 30, 1987. At that time registered advisers totalled approximately 12,700. Over half of the registered advisers stated on the Form ADV that they provided financial planning services.

C. SEC Special Planner Inspections

1. Background

To collect in-depth, field-verified information on financial planners -- information not available from the literature or available databases -- the SEC's Division of Investment Management and SEC regional offices performed special inspections of a random sample of 100 advisers registered with the SEC, who stated on Form ADV that they offered financial planning services. 21/ The advisers registered with the SEC constitute the largest pool of identifiable "financial planners" registered with any regulatory body and thus provide a larger and more balanced sample than is otherwise available. In addition, the staff chose to inspect registered planners because the SEC clearly had jurisdiction over these planners for inspection purposes, allowing access to their books and records. The collection of information could also be "piggy-backed" onto the SEC's standard, on-site adviser inspection program.

The inspections took place from February to April, 1987; each took, on average, about four days in the field to complete.

20/ See infra Appendix B, "Registration as an Investment Adviser".

21/ The sample was selected from a list of all registered advisers who reported on their Form ADV that they provide financial planning or some similarly termed services. (See Appendix E, Item 20 on Part 1 of the Form ADV.) The number of advisers on that list was divided by 100 to obtain a quotient. The staff then selected planners, starting from the top of the list, with the frequency of that quotient, to obtain a random sample of 100. The inspections disclosed that only 81 of the 100 planners inspected were actively engaged in any type of advisory business. The other 19 were either in a business start-up phase or were inactive.

A typical adviser inspection, on the other hand, takes about two days.

The completed inspection outlines (described below) were sent to headquarters staff, where the data were entered in a computerized database for the purpose of tabulation and analysis.

2. Inspection outlines

The inspection outline that was used to collect the information gathered in the SEC Special Planner Inspections was divided into three parts: the registrant; clients; and the products sold by the registrant to clients. 22/

a. Registrant outline

The registrant outline sought to elicit information about the registrant's business. Items covered in the registrant outline included information on registration, organization, staffing, education, qualifications, clients, financial plan preparation, services provided, compensation, other businesses, types of products sold, and the registrant's financial interests in those products. Several items in the outline sought information about financial product sales activities of the registrant. Sales activities were of special interest because, as is discussed below, 23/ advisers who also sell financial products have a potential conflict between their duty to provide objective advice and their desire to sell products to their clients. The registrant itself answered the registrant outline. The SEC inspector then reviewed the data and followed up where needed.

b. Client outline

The client outline was used to elicit information about the clients of the inspected registrants. Client information is difficult to obtain because planners are reluctant to divulge the names of their clients, and the Paperwork Reduction Act 24/ discourages direct consumer surveys. The SEC examiners used

22/ The outlines were written by SEC headquarters staff, pre-tested both by headquarters and field staff, and then offered to the SEC field inspectors for comment. In this process outlines were revised several times before they were used to conduct inspections.

23/ See infra Chapter V.B.4., "Other business activities;" and Chapter V.C.1, "Compensation."

24/ 44 U.S.C. § 35 et seq.

clients' files to complete the outline but no individual clients were contacted. Items covered in the client outline included marital status, education, occupation, age, investment income, earned income, net worth, reason for seeking financial advice, investment objectives, the financial plan generally, special recommendations of the financial plan, commissions paid for products other than the plan, and the cost of the plan itself. In all, outlines were completed for 924 clients.

c. Financial product outline

The product outline explored the types of financial products bought from the registrants by the registrants' clients who were studied in the client outline. The information for the product outline was found in the files of the registrant, including the client files. Items covered in the outline included the type of product, whether and where it was registered, risk and liquidity, the amount invested by clients, and the total compensation provided to the registrant for sale of the product. An outline was prepared for each product purchased by a client, but duplicate product outlines were not prepared. Thus, regardless whether one, or fifty, or two hundred clients purchased a particular product, only one outline was completed for that product. Outlines were completed for 724 products, which means that the sampled clients of the sampled firms collectively purchased 724 products. The number of clients that purchased a product was also recorded on the product outline of that product. Thus, for example, if thirty clients purchased xyz product, that fact was included in xyz's product outline. The outline did not, however, record the total volume sold (in terms of shares, units, interests) of each product.

D. SEC 1986 Inspection Report Review

The adviser inspection reports, prepared by SEC inspectors as part of the SEC's regular inspection program, were another source of information for the report. The SEC's Division of Investment Management reviewed all adviser inspection reports completed during calendar 1986 -- a total of 1,337 reports. A coding sheet was then completed for each inspection of an adviser who could be identified as a financial planner -- 294 in all. 25/

25/ The number of advisers who were planners may actually have been higher because the inspection reports themselves do not necessarily identify an adviser as a financial planner. Information about an adviser's type of business is not usually noted in an inspection report unless that information relates to a deficiency in the adviser's operations. Starting in fiscal year 1988, the adviser's type of business
(continued...)

The coding sheet was used to compile a 1986 inspection data-base containing the name of the registrant, location, assigned regional office, date of the inspection, types of deficiencies found, financial products sold, and any identified associations with either broker-dealers or insurance companies.

The coding sheets from these 294 inspections were analyzed to determine both the composition of the inspected group of financial planners and the deficiencies that were found. The deficiencies reported were then categorized under the twelve standard SEC adviser inspection focus areas. ^{26/} This information was used to supplement the information obtained in the SEC Special Planner Inspections.

E. 1987 Form ADV Review

A random sample of 100 planners was drawn from a listing of 6,022 advisers registered with the SEC on March 30, 1987, who had answered "Yes" to the question whether they provided financial planning services. Using a table of random numbers, a staff member picked the number 59. Starting with the fifty ninth planner on the list, every sixtieth planner was identified. The Forms ADV for these 100 planners were retrieved and reviewed to determine the kind of disclosures these planners made on Form ADV regarding their financial interests in products sold to clients.

F. NASD Pilot Review

The NASD announced in May, 1986, that it would perform a pilot inspection program to explore the feasibility of becoming a self-regulatory organization for the advisory activities of NASD members. On the national level the oversight and inspection of advisory activities is currently performed only by the SEC. Nearly half of the SEC registered advisers are also either registered with the SEC as broker-dealers or are affiliated persons of registered broker-dealers, and are thus "dual registrants." The broker-dealers are also members of the NASD. From the NASD member firms that volunteered to participate in the pilot inspection program, the NASD chose to inspect a diversified group of 50 firms of which 46 firms were actually inspected. Of these, 33 were actively engaged in financial planning. The inspected group included both large and small members.

^{25/}(...continued)
will be noted in the inspection reports.

^{26/} These focus areas are described more fully infra Chapter V.E.2.a.

Following an orientation conducted by the SEC, NASD inspectors conducted the inspections. The NASD then furnished the Division with the results of the inspections of the 33 active firms. The SEC evaluated the NASD inspections by re-inspecting 15 of the 33 NASD inspected firms using experienced SEC regional office inspectors. To assure a fair comparison, the SEC inspectors were not given copies of the NASD inspection reports. Then the SEC headquarters staff reviewed the 33 reports and accompanying work papers of the NASD inspections and compared the NASD results with the results of the inspections of the 15 firms re-inspected by the SEC regional offices. 27/

27/ For a more comprehensive discussion of the NASD Pilot Project, see infra Chapter VI.

V. FINDINGS

This part of the report responds to the questions posed by the Subcommittee. It is organized into seven sections. Six are in this Chapter: A. customer demographics; B. adviser characteristics; C. compensation of advisers; D. registration of advisers; E. inspection of advisers; and F. enforcement. The evaluation of the NASD pilot program is found in Chapter VI.

A. Customer Demographics

The Subcommittee posed the following questions concerning customer demographics:

What are the demographic characteristics of financial planner/adviser customers?

Are the customers individuals or institutions?

If the customers are individuals, what is their: income level, educational background, reason for seeking financial advice generally and for selecting a particular planner/adviser, and previous financial experience?

The report presents information responsive to all of these questions except the last, which asked for data on the customer's previous financial experience. No information responsive to that question could be compiled within the scope of the report, which relied on information in the literature and obtained from planners, and not on information derived from direct contacts with clients. Other information about customers, such as income, net worth, and education was available, however. This information provides some idea of a customer's financial sophistication relative to the general population -- most probably the concern underlying the Subcommittee's question. The report also includes information on the knowledge and attitudes of customers concerning the regulation of financial planners.

The discussion of "Customer Demographics" is organized into seven topics: 1) "Client type," which discusses whether the customers are individuals or institutions; 2) "Demographics," which describes the age, sex, and marital status of customers; 3) "Profession," which describes the customers' occupations; 4) "Financial condition," which includes customer income and net worth; 5) "Education," which describes the educational level of customers; 6) "Reasons for seeking advice," which discusses why customers seek financial advice and why they choose a particular planner; and 7) "Consumer Satisfaction," which describes client satisfaction with planner services.

1. Client type

This section discusses the types of client that are served by advisers generally and financial planners specifically. The ADV Database was the source of this information. 28/

From information in the ADV Database, it is possible to divide adviser customers into six categories: 1) individuals; 2) corporations; 3) pension/profit sharing plans; 4) trusts, estates, and charities; 5) banks and thrifts; and 6) investment companies. Most advisers provide advice to more than one type of client. Of the total 12,700 advisers in the ADV Database, 85% advise individuals, 58% advise pension/profit sharing plans, 54% advise corporations or business entities, 45% advise trusts, estates, or charities, 14% advise banks and thrifts, and 13% advise investment companies.

Advisers can be separated roughly into two categories: advisers who are planners and those who are not. Individuals are by far the most common type of client for both. Table 1 sets out the percentage of planners and non-planner advisers who advise the various types of client.

Table 1

PERCENTAGE OF ADVISERS WHO
PROVIDE ADVICE TO THE FOLLOWING
TYPES OF CLIENT*

<u>TYPE OF ADVISER</u>	<u>TYPE OF CLIENT</u>					
	<u>Individuals</u>	<u>Corporations</u>	<u>Pension Profit Sharing-Plans</u>	<u>Trusts, Estates, Charities</u>	<u>Banks and Thrifts</u>	<u>Investment Companies</u>
Financial Planners	98	61	57	42	9	5
Non- planners	70	46	60	49	20	23
Total	87	55	59	46	14	

Source: ADV Database

* Totals add to more than 100% because many advisers provide advice to more than one type of client and Form ADV requires the adviser to disclose all of the types of client to which it provides service.

The figures disclose that virtually all (98%) financial planners in the ADV Database give advice to individuals, although individuals are by no means their only clientele. More than half advise corporations and pension/profit-sharing plans, and almost half (42%) advise trusts, estates and charities. Only a small percentage advise banks and thrifts, and investment companies.

2. Demographics

This section describes the age, sex, and marital status of clients. The literature and SEC Special Planner Inspections were the sources of this information.

a. Age

A few professional associations have conducted membership surveys which include the age of their members' clients. The International Association for Financial Planning ("IAFP") conducted a membership survey in 1985 which reported the average client age to be 45 years. 29/ In a 1984 survey of National Association of Life Underwriters ("NALU") members, three out of four agents said that they primarily marketed to clients between the ages of 35 and 55. 30/ The IAFP's general population consumer survey revealed that 65% of high income (\$50,000 or more annual income) customers were between 35 and 54 years of age, 19% were under 35, and 16% were over 55 years of age. 31/

The SEC Special Planner Inspections were consistent with the membership surveys in finding that most planning clients are middle-aged. The average age of financial planning clients in the inspected firms was 48.5 years and their spouses were an average of 45.4 years.

The typical client of a financial planner is thus most likely middle-aged (between 35 and 55 years old), and older than

29/ Int'l Ass'n for Fin. Planning, 1985 IAFP Membership Survey Summary 11 [hereinafter 1985 IAFP Membership Survey].

30/ Nat'l Ass'n of Life Underwriters & Life Ins. Mktg. and Research Ass'n, The U.S. Survey of Agency Opinion, Volume 1: Sales Practices 15 (J. Kissane ed. 1985) [hereinafter 1985 NALU-LIMRA Survey].

31/ Reichman Research, Inc., IAFP Consumer Survey on Fin. Attitudes, Table 22 (responses to Q.5F) (June 1987) [hereinafter 1987 IAFP Consumer Survey on Fin. Attitudes].

the median age of the United States resident population (31.5 years). 32/

b. Sex, marital status

The few published membership and consumer surveys and the SEC Special Planner Inspections results all indicate that the "typical" planner client is likely to be male and is likely to be married. The IAFP membership survey found the typical client ratio to be 67% male and 33% female. 33/ The IAFP general population consumer survey reported that, of those who presently use financial planners, 57% were male and 43% were female. 34/ Interestingly, among the present financial planning clients identified as high income earners, only 47% were male and 53% were female.

Financial planning clients tend to be married. A study of client profiles administered for the Institute of Certified Financial Planners ("ICFP") showed that the majority of the ICFP members' financial planning clients were married. 35/ Similarly, the IAFP membership survey revealed that 80% of the clients were married. 36/ The IAFP consumer survey found that 84% of the high income respondents who presently use a financial planner were married. 37/

The SEC Special Planner Inspections showed similar results: 77% of the clients reportedly were married, 16% were single (never married), and 7% were divorced.

32/ Bureau of the Census, U.S. Department of Commerce, Statistical Abstract of the United States 17 (107th ed. 1987) [hereinafter Statistical Abstract].

33/ 1985 IAFP Membership Survey, supra note 29, at 11.

34/ 1987 IAFP Consumer Survey on Fin. Attitudes, supra note 31, at Table 22 (responses to Q.5F).

35/ T. Hira, H. Van Auken & D. Norris, Financial Planning Consumers: Who Are They, Why Do They Buy?, 7 J. Inst. Certified Fin. Planners 221, 223 (1986) [hereinafter Financial Planning Consumers].

36/ 1985 IAFP Membership Survey, supra note 29, at 11.

37/ 1987 IAFP Consumer Survey on Fin. Attitudes, supra note 31, at Table 22 (responses to Q.5F).

3. Profession

Only two sources found in the literature provided quantitative data about the professions of planner clients. Thirty-four percent of the IAFP members' clients reported being business owners, 31% corporate employees, 15% professionals, and 9% retirees. 38/ The study of ICFP client professions reported that 35% were business owners, 30% corporate employees, 25% professional, government, or educators, and 7% retirees. 39/

The SEC Special Planner Inspections found a somewhat different profile of planner client occupations. They found that the most common occupation of financial planning clients was business/legal professional (30%). The next largest segment of clients was retired persons (13%); followed by medical professionals (13%) and technical professionals (13%); 9% of the clients were proprietors of a business; 6% were academics; and 6% worked in the service industries. The professions were somewhat different among the clients' spouses. One-third (36%) of the clients' spouses were homemakers; 13% were business/legal professionals; 12% worked in service industries; 10% were academics; 9% were medical professionals; and only 7% were retirees. Table 2 summarizes the SEC Special Planner Inspections' information on occupations.

38/ 1985 IAFP Membership Survey, supra note 29, at 11. Eleven percent were "Educator, Military/Government, or Other."

39/ Financial Planning Consumers, supra note 35, at 224.

Table 2

EMPLOYMENT OF CLIENTS AND THEIR SPOUSES

	<u>Client</u>		<u>Spouse</u>	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Business/professional	276	30	82	13
Retired	123	13	45	7
Technical professional	120	13	21	3
Medical professional	116	13	54	9
Proprietor of a business	80	9	28	4
Academic	55	6	61	10
Service industry worker	54	6	74	12
Factory worker	24	3	0	0
Not employed	21	2	24	4
Government	18	2	12	2
Homemaker	12	1	224	36
Armed forces	7	1	1	0
Construction worker	6	1	1	0
Farmer	4	0	2	0
	-----		-----	
Totals	916		629	

Source: SEC Special Planner Inspections
Item 3 of Client Outline

While a disparity exists between the percentage of clients who are business owners reported in professional association surveys (approximately 34%) and the percentage reported in the SEC Special Planner Inspections (9%), both the literature surveys and the SEC Special Planner Inspections indicated that most planner clients are from business or the professions and that very few are from traditional blue-collar occupations.

4. Financial condition

The surveys of planner clients reported in the literature show that planner client income and net worth is reasonably uniform throughout the industry and markedly higher than that of the general population. 40/ Fifty-three percent of the ICFP planners reported that their clients' income was typically between \$50,000 and \$100,000. 41/ Typical client income was between \$25,000 and \$50,000 for 25% of the financial planners and over \$100,000 for 20%. 42/ Forty-five percent of the financial planners surveyed by the NALU reported that their typical client income was over \$35,000 and 18% reported that their typical client income was over \$50,000. 43/ A 1985 IAFP survey listed the typical client household income as \$75,000. 44/

Average client net worth was over \$350,000 for 51% of the ICFP surveyed planners. 45/ Twenty-six percent of the respondents reported that client net worth was between \$150,000

40/ The average annual total compensation for the general population of the United States in 1985 was (including contributions for social insurance, private pension and welfare funds, etc.) \$25,287 per full-time equivalent employee, and average annual wages and salaries were \$20,991. The median household net worth for the general population was \$32,667. Statistical Abstract supra note 32, at 400, 449.

41/ Financial Planning Consumers, supra note 35, at 223.

42/ Id.

43/ Life Ins. Mktg. and Research Ass'n, 1984 NALU-LIMRA Survey of Agency Opinion, cited in A Portrait of the Agent as a Financial Planner -- United States (1/R Code 7.30), Oct. 25, 1984, at 4 [hereinafter 1984 NALU-LIMRA Survey].

44/ 1985 IAFP Membership Survey, supra note 29, at 11.

45/ Financial Planning Consumers, supra note 29, at 223.

and \$350,000 and for about 20% of the planners, client net worth was less than \$150,000. 46/ The typical IAFP client's personal net worth was reported as \$250,000. 47/

The SEC Special Planner Inspections also found that clients of planners are relatively affluent. The average combined (husband and wife) net worth (excluding principal residence) of financial planning clients was reported to be \$405,640 while the median net worth 48/ was \$250,000. The annual average combined earned income of these clients was \$87,039 with a median combined earned income of \$57,623.

5. Education

The surveys in the literature disclosed that people who seek financial planning advice are generally well educated. Over 60% of the ICFP members surveyed had clients who held at least college degrees, and another 20% reported that their clients had either a graduate or professional degree. 49/ An IAFP survey showed that 80% of the members' financial planning clients had earned a college or higher degree. 50/ In contrast, in 1985, only 19.4% of the general population over 25 years of age had completed 4 years or more of post high school education. 51/

The SEC Special Planner Inspections showed similar results. Nearly half of the clients (44%) had earned at least a college degree while another third of the clients (34%) had also earned a graduate or professional degree. Only 1% had not graduated from high school. On average, clients were reported to have attained higher levels of education than their planners (of whom 6% had not graduated from high school). Client spouses were also found to be well-educated. Almost half (48%) of the spouses had at least college degrees and approximately 15% of client spouses had graduate degrees; again, only 1% had not completed high school.

46/ Id.

47/ 1985 IAFP Membership Survey, supra note 29, at 11.

48/ Median net worth means that one-half of clients were above this level and one-half were below.

49/ Financial Planning Consumers, supra note 35, at 223.

50/ 1985 IAFP Membership Survey, supra note 29, at 11.

51/ Statistical Abstract, supra note 32, at 122.

6. Seeking advice

Both the literature and the SEC Special Planner Inspections provided information concerning the reasons customers seek financial advice and customers' means of finding a particular planner.

From one survey available in the literature, it appears that only a relatively small percentage of the population seeks financial advice. The IAFP consumer survey found that 13% of the total public and 22% of those with high incomes (\$50,000 or higher income) used financial planner services. 52/ On the other hand, a recent study of subscribers to Sylvania Porter's Personal Finance Magazine, conducted for the ICFP, disclosed that 43% of the respondents currently use, or at one time used, the services of a financial planner. 53/ It is unlikely that these respondents are representative of the general public.

The reasons for seeking financial planning advice, as revealed both in the literature and in the SEC Special Planner Inspections, were relatively constant. The several reasons offered were: minimization of taxes, retirement planning, coping with inflation, saving for a child's education, and providing financial security for the family. 54/

The SEC Special Planner Inspections offered some insight into the reasons why clients seek out planners. SEC examiners looked at each client file to determine why that client sought

52/ 1987 IAFP Consumer Survey on Fin. Attitudes, supra note 31, at Table 22 (responses to Q.5F).

53/ Inst. of Certified Fin. Planners, Utilization of Financial Planners: Consumer Survey 1 (Aug. 6, 1987) (prepared by the Development Research Group, Inc.) [hereinafter 1987 ICFP Consumer Survey].

54/ See, e.g., Financial Planning Consumers, supra note 35, at 225; see also 1987 IAFP Consumer Survey on Fin. Attitudes, supra note 31, at Table 32 (responses to Q.6E). The respondents to the recent ICFP consumer survey of subscribers to Personal Finance Magazine reported that their expectations for financial planning services were overwhelmingly for investment advice (75%), tax planning (60%), and both general financial advice and retirement planning (56%). 1987 ICFP Consumer Survey, supra note 53, at 3.

financial planner advice. 55/ Table 3 identifies the choices provided by the SEC Special Planner Inspections client outline, the total number of times each choice was marked, the number of times each choice was ranked number one, and the related percentages. Again, it is important to note that the information was derived from client files, not from direct discussion with clients.

55/ These files typically contain a questionnaire or other document provided by the planner to the client for the purpose of eliciting information about the client's investment objectives, background, etc.

Table 3

REASONS WHY CLIENTS SOUGHT THE ADVICE OF FINANCIAL PLANNERS

<u>Reasons clients sought advice</u>	<u>Number Times Answered</u>	<u>%</u>	<u>Number Times Ranked One</u>	<u>*/ %</u>
Plan for retirement	396	16.3	238	20.4
Reduce income taxes paid	385	15.9	182	15.6
Plan financial future	310	12.8	191	16.4
Increase net worth	219	9.0	92	7.9
Estate planning	212	8.7	85	7.3
Save for children's education	204	8.4	84	7.2
Increase income	126	5.2	71	6.1
Portfolio management	105	4.3	54	4.6
Help in personal budgeting	96	4.0	49	4.2
Hedge against inflation	92	3.8	23	2.0
Help in saving money	87	3.6	37	3.2
Purchase securities	74	3.1	21	1.8
Purchase insurance	62	2.6	11	0.9
Buy a new residence	34	1.4	18	1.5
Purchase tax shelter investment	21	0.9	8	0.7
	----		----	
Total number of responses	2,423		1164	
Average reasons per client	2.6			

Source: SEC Special Planner Inspections
Item 10 of Client Outline

*/ The total number of times a registrant ranked a reason as "number one" (1164) is greater than the number of registrants sampled (924). The discrepancy arises because some registrants rated more than one reason as "number one".

The three most important reasons for seeking planner advice were retirement planning, reduction of income taxes, and planning for the client's financial future.

The table shows that the purchase of financial products such as insurance, securities or tax-shelters were among the reasons least frequently cited by clients for seeking financial planning help, although clients seeking a "reduction of income taxes" could be regarded as seeking investment in tax-sheltering products. The purchase of products was cited by clients less than 4 percent of the time and was ranked as the most important reason for seeking planner advice by less than 2 percent of planner clients. These rankings suggest that planner clients are seeking planners for financial advice and are not, at least initially, looking to planners as the vehicles through which to buy securities or insurance.

The SEC Special Planner Inspections also directly asked planners to describe their clients' investment objectives. Table 4 discloses their responses.

Table 4

INVESTMENT OBJECTIVES OF CLIENTS

<u>Objective</u>	<u>Number Picking as First Objective</u>	<u>%</u>
Capital growth with some safety of principal	205	25
Capital growth and income	169	20
Preservation of capital	126	15
Tax savings	122	15
Income	122	15
Aggressive growth of capital	81	10

Total	825	

Source: SEC Special Planner Inspections
Item 11 of Client Outline

According to the planners, the most popular client objective (25%) is capital growth with some safety of principal; 20% of clients are seeking capital growth and income; 15% are most concerned with preservation of capital; another 15% are looking to save on taxes; and another 15% are seeking income; 10% are seeking aggressive growth of capital. These answers suggest that, from the planner's perspective also, the client's purposes for seeking financial advice are conservative.

Both the SEC Special Planner Inspections and the recent ICFP consumer survey 56/ also provided information about how clients locate a particular planner. The Inspections provided this information from the planner's perspective. 57/ Financial planners use a variety of methods to attract clients to their planning services and product sales operations. Table 5 shows these various methods and the number of planners and product sales affiliates of planners that reported using or planning to use each method. 58/

56/ 1987 ICFP Consumer Survey, supra note 53.

57/ The Registrant Outline, Item 6 asked the planner to characterize how it attracts clients.

58/ More than one method is used by most planners.

Table 5

HOW CLIENTS ARE ATTRACTED TO FINANCIAL
PLANNERS AND THEIR PRODUCTS

	<u>Financial Planner</u>		<u>Product Sales</u>	
	<u>Number Indicating They Use</u>	<u>%</u>	<u>Number Indicating They Use</u>	<u>%</u>
Referrals from clients	65	17	51	15
"Word-of-mouth"	62	16	53	18
Yellow pages listings	53	14	35	10
Referrals from brokers, accountants & others	52	13	38	11
Conducting seminars	37	10	22	6
From product sales clients	31	8	30	9
From non-investment adviser clients	28	7	31	10
Advertising	20	5	21	6
Direct mail	19	5	19	5
Cold calling	10	3	17	8
No attempt to get clients	9	2	4	2
	-----		-----	
Total number responses	386		346	

Source: SEC Special Planner Inspections
Item 6 of the Registrant Outline

The table shows that the method planners cite most often is "referrals from [existing] clients", with "word-of-mouth," "yellow pages" listings, and referrals from brokers, accountants and others, the next most popular methods. A very small percentage of financial planners say they rely on advertising other than yellow pages advertising.

Consumers in the recent ICFP survey also cited personal referrals as the most common source of information in finding a planner. The consumers cited referrals from other professionals (lawyers, brokers, etc.) as the most common source of information (48% cited this source), and referrals from friends or family members as another common source (13.7% cited this source). But, while planners surveyed in the SEC Special Planner Inspections did not regard advertising as an important source of getting clients, a fairly large percentage (23%) of planner clients surveyed in the ICFP survey listed advertising as a source of information used in choosing a planner. 59/

7. Consumer satisfaction

The recent survey of financial planning consumers conducted on behalf of the ICFP provides information regarding consumer satisfaction. The survey found that respondents were generally satisfied with their planner: 14% ranked their planner as excellent, 56% as satisfactory, and 21% as unsatisfactory. Table 6, taken directly from the survey, cross-tabulates planner designations and satisfaction.

59/ 1987 ICFP Consumer Survey, supra note 53, at attachment - question #4.

Table 6

CLIENT SATISFACTION AND PLANNER DESIGNATION

<u>Designation</u>	<u>Excellent</u>	<u>Satisfactory</u>	<u>Unsatisfactory</u>
CFP	19%	58%	22%
ChFC*	10%	60%	25%
CLU	6%	79%	12%
CPA	10%	61%	20%
Lawyer*	20%	70%	10%
CFA*	25%	75%	0%

* Should probably not be viewed as statistically valid because of the small number of respondents using these types of professionals as financial persons.

Source: 1987 ICFP Consumer Survey, supra note 53, at 2.

The table shows that both the largest percentage of unsatisfactory marks (22%) and the largest percentage of excellent marks (19%) were given to CFP-planners. Similarly, both the lowest percentage of unsatisfactory (12%) and excellent (6%) marks went to planners who are CLUs.

Table 7, also taken directly from the survey, reports the level of satisfaction in relation to how a planner is paid. Planners compensated by fees alone were marked excellent by 23% (the highest percentage of any type) of their clients and unsatisfactory by 21%. On the other end of the scale, the most unsatisfactory marks (28%) went to those compensated by a combination of fees and commissions.

Table 7

CLIENT SATISFACTION AND PAYMENT METHOD

<u>Payment mode</u>	<u>Excellent</u>	<u>Satisfactory</u>	<u>Unsatisfactory</u>
Fee	23%	54%	21%
Salary*	40%	20%	40%
Commission	12%	64%	22%
Fee & Commission	3%	69%	28%
Don't know	7%	60%	26%

* Should probably not be viewed as statistically valid because of the small number of respondents using this type of professional as financial planner.

Source: 1987 ICFP Consumer Survey, supra note 53, at 2.

8. Summary

A general picture of the typical financial planner clientele emerges from the various sources of information. The typical financial planner client:

- * is male, middle-aged,
- * is married,
- * is working in a business/professional area,
- * is reasonably well educated,
- * has a relatively high income and net worth,
- * is seeking to plan for retirement, or to reduce taxes paid,
- * found the planner through referral from another client of the planner.

B. Planner/Adviser Characteristics

The Subcommittee posed the following questions concerning planner/adviser characteristics:

What are the characteristics of financial planners or advisers? What is (are) their:

size (e.g., the number of employees, customers, offices and states of operation);

background (e.g., their education, experience and qualifications);

other business activities (e.g., are they a broker-dealer, insurance agent, banker, accountant, etc.); and

custody of, or discretionary authority over, client funds and the amount of funds involved?

To respond to these questions, this subchapter is organized into five subsections: 1) Size and structure, 2) Location, 3) Background, 4) Other business activities, and 5) Custody and discretion.

1. Size and structure

A variety of sources suggest that most financial planners either work alone or work in small business organizations. Member surveys conducted by financial planner professional associations disclose that at least half the members work in organizations of ten or fewer employees. 60/ The ADV Database shows that the average number of investment advisory employees for each adviser (including advisers who are financial planners) was 3.1 and for each financial planner was 2.7. The SEC Special Planner Inspections likewise indicate that the financial planning activity is likely to be small, with an average of 2.5 employees. The affiliated product sales firm was identified as being much larger, with an average 6.6 employees.

As for structure, membership surveys and SEC data show that the overwhelming number of financial planner firms are either sole proprietorships or small corporations. Very few are organized as partnerships. 61/

60/ For example, a 1986 survey by the National Association of Personal Finance Advisers (NAPFA) reported that about 80% of the members either were sole proprietors or worked in 1 - 6 person corporations. See NAPFA: Membership/Benefits Survey (June 6, 1986) and analysis (Oct. 13, 1986), with letter from Mary A. Malgoire, President, NAPFA, to Div. of Investment Management, SEC, May 18, 1987 (see response to question 20) [hereinafter 1986 NAPFA Membership/Benefits Survey Results]. A 1986 ICI survey showed that 63% of its associate members (investment advisers not serving as adviser to any fund), reported that they worked as sole proprietors or in firms with 2 - 5 employees. Internal Memorandum of the Investment Company Institute from Mary Walsh to Robert Bunn, Jr. (Aug. 20, 1986) (presenting results of 1986 ICI Associate Members Survey) [hereinafter 1986 ICI Associate Members' Survey]. A 1986 IAFP member survey showed that 50% of the members worked with 10 or fewer people. Int'l Ass'n for Fin. Planning, Summary, 1986 General Membership Survey 10 [hereinafter 1986 IAFP Membership Survey]. While most planner firms have few employees, there are some very large firms. For example, the 1986 IAFP member survey found that 16% of the members had 11 - 50 employees, 12% had between 50 and 500 employees, and 22% had more than 500 employees. Id. at 10.

61/ For example, a 1986 NAPFA survey reported that 88% of members responding were either sole proprietors (35%) or worked for corporations (53%). 1986 NAPFA Membership/Benefits Survey Results, supra note 60, responses to
(continued...)

As will be discussed in more detail below, 62/ financial planners are often involved in some way with the sale of financial products, such as mutual funds, insurance contracts, limited partnerships, or stocks and bonds. The SEC Special Planner Inspections found that 69 of 81 active planners (85%) were affiliated with an organization that sold financial products. The SEC Special Planner Inspections also found that employee time in the inspected firms was devoted more heavily to product sales than to planning. Of the 81 firms and their product sales affiliates inspected, a full-time employee equivalent of 319 professionals were devoted to the sale of products, while 109 were involved in planning. 63/ The 69 firms actively engaged in financial planning used an average of 2.5 people in the planning activity while the related product sales activity involved an average of 6.6 persons.

The number of clients typically served by a financial planner is difficult to count. The number might include all persons for whom the planner had performed any kind of planning service during a year, or might include only those persons for whom the planner had prepared a comprehensive financial plan. The SEC Special Planner Inspections found that in 1986 more than 3,000 persons came to the 81 inspected planners to discuss the possibility of having a financial plan prepared -- an average of 40 per active planner. The SEC 1986 Inspection Report Review

61/(...continued)

Question 20. The American Society of CLU & ChFC determined that 93% of members were either sole proprietors (48%) or owners or employees of corporations (45%). Letter from Burke A. Christensen, Vice Pres. and Gen. Counsel, ASCLU & ChFC, to Div. of Investment Management, SEC (May 6, 1987) (with selected excerpts from ASCLU & ChFC's 1985 membership survey. Percentages herein are extracted from Table 10, T-5 of that survey's result) [hereinafter ASCLU & ChFC 1985 Survey]. The 1986 IAFP member survey found that 90% of the respondents were either sole proprietors (29%) or were associated with corporations (61%). 1986 IAFP Membership Survey, supra note 60, at 10. The SEC Special Planner Inspections found that 99% of the firms were organized either as sole proprietorships (38%) or corporations (61%).

62/ See infra Chapter V.C.2.

63/ In addition, the planning activity of the firms inspected takes place on average at 1.5 separate office locations, but the sales activity takes place on average at 1.9 office locations.

found that, of the 294 planners inspected, the 205 active planners had, among them, 6,854 persons listed as clients, or an average of 33.4 clients per planner. 64/

The literature contains few surveys of client number. The average number of financial planning clients among IAFP members was reported as 175. 65/ A study performed for the ICFP reported that 45% of the planners had fewer than 100 clients, 33% had more than 200 clients, and about 20% had between 100 and 200 clients. 66/

One survey of planners from small cities, derived from listings in the Yellow Pages, 67/ found that the number of clients served by a financial planning firm was inversely related to the educational qualifications of the planners employed by the firm. The survey ascribed point values to the educational backgrounds of each employee of a firm. Only degrees in finance or related fields were assigned values. A bachelor's degree was given a point value of 1, a graduate degree below Ph.D a 2, and a Ph.D. a 3. Firms were then differentiated into two groups, those with an average point score of less than 1, and those with a point score of 1 or more. The survey found that on average the firms in the first group (a point score of less than 1) had 84 clients per financial planner. The firms with a point score of 1 or higher had 52 clients per planner. 68/

2. Location

A review of the literature confirms that financial planners are located near metropolitan areas. A survey of 21,221 IAFP

64/ Not all of the planners are "full time" planners, and some of the clients may have been institutional clients.

65/ 1985 IAFP Membership Survey Results, supra note 29, at 11.

66/ T. Hira, H. Van Auken & D. Norris, A Look Behind the Scenes: A Survey of How CFPs Work 7 J. Inst. Certified Fin. Planners 69, 76 (1986) [hereinafter A Look Behind the Scenes].

67/ Cities generally of a population of 250,000 or less. J. Hilliard, An Interpretative Survey of the State of Professionalism in the Personal Financial Planning Industry, (Fall 1986) (unpublished thesis) [hereinafter Hilliard].

68/ Id. at 44-46. (The analysis did not mention the relative wealth, assets, or nature (institutional or individual) of the clients served by the two groups.)

members conducted in 1985 69/ revealed that thirty-nine percent of the 2,517 respondents were located in metropolitan areas with a population of over 1 million and 21% worked in areas with a population of between 500,000 and 1 million, for a total of 60% of respondents in areas with over 500,000 people. Fifteen percent of the members operate in medium-sized cities (250,000 - 500,000), 19% operate in small cities (50,000 -250,000), and only 7% are in towns under 10,000.

A similar survey among ICFP members also found that financial planners were located in more populous areas. 70/ Approximately half (49%) of those members responding to the survey were located near the large cities or metropolitan areas which they define as their market. Fifteen percent were located in medium-sized cities, while 34% were in small towns and cities. The practice of approximately 95% of the financial planners surveyed was described as local or regional, as opposed to national or international.

A third survey of 14,995 IBCFP registrants from the United States and 22 from 11 other countries (total 15,017) revealed more specific information regarding the geographic distribution of financial planners. 71/ Of the 14,995 registrants located in the United States, the largest number (19%) are located in the state of California, with 37% of the California group located in Los Angeles. The smallest number of CFPs (.1%) are located in the state of Wyoming.

According to the AICPA Personal Financial Planning Division Membership Questionnaire 72/, California also has the largest number of CPAs who do personal financial planning (11.4%). Texas is next with 7.4%, while New York places third with 7%. The fewest financial planning CPAs (.1%) are located in Nevada.

69/ 1985 IAFP Membership Survey, supra note 29, at 8.

70/ A Look Behind the Scenes, supra note 66, at 74.

71/ Int'l Bd. of Standards and Practices for Certified Fin. Planners, IBCFP Registrant Survey Results (June 1987) [hereinafter 1987 IBCFP Survey Results].

72/ American Inst. of Certified Pub. Accountants, Tabulated results of 1986 AICPA Personal Financial Planning Division Membership Questionnaire (attached to letter from John H. Graves, Dir., Technical Information Div., AICPA to Div. of Investment Management, SEC (July 6, 1987)) [hereinafter AICPA PFP Questionnaire].

Another source for geographic location statistics for financial planners is the ADV Database. 73/ As part of the data gathering for this report a comparison was made of the statistics taken from the ADV Database and the financial planner listings in the Yellow Pages throughout the United States. 74/ Table 8 illustrates this comparison. The table shows that although about three times more financial planners list themselves in the Yellow Pages than are registered with the SEC, 75/ the distribution by state as a percentage of the total is practically the same for both sources.

73/ The ADV Database of May 1985 provided this information.

74/ These Yellow Pages listings were compiled by the American Business Lists, Inc. (Mar. 1987).

75/ The disparity in numbers may be accounted for in a number of ways. See supra Chapter III, and infra Chapter V.D.1. for a discussion of the distinction between financial planners who must register with the SEC, and those who need not. See also supra Chapter IV.B., for a discussion of the numbers that comprise the ADV Database. The Database counts firms, not the individuals employed by firms.

Table 8

DISTRIBUTION OF FINANCIAL PLANNERS BY STATE
ADV AND YELLOW PAGES COMPARED

<u>STATE</u>	<u>ADV</u>	<u>%</u>	<u>Yellow Pages</u>	<u>%</u>
AL	41	0.83%	135	0.95%
AK	31	0.63%	65	0.46%
AZ	91	1.84%	324	2.27%
AR	42	0.85%	67	0.47%
CA	664	13.41%	2387	16.76%
CO	129	2.60%	476	3.34%
CT	131	2.64%	295	2.07%
DE	53	1.07%	46	0.32%
DC	68	1.37%	55	0.39%
FL	210	4.24%	708	4.97%
GA	76	1.53%	293	2.06%
HI	23	0.46%	93	0.65%
ID	29	0.59%	78	0.55%
IL	243	4.91%	570	4.00%
IN	135	2.73%	212	1.49%
IA	45	0.91%	153	1.07%
KS	76	1.53%	199	1.40%
KY	51	1.03%	81	0.57%
LA	64	1.29%	197	1.38%
ME	23	0.46%	43	0.30%
MD	115	2.32%	210	1.47%
MA	131	2.64%	456	3.20%
MI	248	5.01%	424	2.98%
MN	121	2.44%	321	2.25%
MS	40	0.81%	105	0.74%
MO	97	1.96%	277	1.94%
MT	25	0.50%	70	0.49%
NE	33	0.67%	88	0.62%
NV	55	1.11%	75	0.53%
NH	50	1.01%	92	0.65%
NJ	191	3.86%	452	3.17%
NM	38	0.77%	90	0.63%
NY	264	5.33%	525	3.69%
NC	56	1.13%	277	1.94%
ND	19	0.38%	47	0.33%
OH	142	2.87%	754	5.29%
OK	51	1.03%	163	1.14%
OR	60	1.21%	248	1.74%
PA	127	2.56%	445	3.12%
RI	29	0.59%	64	0.45%
SC	59	1.19%	118	0.83%
SD	27	0.55%	52	0.37%
TN	58	1.17%	227	1.59%

TX	265	5.35%	808	5.67%
UT	40	0.81%	168	1.18%
VT	21	0.42%	32	0.22%
VA	136	2.75%	323	2.27%
WA	98	1.98%	443	3.11%
WV	34	0.69%	52	0.37%
WI	83	1.68%	317	2.23%
WY	15	0.30%	43	0.30%
TOTAL	4953	100.00%	14243	100.00%
AVERAGE	125.47		279.27	

Source: SEC ADV Database and compilation of the Yellow Pages by American Business Lists, Inc. (Mar. 1987)

3. Background

This subsection describes the demographics, educational background, experience, and qualifications of planners.

a. Demographics

Surveys in the literature provided the only information about the age and gender of financial planners. It is safe to say that no matter who conducted the survey, or how the results were tabulated, financial planners were shown to be overwhelmingly male and roughly middle-aged.

First, regarding gender: A survey of ICFP members is typical. It reported that 78% of ICFP respondents were male. 76/ Similarly, the 1986 IAFP membership survey reported that 83% of IAFP members were male. 77/ The American Society of CLUs and ChFCs reported that 97% of the Society's respondents were male. 78/

As for age, most financial planners are middle-aged, as that term is loosely defined: For example, the average age of IAFP members responding is reported to be 42 years. 79/ A more recent survey conducted by the IBCFP found that 75% of the respondents

76/ A Look Behind the Scenes, supra note 66, at 71-72.

77/ 1986 IAFP Membership Survey, supra note 60, at 2.

78/ ASCLU & ChFC 1985 Survey, supra note 61, Table 64 at T-26, T-28. Other surveys report similar results: 79% of the respondents to the NAPFA Survey are male, 1986 NAPFA Membership/Benefits Survey Results, supra note 60; 90% of the members of the newly formed AICPA Personal Financial Planning Division are male, AICPA PFP Questionnaire, supra note 72.

79/ 1986 IAFP Membership Survey, supra note 60, at 2.

were in their 30s and 40s. 80/ The average respondents' age of the American Society of CLUs and ChFCs was 46 years; 28% were in their 30s, 30% in their 40s, and 24% in their 50s. 81/

b. Education

There are no federal testing requirements, minimum education requirements, or continuing education requirements applicable to advisers or financial planners per se. 82/ Nevertheless, as discussed below, most financial planners have at least a college degree.

A number of surveys in the literature discuss the educational background of planners. Membership surveys conducted by professional associations show that their members (or member employees) are overwhelmingly college educated. For example, an IAFP survey reported that 82% of the IAFP respondents held a college or higher degree. 83/ An ICFP member survey reported

80/ 1987 IBCFP Survey Results, supra note 71. The IBCFP reported the following numbers:

<u>Age Category</u>	<u>Responses</u>
Under 20	1 - .02%
20-25	31 - .9%
26-30	294 - .7% [sic]
31-39	1300 - 38.5%
40-49	1217 - 36.0%
50-59	318 - 9.4%
60 & over	213 - 6.3%

81/ ASCLU & ChFC 1985 Survey, supra note 61, at T-26, 28. Other surveys report similar results: the NAPFA Membership/Benefits Survey Results, supra note 60, found that 97% of the respondents were in their 30s, 40s or 50s; the AICPA PFP Questionnaire, supra note 72, reported that 63% of the Division members were between 36 and 55 years of age. Finally, the survey of NALU planners found that the median age was 42 years. 1985 NALU-LIMRA Survey, supra note 30, at 4.

82/ Financial planners who are registered representatives of broker-dealers must pass a qualifying examination. See infra Appendix B.

83/ 1986 IAFP Membership Survey, supra note 60, at 2.

that 83% had a college or higher degree. 84/ The American Society of CLU & ChFCs reported that 78% of Society respondents had at least bachelor's degrees, and that an additional 14% had attended college; 5% did not have education beyond high school. 85/ Finally, a survey of the AICPA's Personal Financial Planning Division members found that 95% had at least a bachelor's degree, and 38% had finished graduate study; only 5% had attended college but had not received a degree. 86/

One survey from the literature that included a cross-section of financial planners rather than only planners who are members of a professional association, reported a somewhat lower percentage of planners with college or higher degrees. This survey of financial planners listed in the Yellow Pages from communities with populations of less than 250,000 estimated that only 62% of the respondents had earned a bachelor's or higher degree. 87/

Similarly, the SEC Special Planner Inspections reported planners achieving a lower level of education than the education level reported for the professional association members. Out of a total of 116 financial planning employees surveyed, 71% had earned at least an undergraduate college degree; 15% had some college education, 8% were high school graduates, and 6% had not completed high school. The 319 non-clerical employees that engaged in product sales were reported to have similar levels of education: 66% had at least undergraduate degrees; 20% had some college experience; 10% were high school graduates; and 4% had not finished high school.

The survey results, even of planners not belonging to professional associations, point to a relatively well-educated industry. It is important to note, however, that there is little information concerning the extent to which financial planners are specifically educated to engage in financial planning. A few surveys, most notably the Yellow Pages survey mentioned above,

84/ A Look Behind the Scenes, supra note 66, at 72. More specifically, 51% had a bachelor's degree, 27% had a master's degree, 5% had education beyond a master's degree, and 16% did not have education beyond high school.

85/ ASCLU & ChFC 1985 Survey, supra note 61, Table 65 at T-26.

86/ AICPA PFP Questionnaire, supra note 72.

87/ Hilliard, supra note 67, at 41, 43.

have some data on specific educational credentials, 88/ but there is little hard data on the subject.

c. Experience

The information that exists concerning the experience of financial planners suggests that many planners, perhaps even a majority, are fairly new to the planning business. The one exception is a survey of American Society of CLU and ChFC members, which reported that members were in the planning business for an average of 19 years with only 16% of the members having less than 10 years experience. 89/ A survey of NALU members showed that financial planning agents had an average of 8 years of experience in the planning business and had been in their current positions for 5.5 years. 90/ A survey of NAPFA members showed that 75% had been planners for less than 10 years. 91/ Finally, a survey of California financial planners listed in the Yellow Pages showed that half were in the planning business for less than 10 years. 92/

88/ Id. That survey reported that of the 44% of the respondents who had earned at least a bachelor's degree, half (22%) had earned degrees that were finance related, of the 12% who had also earned at least a masters degree, three-fourths (9%) had earned finance related degrees, and of the 3% who had earned a Ph.D., two thirds (2%) had earned finance related degrees. Id. at 43.

89/ ASCLU & ChFC 1985 Survey, supra note 61, Table 66, at T-27. The relatively greater experience of members of this society comports with the criteria for achieving a CLU or ChFC designation. See Appendix D.

90/ 1984 NALU-LIMRA Survey, supra note 43, at 3.

91/ 1986 NAPFA Membership/Benefits Survey Results, supra note 60, at 2.

92/ The California Department of Corporations sent surveys to all businesses listed in three categories from the Yellow Pages in the State of California: financial planners, investment advisers/investment advisory services, and investment management. Banks and Savings and Loan institutions were excluded because they are exempt from the statutory definitions of broker-dealer and investment adviser under the California securities law. Questionnaires sent out totaled 2,650; 961 were returned. State of California, Dep't of Corporations, Dep't of Corporations' Fin. Planner Survey Results 5 (Oct. 5, 1984) [hereinafter Cal. Dep't of
(continued...)]

Another possible indication of the relative inexperience of planners comes from a review of all SEC inspection reports of planner advisers for the year 1986 (the SEC 1986 Inspection Report Review). Of the 294 planners inspected, 96% had been registered only since 1982, while 72% or 211 had been registered as advisers for two years or less. These results portray a somewhat biased profile, however, to the extent that the SEC deliberately targets new advisers for inspection. 93/

d. Qualifications

While there are no federal qualification standards for investment advisers or financial planners, 26 states require investment advisers or investment adviser representatives to pass a test before they can register. 94/ There are also a number of financial planner professional associations, 95/ and some of these are limited to planners who pass a qualifying examination. For example, to become a Certified Financial Planner, a candidate must meet certain education and experience requirements, and must pass a series of qualifying examinations. The ICFP is a voluntary membership organization for financial planners who are CFPs

92/ (...continued)
Corp. Survey].

93/ For a discussion of the SEC's inspection program, see infra Chapter V.E.

94/ 2 Investment Company Institute, Investment Advisers Guide (1987). The examinations required are usually those required for broker-dealers or registered representatives, and often include the Uniform Securities Agent State Law Examination. Examination by the states is likely to continue to grow: the North American Securities Administrators Association's ("NASAA") Model Amendments to the Investment Adviser Provisions of the Uniform Securities Act of 1956 (Nov. 20, 1986) have added in Section 204(b)(6) the power for a state securities administrator to require an investment adviser state-law examination. The examination has been written, and NASAA is now preparing to establish a means for the states to administer it.

95/ The number of associations is growing rapidly. Each association promotes the association's own definition of financial planning and imposes ethical guidelines. Heffernan, Association Overload, Financial Planning, October 1986, at 100. A glossary of terms, including financial planner trade and professional associations, is provided in Appendix D.

(or who are candidates to be CFPs); it has approximately 8,500 members. 96/ An independent review board known as the IBCFP grants and revokes the CFP designation. A similar situation occurs in the insurance industry with the Chartered Life Underwriter (CLU) and Chartered Financial Consultant (ChFC) designation, which require the candidate to complete ten courses offered by the American College in Bryn Mawr, Pennsylvania. When the candidate has met the education and examination standards, shown three years of relevant experience, and met ethical standards, the American College will grant the designation. These designations qualify their holders to join the American Society of CLU, a membership organization.

The Chartered Financial Analyst ("CFA") designation is awarded by the Institute of Chartered Financial Analysts, which administers the three examinations for the designation. In addition to the requirement to pass all three tests, candidates must have had three years of experience, and comply with a code of ethics and standards of professional conduct. The affiliated Financial Analysts Federation ("FAF") is a membership organization composed of investment managers and securities analysts who have passed at least the first CFA examination and are members of one of the 57 affiliated chapters and societies. The Code of Ethics and standards of professional conduct are identical to that of the Institute and both organizations have disciplinary programs that cooperate for joint members. The Institute has chartered 10,000 individuals as CFA's, and the Financial Analysts Federation lists 16,000 members. 97/

The Registry of Financial Planning Practitioners is administered by the International Association for Financial Planning. The Registry requires that candidates be in financial planning practice for three years, possess a CFP, ChFC, CPA, JD, LLM or a bachelor's degree in business, pass a practice knowledge examination, provide references from five clients that have used the planner for two years and had a plan prepared, and submit a sample plan prepared for clients for review. NAPFA, one of the newer financial planning organizations, limits membership to fee-only planners. It is reported to have 160 members. 98/

96/ Telephone interview with Brent A. Neiser, Director of Education and Professional Development, ICFP (Feb. 11, 1988).

97/ Morley, What's So Special About a CFA?, Pension World, Sept. 1985, at 50.

98/ CFA Report, supra note 16, at 20.

As disclosed in professional association member surveys, 99/ a Yellow Pages survey conducted by the California Department of Corporations, and in data from the SEC Special Planner Inspections, many financial planners are members of several professional associations and have a number of professional qualifications in addition to those specifically tailored to financial planning. For example, the Yellow Pages survey determined that 55% of those listed as financial planners were also insurance brokers; 48% were IAFP members; 25% were ICFP members; 25% had real estate licenses; 6% were CPAs; 4% were attorneys; and only 15% claimed no memberships and no other professional qualifications. 100/ The IAFP's 1986 general membership survey disclosed that 70% of the respondents were licensed life insurance agents; 60% were licensed health insurance agents; 31% were CFPs; 19% were licensed real estate agents; 20% were CLUs; 17% were ChFCs; 13% were CPAs; and 5% were attorneys. 101/

The SEC Special Planner Inspections requested specific information on the professional qualifications of individuals who provide financial planning and of individuals engaged in product sales as affiliates of financial planners. Table 9 lists the indicated professional qualifications of the 116 non-clerical employees of the 81 active planners and of the 111 employees of the related product-sales organizations:

99/ Surveys have been conducted by the IBCFP (1987 IBCFP Survey Results); the Financial Analysis Federation (FAF Membership Survey: Interpretive Report I-19 (conducted by Opinion Research Corp. for FAF, ORC Study #64123) (Aug. 1985) [hereinafter FAF Membership Survey]); IAFP (1986 IAFP Membership Survey); and the AICPA's Personal Financial Planning Division (AICPA PFP Questionnaire, 1986). They all show members with multiple affiliations and qualifications.

100/ Cal. Dep't of Corp. Survey, supra note 92, at 1, 5.

101/ 1986 IAFP Membership Survey, supra note 60, at 2.

Table 9

PROFESSIONAL QUALIFICATIONS OF EMPLOYEES

	<u>Financial Planner</u>		<u>Product Sales</u>	
	<u>Number Indicating They Have</u>	<u>%</u>	<u>Number Indicating They Have</u>	<u>%</u>
Certified Financial Planner	37	26	33	25
Chartered Life Underwriter	27	19	23	18
Chartered Financial Consultant	21	15	13	10
Registry of Financial Planning Practitioners <u>102/</u>	20	14	15	11
Attorney	16	11	12	9
Certified Public Accountant	14	10	8	6
Chartered Financial Analyst	4	3	2	2
Public Accountant	2	1	2	2
Chartered Property and Casualty Underwriter	<u>2</u>	1	<u>1</u>	18
Total professional qualifications held	143		109	

Source: SEC Special Planner Inspections
Item 10 of the Registrant Outline

102/ The IAFP has established "The Registry of Financial Planning Practitioners." This is a special listing of IAFP members that are actively engaged in financial planning that have met certain qualifications. See Appendix D.

The CFP designation was the most dominant professional qualification of planners and product sales employees, held by 26% of the planner employees and 25% of the product sales employees. The CFP designation appears to be developing as the most recognized designation in the planning field. The next most prevalent designation, CLU, was held by 19% of the planner employees and 18% of the product sales employees. The relatively large number of persons holding the CLU designation indicates the extent to which life insurance agents have sought to broaden their advisory activities by rendering advice about securities investments, including investments in variable annuities.

The 116 non-clerical planner employees of the inspected firms held a total of 143 designations, which means that a number of persons held more than one designation.

4. Other business activities

Because the term "financial planning" covers a broad spectrum of activities, there are no easy boundaries which allow demarcation of those business activities undertaken by financial planners that are different from, or "other" than, financial planning activities. A planner may also provide accounting services or give legal advice as an attorney, but those activities would form an integral part of the planner's planning business. To illustrate, consider a survey of IAFP members. The survey showed that the so called "business functions" of the respondents fell into the following categories: 103/

financial planner:	41%
executive/manager:	11%
insurance agent/ broker:	8%
accountant:	8%
sales/marketing representative:	7%
account executive/ stockbroker:	6%
investment counselor/ asset manager:	3%

103/ 1986 IAFP Membership Survey, supra note 60, at 3.

The most meaningful question regarding the "other business activities" of financial planners, then, is not whether they perform planning services that are not strictly financial planning services, but whether they engage in business activities outside the realm of planning. The surveys reported in the literature, the data from the ADV Database, the SEC Special Planner Inspections, and the SEC 1986 Inspection Report Review suggest that selling financial products, rather than only giving advice about them, is a significant "other business" of financial planners.

A random survey of financial planners taken from the California Yellow Pages, for example, disclosed that the largest number of respondents (62%) sold securities to their clients, 55% were licensed insurance brokers or agents, and 20% sold real property to their clients. 104/ A survey of thirty Washington, D.C. financial planners, performed as part of a study by the Consumer Federation of America, reported that 93% were licensed to sell insurance and/or securities, or worked with someone who was so licensed. 105/ A survey limited to small cities and based on Yellow Pages listings of financial planners, reported that approximately 90% of the planners sold securities as part of plan implementation. 106/ Finally, a 1984 NALU survey found that 98% of the financial planning NALU agents whose primary companies offered individual life policies, actually sold that product. Of that group, 56% placed the business exclusively with the primary company and 43% placed it with the primary company and others. Products found to be most frequently placed with the primary company were variable life policies, money market funds, mutual funds, and tax shelters. 107/

The ADV Database also indicates that selling financial products is an important part of an adviser's business activity. The data show that more than half (56%) of the advisers who regard themselves as financial planners are affiliated in some way with broker-dealers, and more than one third (38%) are affiliated with insurance companies or agencies. The SEC 1986 Inspection Report Review yielded similar results. Of the 294 planners inspected, approximately 214, or 73%, were either dually registered as advisers and broker-dealers, or were registered

104/ Cal. Dep't of Corp. Survey, supra note 92, at 1, 2.

105/ CFA Report, supra note 16, at 16.

106/ Hilliard, supra note 67, at 45.

107/ 1984 NALU-LIMRA Survey, supra note 43, at 5-6.

representatives of broker-dealers. Thirty-five, or 12%, were registered to sell life insurance products to their customers.

The SEC Special Planner Inspections also collected data on other businesses of planners. As part of the inspections, planners were asked to describe other types of business activities performed by persons or affiliated sales organizations. Table 10 shows the results.

Table 10

OTHER TYPES OF BUSINESS ACTIVITIES

	<u>Financial Planning Organization</u>		<u>Affiliated Product Sales Organization</u>	
	<u>Number</u>		<u>Number</u>	
	<u>Engaging in</u>	<u>%</u>	<u>Engaging in</u>	<u>%</u>
Insurance sales	41	51	56	81
Tax advising	37	46	17	25
Securities brokerage	31	38	57	83
Pension consulting	22	27	17	25
Teaching	15	18	11	16
Accounting	12	15	4	6
Real estate sales	11	14	11	16
Legal	7	9	4	6
Commodity sales/advising	3	4	4	4

Source: SEC Special Planner Inspections
Item 22 of Registrant Outline

The importance of product sales, whether conducted by the planner organization or affiliated product-sales organization, was revealed. Forty-one, or 51%, of the financial planning organizations also sold insurance, 38% engaged in securities brokerage, and 14% sold real estate. Fifty-seven, or 83%, of the affiliated product-sales organizations were engaged in securities brokerage, 81% sold insurance, and 16% sold real estate.

The data, then, suggest that product sales form an important, perhaps integral, part of the business of financial planners.

5. Discretion and custody

Two areas of potential concern regarding investment advisers and financial planners are whether they exercise discretion over the securities transactions of their clients, or have custody of client funds or securities. A planner with investment discretion has the permission of the client to make securities trades without prior approval. Investment discretion poses some risks to the client because the adviser or planner could make trades inconsistent with the client's investment objectives. However, clients normally get written confirmation notices for all trades and periodic statements showing the securities bought and sold for the account and those in the account at the end of the period. A planner can also be given discretion to choose brokers or determine commissions. The potential risk to the client in those instances is that the planner could choose a broker on some basis other than the quality of service rendered to the client. A planner who has "custody" of client funds or securities either holds them outright, or has authority to obtain possession of them, or has the ability to appropriate them. Giving custody to a planner poses the risk to the client of theft or loss of the funds or securities.

An FAF survey of membership found that 59% of members had some responsibility for managing or administering funds. Half of those members managed less than \$100 million in funds, more than a quarter managed between \$100 and \$500 million, and almost a fifth managed more than \$500 million. ^{108/} While the ICI's 1986 adviser membership survey did not measure the proportion of members with discretion over or custody of client funds, it did gauge the assets under management by each member. About 26%

^{108/} FAF Membership Survey, supra note 99, at I-15. The percentage of FAF members with investment discretion over customer accounts is higher than for planners generally, because FAF members are typically portfolio managers and not planners.

managed less than \$10 million, 28% managed \$10-50 million, 21% managed \$50-100 million, 14% managed \$100-300 million, and almost 12% managed over \$300 million. 109/

The ADV Database provided investment discretion data on all advisers who are registered with the SEC. As of the close of business September 30, 1987, about 32% of all advisers said they had investment discretion, and managed \$2.0 trillion in 5.5 million accounts. However, only about 10% of planners said they had investment discretion, and managed \$215 billion in 107,000 accounts. About 28% of all advisers said they provide non-discretionary management, and managed \$1.6 trillion in 10.9 million accounts. Approximately 20% of all planners said they provide non-discretionary management and managed \$541 billion in 438,000 accounts. Twenty-six percent of all advisers said they had discretion to choose brokers, and 42% of the advisers, because of their dual role as registered representatives, said they had discretion to determine commission rates that are paid. In contrast, ten percent of all planners said they had discretion to choose brokers and to determine commission rates that are paid.

The SEC 1986 Inspection Report Review found that of the 294 planners inspected, 109, or 37%, managed client assets on either a discretionary or non-discretionary basis. The amount under management totaled \$225.9 million, or an average of \$2,073,000.

The ADV Database provided the only information as to custody of client funds or securities. It shows that about 3% of all advisers have direct custody of \$917 million of client funds or securities. Similarly, 3% of all advisers have custody of an additional \$1.2 billion in customer funds or securities through a related person. Broker-dealers are the most frequent (about 50%) "related person" to have custody for advisers.

6. Summary

Most planning firms are small, registered in one state, located in more populous areas, serve the immediate locale and also sell insurance or securities. The average individual planner is male, middle-aged, a college graduate and has a background in or is currently providing insurance, securities, or tax/accounting services. The degree of professional experience among financial planners varies widely. Few planners or advisers have custody of client funds.

C. Compensation of Planners/Advisers

Under this heading, the Subcommittee asked the following questions:

Is the financial planner/adviser compensated for services by a flat fee or by a commission?

If compensation is by commission, what is the type and number of products offered, and what level of disclosure do planners/advisers provide concerning their interest in products they sell -- financial or otherwise?

To respond to these questions, this subchapter is organized into discussions of Compensation, Products Sold, and Disclosure.

1. Compensation

As discussed below, fee-only planners constitute a small segment of the overall planner community. Most financial planners receive at least a portion of their income from sales commissions. In one Yellow Pages survey of financial planners, more than 70% of the respondents reported that they were compensated either by fees and commissions or by commissions only. 110/ In another Yellow Pages study, one limited to small population centers, most respondents, 85%, reported earning at least part of their income through commissions, 72% earned more than half of their income through commissions, and 16% earned their total income through commissions. 111/ Only 11% earned more than half of their income through fees. 112/ Similarly, in a small survey of financial planners in Washington, D.C., conducted by the Consumer Federation of America ("CFA"), only 1 of the 30 surveyed planners was paid a salary and only 2 were fee-only planners whose plan implementation did not include selling products to clients from which commissions were earned. 113/ The CFA study found that, in general, planners who sold products almost always earned the majority of their income from

110/ Cal. Dep't of Corp. Survey, supra note 92, at 2. The survey was of financial planners identified in the California yellow pages.

111/ Hilliard, supra note 67, at 33.

112/ Id. at 33.

113/ CFA Report, supra note 16, at 16, 18.

commissions on the sale of products to implement the financial plan. 114/ Most of the financial planners interviewed by CFA charged a fee in addition to being compensated by commissions. The fee was most often based on an hourly rate (primarily in the \$65 to \$90 an hour range). Flat fees, the next most common method of compensation, ranged from \$250 for a computerized plan to \$10,000 for a plan for a wealthy client with substantial, complex investment assets. Four of the thirty planners surveyed were compensated according to a percentage of client income or assets. 115/

Two recent IAFP studies, one of consumers, the other of IAFP members, also reflect the importance of sales commissions to the financial planning industry. More than one-third (35%) of the consumer-respondents reported compensating their planners through commissions only, and an additional 14% reported paying both commissions and fees; 36% paid only a flat fee or an hourly rate; 15% were unsure. 116/ Similarly, a majority of IAFP respondents reported that they relied, at least in part, on commissions for their income: 68% relied on a combination of fees and commissions, salaries and commissions, or on commissions only; 11% were salaried employees; 10% were fee-only planners; and 10% earned a salary plus bonus. 117/

Surveys of other member organizations or consumers likewise show commissions to be an important means of compensating financial planners. As of June 1987, 70% of the CFP registrants were compensated by fees and commissions, or commissions only. 118/ A 1986 ICFP study reported that 70% of financial planners responding received at least 75% of their compensation from

114/ Id. at 17.

115/ Id. at 18.

116/ 1987 IAFP Consumer Survey on Fin. Attitudes, supra note 31, at Table 36 (responses to Q.6I).

117/ 1986 IAFP Membership Survey, supra note 60, at 3. A "bonus" may well be another form of commission. Recent stories have appeared in the press regarding the use of non-cash bonuses such as "exotic vacations and fancy gifts" to reward mutual fund salespeople for sales of featured funds. See, e.g., Quinn, Sponsors Are Sweetening the Pie for People Who Sell Mutual Funds, The Wash. Post, Aug. 17, 1987 (Business).

118/ 1987 IBCFP Survey Results, supra note 71, at 1.

commissions. 119/ And consumers who responded to a survey of Personal Finance Magazine subscribers reported the following means by which they compensated their planner: 37% paid fees only, 32% paid commissions only, and 11% paid both fees and commissions. Sixteen percent of the respondents did not know how they compensated their planner. 120/

Data from the American Society of CLU & ChFC also suggest that planners are very dependent on commission income. Only 14% of the respondents had a flat retainer fee relationship with their clients; only 33% charged professional fees for their services. 121/

The ADV Database's information on financial planner compensation showed that planners who are registered investment advisers seem to be less commission dependent than financial planners included in the Yellow Pages and other professional association surveys. Table 11 shows the percentage of advisers that receive the various types of compensation.

119/ A Look Behind the Scenes, supra note 66, at 74-75.

120/ 1987 ICFP Consumer Survey, supra note 53, at 2.

121/ ASCLU & ChFC 1985 Survey, supra note 61, at T-6 (Tables 15 and 16).

Table 11

COMPENSATION OF ADVISERS

	<u>Financial Planners</u>	<u>Non-Planners</u>	<u>All Advisers</u>
Hourly charges	74%	19%	50%
% of assets under management	28%	76%	46%
Fixed fees	54%	23%	41%
Commission	37%	8%	24%
Other benefit	9%	10%	10% <u>122/</u>

Source: ADV Database

122/ A small number (9%) of the advisers reported that, in addition to fees charged to clients, they also receive cash or some other economic benefit from non-clients in connection with giving advice to clients. This additional compensation arrangement was used by 14% of the financial planners, 6% of the discretionary investment managers, and 10% of the non-discretionary managers. In addition, 10% of all advisers pay fees to other persons in return for client referrals. Of that sub-group of advisers that pay referral fees, the practice is most prevalent among discretionary money managers. Nineteen percent of the discretionary managers pay referral fees, while just 9% of the non-discretionary managers and planners make such payments. As discussed below, the SEC has rules concerning the disclosure to clients of the payment of these so-called cash solicitation fees. See infra Chapter V.C.3.

An adviser often allows a client to choose from the several offered methods of payment for planning services. As shown in Table 11, non-commission charges to clients are usually on an hourly basis. Seventy-four percent of planner/advisers used or made available this fee arrangement. Fixed fees is the second most common method of non-commission compensation, made available by 54% of the financial planners.

Table 11 shows that only 37% of advisers who are also financial planners reported that they used or made available a compensation arrangement based on commissions. This percentage is substantially lower than the percentages reported in the surveys found in the literature. The SEC has no hard data to explain this difference. The probable explanation is that many advisers responding to the compensation question on Form ADV only identified their means of compensation for performing advisory services. If they also sold products pursuant to some other identity, for example, a broker-dealer or insurance agent, they did not regard that income as compensation for their advisory services.

The SEC Special Planner Inspections provided the most detailed breakdown of compensation methods for financial planners. Planners who charged a fee for preparing an initial financial plan for their clients earned a total compensation of \$745,000, which averages \$13,314 per respondent in 1986. The same group reported receiving a total of \$2,064,000 for all fee-based advisory activities, or an average of \$37,500 per planner, excluding commission income and income earned from other business activities. The source of this additional \$24,200 of income was the preparation of follow-up plans, or consultations and other advisory services for which an hourly or flat fee was charged. 123/ In contrast, the total amount of fees, commissions and other compensation received by the sales affiliates from product sales to all clients (not only those receiving financial plans) was \$109,413,000, which averages \$1,519,631 per respondent.

Planners inspected in the SEC Special Planner Inspections were found to have charged clients for services rendered in a variety of ways. Table 12 shows the number and percentage of

123/ Planners in the SEC Special Planner Inspections reported that during 1986, on average, they prepared a second complete or partial plan for an additional 18 clients, and had consultations with 23 clients that did not involve the preparation of a plan or the sale of products.

planners using the various methods listed. A planner could report using more than one method. 124/

124/ The SEC Special Planner Inspections did not capture data on the percentage of planners for whom commissions on sales were one means, but not the exclusive means, of compensation.

Table 12

HOW PLANNERS ARE COMPENSATED

	<u>Number Answering</u>	<u>Percent of Planners</u>
Hourly charges	44	54
Fixed fees for plan & consultation	35	43
Fixed fees for a plan	31	38
Percent of assets managed	13	16
Commissions only	10	12
Percent of client income	7	9
Percent of client assets	4	5
Fixed fees less commissions	3	4
Subscription fees	1	1

Total responses	148	
Average	1.8	

Source: SEC Special Planner Inspections
Item 21 of Registrant Outline

The table shows that 54% of the planners charged for their services on an hourly basis while 43% charged a fixed fee for plan preparation and related consultations. Many planners maintain several fee arrangements and allow each client to choose the most suitable fee arrangement. For example, a prevalent combination requires clients to pay a fixed fee for a plan and then to pay hourly charges for any consultations that take place after delivery of the plan.

The SEC Special Planner Inspections data show that each client paid, on average, \$1,375 for his financial plan; the median amount was \$500.

The Inspections also found that 82% of the financial planner/advisers who recommended mutual funds and variable annuities to clients as part of the financial plan were compensated through direct sales loads. The remainder (18%) were compensated through "12b-1" fees. ^{125/} Only a very small portion of advisers do not receive any commissions or other types of remuneration from products they recommend or sell. Again, a significant statistic regarding the compensation of inspected planners is that 69 of the 81 planners inspected, or 85%, are engaged in product sales either directly or through affiliates.

2. Products sold

a. In general

The SEC Special Planner Inspections sought information on the types of products sold to planner clients. To obtain this information, inspectors reviewed the products purchased by each of the 924 clients who comprised the sample of clients reviewed for the Inspections. The inspectors found that these 924 clients purchased 322 different mutual funds, 264 different limited partnerships, and 96 different types of insurance products, as

^{125/} Rule 12b-1 under the Investment Company Act, 17 C.F.R. § 270.12b-1 (1987), permits mutual funds to use fund assets to finance distribution of their shares, provided a number of conditions intended to protect fund shareholders are met. A fund is subject to the rule if it uses fund assets for, among other things, advertising compensation of underwriters, dealers and sales people, the printing and mailing of prospectuses to non-shareholders, and the printing and mailing of sales literature. Although 12b-1 fees are used to pay for sales and promotional expenses, they are not considered "sales loads," as that term is defined in the Investment Company Act, because 12b-1 fees are paid out of fund assets, rather than directly by investors.

well as a variety of other equity, debt, municipal and government securities. 126/ The total cost of products purchased by these clients was almost \$38 million, which averages about \$52,000 per product.

The Inspections also sought information regarding the overall importance of the sale of each type of product to the business of the planner or to the product sales organization affiliated with the planner. It found that of the 69 inspected planner/sales affiliate organizations that sold products, 58, or 84%, sold mutual funds, 56, or 81%, sold real estate limited partnerships, and 53, or 77%, sold term life insurance. On the other hand, only about half of the planner/affiliates sold United States Government securities, or exchange and NASDAQ-traded equity securities. 127/

One other statistic from the SEC Special Planner Inspections helps depict the nature of the product sales activity of planner affiliates. The planners were asked to list their top three income producing products: of the 69 organizations selling products, 47, or 68%, reported that the sale of mutual funds was

126/ SEC Special Planner Inspections, Item 1 of Product Outline. In all, the 924 clients purchased 724 different products from the sales organizations affiliated with the inspected planners during 1986.

127/ SEC Special Planner Inspections, Item 24 of Registrant Outline. The tabulated results are:

<u>Product type</u>	<u>Number selling to clients</u>	<u>Percent</u>
Investment cos. other than var. ins. prods.	58	84
Real est. lim. ptnerships.	56	81
Term life insurance	53	77
Univ. & variab. life ins.	52	75
Disability ins.	50	72
Other lim. ptnership. interests	43	62
Variable annuities	36	52
Equity securities other than lim. ptnerships. or mutual funds	36	52
Fixed annuities	35	51
U.S. Govt. securities	35	51

in the top three, and 41, or 59%, put the sale of real estate limited partnerships in the top three. 128/

b. Limited partnerships

The information regarding the sale of limited partnership interests is perhaps the most important information gained from the Special Inspections. The recommendation to clients that they purchase limited partnership interests distinguishes financial planner investment advisers from the more traditional investment advisers. These investments may pose a greater risk to clients than more traditional investments because the disclosures made about them may be less comprehensive than for other securities, 129/ or because limited partnership interests are more likely to be illiquid than are shares of stock in publicly traded companies, 130/ or because some limited partnership interests involve business ventures that are highly speculative. One feature of many limited partnership investments that accounts for at least some of their past appeal -- that they have been regarded as good tax shelters -- may no longer pertain following the Tax Reform Act of 1986. 131/

128/ These results are consistent with a survey of broker-dealers performed by Financial Planning in 1985. The survey reported that, in 1985, five large financial planning-oriented broker-dealers paid more than half of their total compensation out of mutual fund sales and ten paid more than half of their commissions through limited partnership sales. Veres, Who's Who in Planning, Fin. Planning, June 1987, 84, at 86.

129/ Limited partnership interests are often exempt from many of the disclosure requirements of the Securities Act of 1933.

130/ Liquidity concerns the ability of someone owning an investment to convert the investment into cash. Usually liquidity depends on the availability of other purchasers for the product. Limited partnership interests tend to be illiquid because there are usually "thin" or no markets for resale. Thus these interests either cannot be resold at all, or can be resold only at a substantial loss.

131/ The Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended at 26 U.S.C. § 1 et seq.). As discussed above, an important reason for seeking advice from a financial planner is tax avoidance. See supra Chapter V.A.6. and Table 3.

Regarding liquidity and risk, Item 7 in the product outline of the SEC Special Planner Inspections asked for information about the liquidity of limited partnership interests sold to planner clients as described by the offering circulars for such interests. Table 13 gives the results.

Table 13

LIQUIDITY OF LIMITED PARTNERSHIP INTERESTS
SOLD TO PLANNER CLIENTS

	<u>Number</u>	<u>%</u>
Illiquid: no secondary market	156	66
Somewhat liquid: limited secondary mkt.	64	27
Liquid: good secondary market	17	7
<hr/>		
TOTAL	237	100

Source: SEC Special Planner Inspections
Item 7 of Product Outline

As Table 13 shows, only 7% of the limited partnership interests sold to clients were regarded as liquid in the offering circulars used to sell them. The SEC Special Planner Inspections found that the average expected life of the limited partnership interests sold to clients was almost 17 years. 132/

Limited partnership investments may also present a risk of loss of the capital invested. Table 14 summarizes the degree of risk of the limited partnership interests sold to clients, as stated in the offering circulars for those interests.

132/ Limited partnership offering circulars usually estimate the life of the limited partnership by stating the year the general partner expects the partnership's assets to be sold or to stop generating income.

Table 14

DEGREE OF RISK IN LIMITED PARTNERSHIP INTERESTS
SOLD TO PLANNER CLIENTS

	<u>Number</u>	<u>%</u>
Speculative with a high degree of risk	105	44
Moderate risk	87	36
Low risk	29	12
No risk statement given	20	8
	<u>---</u>	
Total	241	

Source: SEC Special Planner Inspections
Item 6 of Product Outline

The table shows that 44% of the limited partnership interests sold were regarded by their issuer as speculative with a high degree of risk, 36% were regarded as moderately risky, and 12% were described as low risk. No specific risk statement was given for 8% of the offerings.

3. Disclosure

The disclosures a financial planner must make about its interest, financial or otherwise, in the products it sells depends on whether the planner is an investment adviser under the Advisers Act. Those that are not may nonetheless be subject to disclosure obligations as insurance agents or intrastate advisers, and must also avoid committing common law fraud, but they are not subject to the specific statutory disclosure obligations found in the Advisers Act. The following discussion is limited to investment adviser disclosure. The first part of the discussion will briefly summarize the disclosures mandated by the Act; the second part will discuss results of a survey of disclosures actually made on Forms ADV filed with the SEC by a sample of advisers; the third part will discuss disclosures required of broker-dealers executing trades for customers.

a. Advisers Act disclosure requirements

(1) Section 206

As discussed below, ^{133/} every adviser, including those exempt from registration under the Advisers Act, are subject to the requirements of the Act's antifraud provisions, which are found in Section 206 and the rules thereunder. To summarize here, paragraphs (1), (2) and (4) of Section 206 are general anti-fraud provisions. Paragraph (3) requires specific disclosure to the client whenever the adviser acts as a "double agent" in an agency cross transaction, or is a principal (*i.e.*, sells securities to or buys securities from the client) in transactions with the client. Compliance with paragraph (3) of Section 206 does not relieve advisers from the more general disclosure obligations of paragraphs (1), (2), and (4) of Section 206. These paragraphs require an adviser to disclose to clients any material facts concerning the adviser's conflicting interests. Disclosure required by Section 206(3) must be in writing. Disclosure need not be in writing under paragraphs (1), (2), and (4).

^{133/} See *infra*, Appendix B, text accompanying notes 52 to 61.

(2) Form ADV

The brochure rule 134/ requires investment advisers required to register under the Act to provide Part II of Form ADV, or a document containing, at a minimum, the information in Part II of Form ADV, to advisory clients upon initiation of an advisory relationship. The Form requires that advisers disclose conflicts of interest in two different ways: First, the Form poses a series of questions to which the adviser must respond by "checking a box"; second, the adviser must describe, in narrative form, the details underlying affirmative answers to the box-checking questions.

The key questions regarding conflicts of interest are as follows: 135/

- Does the adviser offer investment advisory services for commissions? (question 1C(5))
- Is the adviser actively engaged in a business other than giving investment advice? (question 7A)
- Does the adviser sell products or services other than investment advice to clients? (question 7B)
- Does the principal business of the adviser or its principal executive officers involve something other than providing investment advice? (question 7C)
- Is the adviser registered as (or has it applied to become) a securities broker-dealer (or commodities future professional)? (questions 8B and C)
- Does the adviser have arrangements that are material to its advisory business or its clients with a related person who is a broker-dealer, investment company, other investment adviser, financial planning firm, commodities professional, accounting firm, law firm, insurance company or agency, pension consultant, real estate broker or dealer, or an entity that creates or packages limited partnerships? (question 8C)

134/ See infra Appendix B.5.b.(4). This disclosure is required by Rule 204-3, 17 C.F.R. § 275.204-3.

135/ Most of the questions that follow are direct quotes from the Form. A few are paraphrases. Part II has other questions as well. The ones set forth here address conflicts of interest.

- Is the adviser or a related person a general partner in any partnership in which clients are solicited to invest? (question 8D)
- Does the adviser or a related person, as principal, buy securities for itself from or sell securities it owns to any client? (question 9A)
- Does the adviser or a related person as broker or agent effect securities transactions for compensation for any client? (question 9B)
- Does the adviser engage in agency cross transactions? (question 9C)
- Does the adviser recommend to clients that they buy or sell securities or investment products in which the adviser or a related person has some financial interest? (question 9D)
- Does the adviser buy or sell securities that it also recommends to clients? (question 9E)

Two other Form ADV questions require disclosure about conflicts: one asks whether the adviser has discretion regarding clients' securities trading, selection of brokers, or commissions paid to brokers (question 12); the other asks whether the adviser is compensated by third parties for giving advice to clients, or compensates third parties for client referrals (question 13).

b. Survey of disclosures on Form ADV

To assess disclosures actually made on Form ADV by financial planners who are registered advisers, a random sample of 98 Forms ADV were reviewed. These Forms ADV were drawn from a listing of all advisers registered with the SEC who had answered "yes" to the question on Part I of Form ADV asking whether the adviser provided financial planning services. ^{136/} Part II of the Forms ADV filed by the planners in the sample were reviewed to assess the disclosures made.

^{136/} The list was of the approximately 6000 advisers registered with the SEC on March 30, 1987 who had answered "yes" to the question whether they provided financial planning services.

(1) "Box checking"

One way to assess the disclosures advisers make concerning possible conflicts of interest is to examine for consistency their answers on the Form ADV to the questions regarding conflicts of interest. For example, as set forth above, there are a number of questions on the Form concerning:

- * the adviser's affiliations or activities with broker-dealers (questions 8A, 8B, 8C(1), 9B),
- * the adviser's sale of products to clients (questions 1C(5), 7B, 9A),
- * the adviser's other businesses (question 7A, 7C), and
- * the adviser's financial interest in the products it recommends to clients (8D, 9D).

To determine whether the advisers' disclosures had a reasonable degree of internal consistency, a number of cross tabulations were done of the questions with seeming common roots. For example, question 1C(5) asks whether the adviser offers investment advisory services for commissions; question 8C(1) asks whether the adviser has "material" arrangements with a broker-dealer. Most advisers answering "yes" to question 8C(1) might also be presumed to earn commissions, at least indirectly, from their advisory clients, and therefore need to respond affirmatively to question 1C(5). However, of the 52 advisers who answered "yes" to the broker-dealer "material arrangement" question, 28, or more than half (54%), answered "no" to the commission question.

Another set of questions that could indicate internal consistency of disclosures, is, again, the "commission" question (question 1C(5)) and the question whether the adviser sells products or services other than investment advice to clients (question 7B). Of the 59 advisers who affirmatively answered question 7B (disclosing that they did sell products or services other than investment advice to clients), 31, or 53%, responded negatively to the "commission" question.

Finally, concerning the "commission" question (question 1C(5)), one might expect some consistency between an affirmative response to that question and the question concerning whether the adviser or a "related person" as a broker or agent effects securities transactions for compensation for any client (question 9B). Of the 54 advisers who answered "yes" to the broker question, 30, or 55%, answered negatively to the "commission" question.

These answers suggest, but do not conclusively demonstrate, some inconsistency in the responses. An adviser with a broker-dealer affiliate could answer "no" to question 1C(5) and "yes" to questions 8C(1) and 9B, on the theory that its commission income was earned from performing the broker-dealer activities, not from rendering advice.

One pair of questions should have a very close correlation: question 8C(1) ("material" relationship with a broker-dealer) and question 9B (adviser or related person acts as a broker). Any adviser who answers "yes" to one should generally answer "yes" to the other, and any adviser who answers "no" to one should generally answer "no" to the other. Of the 98 advisers in the sample, 76, or 78%, did answer the pair of questions consistently; 22 did not. Of the 22, 10 said that they did have a "material" arrangement with a broker-dealer, but did not themselves or through a related person act as a broker-dealer. The other 12 answered in the reverse.

(2) Written disclosures

Part II of Form ADV requires a written explanation of questions answered in the affirmative. An evaluation of the quality of these written disclosures, both as to their inherent clarity, and in relation to the "boxes" checked, is necessarily a subjective one. Set forth below are a few examples of disclosures that seem reasonably clear as to the adviser's financial interest in products sold, and a few that do not. The advisers who made good narrative disclosure also generally checked the "correct" boxes.

"GOOD" DISCLOSURE

Adviser # 1: [Adviser] sells insurance products and receives commissions on those products.

[Adviser] is a registered representative with [Broker-dealer Firm], a registered Broker-dealer located at [address]. [Adviser] may also be an agent of [a mutual fund timing service]. As a result, if an advisory client implements recommendations made by [Adviser] by purchasing securities, there may be a conflict of interest since [Adviser] may receive commissions through [Broker-dealer Firm] his Broker-dealer.

Adviser # 2: I am a Registered Representative of [Broker-dealer Firm], a wholly owned subsidiary of [Firm]. . . . I may recommend products offered by [Broker-dealer Firm] or its affiliates. If my Client purchases these products through me, as a Registered

Representative of [Broker-dealer Firm], I will be compensated based on [Broker-dealer Firm's] normal commission schedule. Thus a conflict of interest exists. The client is under no obligation to purchase products I recommend, or to purchase such products through me or [Broker-dealer Firm].

Adviser #3: [Individual], an associated person with [Adviser], is a registered representative with [Broker-dealer Firm], a registered securities broker-dealer. As such he may receive commissions on certain investments clients may make. Persons associated with [Adviser] normally will suggest the use of the above broker to clients. The products offered through this arrangement will be the same as investments offered currently by other brokerage firms, and commissions will be those common in the industry. [Adviser] may at times sell securities to or buy securities from investment advisory clients or others as principal. [Adviser] may also recommend the purchase or sale of securities in which it or persons associated with [Adviser] may have a position.

While such relationships as those detailed above do present a conflict of interest because persons associated with [Adviser] will be receiving advisory fees while at the same time they may also be receiving commissions or other fees for the sale of securities, insurance or real estate, these facts are always disclosed to clients, the conflicts of interest are pointed out, and clients are free to seek execution of their orders and other transactions elsewhere.

"POOR" DISCLOSURE

Adviser #4: Insurance and investment products are sold on a commission basis only.

The marketing of insurance & investment products comprise most of the applicant's activities.

* * * *

As a registered representative with [Broker-dealer firm] investment transactions may take place. However, the client is free to choose any broker-dealer or insurance company for the implementation of his/her plan. Furthermore, the client is free

to select investment or insurance products other than those generically recommended.

[This adviser did not check "yes" to the commission income question.]

Adviser #5: During implementation I will take on the role of a registered representative with [Broker-dealer Firm] and will make sales of securities. This will occupy about 10% of my time.

[Broker-dealer Firm] is the broker-dealer through whom our investments would be made. It is a sister division of [Adviser's employer]. A representative of [Broker-dealer Firm] of which I am a registered representative, would actually make the securities sales to clients.

* * * *

After the planning is finished and implementation begins I will assume the role of a registered representative with [Broker-dealer Firm]. It will be made clear to the client that at the termination of the planning agreement I will be changing roles.

[This adviser did not check "yes" to the commission income question.]

Adviser #6: [Discussion of fee structure.] In addition I receive compensation from products sold through insurance companies and a broker dealer.

* * * *

[Adviser] also sells insurance and securities on a full time basis.

[Adviser] is registered with the [NASD] as a principal with [Broker-dealer Firm]. [Adviser] is also a general agent with [Life Insurance Firm].

[This adviser did not check "yes" to the commission income question.]

c. Broker-dealer disclosure

This report does not purport to provide a comprehensive review of a broker-dealer's obligations to disclose to clients

the "interest" the broker has in transactions effected for customers. The following is a brief summary of some of the key disclosure obligations.

Rule 10b-10 under the Exchange Act requires a broker-dealer executing a transaction with a customer to provide a written confirmation at or before completion of the transaction disclosing information concerning the transaction. 137/ The confirmation provides a customer with the terms of the trades executed by a broker-dealer. For trades in certain over-the-counter and exchange-listed securities, in which the broker-dealer acted as agent for the customer, the confirmation must disclose both the transaction price and the commission (or other remuneration). 138/ In trades in which the broker-dealer acted as a "risk" principal, 139/ the broker-dealer must disclose the reported trade price, the price to the customer in the transaction, and the difference, if any, between the reported trade price and the price to the customer in the transaction. Mark-ups would constitute the difference between the two prices. 140/ In riskless principal transactions, 141/ the

137/ 17 C.F.R. § 240.10b-10 (1987). The confirmation rule applies to transactions in all securities except United States Savings Bonds and Municipal securities. Municipal Securities are governed by MSRB Rule G-15 which provides disclosure requirements similar to Exchange Act Rule 10b-10.

138/ 17 C.F.R. § 240.10b-10(a)(7)(ii) (1987).

139/ A broker-dealer acts as a risk principal in a "transaction in which a broker-dealer sells securities to a customer out of its bona fide inventory or takes a customer's securities into its bona fide inventory." See Securities Exchange Act Rel. No. 15251, at n.54 (Oct. 20, 1978) (available in 15 SEC Docket 1370, 1328 (1978)).

140/ 17 C.F.R. § 240.10b-10(a)(8)(i)(B).

141/ A riskless principal transaction is one in which a broker-dealer (other than a market maker) acting as principal for its own account, after receiving an order to buy or sell a security from a customer, purchases the security from another person to offset a contemporaneous sale to such customer or sells the security to another person to offset a contemporaneous purchase from such customer. See Securities Exchange Act Rel. No. 15220 (Oct. 6, 1978) (15 SEC Docket 1260, 61 (1978)).

broker-dealer must disclose the amount of any mark-up, mark-down, or similar remuneration received by a broker-dealer. 142/

Rule 15c1-5, in essence, requires disclosure by broker-dealers of their relationship, if any, with the issuer of securities they sell to customers. The Rule defines as a "manipulative, deceptive, or other fraudulent device or contrivance," a broker-dealer's "induc[ing] the purchase or sale by such customer of" any security of an issuer with which the broker-dealer is under common control, unless the broker-dealer discloses the control relationship to the customer. 143/ Rule 15c1-6 requires similar disclosure of the broker-dealer's participation in the distribution of, or interest in, securities it sells or buys for customers. 144/

A broker-dealer is not required to send written confirmations for investments in money-market funds if the broker-dealer gives to the customer within five business days after the end of each monthly period a document disclosing, for example, each purchase or redemption. 145/

D. Registration

Under this heading, the Subcommittee asked the following questions:

With what state or federal regulatory authorities or self-regulatory organizations are financial planners registered?

Do the financial planners: file reports, submit to inspections or otherwise communicate with authorities or organizations?

142/ 17 C.F.R. § 240.10b-10(a)(8)(i)(A) (1987).

143/ 17 C.F.R. § 240.15c1-5 (1987). The Rule also requires such disclosure before the broker-dealer "effect[s] with or for the account of a customer any transaction in" such security.

144/ 17 C.F.R. § 240.15c1-6 (1987). The Rule also requires disclosure before the broker-dealer does any act "designed to effect with or for the account of such customer any transaction" in such security.

145/ 17 C.F.R. § 140.10b-10(c) (1987) requires this disclosure. Additional disclosure requirements are set forth in Rule 10b-10(c).

This section answers these questions; it is organized into subsections on registration by 1) the federal government, 2) state governments, 3) self-regulatory organizations, and 4) other organizations.

1. Federal registration

A financial planner is not required to register with any federal regulatory authority unless it meets the definition of an adviser under the Advisers Act or engages in activities, such as that of broker-dealer, that require registration under the Exchange Act. As noted earlier, the Advisers Act's definition of "adviser" includes "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. . . ." 146/ Some commenters believe that "it is virtually impossible today for a financial planner not to provide advice about securities". 147/ If this were the case, most financial planners would be advisers required to register with the SEC. 148/ There is, as yet, insufficient data from which to verify this view.

As disclosed in Table 15, from October 1, 1980 to October 1, 1987, the number of investment advisers registered with the SEC increased from 4,580 to an estimated 12,700; a growth of 173%.

146/ Investment Advisers Act, § 202(a)(11).

147/ Note, Financial Planning: Is it Time for a Self-Regulatory Organization?, 53 Brooklyn L. Rev. 143, 166 (1987) [hereinafter Financial Planning Note].

148/ Unless, of course, they were associated with an already registered investment advisory firm, or with a bank. See infra Appendix B.2., "Exclusions from the Definition of Investment Adviser."

Table 15

INVESTMENT ADVISERS REGISTERED WITH THE SEC
AT THE BEGINNING (OCTOBER 1) OF THE FISCAL YEAR

<u>Year</u>	<u>Number</u>
1981	4,580
1982	5,100
1983	5,445
1984	7,043
1985	9,083
1986	11,100
1987	11,000
1988	12,700 est.

Source: ADV Database.

The SEC staff believes that financial planners account for most of the growth in new registrants, but cannot substantiate this belief because, until 1986, Form ADV did not require the registrant to disclose the registrant's financial planning activities. Of the 12,700 investment advisers registered with the SEC, slightly more than half -- 7,000 -- currently report that they do financial planning. 149/

There is a vast discrepancy between estimates of the number of financial planners (50,000 to 250,000) in the literature 150/ and the number (7,000) estimated to be registered with the SEC. This discrepancy is partly explained by three factors.

First, estimates in the literature are usually based on the number of individuals who hold themselves out as performing financial planning. The SEC's figures are based on the number of entities, not individuals, that register. An entity can be one individual or can include several thousand employees. There is at least one registered adviser who employs 5,000 individual planners. In addition, even if the SEC staff were to tally the number of individuals employed by each financial planner registrant, limitations on Form ADV would prevent an accurate count because Form ADV has only one reporting category for registrants with 10 or more employees -- "10 or above." The ADV Database is thus simply inadequate to identify the number of individual planners employed by all but the smallest firms.

Second, the term "financial planner" is a catch-all for many activities that do not require registration, either at the SEC or in most states. For example, accountants providing only tax advice can call themselves financial planners and, as long as they do not receive special compensation for financial planning and the planning is solely incidental to their accounting practice, they do not have to register with the SEC. The same is

149/ See Chapter IV.B. (describing the ADV Database). In a report by the NASD it is estimated that approximately 50% of registered advisers are NASD members or associated persons. Nat'l Ass'n of Sec. Dealers, NASD Investment Adviser Pilot Examination Program, Association's Examination Study Group Report 8 (1986) (quoting SEC) [hereinafter NASD Pilot Exam Report].

150/ CFA Report, supra note 16, at 7. See also Kapner, NASD Looking Toward Creation of SRO for Investment Advisers, Inv. Dealers Dig., Nov. 4, 1985, at 4; Kapner, Financial Planning Industry Moves to Regulate Itself, Inv. Dealers Dig., July 22, 1985, at 8.

true for attorneys, insurance agents, broker-dealers and banks. Therefore, many financial planners may not be required to register with the SEC as investment advisers.

Finally, there is a public relations value to the use of the term "financial planner". Given that there are no restrictions on the use of that term, it is not surprising that a wide discrepancy exists between the number of planners registered with the SEC and the number of individuals reported in the literature to be financial planners.

Persons required to register with the SEC as advisers must comply with the Act's reporting 151/ and record keeping provisions. Registrants are also required to follow specific custody requirements. The SEC periodically inspects registrants to determine their compliance with the Act. 152/

As noted earlier, if, in addition to investment advice, the financial planner provides other services, it may have to register those other activities as well. For example, if an adviser acts as a broker-dealer, it will have to register with the SEC and relevant self-regulatory organizations pursuant to the provisions of the Exchange Act. 153/ If the planner sells insurance or real estate, it will have to be licensed to sell those products by the appropriate state or states.

2. State registration

An increasing number of states regulate financial planners or advisers or both. The majority of states (40) regulate advisers under their securities laws. 154/ Most jurisdictions

151/ Advisers register on Form ADV and file annual reports on Form ADV-S. They must amend Form ADV to disclose material changes. Additionally, they must furnish an informational brochure to clients, either by using Part II of the Form ADV or material containing all of the information in Part II. These requirements are discussed more fully infra, Appendix B.

152/ The SEC's inspection program is discussed infra Chapter V.E.

153/ A large number of financial planners are so registered.

154/ II Inv. Co. Inst., Investment Advisers Guide (State) 8-1 (1987) [hereinafter Investment Advisers Guide]. States that do not have requirements for adviser registration are: Alabama, Arizona, Colorado, Georgia, Iowa, Massachusetts, North Carolina, Ohio, Vermont, Wyoming, and Washington, D.C. (continued...)

that require registration of advisers and many that otherwise regulate advisers have adopted the Uniform Securities Act ("Uniform Act"). 155/ The Uniform Act, among other provisions, provides for the registration and regulation of advisers. The Uniform Act requires advisers to file annual financial reports and correcting amendments as needed and prohibits fraudulent activities. The Uniform Act also provides for periodic inspection of all records maintained by advisers. Dishonest or unethical practices in the securities business are considered grounds for revocation or suspension of registration in most states. 156/ Uniform Form ADV, the same as the SEC's Form ADV, is used for adviser registration in most States.

In the Uniform Act, the term "investment adviser" is defined to exclude banks, attorneys, accountants, teachers, engineers, broker-dealers, publishers, government securities advisers, and persons who have no place of business in the particular state. Generally, an adviser's compliance with the record keeping requirements of the Advisers Act will satisfy the states' record keeping requirements. 157/ Finally, the Uniform Act restricts the use of performance fees. 158/

Some states have only adopted parts of the Uniform Act. For example, eight jurisdictions that have adopted most of the Act do not require advisers to register. 159/ But most states that have adopted the Uniform Act have gone beyond its provisions. For example, although neither the Uniform Act nor the Advisers Act requires the registration of adviser representatives, twelve States have added that specific provision. 160/ A few States that have not adopted the Uniform Act nonetheless require the registration of representatives or agents of advisers. 161/

154/ (...continued)

See the State-By-State summary.

155/ Id. at 8-1.

156/ Id. at 8-4.

157/ Id. at 8-2, 8-3. States may differ in the number of years records are required to be maintained.

158/ Id. at 8-37.

159/ Id. at 8-6.

160/ Id.

161/ Id.

States that have not adopted the Uniform Act but which nevertheless require registration of advisers have some laws and regulations similar to those in the "uniform" states. However, in many cases, the provisions of the individual non-uniform state acts vary considerably from those of the Uniform Act. In some instances the non-uniform acts are stricter. For example, seven of the non-uniform states require an applicant to pass a qualifying examination to become licensed as an adviser or to become qualified as an adviser representative. Only 19 of the 31 states that have passed the Uniform Act also have an examination requirement. 162/

Several states also have provisions detailing the manner in which customer accounts are to be segregated if the adviser retains custody of client funds or securities. Several state laws also contain some regulation of advertising. 163/

Some states also prohibit licensed advisers from representing themselves as financial planners when the representation does not accurately describe the nature of the services offered, the qualifications of those offering the services, or the method of compensation for the services. 164/

A number of states prohibit an individual from acting as both a broker-dealer and an adviser unless the brokerage and advisory firms are under common control, or unless the broker-dealer acknowledges in writing that it is aware that the employee is also active as an investment adviser. States concerned with the dual registration of brokers and advisers frequently require advisory contracts to contain specific disclosures or otherwise require the adviser to obtain specific acknowledgements from the client that separate fees may be charged for both the advisory and brokerage activities.

162/ Id. at 8-7, 8-8. The Uniform Act does not require advisers to pass qualifying examination.

163/ Id. at 8-7.

164/ Address by Conrad G. Goodkind, Investment Company Institute Conference on Investment Adviser Operations and Regulation (June 20-21, 1984) (discussing special state registration considerations).

3. Self-regulatory organizations

There are, at present, no federally recognized investment adviser self-regulatory organizations ("SROs"). But, as discussed below, data from the ADV Database, the literature, and the SEC Special Planner Inspections all reveal a large number of dually registered advisers/broker-dealers. Since broker-dealers and their registered representatives must, by law, be members of a self-regulatory organization, 165/ many financial planners belong to a self-regulatory organization -- usually the NASD -- but do not belong to an SRO that regulates advisory activities.

The ADV Database shows that almost half of the registered advisers are either registered securities broker-dealers (10%); or have arrangements material to an advisory business or clients with related persons who are broker-dealers (35%). The percentage of financial planners who are also registered representatives and registered with the NASD is consistently high among the various financial planning surveys: 83% of the ChFC members, 166/ 73% of the NALU members who do financial planning, 167/ 70% of the IAFP members, 168/ 63% of the CLU members, 169/ and 24% of the FAF members 170/ report that they are registered with the NASD. A survey of financial planners listed in the California Yellow Pages found that more respondents were members of the NASD

165/ Securities Exchange Act of 1934, § 15(b)(8), 15 U.S.C. § 78o(b)(8).

166/ Selective summary of 1985 ASCLU membership survey (attached to letter from Burke A. Christensen, ASCLU Vice President & General Counsel, to Div. of Inv. Management, SEC (Aug. 20, 1986)) [hereinafter 1985 ASCLU Selective Summary].

167/ 1984 NALU-LIMRA Survey, supra note 43, at 3.

168/ 1986 IAFP Membership Survey, supra note 60, at 2.

169/ 1985 ASCLU Selective Summary, supra note 166.

170/ FAF Membership Survey, supra note 99, at I-19. In addition, 14% of the members of the AICPA Personal Financial Planning Division hold insurance broker or agent licenses, 11% are licensed broker-dealers, and 11% are real estate brokers. AICPA PFP Questionnaire, supra note 72.

(49%) than of any other organization, financial planning or otherwise. 171/

The SEC Special Planner Inspections found that of the 69 active product sales organizations affiliated with the 81 active inspected financial planners, 23 were registered as broker-dealers. All 23 broker-dealers were registered with at least the NASD. The remaining 46 entities were associated persons of broker-dealers. The sales activities of these associated persons are subject to the supervision of the registered broker-dealer.

4. Other organizations

The number of professional associations to which financial planners may belong is growing rapidly, each promoting its own definition of financial planning and its own ethical guidelines. 172/ Since membership in these organizations is voluntary, the organization's control over members is limited; when it brings an expulsion proceeding against a planner, the planner simply quits the organization. Nevertheless, the codes of conduct of these organizations have some effect on members, and loss of membership in some organizations can serve as a limited deterrent to improper conduct.

In addition to joining voluntary membership associations, many financial planners are members of a recognized profession -- attorney, accountant -- or have passed a qualifying examination. For example, to become a Certified Financial Planner (CFP), a candidate must meet certain education, examination, and experience requirements. 173/

A certifying board, the IBCFP, now grants and revokes the CFP designation. A survey of IBCFP members presents the multifaceted professional profile typical of planners: 36% of IBCFP's members are also CPAs, 34% are also CLUs, 20% are also

171/ Cal. Dep't of Corp. Survey, supra note 92, at 5; 48% belonged to the IAFP.

172/ Heffernan, Association Overload, Financial Planning, October 1986, at 100. A glossary of terms, including professional and trade associations, is provided in Appendix D.

173/ ICFP, a voluntary membership organization for financial planners with the CFP designation (or who are candidates for the CFP), has approximately 16,000 members. Investment Adviser, Financial Planner Subcomm. Hearings, supra note 2, at 183 (testimony of Charles E. Hughes, Jr., ICFP).

ChFCs and 10% are also JDs. 174/ Similarly, 36% of the ChFC members and 21% of the CLUs have additional professional affiliations (excluding registered representative and registered adviser). 175/ Of the respondents to a survey of financial planner/NALU members, 10% were CLU certified, 14% were ChFCs and 16% were enrolled in ChFC courses. 176/

The Chartered Financial Analyst ("CFA") designation is awarded by the Institute Of Chartered Financial Analysts, which administers the three examinations for the designation. In addition to the requirement to pass all three tests, candidates must have had three years of experience, and comply with a code of ethics and standards of professional conduct. The affiliated Financial Analysts Federation ("FAF") is a membership organization composed of investment managers and securities analysts who have passed the first CFA examination and are members of one of the 57 affiliated chapters and societies. The Code of Ethics and Standards of Professional Conduct are identical to those that of the Institute and both bodies have disciplinary programs that cooperate for joint members. The Institute has chartered 10,000 individuals as CFAs, and the Financial Analysts Federation lists 16,000 members. 177/

The Registry of Financial Planning Practitioners is administered by the International Association for Financial Planning.

174/ 1987 IBCFP Survey Results, supra note 71.

175/ ASCLU & ChFC 1985 Survey, supra note 61, at 30.

176/ 1984 NALU-LIMRA Survey, supra note 43, at 4. Other indications of the multiple memberships of planners may be found in the literature. Responses to an FAF survey disclose that 48% of the respondents are CFAs, 6% are certified investment counselors and CPAs, financial planners and attorneys are each 2%. FAF Membership Survey, supra note 98, at I-19. The IAFP claims to have more than 23,000 active members. CFA Report, supra note 16, at 19. The 1986 IAFP membership survey shows that 31% of those responding are CFPs, 20% are CLUs, 17% are ChFCs, 13% are CPAs (the fastest growing category) and 5% are lawyers. In addition, 70% hold life insurance licenses, 60% have health insurance licenses and 19% are licensed real estate agents. 1986 IAFP Membership Survey, supra note 60, at 2. This group ranked their primary affiliations as: IAFP- 50%, ICFP-17%, NALU- 13%, CLU- 11%, AICPA- 9%. Id. at 2.

177/ Morley, What's So Special About a CFA?, Pension World, Sept. 1985.

The Registry requires that candidates be in financial planning practice for three years, possess a CFP, ChFC, CPA, JD, LLM or a bachelors degree in business, pass a practice knowledge examination, provide references from five clients that have used the planner for two years and had a plan prepared, and submit a sample plan prepared for a client for review.

Registered advisers involved in financial planning and surveyed for the SEC Special Planner Inspections reported the following qualifications and memberships among non-clerical employees: 26% CFPs, 19% CLUs, 15% ChFCs, 14% listed in the Registry of Financial Planning Practitioner, 178/ 11% attorneys, and 10% CPAs. Advisers engaged in product sales generally fall into the same categories: 30% are CFPs, 21% are CLUs, 14% belong to the IAFP Registry, 12% are ChFCs, and 11% are attorneys. CFAs account for less than 3% of the registrants.

5. Summary

Financial planners, if they are advisers, register with the SEC and the securities regulators of most states. The SEC registered planners file annual reports and are subject to periodic inspections. The requirements of the states vary. Those registered advisers who also sell securities, and so are either broker-dealers or associated with broker-dealers, register with the SEC, the states, and self-regulatory organizations in their sales capacity, file annual reports, and submit to inspections. Many of the planners -- the proportion varies from source to source -- also sell insurance and so are regulated in that capacity by state insurance commissions.

E. Examinations/Inspections

Under this heading, the Subcommittee posed the following questions:

What level of examinations are financial planners/advisers subjected to?

What is the: amount of time before the first inspections and between subsequent inspections, number of existing uninspected planners/advisers, result of inspections, number and kind of violations, number and outcome of cases brought, and method of detecting violations (i.e., is detection the

178/ The IAFP Registry is discussed in the previous paragraph.

result of a scheduled inspection or a customer complaint)?

Although the Subcommittee asked the SEC generally to examine "the degree of abuse" in the industry, only the Subcommittee's requests relating to the inspection of advisers specifically requested data on law violations. Because of the importance of a discussion of law violations to full analysis of the advisory industry, the Subcommittee's last two questions above -- which deal with the cases brought and the detection of violations -- are covered in a separate subsection on enforcement.

The SEC's regional offices maintain the dates of adviser inspections on card files as part of their inspection targeting program. 179/ These data are not included in the SEC's central database and, therefore, exact numbers of first inspections, subsequent inspections, and existing uninspected advisers were not available. Other data were used to describe the frequency and scope of inspections.

1. Frequency and scope of inspections 180/

An important means by which the SEC oversees the regulation of advisers is the investment adviser inspection program. 181/ Each regional office is responsible for conducting a predetermined number of investment adviser inspections each year. The primary purposes of adviser inspections are: (1) to ascertain whether the adviser is in compliance with the Advisers Act and the rules and regulations thereunder; and (2) to ensure that the adviser's activities and services are consistent with the information disclosed to clients in the adviser's Form ADV 182/ and other documents furnished to clients. The inspections focus

179/ The files are now in the process of being computerized.

180/ For the sake of clarity, the activity of visiting, examining and reviewing an adviser's place of business will be referred to as an "inspection" rather than an "examination."

181/ Financial planners that are exempt from the Advisers Act because they are broker-dealers are subject to extensive SEC and self-regulatory organization inspection programs. See Securities Exchange Act § 17, 15 U.S.C. § 78q.

182/ Part II of Form ADV can be and often is delivered to clients to satisfy the brochure rule. Form ADV is discussed more fully infra Appendix B, text accompanying notes 30 to 37 and the brochure rule is discussed more fully infra Appendix B, text accompanying notes 62 to 63.

on the adviser's books and records, sales materials, investment activities, and the adviser's relationships and agreements with clients and affiliates.

Inspections are generally conducted on a surprise basis. Regional office examination staff choose which advisers to inspect since they are in closest touch with the advisers in their geographical area, and thus best able to keep track of possible problems.

Table 16 shows the number of advisers at the beginning of each year, the number of inspections performed each year, the percentage of the adviser population inspected each year, and the number of adviser inspections per staff year 183/ from 1980 to 1987.

183/ A staff year is the equivalent of one person working an entire year -- 2080 hours (52.2 weeks @ 40 hours/week).

Table 16

INVESTMENT ADVISER INSPECTIONS
1980 - 1987

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Advisers	4,580	4,580	5,100	5,445	7,043
Inspections	529	512	710	737	837
% Inspected	11.6%	11.2%	13.9%	13.5%	11.9%
Inspections/ staff year	10.5	10.4	18.6	18.7	24.3
		<u>1985</u>	<u>1986</u>	<u>1987</u>	
Advisers		9,083	11,100	11,000	
Inspections		1,039	1,337	1,294	
% Inspected		11.4%	12.0%	11.8%	
Inspections/ staff year		23.6	25.3	27.1	

Source: Compilation of SEC In-House Data

The table shows that the percentage of the adviser population inspected each year has varied from a low of 11.2% in 1981 to a high of 13.9% in 1982 when a major change in the way inspections were conducted was implemented. The decline in the percentage of advisers inspected annually between 1982 and 1987 is the result of the rapid growth in the adviser population rather than a decrease in the productivity of the inspection staff. Actually, the productivity of the inspection staff increased by over 156% in seven years, from 10.6 inspections per staff year in 1980 to 27.1 in 1987.

In addition to increasing productivity, the SEC's inspections program has also sought to improve the use of inspection time.

First, the SEC has increasingly tailored the scope and focus of adviser inspections to mirror the perceived risk in a particular adviser's operations. Second, the SEC has better coordinated inspections with state-conducted inspections. 184/ Finally, the SEC has made more effective use of inspection time by targeting for inspection those advisers who pose a risk to client assets either because of the nature of the adviser's business, or because of information in the SEC's possession pointing toward possible problems in the adviser's business. New advisers are also targeted for inspection, since an early review of their operations helps to acquaint them with their regulatory obligations and builds a foundation for later compliance. However, the SEC cannot inspect all new advisers during their first year of operation, because in most recent years the increase in new advisers per year has been larger than the number of inspections conducted per year.

The level of deterrence achieved from the inspection program is at least partly a function of each adviser's perception of the

184/ This coordination has taken a number of forms. For example, the SEC together with NASAA has developed a Form ADV that is uniform for the federal government and most of the states. This uniformity has eliminated gaps between the information required for federal and state regulation, and has increased the efficiency of adviser examinations. The SEC has also implemented a joint inspection and training program with the states. Under this program, the SEC staff has trained examiners in 20 states. Additionally, the SEC exchanges inspection schedules and findings with state examiners to increase inspection coverage and minimize duplication. For a discussion of the role of the states in the regulation of investment advisers see supra text accompanying notes 154 to 165.

probability of being inspected: the higher the percentage of the adviser population inspected, the greater the deterrent effect. The examination picture is complicated, however, because advisers whose activities pose a higher risk to client assets are inspected more frequently than those who do not.

2. Inspection results

Table 17 discloses the cumulative results of the SEC's inspection program over the last seven years (1980-1987). Table 17 shows: the number of inspections completed, the number of deficiency letters sent, the percentage of inspections that resulted in a deficiency letter, the number of inspections referred for possible enforcement action, and the percentage of total inspections referred for possible enforcement action.

Table 17

INVESTMENT ADVISER INSPECTION RESULTS
1980 - 1987

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Inspections	529	512	710	737	837
Deficiency letters	310	235	522	471	446
% Letters/inspected	59%	46%	74%	64%	53%
Enforcement referrals	26	33	45	35	56
% Referrals/inspected	4.9%	6.4%	6.3%	4.7%	6.6%

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>8 Years average</u>
Inspections	1,039	1,337	1,294	848
Deficiency letters	538	820	597	467
% Letters/inspected	52%	61%	54%	55%
Enforcement referrals	65	75	70	50.6
% Referrals/inspected	6.5%	6.5%	6.3%	6.0%

Source: Compilation of SEC In-House Data

Deficiency letters are sent to advisers when violations are discovered during inspections. Thus, the percentage of inspections that result in deficiency letters is an indication of the extent of violations among registered advisers. 185/

Inspectors refer most advisers with serious inspection deficiencies to the enforcement staff in the regional office. From 1980 to 1987 the percentage of inspections that resulted in enforcement referrals was in the 6% range. As with the deficiency letters, enforcement referral percentages have stayed relatively constant despite the increased productivity of the examiners.

These results from the overall program of investment adviser inspections fail to show, however, the kinds of deficiencies frequently found in inspections of planner/advisers. To provide this information, the SEC 1986 Inspection Report Review was conducted. 186/

The review was of the 1,337 inspection reports completed for calendar year 1986, out of which 294 were identified as reports of inspections of financial planners. The deficiencies found by inspectors were categorized to match the twelve standard focus areas normally used by the SEC inspectors in inspecting advisers. 187/

a. Deficiencies

Table 18 presents in statistical format the results of the SEC 1986 Inspection Report Review. The first line lists the "inspection category" of the deficiencies. The numbers, 1 through 12, correspond to the following deficiency categories:

1. Books and records
2. Financial matters
3. Registration
4. Custody arrangements

185/ See infra Chapter V.E.2.b. ("Resolution of deficiencies") for a discussion of deficiency letters.

186/ For a description of the SEC 1986 Inspection Report Review, see supra Chapter IV.D.

187/ These focus areas are described more fully infra.

5. Investment activities
6. Securities transactions
7. Advisory services
8. Contracts
9. Fees
10. Conflicts of interest
11. Advertising
12. Correspondence

Table 18

DEFICIENCY AREAS BY INSPECTION CATEGORY
FOR 1986 INSPECTIONS 188/

	No. of <u>Exams</u>	Categories of Deficiencies											
		<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>9</u>	<u>10</u>	<u>11</u>	<u>12</u>
All insp.	1,337	668	124	588	105	24	58	33	273	70	80	285	10
Deficiencies as % of inspections completed		50%	9%	44%	8%	2%	4%	2%	20%	5%	6%	21%	1%
Non-planner inspections	1,043	523	110	447	93	21	55	26	198	57	57	217	9
Deficiencies as a % of non-planner inspections		50%	11%	43%	9%	2%	5%	2%	19%	5%	5%	21%	1%
Financial planner (FP) inspections	294	145	14	141	12	3	3	7	75	13	23	68	1
Deficiencies as % of FP inspections completed		49%	5%	48%	4%	1%	1%	2%	26%	4%	8%	23%	

Source: Compilation of SEC 1986. Inspection Report Review Data

188/ The number of deficiencies reported actually somewhat understates the number of deficiencies found. For example, if an adviser was found not to have maintained three required records, it would in fact have three deficiencies. However, the SEC has not in the past quantified deficiencies that way, so the adviser is reported to have one books and records deficiency. Starting in fiscal year 1988 each deficiency will be counted as one deficiency.

As shown by Table 18, the deficiencies reported for financial planners are roughly similar in proportion to those for all advisers, and for non-planner advisers. To provide more background on the type of deficiencies associated with financial planners, the following discussion summarizes the principal deficiencies reported for each category as well as the problems these deficiencies represent.

(1) Books and records

Advisers are required to maintain accounting records typical of any ongoing business (e.g., general and auxiliary ledgers, journals, and source documents including check books, bills or statements of account) in addition to some records kept specifically for the purposes of complying with the Act. The number of record-keeping violations by financial planners is roughly correlated to two factors: (1) the number of clients the financial planner has and (2) whether the financial planner is associated with or registered as a broker-dealer.

The less active a financial planner is, the smaller will be the business need to maintain and preserve all of the formal records required by the Act, and the less likely it will be to comply with books and records requirements. For an inactive planner, a personal checkbook may be the simplest means for keeping track of revenues and disbursements. Thus, the inactive financial planner is often in technical violation of most of the Act's record keeping provisions and such deficiencies are reported. However, such financial planners obviously pose little risk to clients so long as they remain inactive.

Advisers offering financial planning services who are also registered as or associated with a broker-dealer normally maintain books and records sufficient for many of the record-keeping requirements under the Act. Because these advisers are dually registered, their records are subject to additional review by other organizations including the NASD, the broker-dealer's internal compliance unit, and external auditors. The SEC staff has found that these other reviews effectively reduce the number of technical books and records violations under the Act.

(2) Financial matters

Advisers are not subject to stringent and complex statutory financial responsibility requirements as are broker-dealers, unless, of course, the adviser is also a broker-dealer. Solvency of the financial planner is nonetheless of concern to the SEC because, if a financial planner that collects fees in advance is insolvent, it may not be able to fulfill obligations to clients. During calendar year 1986, examiners reported that 14, or almost 5%, of the 294 financial planners inspected were technically

insolvent. The SEC attempts to resolve these situations by requesting that the financial planner show that the planner's financial condition will not prevent it from fulfilling obligations to clients. 189/

(3) Registration

Of the 294 planners examined in 1986, 141, or 48%, had registration deficiencies. Deficiencies arise when a planner does not meet the registration reporting requirements or does not comply with the brochure rule. 190/

Examiners found that many financial planners were misinformed about the requirement to keep their registration forms current. They were also generally unaware of the requirement to file with the SEC the annual reporting form for advisers. The brochure rule problem was most often a failure annually to "offer to deliver" the written disclosure statement to clients and to maintain a record showing when the statement was provided. 191/

(4) Custody arrangements

In 12, or 4%, of the 294 financial planner inspections, deficiencies were found involving the custody rules. A planner with access to or physical possession of client funds and securities has "custody." Custody requirements include annual verification of the amount of client funds and securities held by the planner, and a surprise audit by an independent public accountant. 192/ A financial planner with custody of client funds and/or securities presents a risk to clients that the funds and/or securities may be lost if the planner becomes insolvent.

In the 12 situations cited, the financial planners were found to have had custody of their clients' funds

189/ The SEC recently adopted Rule 206(4)-4, 17 C.F.R. § 275.206(4)-4 (1987) to require advisers with custody or discretionary authority to disclose to clients the adviser's financial condition if that condition is reasonably likely to impair the adviser's ability to meet contractual commitments to the client.

190/ For a discussion of the brochure rule, see infra Appendix B.5.b(4).

191/ See Rule 206(4)-3, 17 C.F.R. § 275.206(4)-3 (1987).

192/ Rule 206(4)-2, 17 C.F.R. § 275.206(4)-2 (1987).

unknowingly. 193/ To resolve these situations, the examiners required the financial planners to choose between altering their arrangements so as not to have custody, or complying with the custody rules. None of these situations involved the loss of client funds.

(5) Investment activities

Deficiencies reported under this category involved the failure of financial planners to disclose fully that their investment recommendations were limited to the investment products offered through an affiliated broker-dealer. 194/

(6) Securities transactions

Deficiencies reported under this category involved the planner's failure to report and maintain a record of the personal securities transactions of all advisory representatives. Three of the 294 financial planner inspection reports cited this deficiency. In each situation, the financial planner failed to have a formal procedure for reporting and maintaining a record of these transactions. In each case the identification of these deficiencies resulted in the financial planner adopting procedures to report personal securities transactions.

(7) Review of advisory services

This category refers to deficiencies found in the allocation of client transactions and turnover of client assets under management. Few (seven in 1986) deficiencies were reported in this category. In all cases the financial planner was registered or associated with a broker-dealer and failed adequately to disclose brokerage allocation practices to clients.

193/ The most common cause of unintended custody is an overbroad power of attorney given by the client to the adviser. Other causes include, an adviser's taking temporary possession of client securities to deliver them to a broker-dealer, and an adviser's acting as a trustee to a trust established by a client.

194/ This disclosure is required under the general antifraud provisions of Section 206 of the Investment Advisers Act [15 U.S.C. § 80b-6]. In addition, item 8 of Form ADV requires advisers to disclose and describe other financial industry activities or affiliations.

(8) Contracts

Deficiencies relating to client contracts were found in 26% of the financial planners inspected (75 out of 294) in 1986, a somewhat higher percentage than the 20% average for all advisory inspections. Planners were deficient in three basic areas relating to contracts: "non-assignment" clauses, 195/ "hedge" clauses 196/ and non-disclosure of client refund policies. All of these deficiencies are common in the investment advisory industry and are not unique to planners.

(9) Fees

Thirteen of the 294 planners inspected (4%) had deficiencies associated with fee arrangements. There were three types of deficiencies reported in this category -- all concerning failures to disclose. Financial planners failed to disclose that: (1) the fee arrangement was subject to negotiation, (2) partial or full refunds were available to clients, and (3) their fees were substantially in excess of those of others providing the same service. 197/

(10) Conflicts of interest

In 23, or 8%, of the financial planner inspections, examiners found conflicts of interest problems. Special inducements or compensation received by the financial planner from third parties require full disclosure to the client. 198/

As discussed earlier, financial planners whose compensation depends on commissions from sales of products they recommend present continuing conflict of interest problems. These compensation arrangements are of special concern in inspecting financial planners; they require examiners to focus on the total

195/ A "non-assignment" clause must be included in each contract, stating that no assignment of the contract will be made without client consent.

196/ A "hedge" clause in a contract is language that may mislead investors into thinking that they have waived rights they would otherwise have under law.

197/ These disclosures are required by the general antifraud provisions of Section 206 of the Investment Advisers Act, 15 U.S.C. § 80b-6 (1987).

198/ These arrangements are required to be disclosed under Rule 206(4)-3, 17 C.F.R. § 275.206(4)-3 (1987).

relationship of the financial planner to clients -- not just the traditional investment adviser relationship.

(11) Advertising

Examiners found that 68 of the 294 financial planners inspected had deficiencies involving advertising. The most frequent advertising problem noted with financial planners was their use of the term "Registered Investment Adviser" or initials "RIA." in promotional materials. 199/ The use of the term "Registered Investment Adviser", or the initials "RIA," suggests that the person so designated has a level of professional competence, education, or other special training not justified by that designation. Another problem found by examiners was the use of testimonials, which are forbidden by SEC rule. 200/ One problem fairly common to other advisers, but not to financial planners, is the use in publications and advertising of performance statistics. Most planners do not provide portfolio management services, so they have no performance results to present.

(12) Correspondence

Examiners' review of correspondence includes a review of client complaints, internal memoranda and other correspondence relating to the financial planner's business. One purpose of this review is to determine whether the planner is involved in undisclosed material litigation which might have an impact on the planner's advisory business. In the inspections conducted in 1986, one planner was found deficient for having failed to disclose such litigation.

b. Resolution of deficiencies

There are two procedures other than referring the matter for enforcement action used to resolve deficiencies and violations discovered in inspections. As noted earlier in this subchapter, the principal procedure is to send a deficiency letter to the

199/ Section 208(a) of the Advisers Act, 15 U.S.C. § 80b-8(a), prohibits a registered investment adviser from implying or representing that his registration with the SEC indicates an approval or recommendation by the United States Government. Section 208(b) of the Act, 15 U.S.C. § 80b-8(b), states that Section 208(a) shall not be interpreted to prohibit a person from stating that he is registered if he is registered and if the effect of the registration is not misrepresented.

200/ Rule 206(4)-1(a)(1), 17 C.F.R. § 275.206(4)-1(a)(1) (1987).

adviser. The letter details the violations found in the inspection and requests that remedial action be taken. The second method is to inform the investment adviser of the deficiencies found during the on-site visit and allow the adviser to take corrective action.

Of the 294 financial planner inspections conducted in 1986, inspectors did not report any deficiencies in 81, or 28%, of the inspections. For the remaining 213 inspections (72%), deficiency letters were issued in 195 (66% of all exams) inspections while 18 (6%) were resolved on-site. These results vary somewhat from those reported for the resolution of deficiencies among all adviser inspections as reported in Table 19. They show that a higher percentage of planners were deficient in some respects (72%) than were non-planner advisers (49%).

Table 19

RESOLUTION OF DEFICIENCIES REPORTED IN INVESTMENT
ADVISER AND FINANCIAL PLANNER INSPECTIONS
DURING CALENDAR 1986*

	<u>Number of Exams Deficiencies Reported</u>	<u>Number of Exams Deficiency Resolved on Site</u>	<u>Number of Exams Deficiency Letter Sent</u>
All exams (1337)	724 (54%)	63 (5%)	661 (49%)
Non-planner exams (1043)	511 (49%)	45 (4%)	466 (45%)
Financial planner exams (294)	213 (72%)	18 (6%)	195 (66%)

*Excludes enforcement referrals.

Source: Compilation of SEC 1986 Inspection Report Review Data

c. Summary

The regional offices conducted regular inspections of 294 financial planners in calendar 1986. These inspections represented 22% of all adviser inspections conducted by the SEC. Financial planners had a higher rate of deficiencies when compared to all investment advisers. The top four categories of deficiencies included: (1) books and records, (2) registration and reporting requirements, including the brochure rule, (3) contractual problems, and (4) advertising. Deficiencies from record keeping and registration, including the brochure requirements accounted for more than 50% of the deficiencies reported for financial planners.

Inspectors cited deficiencies in 72% of the financial planner inspections conducted during 1986. In most (92%) of these situations, deficiencies were addressed through a deficiency letter sent to the registrant. Deficiencies found in 18 examinations were resolved on-site by the examiner.

F. Enforcement

This subchapter addresses the Subcommittee's questions regarding law violations in the financial planner industry, and the SEC's program to deal with these violations. The SEC's enforcement program is limited necessarily to violations of law that fall within the SEC's jurisdiction. Information about violative conduct of the larger universe of financial planners is found in the literature. ^{201/} In addition, in compiling data about, or reporting its enforcement activities regarding, investment advisers, the SEC does not differentiate between advisers who are financial planners and those who are not. Consequently, the discussion and data that follow concern cases brought against investment advisers generally, not just cases brought against financial planners. The discussion and data do

^{201/} See, e.g., CFA Report, supra note 16; Bamford and Flanagan, Watch Your Assets, Forbes, Oct. 8, 1984, at 21-39; Miller, Financial Adviser's Tumble Brings Charges of Fraud and Huge Losses, Wall St. J., Mar. 27, 1986 (Sect. 2); Downscale Planning, Fin. Planning, Feb. 1987; Auerbach, Financial Planners?, Sylvia Porter's Personal Finance, December, 1984 at 26; Rose, Incentives vs. Clients: Which Ones Most Concern Financial Planners?, Wall St. J., Nov. 24, 1986; Quinn, Sponsors Are Sweetening the Pie for People Who Sell Mutual Funds, Wash. Post, Aug. 17, 1987 (Business); Buy, Hold, or Sell this Broker, Barrons, Aug. 24, 1987 (commenting on the "inherent conflict of interest" of commission dependent advisers).

not include cases brought against broker-dealers who were not also registered (or required to be registered) as investment advisers.

1. Method of detecting violations

Information about potential violations comes to the SEC in a number of ways, including from: public complaints, informants, the securities industry, state and local agencies, and the SEC's routine inspections of advisers. Cause inspections are conducted when the SEC learns of a problem warranting on-site examination of an adviser. 202/

2. Customer complaints

Table 20 shows the number of complaints about investment advisers received by the SEC for the years 1981 - 1986. The number is most likely somewhat understated because the SEC records complaints against advisers who are also broker-dealers as broker-dealer, not adviser, complaints. 203/

Table 20

TOTAL COMPLAINTS AND COMPLAINTS AGAINST INVESTMENT ADVISERS
1981 - 1986

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Total	16,148	11,832	18,534	21,673	22,261	24,960
Invest. adv.	184	179	284	332	484	471
% of Total	1.14%	1.51%	1.53%	1.53%	2.17%	1.89%

Source:

The table shows that the number of complaints against advisers has grown in recent years, both absolutely and in proportion to other complaints. The number is still a small percentage of overall complaints.

The SEC reviews complaints to determine what action is warranted. The complaint may prompt a cause inspection of the adviser or may trigger an enforcement action.

202/ The SEC's inspection program is described supra Chapter V.E.

203/ A review of 100 broker-dealer complaints suggested that approximately 6% involved financial advisers of some type.

3. Enforcement cases

The SEC's formal process for enforcing compliance with the federal securities laws begins with the opening of an investigation. 204/ The investigation will either end without formal action or will result in civil or administrative proceedings or criminal references. 205/ The sanctions imposed on advisers who are found to have violated the law range from censure, to suspension or bar, to court-ordered injunction, to (in rare cases) fines and imprisonment.

To analyze the cases brought by the SEC against investment advisers (some, but certainly not all, of which may be financial planners), releases in the SEC Docket from January 1983 to July 1987 were reviewed to cull out the injunctive actions, administrative proceedings, and criminal references concerning investment advisers. In addition, the SEC's Case Automated Tracking System was used to determine the origin of the cases, and to provide other information about the cases not provided in the Docket.

As noted earlier, cases investigated and charged by the SEC come from a variety of sources. The sources of enforcement activities are set forth below in Table 21.

204/ Investigations may be formal or informal. Formal investigations are ones in which the SEC has issued a formal order of investigation, authorizing the staff to subpoena books, records, and testimony.

205/ Injunctive actions against advisers are brought under Section 209 of the Advisers Act, 15 U.S.C. § 80b-9; in addition to seeking an injunction, the SEC can also request appointment of a receiver, the freezing of assets, or other equitable relief as may be appropriate. Administrative proceedings against advisers are brought under Section 203 of the Advisers Act, 15 U.S.C. § 80b-3. In these proceedings, the SEC may determine to revoke or suspend the registration of an adviser, to limit the adviser's activities, or to censure the adviser. Possible criminal cases that the staff believes are egregious are referred to the Department of Justice for prosecution.

Table 21

ORIGIN OF SEC INVESTMENT ADVISER ENFORCEMENT ACTIVITIES
BY YEAR

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>Total</u>	<u>%</u>
Cause inspection	16	19	14	27	4	80	28%
Public complaint	17	32	12	17	2	80	28%
Routine inspection	12	11	13	10		46	16%
Informant	12	9	9	10	1	41	14%
State/Local agency	3	9	5	4	2	23	8%
Securities industry	6	3	3	1	1	14	5%
Other SEC divisions	3	2	4	1	3	13	5%
Other	7	12	5	8		32	11%
Total	76	97	65	78	13	329*	

* The total number of cases reflected in the "origins" table is larger than the actual number of enforcement actions because some cases listed more than one origin. The actual number of enforcement actions was 284. Percentages are calculated from 284 total cases for the January 1983 to July 1987 period.

Source: CATS

The table shows that the great majority of enforcement activities concerning advisers are prompted by information reaching the SEC indicating a problem with the adviser. Consistently over the years, cause inspections, public complaints, and referrals from outside the SEC (State/Local agencies, the securities industry, informants) account for a large percentage of the enforcement actions. But routine inspections -- the one source of actions not based on advance indications of problems -- also generate a significant number of cases.

Table 22 discloses the number and type of cases brought by the SEC against investment advisers from January 1983 through July 1987.

Table 22

SEC INVESTMENT ADVISER
ENFORCEMENT ACTIONS
JANUARY 1983 THROUGH JULY 1987

<u>Type of Action</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>Total</u>	<u>%</u>
Administrative proceedings	28	36	21	26	17	128	60
Injunctive actions	17	23	17	22	3	82	39
Civil contempt				3		3	1
Total	45	59	38	51	20	213	100

Source: SEC Docket, CATS

Table 22 shows that the annual number of enforcement actions remained relatively constant. Administrative proceedings were the most common method of enforcing investment advisers' compliance with the securities laws, with 60% of the total cases brought in this manner. Injunctions ranked next with 39%.

4. Violations alleged in cases

Table 23 shows the sorts of violations alleged against advisers in enforcement cases brought by the SEC between January 1983 and July 1987. The most common charge was fraud. 206/ In 85% of the 231 cases brought against advisers between January 1983 and July 1987, fraud was one of the charges alleged against the adviser. The second most common charge was violation of the record keeping requirements of the securities laws (35%), and the third, violation of registration requirements. As discussed above, 207/ record keeping and registration violations are by far the most common violations uncovered in the SEC's inspection program, but most of these violations result in deficiency letters, not in the institution of proceedings.

206/ For a discussion of the anti-fraud provision of the Advisers Act, see infra Appendix B.5.b.(3).

207/ See supra Chapter V.E.2.

Table 23

INVESTMENT ADVISER ADMINISTRATIVE PROCEEDINGS,
INJUNCTIVE AND CRIMINAL ACTIONS:
VIOLATIONS ALLEGED OR FINDINGS MADE BY YEAR
JANUARY 1983 TO JULY 1987

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>Tot.</u>	<u>%</u>	<u>*</u>
					(part)			
Fraud	44	53	39	45	15	197	85%	
Books & records	19	23	15	15	9	81	35%	
Failure to register	12	19	14	13	2	60	26%	
Other**	26	18	13	28	11	96	42%	

Source: SEC Docket

* Percentages equal more than 100% because many cases allege more than one violation.

** "Other" includes violations of prior injunctions; misleading statements on registration statements; conspiracy.

Table 24 discloses the type of proceeding or action brought against those charged with the three major types of violation during the same period. As the table discloses, criminal actions were brought only in a few cases, and then, only when the charge was fraud.

Table 24

INVESTMENT ADVISER ADMINISTRATIVE PROCEEDINGS,
INJUNCTIVE AND CRIMINAL ACTIONS:
VIOLATIONS ALLEGED OR FINDINGS MADE BY TYPE OF PROCEEDING
JANUARY 1983 TO JULY 1987

	<u>Admin.</u>	<u>Injunct.</u>	<u>Crim. 208/</u>	<u>Tot.</u>	<u>%*</u>
Fraud	91	86	20	197	85%
Books and records	55	26	--	--	35%
Failure to register	20	40	--	60	26%

* Percentages equal more than 100% because many cases allege more than one violation

Source: SEC Docket

208/ The SEC's data concerning the number of cases brought are not comprehensive because such cases are prosecuted by the Department of Justice.

VI. NASD PILOT PROJECT

A. Background

In the spring of 1986, the National Association of Securities Dealers announced a pilot program to determine the feasibility of inspecting the investment adviser activities of members. About half of the SEC registered investment advisers are "dual registrants", advisers who are registered with the SEC and are either an NASD member or associated with an NASD member. The NASD identified a group of dual registrant member firms that included both large and small firms. 209/ The NASD and the Division of Investment Management ("Division") then jointly selected NASD firms to be inspected.

Following a short (two-day) investment adviser training program for SEC and NASD inspectors participating in the pilot program, 210/ and further on-the-job training at the SEC's regional offices, NASD inspectors independently inspected 46 dually registered investment advisers of which 33 were found to be active. 211/ The NASD used their own specially developed checklist in 60% of the inspections. The SEC's inspection outline was used in the remaining 40% of the inspections. The NASD provided the Division with copies of their inspection reports.

To evaluate the NASD inspections, the SEC regional office adviser inspection staff reinspected 15 of the 33 firms that the NASD had already inspected. In order to provide a so-called "blind" comparison of SEC and NASD inspections, the SEC inspectors were not given copies of the NASD inspection reports. SEC headquarters staff then reviewed all 33 NASD reports and accompanying work papers and compared the NASD inspection results

209/ These firms had volunteered to participate in the NASD pilot inspection program. Some were financial planner firms, but the purpose of the pilot project was to measure the cost and feasibility of the NASD undertaking the program, not to inspect planner firms. Therefore, unlike the other chapters, this Chapter is not focused on financial planners. See NASD Pilot Exam Report, supra note 149.

210/ Examiners were provided with training materials, including regulations under the Investment Advisers Act, adviser registration forms, relevant adviser releases and staff interpretive letters, inspection outlines and sample inspection reports.

211/ The inspections occurred from September 1986 to April 1987.

with the results of the inspections of the 15 firms reinspected by the SEC.

B. Review of the NASD Reports

Review of the NASD inspection reports showed that NASD inspectors quickly became familiar with the Advisers Act and the basic records kept by advisers. The NASD inspectors readily identified important technical deficiencies in books and records, registrations, and advisory contracts. Many of the individual written reports showed that the NASD inspectors well understood general business practices, accounting principles, and the numerous investment products offered. While there was, inevitably, some difference in thoroughness among the inspectors, overall, the NASD inspectors covered the key inspection areas and properly documented their findings.

The amount of time NASD inspectors spent on-site seemed adequate in 29 of the 33 NASD inspections, in light of the adviser's operations and of the limited experience of the NASD inspectors in conducting adviser inspections. As to the remaining four inspections, two involved fairly large broker-dealer operations with affiliated financial planning activities; the size of these firms should have required a longer review than was conducted by the NASD inspectors. Whether a longer review would have uncovered additional deficiencies is uncertain since neither firm was one of the 15 firms that the SEC also inspected. The other two inspections were of firms the SEC also inspected. Problems found by the SEC but missed by the NASD inspectors were serious enough to warrant enforcement referrals.

The NASD inspectors did not limit their reviews solely to compliance with the regulations under the Advisers Act. They also looked for violations by advisers of the Exchange Act and the NASD's rules. It is difficult to include so many regulatory requirements in an inspection; that the NASD inspectors were able to do so at all, indicates the feasibility of expanding the NASD inspection program to cover the investment advisory activities of their members.

C. Review of SEC and NASD Dual Inspections

As noted above, for comparative purposes, 15 of the 33 active investment advisers inspected by the NASD were also independently reinspected by the SEC. Table 25 depicts the deficiencies found by the NASD and SEC using the SEC's twelve inspection focus areas.

Table 25

NUMBER OF DEFICIENCIES REPORTED BY
INSPECTION CATEGORY FOR SEC AND NASD EXAMINED FIRMS

	<u>Examining Entity</u>	
	<u>NASD</u>	<u>SEC</u>
<u>Deficiencies</u>		
Books and records	3	10
Financial matters	0	0
Registration	2	11
Custody arrangements	0	2
Investment activities	0	1
Securities transactions	0	0
Review of advisory services	0	0
Fees	2	4
Contracts	1	1
Conflicts of interest	1	7
Advertising	2	7
Correspondence	0	0
Total	11	43
Number of exams	15	15

Source: Compilation of NASD and SEC Examination Reports

The SEC reported a total of 43 deficiencies compared to 11 cited by the NASD. The explanation of the difference in the numbers is threefold. First, the NASD inspectors were inexperienced in Advisers Act inspections whereas the SEC inspectors were experienced. Secondly, the SEC typically includes as "deficiencies", practices by investment advisers that increase the risk of violations as well as those that actually are violations. Finally, many of the deficiencies noted by the SEC's examiners but not cited by the NASD consisted of violations of the more obscure, usually less significant, requirements of the Advisers Act, the kind predictably missed by inexperienced examiners. Most often they involved the adviser's failure to maintain a record of personal transactions by advisory representatives, or of the date that a copy of the firm's "brochure" was given to solicited clients. So, although the SEC reported a much higher number of deficiencies than the NASD in all categories except the category concerning fees, these numerical differences do not indicate incompetence on the NASD's part, nor was the exercise designed as a test of competence, but only of feasibility. The NASD inspectors exhibited a good understanding of the business operations and range of investment products offered by advisers.

A more serious problem is presented by the two inspections in which the SEC inspection resulted in an enforcement referral after the NASD inspection found only minor problems. In one referral, the SEC found two problems: the adviser failed to disclose to clients before a trade was made that the adviser was engaged in a principal transaction with the client, and the adviser furnished customers with misleading performance data. These activities violate the Advisers Act. In the other referral, the adviser arguably had violated the adviser's fiduciary responsibility in the allocation of directed brokerage. Although the first problem can be to some extent due to unfamiliarity with the Investment Advisers Act, the problem of directed brokerage touches on the NASD's own rules and the NASD inspectors should have caught it.

In the case of one registrant, the NASD and the SEC differed on their interpretation whether a fee-splitting arrangement, where fees were paid to a person soliciting clients for the registered investment adviser, was an arrangement subject to regulation. 212/

212/ The NASD interpreted the fee-splitting arrangement as one subject to all the applicable rule's requirements, including a requirement to disclose the arrangement to clients. The SEC examiner interpreted the arrangement to be an internal distribution of management fees not subject to the rule.

(continued...)

In summary, a review of the 15 examinations performed by both the SEC and the NASD showed that the NASD examiners had a working understanding of the Act and were able readily to identify basic or technical deficiencies relating to the SEC's key inspection focus areas. The NASD did miss important violations at two of the firms inspected, but overall, the performance of NASD inspectors was acceptable.

D. Conclusions

The results of the NASD pilot inspections showed that the NASD is capable of incorporating a compliance review of the adviser-related activities of members. Some additional training in the Advisers Act would be necessary, but there is no reason to think that NASD inspectors would fail to adapt to the regulatory scheme of the Advisers Act.

Incorporation of investment adviser inspections into the NASD's broker-dealer inspections would present a more difficult problem. Investment adviser inspections are not as number-based or generally as extensive as broker-dealer inspections. The pilot adviser inspections were not folded into regular broker-dealer inspections, nor should they have been, nor should a routine NASD adviser inspection program be merged with the NASD's routine broker-dealer inspection program. This combination of the large, quantitative broker-dealer inspections with the smaller, more subjective adviser inspections could relegate the smaller adviser inspection to a minor part of the overall inspection. If the NASD were to start inspecting the investment advisory activities of its members, procedures would have to be developed to assure that the adviser inspections are not made to compete with broker-dealer inspections for NASD examiner time in the administration of the inspection program.

A final potential problem is the inspection of NASD member firms with several branch offices. Although the branches often exhibit a high degree of autonomy from the central office, the NASD often heavily relies upon central office inspection to ensure compliance of the branch offices with the securities laws. This reliance can be misplaced. The large number of branch offices makes the cost of inspecting them on a regular basis high, but branch inspections are necessary to police adequately

212/(...continued)

SEC headquarters staff differed with both the NASD and SEC examiner, finding that the arrangement was subject to some of the rule's requirements, but not to the disclosure requirements.

adviser activities generally, and planner activities particularly. Financial planners, because of their involvement with individual clients, are much more likely to be located in the branch offices than at the broker-dealer's main office.

APPENDIXES

APPENDIX A

APPENDIX A

History of Investment Advisers Act 1/

The Act is the last in a series of federal statutes intended to eliminate abuses in the securities industry that Congress believed contributed to the stock market crash of 1929 and the depression of the 1930s. The Act is based on a Congressionally mandated study by the SEC of investment trusts and investment companies. 2/

The SEC responded to Congress' request for a study by conducting a survey of the investment services industry as it was then constituted. The SEC also held a public conference with representatives of some of the larger investment counsel firms who testified with respect to general problems and possible regulation of investment counsel organizations.

The SEC's report 3/ as presented to Congress subsequently

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- 1/ This discussion of the Advisers Act does not include all technical amendments to that Act.
 - 2/ SEC Report on Investment Trusts and Investment Companies, H. Doc. No. 477, 76th Cong., 2d Sess. (1939). The SEC study and subsequent report formed the basis for the enactment of the Investment Company Act of 1940 (the "Investment Company Act"), 15 U.S.C. § 80a-1 et seq.
 - 3/ Entitled "Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services," the supplemental report (hereinafter "SEC Report") was incidental to the SEC's main study of investment companies and was limited in scope. For example, it did not discuss publishers of impersonal investment advice, nor did it discuss the advisory activities of lawyers, accountants, or broker-dealers.

The SEC Report included appendices and tables which detailed the information that the SEC had received in response to an investment counsel questionnaire. For example, included were the following: list of investment counsel firms which replied to investment counsel questionnaire; list of investment trusts and investment companies with which investment counsel firms were affiliated at some time from January 1, 1933 to June 30, 1936; and affiliations of 56 investment counsel firms with investment company clients. The SEC Report also included state statutes with respect to invest-

(continued...)

was a compilation of the views of the SEC and of industry representatives. The Report was presented to Congress in 1939. After receiving the SEC Report and holding hearings, Congress concluded that federal legislation was necessary to correct the "problems and abuses" in advisory services, 4/ and, accordingly, passed the Advisers Act. The following is a discussion of these problems and abuses as identified by industry representatives, included in the SEC Report, and then considered and credited by Congress in passing the Act.

3/(...continued)

ment counselors (the statutes were from California, Connecticut, Michigan, New Hampshire, Oklahoma, and Rhode Island), and a statement of the purposes and objectives of the Investment Counsel Association of America and the Investment Counsel Association of Southern California.

In addition to considering the SEC Report, Congress held hearings which included testimony from, among others, members of the investment counsel industry and representatives of the SEC. Additionally, witnesses submitted documents which Congress considered. See Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess., pt. 2, 726-727, 997, 1005, 1023 (1940) (hereinafter S. Hearings). The most comprehensive of these documents was a memorandum prepared by the research department of the Illinois Legislative Council, entitled "Statutory Regulation of Investment Counselors." This memorandum discussed the meaning of the term "investment counselor" and the problems with reporting a precise definition; the advantages and disadvantages of state versus federal regulation of investment advisers; which advisers should be exempt from regulation, with a section devoted exclusively to the feasibility of regulating individuals who furnish investment advice solely by means of publications; a survey of existing regulations of advisers; and an enumeration of certain practices of investment counselors which were generally recognized as the phases of investment counsel activities most subject to abuse.

4/ S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940).

1. Investment adviser problems included in the SEC Report

a. Bona fide investment counselor vs. "tipster"

One problem in the industry, described both in the SEC Report and the legislative history of the Act, 5/ was the presence of the so-called "tipster," a person or an entity prone to making exaggerated claims and having no particular qualifications. 6/ The SEC Report and witnesses before Congress were both concerned that a distinction be made between "tipsters" and bona fide investment counsel providing personalized service based on research and experience. Many in the industry wanted to upgrade the profession and prohibit "'tipster' services which were masquerading as bona fide investment counsel." 7/

The profession of investment counselor was, itself, relatively new at the time of the Congressional hearings. Generally, prior to 1919, investment advice had been furnished by individuals and firms, "not as part of a business of servicing the investments of clients for a consideration but as ancillary to their regular business or profession. Lawyers, banks and trust companies, brokers and dealers in securities, in the course of their business furnished investment advice to their clients" 8/

However, after World War I there was a growth in the number of investment counselors unaffiliated with any other form of financial organization. 9/ Several causes were posited for this development, including that the class of investors had expanded from financial industry professionals to include private individuals who previously had been more likely to put their funds in savings banks and mortgages. 10/ Members of the existing

5/ The SEC Report formed the basis for much of the Act's legislative history. Id. at 5.

6/ Id. at 21-22.

7/ SEC Report, supra Appendix A, note 3, at 28.

8/ Public Examination, Investment Counsel Firms, at 21638, as found in SEC Report, supra Appendix A, note 3, at 3.

9/ Id.; S. Hearings, supra Appendix A, note 3, at 724.

10/ The sale of Liberty Bonds and the post war boom in stocks generated the interest of private individuals in stock. Public Examination, Investment Counsel Firms, at 21637-40,

(continued...)

investment counsel firms saw growth in the number of individual investors as a "gap in the financial picture . . . [in] that there was no agency which was solely representing the private buyer of securities." 11/ "The rise of investment counsel in the early 1920's was occasioned partly by certain weaknesses in . . . [the] investment banking system and partly by the increased complexity of the financial structure and operation of companies. A growing recognition by the investor of his difficulty in obtaining, under such conditions, competent and unbiased guidance in the management of his investments . . . caused a rapidly increasing demand for investment counsel services." 12/ The necessity for and the rapid growth of investment counsel service was due to "[a] great increase in the complexity in the numbers, and background of securities . . . available for investment." 13/ Losses experienced by investors during the depression years caused many public investors to seek continuous supervision and advice concerning their investments. 14/

A new class of "investment counsel" emerged to meet this need for unbiased investment information and guidance. These new professionals were characterized by two fundamental principles, "first, that they would limit their . . . activities to the study of investment problems from the investor's standpoint, not engaging in any other activity such as security selling or brokerage, which might directly or indirectly bias their investment judgment; and second, that their remuneration for this work would consist solely of definite, professional fees fully disclosed in advance."

The name 'investment counsel,' not then in use, was selected to describe both the work based on these two principles, and the persons engaged in that work." 15/

10/ (...continued)
as found in SEC Report, supra Appendix A, note 3, at 4.

11/ Id.

12/ S. Hearings, supra Appendix A, note 3, at 724.

13/ Public Examination, Investment Counsel Firms, at 21672, as found in SEC Report, supra Appendix A, note 3, at 23.

14/ Public Examination, Chain Store Stocks, Inc., at 15643, as found in SEC Report, supra Appendix A, note 3, at 5.

15/ S. Hearings, supra Appendix A, note 3, at 724.

Since investment counsel were supposed to furnish unbiased, continuous, personalized advice, many industry representatives did not want investment counsel to be tainted by conflicts of interest. Industry representatives testifying before the SEC asserted that investment counsel firms should be prohibited from engaging in any business other than that of rendering investment advice. They also suggested that investment counselors be "divorced" from the directorships of corporations because of the conflicts between a director's duty to the corporation and an adviser's duty to clients who might hold securities in the corporation. 16/ Other problems identified were trading by investment counselors for their own account in securities in which their clients were interested, 17/ and affiliations between advisers and investment bankers, 18/ and advisers and brokerage houses. 19/

b. Compensation

Industry representatives also questioned the propriety of "performance fees," i.e., fees contingent upon a percentage of profits in client accounts managed by advisers. Performance fees were then the basis upon which many advisers were compensated. Industry representatives saw this compensation arrangement as inimical to the best interests of clients, because it encouraged advisers to gamble with clients' funds, taking unacceptable risks in the hope of producing larger fees if successful, with nothing to lose if not successful, except their time and their clients' assets. 20/

16/ SEC Report, supra Appendix A, note 3, at 29.

17/ Id. at 29-30.

18/ Public Examination, Investment Counsel Firms, at 21687, as found in SEC Report, supra Appendix A, note 3, at 29.

19/ Id. at 21687, as found in SEC Report, supra Appendix A, note 3, at 29.

20/ Id. at 21714, as found in SEC Report, supra Appendix A, note 3, at 30. Or, as the Senate Committee expressed it, such arrangements were of the "heads I win, tails you lose" variety and should be prohibited. S. Rep. No. 1775, supra Appendix A, note 4, at 22.

c. Solvency and custody

Before passage of the Advisers Act, investment counsel organizations 21/ were not obligated to comply with any standards designed to protect client assets in the possession of advisers. Audits of books and records and verifications of clients' funds and securities by independent accountants were neither legally required nor voluntarily done. Because many investment counsel firms were organized as corporations, the shareholders or owners of such firms were insulated from personal liability in the event that the undercapitalized firm became insolvent. 22/

d. Assignment

Another problem disclosed in the SEC's review of the advisory industry was the practice of assigning advisory agreements. Customers who selected a particular adviser in reliance on the management and policies of the person controlling the firm might find their expectations frustrated by the transfer of a controlling block of stock of the investment counsel firm to another entity without client consent. 23/ Such a transfer often resulted in the receipt of advisory services substantially different from those a client expected to obtain when it first retained the firm. 24/

21/ The SEC Report identified as investment counsel organizations those firms or departments of firms which provided investment advisory services to individuals, investment companies, banks, life insurance companies, and other insurance companies. SEC Report, supra Appendix A, note 3, at 5-8.

22/ SEC Report, supra Appendix A, note 3, at 30. While the SEC Report discussed the solvency problem, the ensuing legislation did not deal directly with financial standards for advisers but relied on general antifraud prohibitions to govern how client funds were handled. See Section 206 of the Advisers Act, as first enacted.

23/ Id. at 30.

24/ S. Rep. No. 1775, supra Appendix A, note 4, at 22. The Act, in Section 205, required contracts between advisers and clients to prohibit assignment of the advisory contract without the client's consent.

2. The Investment Advisers Act of 1940

Some but not all of the problems noted above were addressed in the original Act. The proposed original bill also contained a section attributing specific abuses to the investment advisory profession. This provision was eliminated from the final version, apparently at the urging of advisers concerned with the irreparable harm a public indictment might cause their fledgling profession. 25/

a. Provisions of the Act as originally enacted

The original Advisers Act was modest in the regulatory scheme it imposed. The Act's basic purpose was to achieve, through a regulation and reporting process, a "compulsory census" of advisers. It sought to determine the number of people engaged in the advisory business; their associations; the extent of their authority; their backgrounds; and their handling of client funds. The Act also included a few broad provisions that prohibited fraud and the embezzlement of client funds. 26/

25/ See S. Hearings, supra Appendix A, note 3, at 715-717; Securities and Exchange Comm'n v. Capital Gains Research Bureau, 375 U.S. 180, 191-92 (1963). As proposed by the SEC staff, Section 202 of the Act would have declared that the national public interest and the interests of investors are adversely affected when: (1) investors are unable to obtain adequate information as to the activities, practices, ability, training, and integrity of advisers and their associates; (2) persons of proven lack of integrity in financial matters are permitted to engage in business as advisers; (3) the compensation of advisers is based upon profit-sharing contracts and other contingent arrangements conducive to excessive speculation and trading; or (4) the business of advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients. Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess., pt. 1, 29, 33 (1940). In contrast, the Investment Company Act of 1940 "Findings and Declaration of Policy" provision included a survey of the problems in the investment company industry that led to the enactment of that Act. Compare Section 201 [15 U.S.C. § 80b-1] of the Advisers Act with Section 1(b) [15 U.S.C. § 80a-1(b)] of the Investment Company Act. See S. Hearings, supra Appendix A, note 3, at 606, 715-717.

26/ S. Hearings, supra Appendix A, note 3, at 48.

1) Registration and reporting

To implement this "compulsory census," the Act required advisers to register with the SEC by filing an application containing specified information. 27/ Certain advisers were exempted from registration by the Act. 28/ Other persons engaging in investment advisory activities were excluded from the Act's definition of "investment adviser" and were thus not subject to any provisions of the Act. 29/ Registration could be denied or revoked if the registrant had been convicted of certain crimes within ten years of registration or had been enjoined by a court in connection with a securities or financial fraud, or if the registrant's application was materially misleading. 30/

The Act also required a registered adviser to file with the SEC annual and special reports to keep current the information in the registration application. 31/

2) Prohibited and regulated transactions

The Act went beyond a mere registration statute. It also prohibited or limited certain practices. The antifraud provision

27/ Section 203(a) [15 U.S.C. § 80b-3(a)].

28/ Section 203(b) [15 U.S.C. § 80b-3(b)] exempted from registration (1) any adviser, all of whose clients resided in the state in which the adviser maintained his principal place of business, and who did not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange; (2) any adviser whose only clients were investment companies and insurance companies; and (3) any adviser who had fewer than 15 clients and who did not hold itself out to the public as an adviser. Subsequent amendments to this section will be discussed infra.

29/ Section 202(a)(11) [80 U.S.C. § 80b-2(a)(11)] of the Act specifically excluded from the definition of "investment adviser" the following: banks or bank holding companies, lawyers, accountants, teachers, engineers, publishers, advisers whose practice was limited to government securities, and broker-dealers whose performance of advisory functions was solely incidental to the broker-dealer business.

30/ Section 203(d) [15 U.S.C. § 80b-3(d)].

31/ Section 204 [15 U.S.C. § 80b-4].

prohibited transactions and practices which defrauded or operated as a fraud or deceit upon clients or prospective clients. 32/ A specific conflict of interest provision was included in the antifraud provision to address instances in which an adviser dealt with an advisory client as agent for another, or as a principal. 33/ "Performance fees" also were prohibited. 34/

To remedy another abuse identified in the SEC Report, the Act also prohibited the assignment of investment advisory contracts without the client's consent. 35/

3) Unlawful representations

The Act prohibited unlawful representations, including the representation or implication that any person registered under the Act had been sponsored, recommended, or had its ability or qualifications passed upon by the United States or any federal agency. 36/ In an attempt to address the "tipster" problem, 37/

32/ Section 206 [15 U.S.C. § 80b-6].

33/ Section 206(3) [15 U.S.C. § 80b-6(3)]. An adviser was prohibited from selling securities to or purchasing securities from any client, either as a principal for its own account or acting as a broker for a person other than such client, without first advising the client in writing of the capacity in which the adviser was acting in the specific transaction and obtaining the client's consent. See also Rule 206(3)-2 [17 C.F.R. 275.206(3)-2]; Investment Advisers Act Rel. No. 40 (Feb. 5, 1945). The Rule allows clients to consent in advance, i.e., give a general or blanket consent, to agency cross transactions provided that the adviser discloses such transactions by means set forth in the Rule.

34/ Section 205 (1) [15 U.S.C. § 80b-5(1)]. A performance fee bases the adviser's compensation on a share of capital gains or capital appreciation of the client's funds. The performance fees prohibition is discussed more fully infra.

35/ Section 205(2) [15 U.S.C. § 80b-5(2)]; Section 202(a)(1) [15 U.S.C. § 80b-2(a)(1)] of the Act defined "assignment" to include a transfer of a controlling block of stock in an adviser by a shareholder of such adviser. Section 205 further provided that, if the adviser is a partnership, the client must be notified of any change in membership.

36/ Section 208(a) [15 U.S.C. § 80b-8(a)].

37/ See supra Appendix A, text accompanying notes 5 to 19.

the Act also provided that no registered adviser could use the name "investment counsel" to describe the adviser's business unless it was primarily engaged in the business of rendering investment supervisory services. 38/ As discussed below, 39/ the 1960 amendments to the Act somewhat modified this prohibition.

4) Administrative and enforcement machinery

The Act's enforcement provision empowered the SEC to conduct investigations into an adviser's conduct whenever it appeared that the law was being, or was about to be, violated. The Act gave the SEC the typical investigative tools, including the power to subpoena, administer oaths and affirmations, take evidence, and require the production of any documents which were relevant and material to an inquiry. 40/ The Act also empowered the SEC to seek injunctive relief whenever the SEC determined that a violation had occurred, was occurring, or was about to occur. 41/

5) Publicity

The Act "provide[d] for confidential treatment of information obtained in the administration and enforcement of the title, to the extent that such treatment [was] consistent with efficient enforcement." 42/

38/ Section 208 [15 U.S.C. § 80b-8]. Section 202(a)(13) [15 U.S.C. § 80b-2(a)(13)] of the Act defined "investment supervisory services" as "the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client." The Act thus recognized the existence of a class of advisers characterized by a personalized relationship with clients.

39/ See infra Appendix A, text accompanying notes 43 to 63.

40/ Section 209(b) [15 U.S.C. § 80b-9(b)]. The SEC could also invoke the aid of any federal court of appropriate jurisdiction to compel compliance with subpoenas.

41/ Section 209(e) [15 U.S.C. § 80b-9(e)].

42/ See Section 210 [15 U.S.C. § 80b-10]. S. Rep. No. 1775, supra Appendix A, note 4, at 23.

b. 1960 amendments

The first amendments to the original Advisers Act were passed in 1960, 43/ fifteen years after the SEC had first urged such action in a special report to Congress. 44/ To strengthen the enforcement of the Act and extend the Act's coverage, the following amendments were made:

1) Records and inspection

The Act had not required advisers to maintain books and records, nor had it authorized the SEC to examine the adviser's books and records, except pursuant to an investigation of a suspected violation of the Act. Because "[t]he prospect of an unannounced visit of a Government inspector is an effective

43/ Investment Advisers Act-Amendments; Pub. L. No. 86-750, Sections 1-16, 74 Stat. 885 (1960).

44/ Loss, Vol. II, Ch. 8D, 1393 n.2, citing SEC, Protection of Clients' Securities and Funds in Custody of Investment Advisers (1945), summarized in Inv. Adv. Act Rel. 39 (1945). According to Professor Loss:

A bill was introduced shortly after this report was submitted. . . . But hearings were never held. The 1957 and 1959 legislative programs . . . repeated substantially the same proposals among others. And the January 1959 report on independent regulatory commissions by the House Special Subcommittee on Legislative Oversight concluded: "It is time, in view of the increasing public reliance upon investment advisers, to strengthen the act and make it more than a mere census taking of persons in the investment advisory business." . . . Finally, most of the 1945 proposals . . . became law in late 1960. These, aside from a minor amendment of one section of the 1939 act, were the only part of the five-act legislative program of 1959 to clear the last hurdle . . . -- presumably because "This was the only bill in the Commission's legislative program which was supported without dissent by the industry."

Loss, supra Appendix A, note 44 (citations omitted) (quoting S. Rep. No. 1760, 86th Cong., 2d Sess. 2 (1960)).

stimulus for honesty and bookkeeping veracity," 45/ the Act was amended to authorize the SEC to require advisers to keep books and records as the SEC prescribed by rule, and to allow reasonable inspection by the SEC. 46/

2) Sanctions and disqualifications from registration

The Act as originally adopted provided that registration could be denied or revoked if the registrant had been convicted of certain crimes within ten years or had been enjoined by a court in connection with a securities or financial fraud, or if the registrant's application for registration was materially misleading. 47/ The Act was expanded in 1960 to allow the SEC to exclude from registration any person convicted of embezzlement, fraudulent conversion, or misappropriation of funds or securities; anyone who had violated the mail fraud statute or who was subject to any injunction based on such activities; anyone, on the basis of the SEC's findings, who had willfully violated the Securities Act of 1933 (the "Securities Act"), 48/ the Securities Exchange Act of 1934 (the "Exchange Act"), 49/ the Investment Company Act, or the Advisers Act; 50/ and any adviser who had aided, abetted, counseled, induced, or procured any person to commit the acts which were grounds for disqualification. Congress also recognized that certain similarities existed between advisers and broker-dealers, especially since both "occupations involve[d] similar delegation[s] of trust and responsibility; consequently, one banned from the latter occupation should not be allowed to enter the first." Thus, a

45/ Amendments to the Investment Advisers Act of 1940, S. Rep. No. 1760, 86th Cong., 2d Sess. 3 (1960).

46/ Section 204 [15 U.S.C. § 80b-4]. Advisers exempt from registration under Section 203(b) were not required to keep such records, nor were they subject to inspection.

47/ Section 203(d).

48/ 15 U.S.C. § 77a et seq.

49/ 15 U.S.C. § 78a et seq.

50/ Until the 1960 amendments the SEC could not deny or revoke an adviser's registration on the basis of a finding of a willful violation of the Securities Act, the Exchange Act, the Investment Company Act, or the Advisers Act.

willful violation of the Exchange Act 51/ or the Securities Act 52/ ". . . [was made a] ground for disqualification [from registration as an adviser under the Act.]" 53/ Finally, under the original Act, if an adviser engaged in any of the activities prohibited by original section 203(d), the only sanction the SEC was empowered to impose was revocation of the adviser's registration. 54/ The 1960 amendments gave the SEC the additional power to suspend an adviser for a period not to exceed twelve months. 55/

3) Extension of antifraud provisions and rule making authority

The extension of the antifraud provisions of the Act 56/ to advisers who were not registered with the SEC, either because they failed to comply with the Act's registration requirements or because they were expressly exempted from those requirements, 57/ was one of the most significant amendments to the Act. The anti-fraud section was also amended to empower the SEC to promulgate rules and regulations, which would define and prescribe means reasonably designed to prevent acts and practices which were fraudulent, deceptive, or manipulative. 58/ This change was thought to be appropriate because the statutory language, while generally proscribing fraudulent and deceptive activities, had not provided for prophylactic rules designed to prevent those activities. 59/

51/ 15 U.S.C. § 78a et seq.

52/ 15 U.S.C. § 77a et seq.

53/ S. Rep. No. 1760, supra Appendix A, note 44, at 2-3.

54/ Id. at 5.

55/ Id. at 5.

56/ Section 206 [15 U.S.C. § 80b-6].

57/ Section 203(b) [15 U.S.C. § 80b-3(b)].

58/ Section 206(4) [15 U.S.C. § 80b-6(4)].

59/ S. Rep. No. 1760, supra Appendix A, note 44, at 4, 7.

4) State law

Because very few states regulated advisers in 1940, the original Advisers Act did not include a provision dealing with possible conflicts between federal and state law. 60/ In 1960, the Act was amended to provide concurrent state-federal jurisdiction in the regulation of advisers so long as no conflict existed with the Act's other provisions or accompanying rules. 61/ Concurrent jurisdiction was provided "in view of the important role which State authorities must play in the supervision of securities." 62/ Additionally, the Act was amended to make clear that information which tends to indicate a violation of state law gathered by the SEC in an inspection or an investigation could be disclosed to appropriate state officials. 63/

3. 1970 amendments

The Act was amended again in 1970. 64/ The amendments had

60/ See id. at 9.

61/ Section 222 [15 U.S.C. § 80b-22]; S. Rep. No. 1760, supra Appendix A, note 44, at 9.

62/ S. Rep. No. 1760, supra Appendix A note 44, at 9.

63/ Section 210(b) [15 U.S.C. § 80b-10(b)]; S. Rep. No. 1760, supra Appendix A, note 44, at 9. This information can only be disclosed with SEC approval.

64/ Investment Company Amendments Act of 1970, Pub. L. No. 91-547, Sections 23-26, 84 Stat. 1430, 1452-57 (1970). The advisory industry supported these amendments. See S. Rep. No. 184, 91st Cong., 1st Sess. 3 (1969). The Senate reported the events leading to the passage of these amendments:

During the 1950's a dramatic surge of growth -- a surge that has continued to this day [1969] -- made mutual fund companies an investment medium of major significance. Therefore, in 1958 the Commission . . . authorized the securities research unit of the Wharton School of Finance and Commerce of the University of Pennsylvania to study investment companies and to report its findings. This study, known as the Wharton report was transmitted to the Congress in August of 1962. The Wharton report assembled a wealth of factual material

(continued...)

four major effects. First, they extended the registration requirements to include advisers to investment companies. ^{65/} Second, they strengthened the revocation and sanction provisions by, among other things, giving the SEC the power directly to

^{64/}(...continued)
about the mutual fund sector of the investment company business and identified what its authors believed to be the more important problems facing the industry. The report, however, made no legislative recommendations.

While the Wharton report was being prepared, the Securities and Exchange Commission was also making a detailed study of the securities industry and the securities markets. . . . Among the subjects with which this special study dealt were the sale of mutual fund shares and the special problems connected with the sale of contractual plans on the installment basis.

The Wharton and the special study reports led the SEC to make further inquiries. It presented the results of these inquiries and a detailed program for amending the act in its report on the Public Policy Implications of Investment Company Growth, transmitted to the Congress on December 2, 1966.

. . . . [Bills were introduced and hearings were held on the proposed legislation during 1967, 1968 and 1969.] As a result of these hearings many changes were made in the proposed legislation. This was due to the information derived from written and oral presentations on behalf of the Commission as well as from numerous lawyers, economists, and other individual witnesses knowledgeable in investment company matters. Testimony was also received from many representatives of the investment company industry on economic matters involved and on the regulatory problems presented.

Id. at 3-4.

^{65/} Section 203(b)(2) [15 U.S.C. § 80b-3(b)(2)]; S. Rep. No. 184, supra Appendix A, note 64, at 44.

sanction associated persons of an adviser. 66/ Third, they gave the SEC the power to exempt any persons or transactions from any or all provisions of the Act. 67/ Fourth, the amendments permitted registered advisers to charge investment companies and certain wealthy clients a limited type of performance fee. 68/ Finally, the Act was amended to add violations of the Investment Company Act and the failure to supervise employees as grounds for sanction. 69/

66/ Section 203(e) and (f). Additionally, the amendments gave the SEC the power to censure an adviser for, among other things, securities laws violations committed by the adviser's associated persons.

67/ Section 206A [15 U.S.C. § 80b-6A]; S. Rep. No. 184, supra Appendix A, note 64, at 46. The SEC must find that such action is necessary or appropriate in the public interest, and consistent with the protection of investors and the purposes and policies of the Act.

68/ Section 205 [15 U.S.C. § 80b-5]. Investment companies or any other client other than employee benefit plans having \$1 million managed by the adviser could agree to pay a fee based on proportionate increases and decreases in the funds under management, as measured against an appropriate index of securities prices or such other measure of performance specified by the SEC. This type of fee is known as a "fulcrum fee".

69/ In creating a statutory duty to supervise, Congress also provided a safe harbor that allowed an adviser to fulfill the duty of supervision if the adviser (1) established procedures to prevent and detect violations by employees; and (2) reasonably discharged the duties and obligations imposed by such procedures without reasonable cause to believe that these procedures were not being complied with. Sections 203(e)(5) and (f) [15 U.S.C. § 80b-3(e)(5) and (f)]. The statutory duty of advisers to supervise employees is identical to the broker-dealer's duty to supervise employees [15 U.S.C. § 78o-15(b)(4)(E)].

a. 1975 amendments

Technical amendments were added to the Act in 1975. 70/ The major effect of the amendments was to require advisers to furnish books and records and other reports to clients as the SEC prescribed by rule.

b. 1976 proposed amendments

The SEC recommended amendments in 1976 to establish minimum qualification standards for persons seeking registration as advisers under the Act, and to require advisers to meet minimum financial responsibility standards. 71/ In addition, the SEC proposed elimination of the exemption from registration for intrastate advisers. The SEC also proposed creation of a statutory private right of action under the Act for clients who could allege financial damage stemming from violations of the Act by advisers. 72/ Finally, the SEC sought through the proposed legislation authority to conduct a formal study of the feasibility of establishing investment adviser self-regulatory organizations. Congress did not act on these proposed amendments. 73/

70/ Securities Acts Amendments of 1975, Pub. L. No. 94-29, Section 29, 89 Stat. 97, 166-69 (1975). The amendment to Section 204 [15 U.S.C. § 80b-4] made the definition of records under the Act consistent with the definition of records in the Exchange Act. Another technical amendment lengthened the statutory period for staff review of adviser registration statements from 30 to 45 days, and required affirmative action by SEC staff to make effective an adviser's registration. See Section 203(c)(2) [15 U.S.C. § 80b-3(c)(2)].

71/ S. 2849, 94th Cong., 2d Sess. (1976) (to amend section 208 by adding a new subsection 208(e)(1)).

72/ S. Rep. No. 910, 94th Cong., 2d. Sess. 8-9 (1976).

73/ The bill was reported out by the Senate Committee on Banking, Housing and Urban Affairs, and it included the minority views of Senator Helms and the additional views of Senator Garn. It was not reported out of the House Committee on Interstate and Foreign Commerce. See Frankel, The Regulation of Money Managers, Vol. I, Ch. 1 at 26-27; S. Rep. No. 910 supra Appendix A, note 72, at 17-23. Congressional critics of the proposed amendments stated that SEC staff did not present specific evidence demonstrating the need for adviser examination and licensing. For example, Senator Helms stated: "No evidence of need was developed at
(continued...)"

c. 1980 amendments

Technical changes to the Act were made in 1980 to deal with business development companies. 74/ These changes stemmed from Congressional recognition of the special purposes served by these companies, and are not of general relevance.

d. 1986 amendment

The Act was most recently amended in 1986. 75/ The sole amendment expanded the list of bases for sanctioning advisers to include: (1) convictions and injunctions related to government securities broker-dealer activities; (2) violations of the Commodity Exchange Act; 76/ and (3) activities of entities or

73/(...continued)

the hearings or presented to the Committee by the SEC." S. Rep. No. 910, supra Appendix A, note 72, at 17.

74/ Small Business Investment Incentive Act, Pub. L. No. 96-477, Sections 201-203, 94 Stat. 2275, 2289-90 (1980). Congress recognized the recent decline in the flow of capital to American companies, and sought to reduce some of the costs of government regulation imposed on the capital raising process. Congress recognized the valuable function served by business development companies in the capital formation process, i.e., that the principal activities of business development companies consist of investing in, and providing managerial assistance to, small, growing and financially troubled businesses. Therefore, changes were made in the Act to reduce the regulatory burdens on business development companies. Additionally, the amendments facilitated the use of the Section 203(b)(3) [15 U.S.C. § 80b-3(b)(3)] exception to registration by advisers to business development companies and where the adviser was subject to registration, permitted it to charge fees based on the performance of the company. See Frankel, Vol. I, Supp. 1984, supra Appendix A, note 73 at 3; see also H. Rep. No. 1341, 96th Cong., 2d Sess. 18, 22 (1980).

75/ Government Securities Act of 1986, Pub. L. No. 99-571, Section 102(m), 100 Stat. 3208, 3220 (1986), as codified in Section 203(e) [15 U.S.C. § 80b-3(e)].

76/ 7 U.S.C. § 1-26 (1987).

persons required to register under the Commodity Exchange Act. 77/

77/ While the 1986 amendment only changed the sanctions provision relating to advisers, Section 203(e), it effectively expanded the sanctions provision for associated persons of advisers, section 203(f). Section 203(f) permits the SEC to sanction an adviser's associates for committing the same acts for which the SEC can sanction an adviser under Section 203(e).

APPENDIX B

APPENDIX B

The Operation of the Investment Advisers Act

The following is a brief description of the Act as it exists today.

1. Definition of "investment adviser" 1/

The term "investment adviser" is defined in the Act 2/ to mean any person who

- for compensation
- is engaged in the business
- of providing advice as to the value of securities or as to the advisability of investing in, purchasing or selling securities to others; or of issuing reports or analyses regarding securities.

To be an adviser under the Act's definition, a person must satisfy all three elements. These elements are discussed individually below.

a. "Compensation"

The term "compensation" has been broadly construed in SEC staff interpretive releases and "no-action" letters 3/ to include the receipt of any economic benefit, whether in the form of an advisory fee, some other fee relating to the total services rendered, a commission, or some combination of the above. In addition, the term has been interpreted to mean that a separate

-
- 1/ Much of the discussion that follows is a paraphrase of, or is taken directly from, a recently published Advisers Act release, Investment Advisers Act Rel. No. 1092 (October 8, 1987). Release 1092 is an updated version of a similar release, Investment Advisers Act Rel. No. 770, published on Aug. 13, 1981.
- 2/ Section 202(a)(11). For purposes of brevity, from this point forward citations will be made to the Public Law sections of the Advisers Act, without reference to the United States Code.
- 3/ References infra in the form [name] (pub. avail. [date]), are to staff "no-action" interpretive letters.

fee for advisory services is not necessary. 4/ The compensation element is satisfied if either a single fee is charged for a number of services, including advisory services, or a single fee is charged for advisory services. The compensation need not be paid by the person receiving investment advice. 5/

b. The "business" standard

A person must be in the "business" of providing investment advice for compensation, but the giving of advice need not be the adviser's sole or principal business.

Whether a person giving advice about securities for compensation would be "in the business" of doing so depends upon all relevant facts and circumstances. A person is considered to be "in the business" of providing advice if the person: (i) holds himself out as an investment adviser or as one who provides investment advice, (ii) receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within any overall compensation, or receives transaction-based compensation if the client implements the investment advice, or (iii) on anything other than rare, isolated and non-periodic instances, provides specific investment advice. 6/ For the purposes of (iii) above, "specific investment advice" includes a recommendation, analysis or report about specific securities or specific categories of securities (e.g., industrial development bonds, mutual funds, or medical technology stocks). It includes a recommendation that a client allocate certain percentages of his assets to life insurance, high-yielding bonds, and mutual funds or particular types of mutual funds such as growth stock funds or money market funds. However, specific investment advice does not include advice limited to a general recommendation to allocate assets in securities, life insurance, and tangible assets.

In applying the foregoing tests, other financial services activities offered to clients may be considered. For example, if a financial planner structures his planning so as to give only general, non-specific investment advice as a financial planner, but then gives specific securities advice in his capacity as a registered representative of a broker-dealer or as agent of an insurance company, the person would not be able to assert that he

4/ FINESCO (pub. avail. Dec. 11, 1979).

5/ Warren M. Livingston (pub. avail. Mar. 8, 1980).

6/ See Zinn v. Parish, 644 F.2d 360 (7th Cir. 1981).

was not "in the business" of giving investment advice. In the staff's view, it is necessary to consider these other financial services activities. Section 208(d) of the Advisers Act makes it illegal for someone to do indirectly under the Advisers Act what cannot be done directly.

c. "Advice about securities"

The third element of the definition is clearly satisfied if the person provides advice about, or issues reports concerning, specific securities. The more difficult questions arise when the advice is less specific. The definition has been interpreted to mean that an adviser who has not given advice about specific securities will still have given the statutory "advice about securities" by giving advice about market trends; 7/ selected statistical or historical advice; 8/ or advice in selecting and retaining an investment manager. 9/ Advice concerning the advantages of investing in, purchasing or selling securities, as opposed to, or in relation to, any non-securities investment or financial vehicle also would be "advising" others within the meaning of Section 202(a)(11).

2. Exclusions from the definition of "investment adviser"

While the definition of adviser is broad, the Act excludes six categories of persons who otherwise presumably satisfy all three elements of the definition. A person who falls within any of the exclusions is not subject to any provisions of the Act, while a person who is exempt from registration is nonetheless subject to the antifraud provisions of the Act. 10/ A person relying on an exclusion must meet all the requirements of the exclusion. The exclusions are as follows:

a. Any "bank or bank holding company"

The definition of "bank" in the Act covers a bank organized or regulated under state or federal law. This exclusion has been interpreted to mean that the following entities are not within

7/ Dow Theory Forecasts, Inc. (pub. avail. Feb. 2, 1978).

8/ Bridge Data Co. (pub. avail. May 31, 1975).

9/ FPC Securities Corp. (pub. avail. Dec. 1, 1974).

10/ State regulators retain jurisdiction over such persons.

the exclusion: a foreign bank, 11/ an adviser subsidiary of a bank holding company, 12/ a savings and loan association, 13/ and a foreign trust company. 14/

b. Any "lawyer, accountant, engineer, or teacher"

The Act also excludes from the definition of adviser four classes of professionals -- lawyers, accountants, engineers, and teachers -- so long as they provide investment advice solely incidental to the practice of their profession. 15/ The term "solely incidental" has been interpreted to mean that the exclusion will be lost if a professional holds itself out to the public as an adviser or financial planner; provides advisory services that are not reasonably related to other professional activities; or calculates advisory service charges differently from usual professional charges. 16/

11/ Letter to Congressman William J. Hughes (pub. avail. June 4, 1980).

12/ William Casey (pub. avail. June 1, 1974).

13/ Ameriway Savings Assoc. (pub. avail. Apr. 28, 1986).

14/ Brewer-Burner & Associates, Inc. (pub. avail. Feb. 7, 1974).

15/ Of course, an affiliate of a professional is not necessarily entitled to rely upon this exclusion. In two recent instances, an affiliated entity of an accounting firm did register under the Advisers Act. Seidman & Seidman established and registered a limited partnership, Seidman Financial Services, L.P., to conduct advisory and financial planning activities. Seidman & Seidman holds the only limited partnership interest in the adviser. Recently, the SEC's Division of Investment Management issued a no-action letter to Price Waterhouse under the Advisers Act to allow the firm to establish a registered investment adviser to oversee the rendering of personal financial planning services by partners and employees of Price Waterhouse, without registration of Price Waterhouse itself. Price Waterhouse is a general partner of the adviser. Price Waterhouse (pub. avail. Oct. 1, 1987).

16/ Jones & Kolb (pub. avail. May 7, 1984); David R. Markley (pub. avail. Feb. 6, 1985); Hauk, Soule & Fasani, P.C. (pub. avail. May 2, 1986).

c. Any "broker or dealer"

A broker-dealer who provides investment advice solely incidental to the conduct of business and receives no special compensation for the investment advice is also excluded from the Act. 17/ Most questions about this exclusion concern what is "special compensation." The term has been interpreted to exclude ordinary brokerage commissions from the meaning of "special compensation" unless a "clearly definable" part of the commission is for investment advice. 18/

A registered representative of a broker-dealer can use the broker-dealer exclusion if the registered representative provides advice under the supervision of and solely on behalf of the broker-dealer. A registered representative who is subject to control by an employer broker-dealer and who is providing investment advice solely on behalf of the employer thus fits within this exclusion. 19/

The SEC staff has addressed the status of securities salespersons who designate themselves as independent contractors. 20/ The issue that arises is whether the salesperson is sufficiently controlled by a broker-dealer firm to be covered by the broker-dealers' registration or whether the salesperson is not so controlled. In the latter circumstances, the person must either refrain from selling securities, or register individually as a broker-dealer. And such a person, i.e., one who sells securities but who is neither supervised by a broker-dealer nor registered as one, cannot rely on the broker-dealer shield to avoid registration as an investment adviser.

17/ The broker-dealer, however, is subject to regulation as a broker-dealer. See infra Appendix B, "Regulation of the Selling Activities of Financial Planners Who are Also, or Are Associated With, Broker-Dealers."

18/ Robert S. Strevell (pub. avail. Apr. 29, 1985).

19/ Elmer D. Robinson (pub. avail. Jan. 6, 1986); Brent A. Neiser (pub. avail. Jan. 21, 1986).

20/ See Letter from Douglas Scarff, Director, Division of Market Regulation, to Gordon S. Macklin, President, NASD (June 18, 1982). See also In the Matter of Haight & Co., Securities Exchange Act Rel. No. 9082 (Feb. 19, 1971), where the staff stated that a broker-dealer or a registered representative who employs the term "financial planner" merely as a device to induce the sale of securities might violate the antifraud provisions of the Securities Act and the Exchange Act.

d. Any publisher

Another exclusion from the term adviser covers the publisher of any bona fide newspaper or financial publication of general and regular circulation. The Supreme Court held, in 1985, 21/ that this exclusion is available to any publisher whose publication: 1) offers only impersonal advice -- advice not tailored to the individual needs of a specific client; 2) is "bona fide" -- it contains disinterested commentary and analysis rather than promotional material disseminated by a "tout" or a "tipster;" and 3) is of general and regular circulation -- it must not be timed to specific market activity or to events affecting the securities industry. The SEC staff has stated that, if a publisher voluntarily registers or remains registered, the publisher is subject to the same regulatory requirements as other advisers. 22/

e. "Government securities" advisers

This exclusion excepts any person whose advice or reports are limited to: 1) securities that are direct obligations of or guaranteed as to principal or interest by the United States; or 2) securities guaranteed by corporations in which the United States has a direct or indirect interest which have been designated by the Secretary of the Treasury as exempted securities for the purpose of the Exchange Act. 23/

f. Other persons

Finally, the SEC is allowed to exempt, by rule or order, those who are not within the intent of the adviser definition. 24/ No rules have been written under this authority, but a procedure exists that permits individuals to apply to the SEC for exemptive orders. 25/

21/ Lowe v. Securities and Exchange Comm'n, 472 U.S. 181 (1985).

22/ Vincent J. Cosentino (pub. avail. Feb. 13, 1986).

23/ Section 202(a)(11)(E).

24/ Either the SEC or the staff, through delegated authority, can issue exemptive orders. Rule 30-5(e), 17 C.F.R. § 200.30-5(e).

25/ Rule 0-5, 17 C.F.R. § 275.0-5 (1986), under the Act, and Investment Company Act Rel. No. 14492 (Apr. 30, 1985). This rule applies to applications filed under Section 206A of the

(continued...)

3. Statutory exemptions from registration

The Act requires every adviser who uses the mail or the facilities of interstate commerce in the adviser's business to register with the SEC 26/ unless exempted from registration. 27/ Any adviser relying on an exemption need not register, but is still subject to the Act's antifraud provision. 28/ Three classes of advisers are exempted from registration: 1) intrastate advisers in unlisted securities -- to qualify for this exemption the adviser must demonstrate that all clients are in the same state as the adviser's business, and that the adviser does not provide advice about exchange-listed securities; 2) advisers to insurance companies -- to qualify for this exemption all of the adviser's clients must be insurance companies; 3) "private advisers" -- to qualify for this exemption the adviser must have had fewer than 15 clients during the previous year, must not hold itself out to the public as an adviser, and must not give investment advice to a registered investment company or business development company. 29/

25/ (...continued)

Act which gives the SEC broad authority to exempt any person from any or all provisions of the Act, subject to the standards described infra, Appendix B, note 29.

26/ Section 203(a).

27/ Section 203(b).

28/ Section 206.

29/ A number of common interpretive questions arise under the "private adviser" exemption. One question concerns the meaning of "holding oneself out to the public as an adviser." The SEC staff has interpreted this phrase to mean that a person "holds oneself out to the public as an adviser" when an adviser advertises, uses the label "investment adviser" on a business card or stationery, lists itself as an adviser in a telephone, business, or building directory, Dale M. Mueller (pub. avail. Feb. 20, 1984); or lets it be known generally by word of mouth that it is available to accept new clients, Peter H. Jacobs (pub. avail. Feb. 7, 1979), Richard W. Blanz (pub. avail. Jan. 28, 1985). Another frequent question is how to determine the number of the adviser's clients. Staff interpretations have stated that foreign clients should be counted the same as American clients, Walter L. Stephens (pub. avail. Nov. 18, 1985); trusts are each counted as one client, Phillip Eiseman (pub. (continued...))

4. Registration as an investment adviser

An adviser registers with the SEC by filing a specified form, called a Form ADV, 30/ and paying a \$150 registration fee. Form ADV is used by the SEC and states that register advisers and that have adopted the form. 31/ It is a disclosure document that gives information to the SEC and the states for administrative purposes. To maintain registration in good standing, an adviser must amend Form ADV when the answers to the questions change 32/ and file a short updating statement annually.

The adviser's registration statement covers employees and those people it controls so long as their advisory activities are undertaken on behalf of the registered adviser. The adviser's employees do not have to register individually with the SEC. 33/

29/ (...continued)

avail. July 22, 1976), even if they share a common trustee, OSIRIS Management (pub. avail. Feb. 17, 1984), or share some of the same beneficiaries, id; First Security Investment Management (pub. avail. Mar. 25, 1985). General partners who are advisers to a limited partnership may count the limited partners as one client, if (1) the limited partnership interests are securities, and (2) the adviser bases advice on the objectives of the partnership as a whole, not the separate interests of individual limited partners. Rule 203(b)(3)-1, 17 CFR § 275.203(b)(3)-1; Burr, Egan, Deleage & Co. (pub. avail. Apr. 27, 1987).

30/ The form is included in Appendix E.

31/ Not all states that register advisers use the Uniform Form ADV. For a discussion of state regulation of advisers, see supra Chapter V.D.2.

32/ Rule 204-1, 17 C.F.R. § 275.204-1.

33/ Persons associated with a broker-dealer registered pursuant to the Exchange Act are likewise not required to register separately with the SEC. These associated persons are required by the rules of the securities industry self-regulatory organizations, such as the New York Stock Exchange or the NASD to register with the self-regulatory organization. See, e.g., NASD Bylaws, Schedule C, Part III, Section (1)(a).

a. Part I of Form ADV

This part of the form is primarily for regulatory use. 34/ It contains information such as the adviser's trade name, who controls the adviser, how the adviser's operations are financed, the states in which the adviser is registered, whether the adviser maintains custody of clients' assets, a description of the ownership of the adviser, the number and size of the adviser's discretionary and non-discretionary accounts, and whether the adviser has been involved in material civil or criminal litigation. The registrant is also supposed to disclose on this part of the form whether or not it is a financial planner.

b. Part II of Form ADV

This part of the form contains information that must be given to the client and is primarily for the client's use. 35/ It calls for disclosure of whether the adviser calls any of the adviser's services "financial planning"; the types of advisory services provided; the advisory fees charged; how securities are analyzed; the adviser's affiliations with other securities professionals; whether the adviser effects securities transactions for advisory clients; whether the adviser has brokerage or investment discretion for clients; and a description of the adviser's education and business background. 36/ An adviser who has custody or possession of client assets or who requires certain prepayments of advisory fees is also required to include a balance sheet, which must be audited.

c. Procedure for declaring Form ADV effective

Within 45 days after the filing of the Form ADV, the SEC must either grant the adviser's registration by order or institute proceedings to deny registration. 37/

34/ Both Part I and Part II of registered advisers' Form ADV are available for public inspection and copying in the SEC's Public Reference Room.

35/ Rule 204-3, 17 C.F.R. § 275.204-3. This requirement is part of the "brochure rule" which is discussed infra Appendix B, text accompanying notes 62 to 63.

36/ The Act does not, however, require any particular educational or business background for registration.

37/ Rule 203(c)(2), 17 C.F.R. § 275.203(c)(2). The SEC may deny the registration of any applicant on any of the same bases
(continued...)

5. Regulation of registered investment advisers

The Act subjects registered investment advisers to administrative oversight by the SEC, including the prospect of periodic inspections by SEC examiners and the institution of administrative proceedings against the adviser for violations of the Act. The Act also imposes on advisers: (1) a fiduciary duty to clients; (2) certain substantive obligations; and (3) record-keeping requirements. These will be discussed in turn.

a. Fiduciary duty to clients

Fundamental to the Act is the idea that an adviser owes clients certain fiduciary obligations. The Supreme Court has held that the Advisers Act reflects a congressional recognition "of the delicate fiduciary nature of an investment advisory relationship," 38/ and that Section 206 of the Act establishes "federal fiduciary standards to govern the conduct of investment advisers." 39/ Additionally, the Supreme Court has recognized that "the Act's legislative history leaves no doubt that Congress intended to impose [on advisers] enforceable fiduciary obligations." 40/ The Supreme Court has described the adviser's fiduciary duty as including "'an affirmative duty of utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients." 41/

The Act's imposition on the adviser of a fiduciary duty to clients is intended to eliminate conflicts of interest and to

37/ (...continued)

that it may revoke an adviser's registration, including false or misleading statements in the application for registration, any securities-related convictions, injunctions, or similar offenses. See Section 203(e).

38/ SEC v. Capital Gains, 375 U.S. 180, 191 (1963) (quoting 2 Loss, Securities Regulation 1412 (2d ed. 1961)).

39/ Transamerica Mortgage Advisers v. Lewis, 444 U.S. 11, 17 (1979) (citing, quoting Santa Fe Industries v. Green, 430 U.S. 462, 471, n.11 (1977); Burks v. Lasker, 441 U.S. 471, 481-82, n.10 (1979); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92 (1963)).

40/ Transamerica, 444 U.S. at 17.

41/ Capital Gains, 375 U.S. at 194.

prevent the adviser from overreaching or taking unfair advantage of a client's trust. An adviser, as a fiduciary, owes clients more than honesty and good faith alone. An adviser must also be sensitive to the possibility of rendering less than disinterested advice whether consciously or unconsciously, and an adviser may be faulted even where it did not intend to injure the client and even if the client does not suffer a monetary loss. 42/

The SEC has stated that an adviser's duty to have a reasonable, independent basis for investment advice flows from the fiduciary relationship with the client. 43/ Other fiduciary obligations placed on the adviser include the adviser's duty to obtain best execution for the client's securities transactions; 44/ to ensure that the investment advice rendered is suitable to the client's objectives, needs, and circumstances; 45/ and to be loyal to the client. 46/

b. Substantive provisions

The registration scheme of the Act is complemented by a few substantive provisions: these include prohibitions on performance fees; requirements of certain disclosures related to conflict of interest or past disciplinary actions; prohibitions against fraud; regulation of adviser advertising, of the adviser's custody of client funds or securities, and of the solicitation of advisory clients requirements concerning delivery of a disclosure document to advisory clients (the "brochure rule"); and requirements concerning an adviser's responsibility to supervise employees.

42/ See Capital Gains, 375 U.S. at 188, 195.

43/ See In the Matter of Alfred C. Rizzo, Investment Advisers Act Rel. No. 897 (Jan. 11, 1984).

44/ An adviser must engage in brokerage practices that are in the client's interest. See Rule 206(3)-2(c), 17 C.F.R. § 275.206(3)-2(c); Interfinancial Corp. (pub. avail. Mar. 18, 1985).

45/ See In the Matter of John G. Kinnard and Co., Inc. (pub. avail. Nov. 30, 1973).

46/ Investment Advisers Act Rel. No. 40 (Feb. 5, 1945); Investment Advisers Act Rel. No. 232 (Oct. 16, 1968).

1) Performance fees: Section 205(1)

As discussed above, one concern that led to the passage of the Act was the compensation arrangement between an adviser and client known as a "performance fee." 47/ A performance fee ties the adviser's compensation to the capital gains or appreciation of a client's funds. 48/ Congress prohibited this method of compensation because of the potential for encouraging advisers to seek the maximum gain by taking the maximum risk with a client's assets. Any fee that is contingent upon some level of investment performance is generally considered to be a performance fee and therefore unlawful. 49/

2) Agency cross and principal transactions: Section 206(3) and Rule 206(3)-2

Section 206(3) regulates principal transactions and agency cross transactions. Principal transactions occur when the adviser sells securities it owns to the client or buys them from the client for its own account. Agency cross transactions occur when an adviser acts as broker to both the advisory client and the opposite party to the transaction. The Act prohibits these transactions, unless the adviser discloses to clients in writing before each transaction the capacity in which the adviser is

47/ See supra Appendix A, text accompanying note 20.

48/ Section 205(1).

49/ See Investment Advisers Act Rel. No. 721 (May 16, 1980). There are two exceptions to the prohibition, one under the Act, and one by rule. The Act excepts "fulcrum fees" for investment companies or those with \$1 million in assets. These fees are based on the asset value of the managed fund averaged over a specified period, and must increase or decrease proportionately with the investment performance of the managed funds in relation to an appropriate index of securities prices. The second exception to the prohibition was codified in Rule 205-3, 17 C.F.R. § 275.205-3 under the Act and allows a performance fee if: the client has at least \$500 thousand under management and a net worth that exceeds \$1 million; compensation is based on a formula including capital gains less losses in the client's account for a period of a year; the adviser reasonably believes that the client understands the risks involved; and specified disclosures are made.

acting. The client must consent to principal transactions and agency cross transactions. 50/

The SEC has, by rulemaking, created a blanket exemption for agency cross transactions, but not for principal transactions. Pursuant to Rule 206(3)-2, 51/ the cross-transaction exemption is available if the adviser discloses the capacity in which it is acting and possible conflicting loyalties; sends the client written confirmations of each transaction and an annual statement of all agency cross transactions; and allows the client to revoke at any time the authority granted the adviser.

3) Antifraud provisions: Section 206

A third substantive provision of the Act is the antifraud provision, which makes it unlawful for any adviser, using the mails or the facilities of interstate commerce, to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative, 52/ and gives the SEC authority to define and prescribe these kinds of acts and means reasonably designed to prevent their occurrence. This provision is broader than Rule 10b-5 under the Exchange Act, 53/ because it does not require the fraud to be in connection with the purchase or sale of a security. The Act's antifraud provision cannot be used by private parties because the Supreme Court has interpreted the Advisers Act to deny the existence of private rights of action under the Act. 54/

The SEC has adopted four rules under the antifraud provision. These rules deal with advertising, custody of clients' assets, solicitation of clients, and disclosure of adverse financial conditions and certain disciplinary events.

50/ Investment Advisers Act Rel. No. 40 (Feb. 5, 1945).

51/ 17 C.F.R. § 275.206(3)-2.

52/ Section 206.

53/ 17 C.F.R. § 240.10b-5.

54/ See Transamerica, 444 U.S. at 24. A limited private right of action exists under Section 215, the contract provision, for rescission (or an injunction against continued operation) of the advisory contract, coupled with restitution of money paid thereunder. Id. at 18-19.

a) Adviser advertising: Rule 206(4)-1

The advertising rule proscribes certain advertising practices as fraudulent, but also generally proscribes any false or misleading statements in an advertisement. 55/ More specifically proscribed are testimonials; 56/ past profitable recommendations, unless the adviser includes a list of all of the past year's recommendations; 57/ representations that a graph, chart, or formula can in and of itself be used to determine which securities to buy or sell; 58/ and advertisements that falsely portray a service as free. 59/

b) Custody of client assets: Rule 206(4)-2

The SEC adopted the custody rule 60/ to deal with advisers who have custody or possession of the funds or securities of their clients. The rule requires all securities of each client to be segregated and all funds of each client to be deposited in a bank account which contains only client funds. A separate record must be maintained for each such account; disclosure must be made to each client of how the client's assets will be kept; a quarterly statement itemizing all debits and credits to the account must be sent to each client; and a surprise audit must be conducted by an independent public accountant once a year. This rule does not apply to an adviser registered as a broker-dealer under the Exchange Act if such person is in compliance with the net capital requirements of the Exchange Act or is a member of an exchange whose members are exempt from the Act's custody rule.

c) Solicitations: Rule 206(4)-3

This rule makes it unlawful for an adviser to pay a cash fee to a person who solicits clients for the adviser unless (1) the

55/ Rule 206(4)-1, 17 C.F.R. § 275.206(4)-1. Paragraph (5) of that rule is a catch-all provision which prohibits any advertisement containing any untrue statement of material fact or which is otherwise false or misleading.

56/ Rule 206(4)-1(a)(1), 17 C.F.R. § 275.206(4)-1(a)(1).

57/ Rule 206(4)-1(a)(2), 17 C.F.R. § 275.206(4)-1(a)(2).

58/ Rule 206(4)-1(a)(3), 17 C.F.R. § 275.206(4)-1(a)(3).

59/ Rule 206(4)-1(a)(4), 17 C.F.R. § 275.206(4)-1(a)(4).

60/ Rule 206(4)-2, 17 C.F.R. § 275.206(4)-2.

adviser is registered; (2) the solicitor is not subject to court order or administrative sanction; and (3) the fee is paid pursuant to a written agreement which makes certain disclosures designed to apprise potential advisory clients of the solicitor's interest in promoting the adviser. 61/

d) Financial and disciplinary disclosures: Rule 206(4)-4

The SEC recently adopted Rule 206(4)-4 to codify case law and SEC interpretive positions that held that advisers have a duty to disclose to clients the precarious financial condition of the adviser or prior disciplinary events. Under the rule --

- (a) advisers with custody or discretionary authority over client assets or who require substantial prepayment of advisory fees must promptly disclose to clients or prospective clients all material facts with respect to a financial condition of the adviser that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients;
- (b) all advisers must disclose to clients any disciplinary event that is material to an evaluation of the adviser's integrity or ability to meet contractual commitments to clients; and
- (c) the rule creates a presumption that for ten years subsequent to the event, certain enumerated disciplinary events are material. These include adverse civil and criminal court actions generally involving fraud or theft, and administrative or self-regulatory organization proceedings involving findings of violations of securities or other investment-related laws and the imposition of significant sanctions.

4) "Brochure rule": Rule 204-3

The brochure rule requires registered advisers to provide to clients the same information required in Part II of Form ADV. 62/ Many advisers simply provide Part II, while others put that

61/ Rule 206(4)-3, 17 C.F.R. § 275.206(4)-3.

62/ Rule 204-3, 17 C.F.R. § 275.204-3. The contents of Part II of Form ADV were discussed supra Appendix B, text accompanying notes 35 to 36.

information into a disclosure statement, or brochure. The brochure must be delivered at least two days before the advisory contract is entered into or at the time the contract is entered into if the client has a right to terminate the contract without penalty within five days of entering into the contract. The adviser also must provide or offer to provide an updated brochure annually. 63/

5) Duty of supervision: Section 203(e)(5)

Registered advisers have a continuing duty to supervise and be responsible for anyone acting on their behalf. 64/

A recent SEC order under this provision of the Act was entered in the matter of Stein Roe & Farnham. 65/ The SEC found that the adviser had failed to reasonably supervise a senior partner with a view to preventing violations of Section 206 of the Advisers Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, thereby violating Section 203(e)(5) of the Advisers Act. Among other matters, the SEC found several weaknesses in the adviser's internal control system, including the absence of a check on a partner's selection of firms to which to allocate the brokerage generated by managed accounts. The adviser also failed to have adequate controls to question transactions which did not follow the adviser's usual procedure for placing of client transactions, and it did not document the reason for purchasing securities not on the adviser's recommended list. The SEC, among other things, required that the adviser engage an independent consultant to review the adviser's supervisory and compliance procedures.

c. Recordkeeping requirements: Rule 204-2

The Act generally requires an adviser to maintain two types of books and records: (1) the typical accounting records that any business would normally keep, such as check books, written agreements with clients, bills, and financial statements; and (2) other records that the SEC believes are necessary in light of the adviser's fiduciary duty, such as the adviser's personal securities transactions, orders by clients, advertisements, and

63/ Rule 204-3(c), 17 C.F.R. § 275.204-3(c).

64/ Section 203(e)(5); Justin Federman Stone, 41 S.E.C. 717 (1963); TBA Financial Corp. (pub. avail. Dec. 7, 1983).

65/ Securities Exchange Act Rel. No. 23640 (Sept. 24, 1986).

the adviser's brochure. 66/ Additional records are required of advisers who have custody of client funds or securities, or of those who provide investment supervisory services. 67/ The records must be retained for five years, 68/ and they can be kept on hard copy, microfilm, or computer. 69/

6. Administrative oversight

a. Inspection 70/

The SEC's regional and branch offices perform most of the SEC's inspections of advisers. 71/ There are two types of inspections: routine and "for cause." In both types SEC staff review on site the adviser's books and records and conduct interviews with adviser personnel. "For cause" inspections are based on public complaints, rumors of trouble, or tips. Routine inspections are done under broad policy guidelines set by the SEC's Division of Investment Management. Inspectors look particularly for evidence of churning (excessive trading); scalping, i.e., the adviser's trading on short-term market activity caused by the adviser's recommendations; brokerage practices not in the client's interest, i.e., the failure to obtain best execution; unsuitability, i.e., the adviser's recommendations that are unsuitable for a client's investment objectives; deceptive advertising; and improper recordkeeping. Inspectors also look to see whether the adviser's disclosures to customers are accurate.

If important problems are uncovered during an inspection, the staff will either send a "deficiency letter" to the adviser detailing the problems found, with a request that the adviser take corrective steps, or, for more serious problems, will refer the matter to the SEC's enforcement staff for further investigation.

66/ Rule 204-2, 17 C.F.R. § 275.204-2.

67/ Rule 204-2(b), and (c), 17 C.F.R. § 275.204-2(b) and (c).

68/ Rule 204-2(e), 17 C.F.R. § 275.204-2(e).

69/ Rule 204-2(g), 17 C.F.R. § 275.204-2(g).

70/ For a more comprehensive discussion of the SEC's inspection program, see Chapter V.E.

71/ The SEC has 9 regional offices and 5 branch offices.

b. Enforcement

The SEC has several formal means to enforce the provisions of the Act. Administrative proceedings 72/ can be brought against an adviser who has been permanently or temporarily enjoined from acting as a securities professional or who has been enjoined for violating the federal securities laws or assisting in such a violation. Additionally, administrative proceedings can be brought against an adviser who has violated any provisions of the Securities Act, the Exchange Act, the Investment Company Act, the Advisers Act, the rules of the Municipal Securities Rulemaking Board, the Commodity Exchange Act, or any of the rules or regulations under any of those statutes or provisions. An administrative proceeding can also be initiated against an adviser for: (1) inclusion of false or misleading statements in an application for registration or a report filed with the SEC; and (2) convictions for any felony or misdemeanor involving the purchase or sale of securities, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense. 73/ Finally, convictions for larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or

72/ Most SEC administrative proceedings are settled by consent. A contested administrative proceeding consists of a hearing before an independent SEC employee known as an administrative law judge and is generally conducted in a manner similar to a non-jury trial, with the SEC's staff and the adviser-respondent each having the right to present evidence and testimony and to cross-examine witnesses. The administrative law judge makes an initial decision which includes findings of fact and conclusions of law. This decision may be reviewed by the SEC either on petition of one of the parties or on the SEC's own initiative. Sanctions available in an administrative proceeding include censure, limitations on the registrant's activities, or revocation of registration.

Any party aggrieved by a final order entered in an SEC administrative proceeding may obtain review of the order in the United States Court of Appeals for the District of Columbia or the circuit in which the party resides or has a principal place of business.

73/ The conviction must have been within ten years preceding the filing of a registration application or at any time thereafter. Section 203(e)(2).

misappropriation of funds or securities are grounds for initiation of administrative proceedings. 74/

In addition to conducting administrative proceedings, the SEC has statutory authority to initiate an action in a federal district court to enjoin violations of the securities laws by any person. 75/ Willful violations of the securities laws or the rules promulgated under them are punishable by fine and imprisonment. 76/ The SEC does not prosecute criminal cases itself, but transmits the evidence to the Department of Justice, which decides whether to prosecute and pursues the prosecution.

An individual barred from association with an adviser may later apply to the SEC for relief from the bar. 77/ The applicant must show that the proposed association is in the public interest and must address certain events occurring subsequent to the SEC's bar. 78/ The applicant also must describe the capacity in which it will be associated with the adviser, and SEC staff must find that the proposed association will be consistent with the public interest. 79/

74/ The statutory provisions pursuant to which proceedings may be brought against an adviser are in Section 203(e) of the Advisers Act. Enforcement action can also be taken against an associated person of an adviser who has committed any of the prohibited activities enumerated in Section 203(e). See Section 203(f).

75/ Section 209.

76/ Id.

77/ See Rule 29 of the SEC's Rules of Practice and Investigations, 17 C.F.R. § 201.29]. Some orders instituting a bar provide a right to reapply after a specified period of time. The SEC generally will grant such applications upon a proper showing made after expiration of the specified period.

78/ Included are: 1) the time elapsed since imposition of the bar; 2) any action taken to recompense any person injured by the applicant's misconduct; 3) applicant's compliance with the order; and 4) applicant's employment record since the bar.

79/ In these circumstances, the SEC is especially concerned with the amount of supervision to be exercised over the applicant and by the applicant.

7. Regulation of the Selling Activities of Financial Planners Who Are Also, or Are Associated With, Broker-Dealers

Financial planners, including those who are exempt from registration as investment advisers, may be subject to federal regulation as broker-dealers if their activities bring them within the definition of broker or dealer under the federal securities laws, 80/ or if they are employees of, or associated with, 81/ entities coming within that definition. Registered broker-dealers, and their associated persons, are subject to a comprehensive regulatory scheme designed to ensure that the customers are treated fairly, that they receive adequate disclosure, and that the broker-dealer is financially capable of transacting business.

An exhaustive discussion of the regulation of broker-dealers and their associated persons is beyond the scope of this report. It may be helpful, however, to give a brief overview of those provisions of the federal securities laws that are relevant to the selling practices of financial planners who, because they also sell securities to their customers, must be registered as broker-dealers or as representatives of broker-dealers.

80/ Section 3(a)(4) of the Exchange Act, 15 U.S.C. § 78c-3(a)(4), defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." Section 3(a)(5), 15 U.S.C. § 78c-3(a)(5), defines "dealer" as "any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business." [Hereinafter references to the Exchange Act will be to the Public Law section, not to the United States Code.]

81/ Exchange Act Section 3(a)(18) defines, in part, "person associated with a broker or dealer" or "associated person of a broker or dealer", as:

any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer

a. Supervision of sales activities

Broker-dealers are required by federal law 82/ and by the rules of self-regulatory organizations 83/ (to which all broker-dealers must by law belong 84/), to maintain reasonable supervision over the activities of their employees for the purpose of preventing violations of the federal securities laws. It is not sufficient for the broker-dealer to have written procedures; the procedures must also be implemented. Under the law, no person who has imposed and followed reasonable procedures in the execution of supervisory responsibilities may be charged with failure to supervise. The emphasis is on reasonable controls and reasonable efforts. In addition, individuals responsible for management and supervision must pass qualifying examinations that test understanding of the laws, rules and regulations that pertain to sales activities. 85/

b. Competency standards for persons who sell securities

The Exchange Act, unlike the Advisers Act, imposes on broker-dealers and their associated persons "standards of training, experience, competence" and other qualifications the SEC deems appropriate. 86/ Pursuant to this mandate, self-regulatory organizations have established qualifying standards

82/ Exchange Act Section 15(b)(4)(E).

83/ The NASD, for example, has explicit rules regarding the duty to supervise. See NASD Rules of Fair Practice, Art. III, Section 27, NASD MANUAL (CCH) paragraph 2177. Section 27(a) states as follows:

Each member shall establish, maintain and enforce written procedures which will enable it to supervise properly the activities of each registered representative and associated person to assure compliance with applicable securities laws, rules, regulations and statements of policy promulgated thereunder and with the rules of [the NASD].

84/ See Exchange Act Section 15(b)(8).

85/ See, e.g., NASD By-laws, Schedule C, NASD MANUAL (CCH) paragraph 1753, II, "Registration of Principals".

86/ Exchange Act Section 15(b)(7).

for members and associated persons. 87/ Qualifying examinations test knowledge of products that are sold, of the markets in which products are sold, and of the laws, rules and regulations that govern sales activities.

c. Suitability standards

A critical element in a broker-dealer's obligation to deal fairly with its customers is that recommendations regarding securities transactions made to customers by the broker-dealer or its registered representatives be suitable in light of the customer's financial resources, sophistication, and investment objectives. The NASD, to which the vast majority of broker-dealers and registered representatives engaged in retail sales belong, has a "suitability" rule which states:

In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and to his financial situation and needs. 88/

The SEC has upheld, and federal courts have affirmed, disciplinary actions taken against broker-dealers and their securities sales representatives for making unsuitable recommendations to clients. 89/

The New York Stock Exchange and the American Stock Exchange impose on member firms the obligation to use "due diligence to learn the essential facts relative to every customer". 90/ This "know your customer" requirement is also regarded as a basis for protecting customers against unsuitable recommendations.

87/ See, e.g., NASD By-laws, Schedule C, NASD MANUAL (CCH) paragraph 1753, for the NASD requirements. Most individuals who sell securities must pass the Test Series 7 examination. Schedule C, III.

88/ NASD Rules of Fair Practice, Art. III, Section 2, NASD MANUAL (CCH) paragraph 2152.

89/ See, e.g., Eugene J. Erdos, Exchange Act Rel. No. 20376 (Nov. 16, 1983).

90/ Rule 405, 2 NYSE GUIDE (CCH) paragraph 2405; Rule 411 ASE GUIDE (CCH) paragraph 9431.

d. Regulation of advertising and sales literature

Self-regulatory organizations have established guidelines regarding the content and review of advertisements and sales literature. The NASD, for example, requires that all sales literature and advertisements be approved in advance, in writing, by a member of the broker-dealer firm's management. 91/ The NASD also requires that certain advertisements be submitted to the NASD before use, 92/ and that all communications with the public be "based on the principles of fair dealing and good faith." 93/ Statements that are false, misleading, untrue as to material fact, exaggerated, or unwarranted, are prohibited. 94/

e. SEC and self-regulatory organization record-keeping and inspection program

The Exchange Act and the rules promulgated thereunder impose on broker-dealers a comprehensive scheme of record-keeping and maintenance. 95/ Included in the records broker-dealers are required to make or maintain are customer account agreements, customer account statements, communications with customers, and margin agreements. 96/ In addition, the SEC and the self-regulatory organizations conduct periodic and surprise inspections of broker-dealers to assure compliance with the record-keeping and other rules and regulations, including those requirements that pertain to sales practices. 97/

91/ NASD Rules of Fair Practice, Section 35(b)(1), NASD MANUAL (CCH) paragraph 2195.

92/ E.g., NASD Rules of Fair Practice, Section 35(c)(1), (2), NASD MANUAL (CCH) paragraph 2195 (advertisements pertaining to options).

93/ Id. at Section 35(d)(1)(A).

94/ Id. at Section 35(d)(1)(B).

95/ See generally Exchange Act Section 17(a)(1).

96/ See generally Exchange Act Rule 17a-3, 4, 17 C.F.R. § 240.17a-3, 4.

97/ See generally Exchange Act Sections 17(b), 17(d).

APPENDIX C

TIMOTHY E. WIRTH, COLORADO, CHAIRMAN
AL SWIFT, WASHINGTON
MICKEL LELAND, TEXAS
CAROLYN COLLINS, ILLINOIS
JOHN BRYANT, TEXAS
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WAYNE DOWDY, MISSISSIPPI
JIM SLATTERY, KANSAS
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(EX OFFICIO)

NINETY-NINTH CONGRESS
U.S. House of Representatives

SUBCOMMITTEE ON TELECOMMUNICATIONS,
CONSUMER PROTECTION AND FINANCE

OF THE
COMMITTEE ON ENERGY AND COMMERCE
WASHINGTON, DC 20515

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HOWARD C. NELSON, UTAH
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(EX OFFICIO)

ROOM 8-331
RAYBURN HOUSE OFFICE BUILDING
PHONE (202) 225-8304

July 9, 1986

CHAIRMAN'S OFFICE

RECEIVED

JUL 10 1986

SEC. & EXCH. COMM.

The Honorable John S.R. Shad
Chairman
The Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

Thank you for testifying before the Subcommittee at our recent hearing on investment advisers and financial planners. We greatly appreciate your efforts to help the Congress better understand the complicated and important issues discussed at the hearing.

It was clear at the hearing that all of the witnesses, including the investors, industry associations and regulators, shared a concern with the Subcommittee Members about the harm to investors caused by unscrupulous investment advisers and financial planners. However, there clearly was no consensus as to the scope of the problem or the possible solution. Consequently, we would ask that you coordinate and supervise a comprehensive study to examine the current status of the industry and the degree of abuse. The following issues should be included in the scope of the study:

(1) customer demographics - What are the demographic characteristics of financial planner/adviser customers? Are the customers individuals or institutions? If the customers are individuals what is their:

- o income level,
- o educational background,
- o reason for seeking financial advice generally and for selecting a particular planner/adviser, and
- o previous financial experience?

(2) planner/adviser characteristics - What are the characteristics of financial planners or advisers? What is their:

- o size (e.g., their number of employees, customers, offices and states of operation);
- o background (e.g., their education, experience and qualifications);
- o other business activities (e.g., are they a broker-dealer, insurance agent, banker, accountant, etc.); and
- o custody of, or discretionary authority over client funds and the amount of funds involved?

- (3) compensation of planners/advisers - Is the financial planner/adviser compensated for services by a flat fee or by a commission? If compensation is by commission:
- o what is the type and number of products offered; and
 - o what level of disclosure do planners/advisers provide concerning their interest in the products they sell -- financial or otherwise?
- (4) registration - With what state or federal regulatory authorities or self-regulatory organizations are financial planners registered? Do the financial planners:
- o file reports,
 - o submit to inspections or otherwise communicate with authorities or organizations
- (5) examinations/inspections - What level of examinations are financial planners/advisers subjected to? What is the:
- o amount of time before the first inspection and between subsequent inspections,
 - o number of existing uninspected planners/advisers,
 - o result of inspections,
 - o number and kind of violations,
 - o number and outcome of cases brought, and
 - o method of detecting violations (i.e., is detection the result of a scheduled inspection or a customer complaint)?
- (6) What is your evaluation of the NASD pilot program?

We understand that this is an ambitious agenda given the difficulty in obtaining information and limited SEC resources. However, we encourage you to utilize the various relevant trade and regulatory associations and organizations to the fullest extent possible. It is particularly important that the Commission work together with the state securities officials.

Because of the importance of this subject, we request that the Commission staff work with the Subcommittee staff in providing an outline and a plan for gathering information. We would appreciate your informing us within 30 days of how the Commission proposes to conduct the study and providing us with an outline of what will be covered.

With best wishes,

Sincerely yours,


Matthew J. Rinaldo
Ranking Minority Member


Timothy E. Wirth
Chairman

APPENDIX D

APPENDIX D

Glossary of Terms

<u>AICPA</u>	Association of Independent Certified Public Accountants
<u>ASCLU</u>	American Society of Certified Life Underwriters
<u>CFA</u>	Chartered Financial Analyst
<u>CFA</u>	Consumer Federation of America
<u>CFP</u>	Certified Financial Planner
<u>ChFC</u>	Chartered Financial Consultant
<u>CLU</u>	Certified Life Underwriter
<u>CPA</u>	Certified Public Accountant
<u>FAF</u>	Financial Analysts Federation
<u>IAFP</u>	International Association of Financial Planners
<u>IBCFP</u>	International Board of Standards and Practices for Certified Financial Planners
<u>ICAA</u>	Investment Counsel Association of America
<u>ICFP</u>	Institute of Certified Financial Planners
<u>ICI</u>	Investment Company Institute
<u>JD</u>	Juris Doctor degree
<u>LLM</u>	Master of Laws degree
<u>NALU</u>	National Association of Life Underwriters
<u>NAPFA</u>	National Association of Personal Financial Advisors
<u>NASAA</u>	North American Securities Administrators Association
<u>NASD</u>	National Association of Securities Dealers
<u>NYSE</u>	New York Stock Exchange
<u>RIA</u>	Registered Investment Adviser
<u>SRO</u>	Self-Regulatory Organization



APPENDIX E



FORM ADV INSTRUCTIONS

1. This is a Uniform Form for use by investment advisers to:

- register with the Securities and Exchange Commission and the jurisdictions that require advisers to register.
- update those registrations. When updating, complete all amended pages in full and circle the number of the item being changed. Each amendment must include the execution page.

2. Organization

The Form contains two parts. Parts I and II are filed with the SEC and the jurisdictions; Part II can be given to clients to satisfy the brochure rule. The Form also contains the following schedules:

- Schedule A — for corporations;
- Schedule B — for partnerships;
- Schedule C — for entities that are not sole proprietorships, partnerships or corporations;
- Schedule D — for reporting information about individuals under Part I Items 11 and 12;
- Schedule E — for continuing responses to Part I items;
- Schedule F — for continuing responses to Part II items; and
- Schedule G — for the balance sheet required by Part II Item 14.

3. Format

- Type all information.
- Give all individual names in full, including full middle names.
- Use only Form ADV and its Schedules or a reproduction of them.

4. Signature

- All filings and amendments must be filed with a signed execution page (page 1).
- Each copy filed with the Securities and Exchange Commission and any jurisdiction must be manually signed.

If applicant is	Form ADV should be signed by
◦ a sole proprietor	the proprietor
◦ a partnership	a general partner for the partnership
◦ a corporation	an authorized principal officer for the corporation
◦ any other organization	the managing agent (an authorized person that participates in managing or directing applicant's affairs)

5. General Definitions (Additional definitions appear in Part I Item 11 and Part II.)

- Applicant — The investment adviser applying on or amending this Form.
- Client — An investment advisory client of the applicant.
- Control — The power to direct or cause the direction of the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any individual or firm that is a director, partner or officer exercising executive responsibility (or having similar status or functions) or that directly or indirectly has the right to vote 25 percent or more of the voting securities or is entitled to 25 percent or more of the profits is presumed to control that company. (This definition is used solely for the purpose of Form ADV.)
- Custody — A person has custody if it directly or indirectly holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them. An adviser has custody, for example, if it has a general power of attorney over a client's account or has signatory power over a client's checking account. (The definition and examples are for the convenience of registrants. Depending on the facts and circumstances, other situations also may involve custody.)
- Jurisdiction — Any non-Federal government or regulatory body in the United States, or Puerto Rico.
- Person — An individual, partnership, corporation or other organization.
- Related person — Any officer, director or partner of applicant or any person directly or indirectly controlling, controlled by or under common control with the applicant, including any non-clerical, non-ministerial employee.
- Self-regulatory organization — Any national securities or commodities exchange or registered association, or registered clearing agency.

6. **Continuation Sheets** — Schedules E and F provide additional space for continuing Form ADV items (Schedule E for Part I; Schedule F for Part II) but not for continuing Schedules A, B, C, D or G. To continue those schedules, use copies of the schedule being continued.

7. **SEC Filings**

- Submit filings in triplicate to the U.S. Securities and Exchange Commission, Washington, D.C. 20549. To register, submit a check or money order for \$150 payable to the U.S. Securities and Exchange Commission. This fee is non-refundable. There is no fee for amendments.
- **Non-Residents** — Rule 0-2 under the Investment Advisers Act of 1940 [17 CFR 275.0-2] covers those non-resident persons named anywhere in Form ADV that must file a consent to service of process and a power of attorney. Rule 204-2(j) under the Investment Advisers Act of 1940 [17 CFR 275.204-2] covers the notice of undertaking on books and records non-residents must file with Form ADV.
- **Updating.** Federal law requires filing amendments:
 - promptly for *any* changes in:
 - Part I — Items 1, 2, 3, 4, 5, 8, 11, 13A, 13B, 14A, and 14B;
 - promptly for *material* changes in:
 - Part I — Items 9 and 10 and all items of Part II except Item 14;
 - within 90 days of the end of the fiscal year for any other changes.
- **Federal Information Law and Requirements** — Investment Advisers Act of 1940 Sections 203(c), 204, 206, and 211(a) authorize the SEC to collect the information on this Form from applicants for investment adviser registration. The information is used for regulatory purposes, including deciding whether to grant registration. The SEC maintains files of the information on this form and makes it publicly available. Only the Social Security Number, which aids identifying the applicant, is voluntary. The SEC may return as unacceptable Forms that do not include all other information. By accepting this Form, however, the SEC does not make a finding that it has been filled out or submitted correctly. Intentional misstatements or omissions constitute Federal criminal violations under 18 USC 1001 and 15 USC 80b-17.

8. **Filings in Jurisdictions** — Consult the requirements of each jurisdiction in which you are filing to determine its requirements for, among other things:

- filings
- updates
- financial statements
- bonding
- examinations and qualifications
- photographs and fingerprints
- limitations on advisory fees

Information on a jurisdiction's requirements is available from its Securities Administrator. For the address and telephone number of the Securities Administrator in a jurisdiction, contact the North American Securities Administrators Association, Inc., 2930 S.W. Wanamaker Drive, Suite 5, Topeka, Kansas 66614, (913) 273-2600.

Uniform Application for Investment Adviser Registration

OMB APPROVAL
OMB No.: 3235-0049
Expires: June 30, 1988

This filing is an: <input type="checkbox"/> Initial Application or an: <input type="checkbox"/> Amendment	If this filing is an Amendment: • Give the Applicant's SEC File Number 801-_____ Yes No • Is Applicant now active in business as an Investment Adviser? <input type="checkbox"/> <input type="checkbox"/>
--	---

WARNING: Failure to complete this Form accurately and keep it current subjects applicant to administrative, civil and criminal penalties.

1. A. Applicant's full name (If sole proprietor, state last, first and middle name):				
B. Name under which business is conducted, if different:				
C. If business name is being amended, give previous name:				
2. A. Principal place of business: (Number and Street — Do not use P.O. Box Number)		(City)	(State)	(Zip Code)
B. Hours business is conducted at this location: from _____ to _____		C. Telephone Number (Area Code) (Telephone Number) at this location: _____		
D. Mailing address, if different from address given in 2A:		(Number and Street or P.O. Box Number)	(City)	(State) (Zip Code)
E. Is the address in Item 2A or 2D being amended in this filing?.....				Yes <input type="checkbox"/> No <input type="checkbox"/>
F. On Schedule E give the addresses and telephone numbers of all offices at which applicant's investment advisory business is conducted, other than the one given in Item 2A.				
3. A. If books and records required by Section 204 of the Investment Advisers Act of 1940 are kept somewhere other than at the principal place of business given in Item 2A, give the following information (if kept in more than one place, give additional names, addresses and hours of business on Schedule E): Name and address of entity where books and records are kept:				
(Number and Street)		(City)	(State)	(Zip Code)
B. Hours business is conducted at this location: from _____ to _____		C. Telephone Number (Area Code) (Telephone Number) at this location: _____		

EXECUTION

For the purpose of complying with the laws of the State(s) I have marked in Item 7 relating to the giving of investment advice, I hereby certify that the applicant is in compliance with applicable state surety bonding requirements and irrevocably appoint the administrator of each of those State(s), or such other person designated by law, and the successors in such office, my attorney in said State(s) upon whom may be served any notice, process or pleading in any action or proceeding against me arising out of or in connection with the offer or sale of securities or commodities, or out of the violation or alleged violation of the laws of those State(s) and I do hereby consent that any such action or proceeding against me may be commenced in any court of competent jurisdiction and proper venue within said State(s) by service of process upon said appointee with the same effect as if I were a resident in said State(s) and had lawfully been served with process in said State(s).

The undersigned, being first duly sworn, deposes and says that he has executed this Form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including exhibits attached hereto and other information filed herewith, all of which are made a part hereof, are current, true and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended, such information is currently accurate and complete.

Date:	Name of Applicant:	By (Signature):
Typed Name and Title:		
Subscribed and sworn before me this _____ day of _____ 19____		
By:		
My commission expires	County of	State of

Answer all items.

FORM ADV
Part I - Page 2

Applicant:	SEC File Number: 801-	Date:
------------	--------------------------	-------

4. A. Persons to contact for further information about this Form: _____ (Name) _____ (Title)

B. Mailing Address (Number and Street, City, State, Zip Code): _____ Area Code and Telephone Number: _____
()

5. A. Applicant consents that notice of any proceeding before the Securities and Exchange Commission or a jurisdiction in connection with its investment adviser registration may be given by registered or certified mail or confirmed telegram to: (Last Name) (First Name) (Middle Name)

B. (Number and Street) (City) (State) (Zip Code) 6. Applicant's fiscal year ends: (Month) (Day)

7. In the box below, give status of applicant's investment adviser registration by indicating:
 "1" for pending "3" for withdrawn before registration within the last 10 years
 "2" for registered "4" for previously registered within the last 10 years

Securities and Exchange Commission _____

AL ___ AK ___ AZ ___ AR ___ CA ___ CO ___ CT ___ DE ___ DC ___ FL ___ GA ___ HI ___ ID ___
 IL ___ IN ___ IA ___ KS ___ KY ___ LA ___ ME ___ MD ___ MA ___ MI ___ MN ___ MS ___ MO ___
 MT ___ NE ___ NV ___ NH ___ NJ ___ NM ___ NY ___ NC ___ ND ___ OH ___ OK ___ OR ___ PA ___
 RI ___ SC ___ SD ___ TN ___ TX ___ UT ___ VT ___ VA ___ WA ___ WV ___ WI ___ WY ___ Puerto Rico ___

Other (Specify): _____

8. Applicant is a (check box that applies and complete those items):

A. <input type="checkbox"/> CORPORATION - Complete Schedule A.	(1) Date of incorporation (Month, Day, Year):	(2) Jurisdiction where incorporated:
B. <input type="checkbox"/> PARTNERSHIP - Complete Schedule B.	(1) Date of establishment (Month, Day, Year):	(2) Current legal address (Number, Street, City, State, Zip Code):
C. <input type="checkbox"/> SOLE PROPRIETORSHIP	(1) Date business began (Month, Day, Year):	(2) Current residence address of proprietor: (Number, Street, City, State, Zip Code) (3) Social Security No.
D. <input type="checkbox"/> Other - Specify _____ Complete Schedule C	(1) Date of establishment (Month, Day, Year):	(2) Current legal address (Number, Street, City, State, Zip Code):

9. Is the applicant taking over the business of a registered investment adviser? (If yes, describe the transfer on Schedule E, including the transfer date, and predecessor's full name, IRS employer number and SEC file number)..... Yes No

10. A. Does any person not named in Item 1A or Schedules A, B, or C, through agreement or otherwise, control the management or policies of applicant?..... Yes No
 (If yes, state on Schedule E the exact name of each person and describe the basis for the person's control.)

B. Is the applicant financed by a person not named in Items 1A or Schedule A, B, or C other than by: (1) a public offering under the Securities Act of 1933; (2) credit given in the ordinary course of business by banks, suppliers or others; or (3) a satisfactory subordination agreement under Securities Exchange Act of 1934 Rule 15c3-1 (17 CFR 240.15c3-1)?..... Yes No
 (If yes, state on Schedule E the exact name of each person and describe the arrangement through which financing is made available, including the amount.)

Answer all items. Complete amended pages in full, circle amended items and file with execution page (page 1).

Applicant:	SEC File Number:	Date:
	801-	

11. Disciplinary questions. Definitions:

- **Advisory affiliate** — A person named in Items 1A, 10A or Schedules A, B or C; or an individual or firm that directly or indirectly controls or is controlled by the applicant, including any current employee except one performing only clerical, administrative, support or similar functions.
- **Investment or investment-related** — Pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, investment company, investment adviser, futures sponsor, bank or savings and loan association).
- **Involved** — Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

A. In the past ten years has the applicant or an advisory affiliate been convicted of or pleaded guilty or nolo contendere ("no contest") to:

- (1) a felony or misdemeanor involving:
- investment or an investment-related business
 - fraud, false statements, or omissions
 - wrongful taking of property or
 - bribery, forgery, counterfeiting, or extortion? Yes No
- (2) any other felony? Yes No

B. Has any court:

- (1) in the past ten years, enjoined the applicant or an advisory affiliate in connection with any investment-related activity? Yes No
- (2) ever found that the applicant or an advisory affiliate was involved in a violation of investment-related statutes or regulations? Yes No

C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:

- (1) found the applicant or an advisory affiliate to have made a false statement or omission? Yes No
- (2) found the applicant or an advisory affiliate to have been involved in a violation of its regulations or statutes? Yes No
- (3) found the applicant or an advisory affiliate to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked, or restricted? Yes No
- (4) entered an order denying, suspending or revoking the applicant's or an advisory affiliate's registration or otherwise disciplined it by restricting its activities? Yes No

D. Has any other federal regulatory agency or any state regulatory agency:

- (1) ever found the applicant or an advisory affiliate to have made a false statement or omission or been dishonest, unfair, or unethical? Yes No
- (2) ever found the applicant or an advisory affiliate to have been involved in a violation of investment regulations or statutes? Yes No
- (3) ever found the applicant or an advisory affiliate to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked, or restricted? Yes No
- (4) in the past ten years, entered an order against the applicant or an advisory affiliate in connection with an investment-related activity? Yes No
- (5) ever denied, suspended, or revoked the applicant's or an advisory affiliate's registration or license, prevented it from associating with an investment-related business, or otherwise disciplined it by restricting its activities? Yes No
- (6) ever revoked or suspended the applicant's or an advisory affiliate's license as an attorney or accountant? .. Yes No

Applicant:	SEC File Number: 801-	Date:
------------	--------------------------	-------

- E. Has any self-regulatory organization or commodities exchange ever:**
- | | | |
|--|------------------------------|-----------------------------|
| (1) found the applicant or an advisory affiliate to have made a false statement or omission? | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
| (2) found the applicant or an advisory affiliate to have been involved in a violation of its rules? | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
| (3) found the applicant or an advisory affiliate to have been the cause of an investment-related business having its authorization to do business denied, suspended, revoked, or restricted? | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
| (4) disciplined the applicant or an advisory affiliate by expelling or suspending it from membership, by barring or suspending its association with other members, or by otherwise restricting its activities? | Yes <input type="checkbox"/> | No <input type="checkbox"/> |

- F. Has any foreign government, court, regulatory agency, or exchange ever entered an order against the applicant or an advisory affiliate related to investments or fraud?**
- | | | |
|--|------------------------------|-----------------------------|
| | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
|--|------------------------------|-----------------------------|

- G. Is the applicant or an advisory affiliate now the subject of any proceeding that could result in a 'yes' answer to parts A-F of this item?**
- | | | |
|--|------------------------------|-----------------------------|
| | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
|--|------------------------------|-----------------------------|

- H. Has a bonding company denied, paid out on, or revoked a bond for the applicant?**
- | | | |
|--|------------------------------|-----------------------------|
| | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
|--|------------------------------|-----------------------------|

- I. Does the applicant have any unsatisfied judgments or liens against it?**
- | | | |
|--|------------------------------|-----------------------------|
| | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
|--|------------------------------|-----------------------------|

- J. Has the applicant or an advisory affiliate of the applicant ever been a securities firm or an advisory affiliate of a securities firm that has been declared bankrupt, had a trustee appointed under the Securities Investor Protection Act, or had a direct payment procedure begun?**
- | | | |
|--|------------------------------|-----------------------------|
| | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
|--|------------------------------|-----------------------------|

- K. Has the applicant, or an officer, director or person owning 10% or more of the applicant's securities failed in business, made a compromise with creditors, filed a bankruptcy petition or been declared bankrupt?**
- | | | |
|--|------------------------------|-----------------------------|
| | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
|--|------------------------------|-----------------------------|

If a 'yes' answer on Item 11 involves:

- an individual, complete a Schedule D for the individual
- a partnership, corporation or other organization, on Schedule E give the following details of any court or regulatory action:
 - the organization and individuals named
 - the title and date of the action
 - the court or body taking the action
 - a description of the action.

12. Individual's Education, Business and Disciplinary Background. Complete a Schedule D for each individual who is:

- A. The applicant, named in Part I Item 1A
- B. A control person named in Part I Item 10
- C. An owner of at least 10% of a class of applicant's equity securities
- D. An officer, director, partner, or individual with similar status of applicant, described in Schedule A Item 2a, Schedule B Item 2, or Schedule C Item 2
- E. A member of the applicant's investment committee that determines general investment advice to be given to clients
- F. If applicant has no investment committee, an individual who determines general investment advice (if more than five, complete for their supervisors only)
- G. An individual giving investment advice on behalf of the applicant in the jurisdiction in which this application is filed
- H. An individual reporting a 'yes' answer to the disciplinary question, Part I Item 11

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Part I - Page 5

Applicant:	SEC File Number: 801-	Date:
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13. Does applicant have custody (see definition in instructions) of any advisory client:

A. funds	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>
B. securities	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>

C. If either answer is yes, the value of those funds and securities at the end of applicant's last fiscal year was:

(1) <input type="checkbox"/> under \$100,000	(3) <input type="checkbox"/> \$1,000,001 to \$5,000,000
(2) <input type="checkbox"/> \$100,000 to \$1,000,000	(4) <input type="checkbox"/> Over \$5,000,000

14. Do any of applicant's related persons have custody (see definition in instructions) of any advisory client:

A. funds	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>
B. securities	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>

If either is yes:

C. is that person a registered broker-dealer qualified to take custody under Section 15 of the Securities Exchange Act of 1934?

	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>

D. the value of those funds and securities at the end of applicant's last fiscal year was:

(1) <input type="checkbox"/> under \$100,000	(3) <input type="checkbox"/> \$1,000,001 to \$5,000,000
(2) <input type="checkbox"/> \$100,000 to \$1,000,000	(4) <input type="checkbox"/> Over \$5,000,000

15. Does applicant require prepayment of fees of more than \$500 per client and more than 6 months in advance?

	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>

16. With a few exceptions, the "brochure rule" (Advisers Act Rule 204-3) requires that clients must be given information about the investment adviser. Will applicant be giving clients:

A. Part II of this Form ADV?	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>
B. Another document that includes at least the information contained in Form ADV Part II?.....	Yes	No
	<input type="checkbox"/>	<input type="checkbox"/>

17. A. The number of employees of applicant who perform investment advisory functions (including research, but excluding unrelated functions such as accounting) is: (check only one box)

(1) <input type="checkbox"/> 1 person, part time	(3) <input type="checkbox"/> 2-9 persons
(2) <input type="checkbox"/> 1 person primarily involved in providing investment advisory services	(4) <input type="checkbox"/> 10 or more persons

B. The number of clients to whom applicant provided advisory services during the last fiscal year was:

(1) <input type="checkbox"/> 14 or fewer	(4) <input type="checkbox"/> 101 to 500
(2) <input type="checkbox"/> 15 to 50	(5) <input type="checkbox"/> over 500
(3) <input type="checkbox"/> 51 to 100	

Applicant:	SEC File Number: 801-	Date:
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18. Does applicant manage client securities portfolios on a discretionary basis? Yes No

If yes, at the end of applicant's last fiscal year these accounts:

A. numbered _____ B. totaled in aggregate market value,
rounded to nearest thousand \$ _____ 000.00

19. Does applicant manage or supervise client securities portfolios on a non-discretionary basis? Yes No

If yes, at the end of applicant's last fiscal year these accounts:

A. numbered _____ B. totaled in aggregate market value,
rounded to nearest thousand \$ _____ 000.00

20. Does applicant hold itself out as providing financial planning or some similarly termed services to clients? Yes No

If yes, during the last fiscal year applicant provided financial planning services to clients:

A. who numbered:

(1) 14 or fewer (4) 101 to 500

(2) 15 to 50 (5) over 500

(3) 51 to 100

B. whose investments in financial products based on those services totaled:

(1) under \$100,000 (3) \$1,000,001 to \$5,000,000

(2) \$100,000 to \$1,000,000 (4) over \$5,000,000

21. Did applicant recommend securities to clients during its last fiscal year in which the applicant acted (itself or through a related person) as an underwriter, general or managing partner, or offeree representative, or had any ownership or sales interest (other than the receipt of normal and customary sales commissions as a broker or brokers representative)? ... Yes No

If yes, the approximate value of securities so recommended during its last fiscal year is:

A. Under \$50,000 C. \$250,001 to \$1,000,000

B. \$50,000 to \$250,000 D. over \$1,000,000

22. Attach to this Form any financial statements required by the jurisdiction in which applicant is filing, other than the balance sheet required by Part II Item 14.

Uniform Application for Investment Adviser Registration

OMB APPROVAL
OMB No.: 3235-0049
Expires: June 30, 1988

Name of Investment Adviser:						
Address:	(Number and Street)	(City)	State)	(Zip Code)	Area Code:	Telephone Number:
					()	

**This part of Form ADV gives information about the investment adviser and its business for the use of clients.
The information has not been approved or verified by any governmental authority.**

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Applicant:

SEC File Number:

Date:

801-

3. Types of Investments. Applicant offers advice on the following: (check those that apply)

- | | |
|---|---|
| <p>A. Equity Securities</p> <p><input type="checkbox"/> (1) exchange-listed securities</p> <p><input type="checkbox"/> (2) securities traded over-the-counter</p> <p><input type="checkbox"/> (3) foreign issuers</p> <p><input type="checkbox"/> B. Warrants</p> <p><input type="checkbox"/> C. Corporate debt securities
(other than commercial paper)</p> <p><input type="checkbox"/> D. Commercial paper</p> <p><input type="checkbox"/> E. Certificates of deposit</p> <p><input type="checkbox"/> F. Municipal securities</p> <p>G. Investment company securities:</p> <p><input type="checkbox"/> (1) variable life insurance</p> <p><input type="checkbox"/> (2) variable annuities</p> <p><input type="checkbox"/> (3) mutual fund shares</p> | <p><input type="checkbox"/> H. United States government securities</p> <p>I. Options contracts on:</p> <p><input type="checkbox"/> (1) securities</p> <p><input type="checkbox"/> (2) commodities</p> <p>J. Futures contracts on:</p> <p><input type="checkbox"/> (1) tangibles</p> <p><input type="checkbox"/> (2) intangibles</p> <p>K. Interests in partnerships investing in:</p> <p><input type="checkbox"/> (1) real estate</p> <p><input type="checkbox"/> (2) oil and gas interests</p> <p><input type="checkbox"/> (3) other (explain on Schedule F)</p> <p><input type="checkbox"/> L. Other (explain on Schedule F)</p> |
|---|---|

4. Methods of Analysis, Sources of Information, and Investment Strategies.

A. Applicant's security analysis methods include: (check those that apply)

- | | |
|--|--|
| (1) <input type="checkbox"/> Charting | (4) <input type="checkbox"/> Cyclical |
| (2) <input type="checkbox"/> Fundamental | (5) <input type="checkbox"/> Other (explain on Schedule F) |
| (3) <input type="checkbox"/> Technical | |

B. The main sources of information applicant uses include: (check those that apply)

- | | |
|--|--|
| (1) <input type="checkbox"/> Financial newspapers and magazines | (5) <input type="checkbox"/> Timing services |
| (2) <input type="checkbox"/> Inspections of corporate activities | (6) <input type="checkbox"/> Annual reports, prospectuses, filings with the Securities and Exchange Commission |
| (3) <input type="checkbox"/> Research materials prepared by others | (7) <input type="checkbox"/> Company press releases |
| (4) <input type="checkbox"/> Corporate rating services | (8) <input type="checkbox"/> Other (explain on Schedule F) |

C. The investment strategies used to implement any investment advice given to clients include: (check those that apply)

- | | |
|---|---|
| (1) <input type="checkbox"/> Long term purchases
(securities held at least a year) | (5) <input type="checkbox"/> Margin transactions |
| (2) <input type="checkbox"/> Short term purchases
(securities sold within a year) | (6) <input type="checkbox"/> Option writing, including covered options, uncovered options or spreading strategies |
| (3) <input type="checkbox"/> Trading (securities sold within 30 days) | (7) <input type="checkbox"/> Other (explain on Schedule F) |
| (4) <input type="checkbox"/> Short sales | |

Applicant:	SEC File Number: 801-	Date:
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5. Education and Business Standards.

Are there any general standards of education or business experience that applicant requires of those involved in determining or giving investment advice to clients? Yes No

(If yes, describe these standards on Schedule F.)

6. Education and Business Background.

For:

- each member of the investment committee or group that determines general investment advice to be given to clients, or
- if the applicant has no investment committee or group, each individual who determines general investment advice given to clients (if more than five, respond only for their supervisors)
- each principal executive officer of applicant or each person with similar status or performing similar functions.

On Schedule F, give the:

- | | |
|-----------------|--|
| • name | • formal education after high school |
| • year of birth | • business background for the preceding five years |

7. Other Business Activities. (check those that apply)

- A. Applicant is actively engaged in a business other than giving investment advice.
- B. Applicant sells products or services other than investment advice to clients.
- C. The principal business of applicant or its principal executive officers involves something other than providing investment advice.

(For each checked box describe the other activities, including the time spent on them, on Schedule F.)

8. Other Financial Industry Activities or Affiliations. (check those that apply)

- A. Applicant is registered (or has an application pending) as a securities broker-dealer.
- B. Applicant is registered (or has an application pending) as a futures commission merchant, commodity pool operator or commodity trading adviser.
- C. Applicant has arrangements that are material to its advisory business or its clients with a related person who is a:

- | | |
|--|--|
| <input type="checkbox"/> (1) broker-dealer | <input type="checkbox"/> (7) accounting firm |
| <input type="checkbox"/> (2) investment company | <input type="checkbox"/> (8) law firm |
| <input type="checkbox"/> (3) other investment adviser | <input type="checkbox"/> (9) insurance company or agency |
| <input type="checkbox"/> (4) financial planning firm | <input type="checkbox"/> (10) pension consultant |
| <input type="checkbox"/> (5) commodity pool operator, commodity trading adviser or futures commission merchant | <input type="checkbox"/> (11) real estate broker or dealer |
| <input type="checkbox"/> (6) banking or thrift institution | <input type="checkbox"/> (12) entity that creates or packages limited partnerships |

(For each checked box in C, on Schedule F identify the related person and describe the relationship and the arrangements.)

D. Is applicant or a related person a general partner in any partnership in which clients are solicited to invest? Yes No

(If yes, describe on Schedule F the partnerships and what they invest in.)

Applicant:	SEC File Number: 801-	Date:
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9. Participation or Interest in Client Transactions.

Applicant or a related person: (check those that apply)

- A. As principal, buys securities for itself from or sells securities it owns to any client.
- B. As broker or agent effects securities transactions for compensation for any client.
- C. As broker or agent for any person other than a client effects transactions in which client securities are sold to or bought from a brokerage customer.
- D. Recommends to clients that they buy or sell securities or investment products in which the applicant or a related person has some financial interest.
- E. Buys or sells for itself securities that it also recommends to clients.

(For each box checked, describe on Schedule F when the applicant or a related person engages in these transactions and what restrictions, internal procedures, or disclosures are used for conflicts of interest in those transactions.)

10. Conditions for Managing Accounts. Does the applicant provide investment supervisory services, manage investment advisory accounts or hold itself out as providing financial planning or some similarly termed services *and* impose a minimum dollar value of assets or other conditions for starting or maintaining an account?.....

Yes No

(If yes, describe on Schedule F.)

11. Review of Accounts. If applicant provides investment supervisory services, manages investment advisory accounts, or holds itself out as providing financial planning or some similarly termed services:

A. Describe below the reviews and reviewers of the accounts. For reviews, include their frequency, different levels, and triggering factors. For reviewers, include the number of reviewers, their titles and functions, instructions they receive from applicant on performing reviews, and number of accounts assigned each.

B. Describe below the nature and frequency of regular reports to clients on their accounts.

Applicant:	SEC File Number: 801-	Date:
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12. Investment or Brokerage Discretion.

- A. Does applicant or any related person have authority to determine, without obtaining specific client consent, the:**
- | | | |
|--|--------------------------|--------------------------|
| (1) securities to be bought or sold? | Yes | No |
| | <input type="checkbox"/> | <input type="checkbox"/> |
| (2) amount of the securities to be bought or sold? | Yes | No |
| | <input type="checkbox"/> | <input type="checkbox"/> |
| (3) broker or dealer to be used? | Yes | No |
| | <input type="checkbox"/> | <input type="checkbox"/> |
| (4) commission rates paid? | Yes | No |
| | <input type="checkbox"/> | <input type="checkbox"/> |

- B. Does applicant or a related person suggest brokers to clients?** Yes No

For each yes answer to A describe on Schedule F any limitations on the authority. For each yes to A(3), A(4) or B, describe on Schedule F the factors considered in selecting brokers and determining the reasonableness of their commissions. If the value of products, research and services given to the applicant or a related person is a factor, describe:

- the products, research and services
- whether clients may pay commissions higher than those obtainable from other brokers in return for those products and services
- whether research is used to service all of applicant's accounts or just those accounts paying for it; and
- any procedures the applicant used during the last fiscal year to direct client transactions to a particular broker in return for products and research services received.

13. Additional Compensation.

Does the applicant or a related person have any arrangements, oral or in writing, where it:

- | | | |
|---|--------------------------|--------------------------|
| A. is paid cash by or receives some economic benefit (including commissions, equipment or non-research services) from a non-client in connection with giving advice to clients? | Yes | No |
| | <input type="checkbox"/> | <input type="checkbox"/> |
| B. directly or indirectly compensates any person for client referrals? | Yes | No |
| | <input type="checkbox"/> | <input type="checkbox"/> |

(For each yes, describe the arrangements on Schedule F.)

14. Balance Sheet. Applicant must provide a balance sheet for the most recent fiscal year on Schedule G if applicant:

- has custody of client funds or securities; or
 - requires prepayment of more than \$500 in fees per client and 6 or more months in advance
- | | | |
|--|--------------------------|--------------------------|
| Has applicant provided a Schedule G balance sheet? | Yes | No |
| | <input type="checkbox"/> | <input type="checkbox"/> |

**Schedule A of
Form ADV
FOR CORPORATIONS**

Applicant:	SEC File Number: 801-	Date:	Official Use
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(Answers for Form ADV Part I Item 8.)

1. This Schedule requests information on the owners and executive officers of the applicant.
2. Please complete for:
 - (a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, director, and individuals with similar status or functions, and
 - (b) every person who is directly, or indirectly through intermediaries, the beneficial owner of 5% or more of any class of equity security of the applicant.
3. If a person covered by 2(b) above owns applicant indirectly through intermediaries, list all intermediaries and below them, if they are not subject to Sections 12 or 15(d) of the Securities Exchange Act of 1934 but are:
 - (a) corporations, give their shareholders who own 5% or more of a class of equity security, or
 - (b) partnerships, give their general partners or any limited and special partners who have contributed 5% or more of the partnership's capital.
4. If the intermediary's shareholders or partners listed under 3 above are not individuals, continue up the chain of ownership listing their 5% shareholders, general partners, and 5% limited or special partners until individuals are listed.
5. Ownership codes are:

NA - 0 up to 5%	B - 10% up to 25%	D - 50% up to 75%
A - 5% up to 10%	C - 25% up to 50%	E - 75% up to 100%
6. Asterisk (*) names reporting a change in title, status, stock ownership or partnership interest or control. Double asterisk (**) names new on this filing.
7. Check "Control Person" column if person has "control" as defined in the instructions to this Form.

FULL NAME			Beginning Date		Title or Status	Ownership Code	Control Person	CRD No., or, if none Social Security Number	OFFICIAL USE ONLY
Last	First	Middle	Month	Year					

List below names reported on the most recent previous filing under this item that are being DELETED:

FULL NAME			Ending Date		CRD. No., or, if none Social Security Number
Last	First	Middle	Month	Year	

Complete amended pages in full, circle amended items and file with execution page (page 1).

**Schedule B of
Form ADV
FOR PARTNERSHIPS**

Applicant:	SEC File Number: 801-	Date:	Official Use
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(Answers for Form ADV Part I Item 8.)

1. This Schedule requests information on the owners and partners of the applicant.
2. Please complete for all general partners and with respect to limited and special partners all those who have contributed directly or indirectly through intermediaries, 5% or more of the partnership's capital.
3. If a person owns applicant indirectly through intermediaries, list all intermediaries and below them, if they are not subject to Sections 12 or 15(d) of the Securities Exchange Act of 1934 but are:
 - (a) corporations, give their shareholders who own 5% or more of a class of equity security, or
 - (b) partnerships, give their general partners or any limited and special partners who have contributed 5% or more of the partnership's capital.
4. If the intermediary's shareholders or partners listed under 3 above are not individuals, continue up the chain of ownership listing their 5% shareholders, general partners, and 5% limited or special partners until individuals are listed.
5. Ownership codes are:

NA - 0 up to 5%	B - 10% up to 25%	D - 50% up to 75%
A - 5% up to 10%	C - 25% up to 50%	E - 75% up to 100%
6. Asterisk (*) names reporting a change in title, status, stock ownership or partnership interest or control. Double asterisk (**) names new on this filing.
7. Check "Control Person" column if person has "control" as defined in the instructions to this Form.

FULL NAME			Beginning Date		Title or Status	Ownership Code	Control Person	CRD No., or, if none Social Security Number	OFFICIAL USE ONLY
Last	First	Middle	Month	Year					

List below names reported on the most recent previous filing under this item that are being DELETED:

FULL NAME			Ending Date		CRD No., or, if none Social Security Number
Last	First	Middle	Month	Year	

Complete amended pages in full, circle amended items and file with execution page (page 1).

**Schedule C of
Form ADV for OTHER
THAN Partnerships
and Corporations**

Applicant:	SEC File Number: 801-	Date:	Official Use
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(Answers for Form ADV Part I Item 8.)

1. This Schedule requests information on the owners and executive officers of the applicant.
2. Please complete for each person, including trustees, who participates in directing or managing the applicant.
3. Give each listed person's title or status, and describe the person's authority and beneficial interest in applicant. Sole proprietors must be identified in the "Title or Status" column.
4. Astrisk (*) names reporting a change in title, status, stock ownership or partnership interest. Double asterisk (**) names new on this filing.

FULL NAME			RELATIONSHIP		CRD No., or, if none Social Security Number	Description of Authority and Beneficial Interest
			Beginning Date			
Last	First	Middle	Month	Year		

List below names reported on the most recent previous filing under this item that are being DELETED:

FULL NAME			Ending Date		CRD No., or, if none Social Security Number
			Month	Year	
Last	First	Middle			

Applicant:	SEC File Number: 801-	Date:
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(Answers for Form ADV Part I Items 11 and 12.)

This Schedule is submitted for an individual who is: (Check all boxes that apply)

- A. the applicant, named in Part I Item 1A
- B. a control person, named in Part I Item 10A
- C. an owner of at least 10% of a class of applicant's equity securities
- D. an officer or director, partner, or individual with similar status of applicant, described in Schedule A Item 2a, Schedule B Item 2, or Schedule C Item 2
- E. a member of the applicant's investment committee that determines general investment advice to be given to clients
- F. if applicant has no investment committee, an individual who determines general client advice (if more than five, complete for their supervisors only)
- G. an individual giving investment advice on behalf of the applicant in the jurisdictions checked below:

AL	AK	AZ	AR	CA	CO	CT	DE	DC	FL	GA	HI	ID
IL	IN	IA	KS	KY	LA	ME	MD	MA	MI	MN	MS	MO
MT	NE	NV	NH	NJ	NM	NY	NC	ND	OH	OK	OR	PA
RI	SC	SD	TN	TX	UT	VT	VA	WA	WV	WI	WY	Puerto Rico
Other: _____ (Specify)												

- H. involved in any yes answer to the disciplinary question, Part I Item 11.

**Schedule D of
Form ADV
Page 2**

Applicant:	SEC File Number: 801-	Date:
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(Answers for Form ADV Part I Items 11 and 12.)

1. Applicant investment adviser: (see Part I Item 1A)		IRS Empl. Ident. No.:				
2. Individual's full name for whom this Schedule is being completed:	Social Security Number:	CRD No., if any:	IRS Empl. Ident. No.:			
3. (a) Residence of individual: (Number and Street) (City) (State) (Zip Code)						
(b) Birth Date:	(c) City:	(d) State or Province:	(e) Country:			
4. NAMES USED. List all names other than the one given in Item 2 above that the individual has used, including maiden names. (Last) (First) (Middle)						
5. EDUCATION. Start with last high school attended. If no degree received, state "none."						
School: (Name, City and State)		Years Attended	Year Graduated	For College and above Degree Major		
6. BUSINESS BACKGROUND. Provide complete consecutive statement of all employment for the past ten years, beginning with the most recent position first.						
Name of Firm and Address	Kind of Business	Exact Nature of Connection or Employment	Beginning Date		Ending Date	
			Month	Year	Month	Year
7. EXAMINATIONS/PROFESSIONAL DESIGNATIONS. List all jurisdiction, self-regulatory organization, and professional examinations and designations. Give examination or designation name (include any examination's title and number), body giving it, and date taken or conferred. If examination was waived, give details.						
8. PROCEEDINGS. For each 'yes' answer to Part I Item 11 involving the individual, give the following details of any court or regulatory action: <ul style="list-style-type: none"> • the adviser and individuals named, • the title and date of the action, • the court or body taking the action, and • a description of the action 						

Complete amended pages in full, circle amended items and file with execution page (page 1).

**Schedule E of
Form ADV
Continuation Sheet for Form ADV Part I**

Applicant:	SEC File Number:	Date:
	801-	

(Do not use this Schedule as a continuation sheet for Form ADV Part II or any other schedules.)

1. Full name of applicant exactly as stated in Item 1A of Part I of Form ADV:	IRS Empl. Ident. No.:
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Item of Form (identify)	Answer

Complete amended pages in full, circle amended items and file with execution page (page 1).

**Schedule F of
Form ADV
Continuation Sheet for Form ADV Part II**

Applicant:	SEC File Number:	Date:
	801-	

(Do not use this Schedule as a continuation sheet for Form ADV Part I or any other schedules.)

1. Full name of applicant exactly as stated in Item 1A of Part I of Form ADV:	IRS Empl. Ident. No.:
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Item of Form (identify)	Answer

Complete amended pages in full, circle amended items and file with execution page (page 1).

**Schedule G of
Form ADV
Balance Sheet**

Applicant:	SEC File Number: 801-	Date:
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(Answers in Response to Item 4 of Form ADV-S, or Form ADV Part II Item 14.)

1. Full name of applicant exactly as stated in Item 1A of Part I of Form ADV:	IRS Empl. Ident. No.:
Instructions	
1. The balance sheet must be: A. Prepared in accordance with generally accepted accounting principles B. Audited by an independent public accountant C. Accompanied by a note stating the principles used to prepare it, the basis of included securities, and any other explanations required for clarity.	
2. Securities included at cost should show their market or fair value parenthetically.	
3. Qualifications and any accompanying independent accountant's report must conform to Article 2 of Regulation S-X (17 CFR 210.2-01 et seq.).	
4. Sole proprietor investment advisers: A. Must show investment advisory business assets and liabilities separate from other business and personal assets and liabilities B. May aggregate other business and personal assets and liabilities unless there is an asset deficiency in the total financial position.	

Complete amended pages in full, circle amended items and file with execution page (page 1).