

MEMORANDUM

March 22, 1993

To: Jeff Duncan  
Senior Counsel for Finance  
House Subcommittee on Telecommunications and  
Finance

From: Division of Investment Management *BJ*

Subject: Exception for Government Securities Advisers

Responsible  
Staff: Robert E. Plaze  
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In response to your request, we have prepared this memorandum discussing the background and scope of the exception from the definition of investment adviser in the Investment Advisers Act of 1940 (the "Advisers Act") for persons whose advice relates solely to U.S. Government securities. We will call you to discuss any further questions or concerns you may have.

I. THE HISTORY OF THE EXCEPTION

Section 202(a)(11)(E) of the Advisers Act provides that the definition of investment adviser does not include:

any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to Section 3(a)(12) of the Securities Exchange Act of 1934, as exempted securities for the purposes of that Act.

We have found relatively little to explain the origins of this exception or its scope. The initial drafts of the Advisers Act introduced in both the House and the Senate in 1940 contained no such exception.<sup>1</sup> However, versions of the legislation introduced later that year (including the legislation ultimately enacted) included the exact provision currently in the Advisers Act.<sup>2</sup> We

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<sup>1</sup> See H.R. 8935, 76th Cong., 3d Sess. §45(a)(16) (1940); S. 3580, 76th Cong., 3d Sess. §45(a)(16) (1940).

<sup>2</sup> See, e.g., H.R. 10065, 76th Cong., 3d Sess. §202(a)(11) (1940); S. 4108, 76th Cong., 3d Sess. §202(a)(11) (1940).

have found nothing in the Committee reports or the transcripts of the Congressional hearings explaining the reasons for the addition.

Nonetheless, we believe that the exception for government securities advisers was probably intended to parallel the treatment of government securities under the other securities laws. Government securities are exempt from registration under Section 3(a)(2) of the Securities Act of 1933 and Section 3(a)(12) of the Securities Exchange Act of 1934 (the "1934 Act"). Prior to the enactment of specific registration requirements for government securities brokers and dealers in the Government Securities Act of 1986<sup>3</sup>, brokers or dealers that executed transactions exclusively in government securities were not subject to 1934 Act regulation.<sup>4</sup>

## II. THE SCOPE OF THE EXCEPTION

The exception is relatively clear on its face. Advice about three classes of securities would appear to fall within the exception. First, advice can be given about direct obligations of the United States, such as Treasury bills and notes. Second, obligations subject to direct government guarantees, such as securities issued by the Government National Mortgage Association, would be covered. The third class of security would be those issued or guaranteed by corporations the securities of which are designated by the Secretary of the Treasury as exempt from the 1934 Act. For example, securities issued by the Farm Credit System would be in this class. Securities of this class need not be directly guaranteed by the U.S. government.<sup>5</sup>

However, as the result of an apparent oversight, certain securities generally considered "government securities" may fall

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<sup>3</sup> 100 Stat. 3208 (1986).

<sup>4</sup> Under Section 15(a)(1) of the 1934 Act, brokers or dealers need not register as such to effect transactions in exempted securities.

<sup>5</sup> Whether advice with regard to particular securities falls within the exception would appear to depend upon the identity of the issuer or guarantor of the security, not on the nature of the instrument. For instance, some collateralized mortgage obligations ("CMOs") are guaranteed by government-sponsored organizations, and we do not believe that advice regarding these CMOs would preclude reliance on the exception. In contrast, we believe that advice regarding privately-issued CMOs would preclude reliance on the exception.

outside the literal scope of the Advisers Act exception. In the Government Securities Act of 1986, the definition of "government securities" (and, as a result, "exempted securities") in the 1934 Act was expanded to include, in addition to securities that are designated as exempt by the Secretary of the Treasury, securities designated by statute as exempt from the laws administered by the Commission.<sup>6</sup> For instance, Student Loan Marketing Association ("SLMA") securities are exempt by statute, and have never been designated as exempt by the Secretary of the Treasury. Securities issued by the Federal Home Loan Mortgage Corporation ("FHLMC") and the Federal National Mortgage Association ("FNMA") have in the past been designated as exempt by the Secretary, but are now exempted by statute.<sup>7</sup> No corresponding amendment was made to the Advisers Act in 1986. Therefore, it can be argued that a person providing advice regarding SLMA, FHLMC and FNMA securities may not rely on the Advisers Act exception because advice regarding securities exempted by statute is not within the exception.<sup>8</sup> However, we believe it likely that the staff of the Commission would, if presented with the question, interpret the exception to permit advice regarding these securities.

The few letters of the Commission's staff interpreting the Advisers Act exception add little to this analysis. The staff has implied that repurchase agreements and reverse repurchase agreements collateralized by government securities do not fall within the exception.<sup>9</sup> In addition, the staff has stated that commodity trading advisers need not register as investment advisers if they provide advice regarding futures contracts on government securities.<sup>10</sup> However, this position appears to have

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<sup>6</sup> Section 3(a)(42) or the 1934 Act.

<sup>7</sup> See Notice Listing Instruments Previously Exempted Under the Securities Exchange Act of 1934, 52 FR 38559 (1987).

<sup>8</sup> For instance, the statute establishing FNMA provides that its securities are exempt from laws administered by the Commission to the same extent as direct obligations of the U.S. Government. 12 U.S.C. 1719(d). No specific exception for advice regarding the exempted securities is provided for.

<sup>9</sup> J.Y. Barry Arbitrage Management, Inc. (pub. avail. Oct. 18, 1989). Nonetheless, advice about repurchase agreements and reverse repurchase agreement may not necessitate registration as an investment adviser because such instruments may not be "securities" under the Advisers Act.

<sup>10</sup> Peavey Commodity Futures Funds, I, II, III (pub. avail. June 2, 1983).

been based upon the jurisdictional provisions of the Commodity Exchange Act rather than the Advisers Act exception.

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We have no way of knowing how many firms rely on the government securities exception in the Advisers Act. It is our understanding that commodity trading advisers ("CTAs") frequently provide advice regarding government securities in addition to advice about futures contracts. The exception permits these CTAs to avoid Advisers Act registration. Banks do not rely on the exception. Banks and bank holding companies are separately excepted from the Advisers Act by Section 202(a)(11)(A).