UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

January 24, 1994

ARTHUR LEVITT
CHAIRMAN

The Honorable Christopher J. Dodd
Chairman
Subcommittee on Securities
Committee on Banking, Housing and Urban Affairs
444 Russell Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

As the 103rd Congress prepares to return for the second session, I am writing to express my hope that the conference to reconcile House and Senate versions of legislation amending the Investment Advisers Act of 1940 ("Advisers Act") will convene and complete its work as soon as possible. Both H.R. 578 and S. 423 would, by imposing modest fees on investment advisers, raise revenues that are critically needed by the Commission to supervise the activities of over 20,000 investment advisers currently registered with the Commission.

As you know, the House bill contains several amendments to the Advisers Act not included in the Senate bill. The amendments address a number of subjects that are of increasing concern to the Commission. We believe the Commission's current rulemaking authority is broad enough to address many of these subjects, and we have decided to go forward and develop the following rules:

- <u>Custody Rule</u>. This rule would prohibit custodian arrangements under which only the investment adviser (and not the client) receives periodic account statements from the custodian. This type of arrangement facilitated the Steven Wymer fraud.

- <u>Suitability Rule</u>. This rule would make explicit the requirement implicit in the general anti-fraud provisions of the Advisers Act that advisers must make a reasonable determination that the advice they give is suitable to their clients, based on a reasonable inquiry into the client's financial situation. Appropriate recordkeeping would also be required.

- <u>Improved Brochure</u>. Under this proposal, the current disclosure brochure that an adviser delivers to its clients describing the adviser's business would be amended to place greater emphasis on the education,

450 5TH ST. NW • WASHINGTON, D.C. 20549 • TEL (202) 272-2000 • FAX (202) 272-3912

business background and business practices of the adviser, the means by which the adviser is compensated, and the conflicts of interest that may be created for the adviser in entering into various compensation arrangements (i.e., commission-based compensation). The "800" number contemplated by the House bill as a means by which clients may obtain adviser disciplinary information would be provided in the brochure.

- Reports on Fees and Commissions. The rule would require an adviser to provide clients with periodic account statements that would include information concerning the sales commissions and other fees, if any, paid to the adviser or persons associated with or under common control with the adviser. These reports should provide clients with a better picture of the total cost of advisory services and the way compensation arrangements may affect investment advice.

The House bill, if adopted in its current form, would require the Commission to periodically conduct a survey to determine the extent to which persons fail to comply with the registration requirements of the Advisers Act. We are currently discussing with the North American Securities Administrators Association the feasibility of conducting a joint inquiry of unregistered investment advisers in the states. We believe that their participation could be very helpful in enforcing the registration provisions of the Advisers Act.

We trust that the anticipated Commission rulemaking will assist the conferees in their efforts toward enactment of this important legislation. The resources the legislation will provide will permit the Commission to begin to examine the activities of the growing number of registered investment advisers on a more frequent and meaningful basis. Further, we believe the development of the rules described above will substantially enhance investor protection.

We appreciate your efforts in connection with developing this legislation, and we look forward to working with you toward final passage of a compromise bill. Please do not hesitate to contact us if we can assist you in any way.

Sincerely,

Arthur Levitt
Chairman