Public Law 86-750

AN ACT

September 13, 1960
[S. 3773]

To amend certain provisions and the Investment Advisers Act of 1940, as amended.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph 12 of subsection (a) of section 202 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

Investment Advisers Act of 1940, amendment.
54 Stat. 847.

"(12) 'Investment company', affiliated person, and 'insurance company' have the same meanings as in the Investment Company Act of 1940. 'Control' means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."

15 USC 80b-2.

(b) Paragraph (18) of section 202(a) of the Investment Advisers Act of 1940, as amended, is amended by striking out "the Philippine Islands,".

SEC. 2. Clause (F) of paragraph (1) of section 203(c) of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

15 USC 80b-3.

"(F) whether such investment adviser, or any partner, officer, director thereof, or any person performing similar functions, or any person directly or indirectly controlling or controlled by such investment adviser, is subject to any disqualification which would be a basis for denial, suspension, or revocation of registration of such investment adviser under the provisions of subsection (d), and".

Registration application.
Information required.

SEC. 3. (a) Paragraph (2) of subsection (c) of section 203 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

"(2) a statement as to whether the principal business of such investment adviser consists or is to consist of acting as investment adviser and a statement as to whether a substantial part of the business of such investment adviser consists or is to consist of rendering investment supervisory services."

(b) Subsection (d) of section 203 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

Denial or suspension of registration.

"(d) The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to, or suspend for a period not exceeding twelve months or revoke the registration of, an investment adviser, if it finds that such denial, suspension, or revocation is in the public interest and that (1) such investment adviser, whether prior or subsequent to becoming such, or (2) any partner, officer, or director thereof, or any person performing similar functions, or (3) any person directly or indirectly controlling or controlled by such investment adviser, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made in any application for registration or report filed with the Commission under this title, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or who has omitted to state in any such application or report any material fact which is required to be stated therein; or (B) has been convicted within ten years preceding the filing of the application or at any time thereafter of any felony or misdemeanor which the Commission finds (i) involves the purchase or sale of any security, (ii) arises out of the conduct of the business of a broker, dealer, or investment adviser, (iii) involves embezzlement, fraudulent conversion, or misappropriation of funds or securities, or (iv) involves the violation of section 1341, 1342 or 1343 of title 18, United States Code, as heretofore or hereafter amended; or (C) is perma-

62 Stat. 643.

nently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security; or (D) has willfully violated any provision of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of this title, as any of such statutes heretofore have been or hereafter may be amended, or of any rule or regulation under any of such statutes; or (E) has aided, abetted, counseled, commanded, induced, or procured the violation by any other person of the Securities Act of 1933, or the Securities Exchange Act of 1934, or of this title, as any of such statutes heretofore have been or hereafter may be amended, or of any rule or regulation under any of such statutes."

48 Stat. 74, 881.
15 USC 77a, 78a.

SEC. 4. Subsection (e) of section 203 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

15 USC 80b-3.

Commencement of proceedings.

"(e) The commencement of a proceeding to deny registration under this section shall operate to postpone the effective date of registration for a period of ninety days, or until final determination whether such registration shall be denied, if that determination is made within such ninety-day period; but if, after appropriate notice and opportunity for hearing, it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration beyond such ninety-day period and until final determination of whether such registration shall be denied, the Commission shall so order. Upon request of any interested party, made more than ninety days after the effective date of such order, the Commission shall consider whether such postponement should continue, and shall take such action, if any, with respect thereto as in its discretion is necessary or appropriate in the public interest or for the protection of investors."

Withdrawal from registration.

SEC. 5. Subsection (g) of section 203 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

"(g) Any person registered under this section may, upon such terms and conditions as the Commission finds necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any person registered under this section, or who has pending an application for registration filed under this section, is no longer in existence or is not engaged in business as an investment adviser, the Commission shall by order cancel the registration of such person."

15 USC 80b-4.

SEC. 6. Section 204 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

Records and reports.

"SEC. 204. Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser (other than one specifically exempted from registration pursuant to section 203(b)), shall make, keep, and preserve for such periods, such accounts, correspondence, memorandums, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memorandums, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

15 USC 80b-3.

SEC. 7. The introductory paragraph of section 205 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

15 USC 80b-5.

"SEC. 205. No investment adviser, unless exempt from registration pursuant to section 203(b), shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to enter into, extend, or renew any investment advisory contract, or in any way to perform any investment advisory contract entered into, extended, or renewed on or after the effective date of this title, if such contract –".

Investment advisory contracts.

SEC. 8. The introductory paragraph of section 206 of the Investment Advisers Act of 1940, as amended, is amended by striking out "registered under section 203".

15 USC 80b-6.

SEC. 9. Section 206 of the Investment Advisers Act of 1940, as amended, is amended by changing the period at the end thereof to a semicolon and by adding the following new paragraph:

Prohibitions.

"(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

SEC. 10. The caption of section 208 of the Investment Advisers Act of 1940, as amended, is amended by striking out "UNLAWFUL REPRESENTATIONS" and inserting in lieu thereof "GENERAL PROHIBITIONS".

15 USC 80b-8.

SEC. 11. (a) Subsection (c) of section 208 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

"(c) It shall be unlawful for any person registered under section 203 of this title to represent that he is an investment counsel or to use the name 'investment counsel' as descriptive of his business unless (1) his or its principal business consists of acting as investment adviser, and (2) a substantial part of his or its business consists of rendering investment supervisory services."

(b) Section 208 of the Investment Advisers Act of 1940, as amended, is amended by adding the following new subsection:

"(d) It shall be unlawful for any person indirectly, or through or by any other person, to do any act or thing which it would be unlawful for such person to do directly under the provisions of this title or any rule or regulation thereunder."

SEC. 12. Subsection (e) of section 209 of the Investment Advisers Act of 1940, as amended, is amended by striking out "has engaged or is about to engage" in the first and in the second sentences and inserting in lieu thereof "has engaged, is engaged, or is about to engage"; by inserting in the first sentence after "any rule, regulation, or order hereunder," the first time that phrase appears, the following: "or that any person has aided, abetted, counseled, commanded, induced, or procured, is aiding, abetting, counseling, commanding, inducing, or procuring, or is about to aid, abet, counsel, command, induce, or procure such a violation,"; and by inserting in the second sentence, after "such act or practice,", the following: "or in aiding, abetting, counseling, commanding, inducing, or procuring any such act or practice,".

15 USC 80b-9.

SEC. 13. Subsection (b) of section 210 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

15 USC 80b-10.

"(b) Subject to the provisions of subsections (c) and (e) of section 209, the Commission, or any member, officer, or employee thereof, shall not make public he fact that any examination or investigation under this title is being conducted, or the results of or any facts

Disclosure of information.
Restriction.

ascertained during any such examination or investigation; and no member, officer or employee of the Commission shall disclose to any person other than a member, officer, or employee of the Commission any information obtained as a result of any such examination or investigation except with the approval of the Commission. The provisions of this subsection shall not apply-

15 USC 80b-12.

"(1) in the case of any hearing which is public under the provisions of section 212; or

"(2) in the case of a resolution or request from either House of Congress."

15 USC 80b-11.

SEC. 14. Subsection (a) of section 211 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

Rules and regulations.

"(a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the functions and powers conferred upon the Commission elsewhere in this title. For the purposes of its rules or regulations the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters."

15 USC 80b-17.

SEC. 15. Section 217 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

Penalty.

"SEC. 217. Any person who willfully violates any provision of this title, or any rule, regulation, or order promulgated by the Commission under authority thereof, shall, upon conviction, be fined not more than $10,000, imprisoned for not more than two years, or both."

SEC. 16. The Investment Advisers Act of 1940, as amended, is amended by adding the following new section:

"STATE CONTROL OF INVESTMENT ADVISERS

"SEC. 222. Nothing in this title shall affect the jurisdiction of the securities commissioner (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder."

Approved September 13, 1960.

Public Law 86-751

September 13, 1960
[S. 1740]

AN ACT

To amend section 202(b) of the Communications Act of 1934 in order to expand the Federal Communications Commission's regulatory authority under such section.

Communications Act of 1934, amendment.
48 Stat. 1070.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (b) of section 202 of the Communications Act of 1934 (47 U.S.C. 202 (b)) is amended to read as follows:

"(b) Charges or services, whenever referred to in this Act, include charges for, or services in connection with, the use of common carrier lines of communication, whether derived from wire or radio facilities, in chain broadcasting or incidental to radio communication of any kind.'

Approved September 13, 1960.

Calendar No. 1832

86TH CONGRESS *2d Session* | SENATE | REPORT No. 1760

AMENDMENTS TO THE INVESTMENT ADVISERS ACT OF 1940

JUNE 28, 1960 – Ordered to be printed

Mr. WILLIAMS OF NEW JERSEY, from the Committee on Banking and Currency, submitted the following

R E P O R T

[To accompany S. 3773]

The Committee on Banking and Currency, having considered the same, report favorably a committee bill (S. 3773) to amend certain provisions of the Investment Advisers Act of 1940, as amended, and recommend that the bill do pass.

PURPOSE OF THE BILL

S. 3773 would amend the Investment Advisers Act of 1940 in a number of respects. The more significant of these amendments would (1) provides new grounds for disqualification of an applicant for registration; (2) grant new power to postpone effectiveness within certain limits; (3) authorize the Commission by rule to require the keeping of books and records and the filing of reports; (4) permit periodic examinations of a registrant's books and records; (5) empower the Commission by rule to define and prescribe means reasonably designed to prevent fraudulent practices; (6) prohibit fraud by those advisers exempt from registration; (7) extend criminal liability to include a willful violation of a rule or order of the Commission; and (8) provide a less restrictive definition of the term "investment counsel."

GENERAL STATEMENT

The general objective of the Investment Advisers Act of 1940 is to protect the public and investors against malpractices by persons paid for advising others about securities. The act makes it unlawful for investment advisers registered under the act to engage in practices which constitute fraud or deceit. The act also requires registered

investment advisers to disclose the nature of their interest in transactions which they may effect for their clients, prohibits profit-sharing arrangements and, for all practical purposes, prevents the assignment of any investment advisory contract without the consent of the interested client.

Pursuant to statutory command, the Securities and Exchange Commission reviews the acts which it administers for the purpose of legislative revision. Extensive proposals were submitted to this committee late in 1956 and again in the 85th Congress, and again in early 1959. S. 1182, 86th Congress, included the SEC proposals relating to the Investment Advisers Act of 1940. In June of 1959, 86th Congress, there were 7 days of hearings on the Commission's entire legislative program, including S. 1182. This was the only bill in the Commission's legislative program which was supported without dissent by the industry.

Of the five acts administered by the Securities and Exchange Commission, the committee is of the opinion that confronted by the problems it must solve, the Investment Advisers Act of 1940 is the most inadequate. The Investment Advisers Act of 1940 was passed as title II of the bill of which title I was the Investment Company Act. Unlike other Federal securities statutes, it has few substantive or regulatory provisions. Modeled somewhat on the broker-dealer registration provisions of the Securities Exchange Act of 1934, it resembles a continuing census of the Nation's investment advisers.

Those defined as investment advisers by the act range from investment counsel firms, brokers whose advice is not incidental to their business, financial publishing houses not of general circulation, tout sheets and others.

REGISTRATION OF INVESTMENT ADVISERS

The committee is aware that the opportunity to advise others how to invest their money is becoming increasingly popular and lucrative. There are now over 1,800 advisers registered under the act. The committee is convinced that under the present law increasing opportunities exist for unscrupulous persons to practice as advisers. Therefore, new grounds for denying entrance into the field or revoking the registration of an adviser have been added. In addition to certain existing crimes, the Commission will be able to reject a person who has been convicted of embezzlement, fraudulent conversion or misappropriation of funds, or securities; or who has violated the mail fraud statute.

Other disqualifications added are based on the analogy between advisers and broker-dealers. The committee believes that in many ways these occupations involve similar delegation of trust and responsibility; consequently, one banned from the latter occupation should not be allowed to enter the first. Thus, a willful violation of the Securities Exchange Act of 1934 or the Securities Act of 1933 will be a ground for disqualification.

The following case demonstrates the parallel between advisers and broker-dealers: An applicant filed for registration both as broker-dealer and as investment adviser. Investigation revealed violations of the Securities Act and the Securities Exchange Act. A report of financial condition filed as a part of the broker-dealer application

falsely set forth his financial condition. An order or denial could not be entered with respect to the application for adviser registration as well as that of broker-dealer, because there was no statutory bar to registration as an investment adviser. It thus became effective. When the applicant filed a petition in bankruptcy, it appeared that customers and other broker-dealers would sustain substantial losses. It is an anomalous situation to permit the Commission to deny registration to a broker-dealer applicant based upon willful violations of the Securities Act and the Securities Exchange Act, but to leave it without authority to deny an application for registration as an investment adviser simultaneously filed by the same person.

Moreover, it seems inconsistent to the committee that the SEC cannot revoke the registration of an investment adviser for a willful violation of the Advisers Act itself when it can revoke registration of a broker-dealer for violation of the Securities Exchange Act.

An important amendment to the registration provisions would grant the Commission additional time to consider or investigate applications for registration.

Under the appropriate registration provisions of the act, an application becomes effective within 30 days. The Commission can postpone effectiveness of an application until final determination only after a hearing.

In recognition of the heavy workload of processing such applications, and the practical difficulty of conducting a hearing and entering an order within the 30 days provided by existing law, the bill would provide that commencement of a denial proceeding would automatically postpone the effectiveness of the application for 90 days. A hearing would then be necessary if an order further postponing the effectiveness were necessary. This order could be appealed to court. When 90 days have elapsed after the entry of this order, any interested party could request the Commission to consider the postponement order again. This reconsideration would not, however, be reviewable in court.

RECORDS AND INSPECTION

Investment advisers cannot now be required to maintain books and records. Moreover, the act does not now authorize the Commission to examine such books and records as the adviser may have kept, unless there is evidence of a violation sufficient to invoke the Commission's power to conduct an investigation.

In the opinion of the committee, the power of inspection under the Securities Exchange Act of 1934 has been indispensable in enforcing the requirements of the statute with regard to broker-dealers who are similar to advisers. The prospect of an unannounced visit of a Government inspector is an effective stimulus for honesty and bookkeeping veracity.

The importance of records and inspections is illustrated by one situation. A registered adviser interviewed by the staff of the Commission stated that he did not have custody of customers' securities or funds, did not execute orders, and with the exception of a checkbook, kept no books or records. Following complaints, an investigation revealed that he held some $600,000 of clients' securities. Without adequate records the Commission could not appraise his financial condition; and it appears that some $1,700,000 in cash and securities

may have been left with him by clients who perhaps sustained a loss of as much as $600,000.

To remedy this situation, the bill would authorize the Commission to require registered investment advisers to keep such books and records as the Commission may prescribe by rule and would provide that these books and records are subject to reasonable inspection by the SEC. This power is modeled after that presently found in the Securities and Exchange Act treating brokers and dealers.

NEW ENFORCEMENT POWERS

A major concern of the bill is to aid the Commission in enforcing compliance with the act. There are at present over 12½ million individuals in the United States who own corporate securities, nearly double those in 1952. It has been noted above that this new group offers strong temptation to confidence men and swindlers who may give them biased advice or misuse their funds or securities.

The committee proposal allowing the SEC to conduct a spot check of accounting statements to be required would help to curb such abuses. Such abuses would be further eliminated if the Commission could promulgate general antifraud rules capable of flexibility. At present the substantive prohibitions of the act only outlaw certain types of unfair investment advisory contracts, and forbid an adviser from perpetrating fraud or from selling securities directly to clients without disclosing the capacity in which he is acting and obtaining the client's consent. The addition of rulemaking powers to the present general prohibition against fraud, which has proved incapable of covering specific evils, is therefore recommended by the committee. The proposal has precedent in similar authority granted to the SEC over brokers and dealers by the Securities Exchange Act of 1934.

Further measures against fraud and deceit in the industry will be effected by applying the above prohibitions to all investment advisers in interstate commerce, whether registered or not. At present they do not apply to those who are defined under the act as advisers, but are exempted from registration. The change would follow the pattern now existing in other securities acts.

SECTION-BY-SECTION ANALYSIS

Definitions. – Section 1 of the bill would make more general and discretionary the statutory definition of "control," by eliminating the cross-reference to the statutory presumption contained in the Investment Company Act. This presumption, while appropriate to that act, is not needed in connection with the Investment Advisers Act. The amendment would leave the question of control in each case as a question of fact.

Section 1 of the bill would also bring up to date the definition of the term "Territory," by eliminating the Philippine Islands from the definition. Section 202(a)(18) of the act defines "Territory" to include, among other areas, Alaska, Hawaii, and the Philippine Islands. As Alaska and Hawaii have become States, inclusion in this definition is no longer appropriate. Alaska has already been removed by Public Law 86-70, the Alaska omnibus bill, and Hawaii is being removed by the Hawaii omnibus bill (S. 3054 and H.R.

11602). Consequently, it is not necessary to take further action with respect to them under this bill. The Philippine Islands are now independent and no longer should be included as a Territory.

Statutory disqualifications for registration. – Sections 2 and 3 of the bill would amend sections 203(c)1)(F) and 203(d) of the act so as to increase the number of offenses which would serve as a basis for denying or revoking registration. Under existing section 203(d), registration can be denied, suspended, or revoked because of (1) conviction within 10 years for a felony or misdemeanor involving the purchase or sale of a security, or arising out of activities as an investment adviser, underwriter, banker, or dealer, or as an affiliated person or employee of an investment company, bank, or insurance company; or (2) the existence of an injunction based upon similar conduct or activity; or (3) willful filing of a false statement in an application for registration or a required report.

The Commission should be able to keep out of the investment advisory business not only persons who would be barred under the standards now embodied in section 203(d), but also any person who has been convicted of embezzlement, fraudulent conversion, or misappropriation of funds or securities; or who has violated the mail fraud statute; or who is subject to an injunction based upon such improper activities. In addition, a willful violation of the Securities Act, the Securities Exchange Act, or the Investment Advisers Act should constitute a basis for denial, suspension, or revocation of the registration of an investment adviser.

A new statutory disqualification, subsection (E), would be added by the bill. This would allow the Commission to deny or revoke the registration as an adviser under the act of any person who has aided, abetted, counseled, commanded, induced, or procured any person to commit the acts which are grounds for disqualification as previously described.

Section 203(d) of the act provides only one ultimate sanction in connection with an effective registration-revocation. The Commission should be authorized to impose a lesser sanction –suspension- when revocation is too drastic. The section now provides for suspension, but only pending final determination in certain situations. The amendment would give the Commission authority to suspend an adviser as a final sanction for a period not to exceed 12 months.

Postponement of registration. – Section 4 of the bill would amend section 203(e) of the act. Section 203(e) now provides that the effectiveness of an application for registration is not postponed by the commencement of a proceeding to determine whether an order of denial should be entered, unless the Commission finds that such postponement is in the public interest. There is an overall limit of 3 months on any postponement order entered upon a finding of public interest.

Under section 211(c) of the act, an order postponing effectiveness of registration can be entered only after notice and opportunity for hearing. This procedure has proved administratively unworkable because such an order generally has to be entered within 30 days after the application is filed or the application will become effective under section 203(c) of the act. It would ordinarily be a practical impossibility within that limited period to give adequate notice of a hearing, conduct the hearing, review the record, and enter an order, all in compliance with the Administrative Procedure Act.

Section 4 would provide that the commencement of a proceeding to deny registration would automatically postpone registration for 90 days (except where final action, either affirmative or negative, is taken before the 90 days is up). The Commission may, after appropriate notice and opportunity for hearing postpone the effectiveness further but this decision would be reviewable in court. When 90 days have elapsed after the effective date of an order of postponement any interested party may request the Commission to consider whether the postponement should be continued. A decision on such a request for reconsideration would not, however, be reviewable in court.

Cancellation and withdrawal of applications and registrations. – Section 5 of the bill would amend section 203(g) of the act by providing that the Commission may cancel an application or a registration of an applicant or an adviser who is no longer in existence or not engaged in business as an investment adviser. Formerly the Commission was authorized to cancel an application or registration if the adviser was no longer in business or was not engaged in business as an investment adviser.

Among its legislative proposals, the Commission recommended amendments which would have dealt specifically with the withdrawal of pending applications. These amendments were opposed by the American Bar Association, and alternative amendments were recommended. The committee understands that the administrative practice of the Commission, in the case of any request to withdraw an application made after denial proceeding has been started, is to determine whether withdrawal is in the public interest (e.g., the Ramey Kelly Corp., SEA Release No. 6209, March 17, 1960), following the general principles laid down in a series of cases beginning with *Jones* v. *SEC*, 298 U.S. 1 (1936), and including such cases as *Columbia General Investment Corporation* v. *SEC*, 265 F. 2d 559 (C.A., 5, 1959 and *Shuck* v. *SEC*, 264 F. 2d 358 (C.A.D.C., 1958). The committee adopted none of the proposed amendments relating to the withdrawal of applications, because it was not convinced that there is any need to change the existing state of the law on this subject.

Keeping books and records; inspection of records. – Section 6 of the bill would amend section 204 of the act, to authorize the Commission to require investment advisers to keep such books and records as the Commission may prescribe by rule and would provide that these books and records are subject to reasonable inspection by the Commission. All investment advisers using means of interstate commerce would be included, except those exempt from registration under 203(b) of the act. This power is modeled after that presently found in section 17(a) of the Exchange Act of 1934 treating brokers and dealers.

The act as present does not authorize the Commission to require an investment adviser to keep any books and records, nor does it authorize the Commission to examine such books and records as he may have kept, unless there is evidence of a violation sufficient to invoke the Commission's power to investigate under section 209 of the act.

The nature of the business of an investment adviser differs from that of a broker on account of the personal details of a client's life which the adviser keeps on file to assist management of a portfolio. The industry has always feared that an investigation or examination might leave it prey to gossipmongering.

Therefore, when the act was written in 1940, section 210(c) of the act was written to prevent the Commission from requiring investment advisers who supervise individual accounts of clients to disclose the affairs of such clients except insofar as this may be determined to be necessary in an investigation or proceeding, as distinct from an inspection. Under the proposed section 6 of the bill, if the inspection which would now be possible of the adviser's records should indicate possible fraudulent or other improper practices with respect to the affairs of any client, the Commission could order a formal investigation to obtain information concerning the adviser's handling of clients' accounts.

A further safeguard of these relationships is provided in section 210(b) of the act as proposed to be amended by section 13 of the bill which would make it unlawful for the Commission to make public the information obtained in an examination or investigation except in the case of public hearings or upon request of either House of Congress. The exceptions previously applied only to the investigation. This change would place the Commission staff under a duty of nondisclosure similar to that of a bank examiner.

Prohibition against certain advisory contract extended to unregistered advisers. – Section 7 of the bill would amend section 205 of the act. Section 205 of the act now prohibits registered investment advisers from entering into, extending, renewing, or performing certain types of investment advisory contracts. These include profit sharing or unilateral assignment of the contract.

Section 205 of the act is not now expressly applicable to investment advisers subject to registration who have not registered; the only sanction applicable to them is for failure to register.

The amendment would make section 205 of the act applicable to investment advisers subject to registration, whether or not they have registered, except those exempt from section 203(b) of the act. Among those who are exempt from registration are investment advisers all of whose clients are residents of the State in which they reside, whose only clients are investment and insurance companies, or who during the past year have had fewer than 15 clients.

Extension of antifraud provisions to unregistered advisers. – Section 8 of the bill would amend the introductory paragraph of section 206 of the act so as to make the antifraud provisions applicable to all investment advisers whether or not registered. Section 203(b) of the act exempts from registration certain investment advisers, primarily those whose business is wholly intrastate or whose only clients are investment and insurance companies, or those who have fewer than 15 clients and do not hold themselves out generally to the public as investment advisers. While it is reasonable to exempt this group from registration, the reasons for exemption from registration do not, in the view of the committee, support a corresponding exemption from prohibitions against fraud.

Moreover, under the present wording of the statute, an investment adviser not exempt from registration may escape liability for fraud simply by neglecting to register, so that the Commission can only proceed against him for having failed to register.

Section 8 of the bill would make the fraud provisions applicable to all investment advisers, whether or not registered. This change follows the pattern now existing in the Securities Act of 1933 and the Secu-

rities Exchange Act of 1934. In both of these statutes there are securities or persons who are exempted, for reasons of policy, from registration, and thus from the regulatory jurisdiction of the Commission, but the fraud provisions of the Securities Act and the Securities Exchange Act are nevertheless applicable to them (sec. 17, Securities Act of 1933, secs. 10(b) and 15, Exchange Act of 1934).

Grant of rulemaking power. – Section 9 of the bill would amend section 206 of the act so as to authorize the Commission to issue regulations which would prohibit fraudulent, deceptive, and manipulative conduct. The substantive prohibitions of the Investment Advisers Act are very limited. They are in essence contained in sections 205 and 206 of the act, which outlaw certain types of unfair investment advisory contracts, and prohibit an investment adviser from perpetrating fraud or from selling securities directly to clients without disclosing the capacity in which he is acting and obtaining the client's consent.

Because of the general language of the statutory antifraud provision and the absence of any express rulemaking power in connection with them, it is not clear what fraudulent and deceptive activities are prohibited by this act and as to how far the Commission is limited in this area by common-law concepts of fraud and deceit. These include proof of a (1) false representation of; (2) a material; (3) fact; (4) the defendant must make it to induce reliance; (5) the plaintiff must rely on the false representation; (6) and suffer damage as a consequence.

In order to overcome this difficulty, section 9 of the bill would amend section 206 to add a prohibition against engaging in conduct which is faudulent [sic], deceptive, or manipulative and to authorize the Commission by rules and regulations to define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative. This is almost the identical wording of section 15(c)(2) of the Securities Exchange Act of 1934 in regard to brokers and dealers.

This provision would enable the Commission to deal adequately with such problems as a material adverse interest in securities which the adviser is recommending to his clients. The Investment Counsel Association of America testified that a general grant of rulemaking power to issue antifraud regulations is preferable to specific and inflexible statutory standards.

Amendment of title. – Section 10 of the bill would amend the caption of section 208 of the act which now reads "Unlawful Representations" so as to substitute a new title, "General Prohibitions."

Indirect violations. – Section 11 of the bill would add a new subsection (d) to section 208 of the act which would make it unlawful for persons to do indirectly, acts which they are forbidden to do directly. This provision is modeled on a similar one found in section 20(b) of the Securities Exchange Act of 1934.

Injunctions, aiders, and abettors. – Section 12 of the bill would amend section 209(e) of the act, so as to make it clear that an injunction may be sought when a person is violating the act at the time the injunction is sought.

This section of the bill would also make it clear that the Commission may obtain an injunction against any person who is aiding, abetting, or inducing another person to violate the act. The addition to the injunction section does not limit the application of the criminal aiding

and abetting statute of the United States Code (18 U.S.C. 2). Rather the amendment borrows the concepts of aiding and abetting from the criminal law and seeks to insure that persons will be liable in administrative actions by the Commission, as well as in criminal actions.

Confidential treatment of investigative material. – Section 13 of the bill would amend section 210(b) of the act. Section 210(b) now provides, subject to certain exceptions, that the Commission shall not make public the fact that any investigation under the act is being conducted, or the results of such investigation, or any facts ascertained.

As this section now reads, it is not clear that the Commission could disclose to appropriate State officials facts ascertained in an investigation which tend to indicate a violation of State law.

The proposed amendment would make it clear that the information gathered in an inspection or investigation could be disclosed in these circumstances, but only with the approval of the Commission itself. The amendment would also make it clear that the prohibitions against disclosure apply not only to the Commission, but also to members, officers, and employees as well. (See also sec. 6 of this bill.)

Rulemaking powers. – Section 14 of the bill would amend section 211(a) of the act, granting the SEC rulemaking power as is "necessary or appropriate to the exercise of powers conferred" on it by the act. The amendment would add the word "functions" to the word "powers" conferred on the SEC by the act. The addition would make the rulemaking power as broad as it is in the Securities Act of 1933 and the Securities Exchange Act of 1934.

Penalty for willful violation of rules. – Section 15 of the bill would amend section 217 of the act, so as to make the penalty provisions also applicable to willful violations of any rule, regulation, or order promulgated by the Commission under the authority of the statute. This amendment is appropriate in view of the granting of authority to issue rules and regulations provided in section 9 of the bill.

The amendment would not affect section 211(d) of the act which provides that there will be no liability for a good-faith failure to act in conformity with an SEC rule.

State law. – Section 16 of the bill would add a new section 222 to the act, which would provide that the jurisdiction of a State securities commissioner or similar officer would not be affected by provisions of the Investment Advisers Act so long as there was no conflict with its provisions.

No section of the act now deals specifically with the effect of the provisions of the act on State laws. The Securities Act of 1933 and the Securities Exchange Act of 1934 now contain provisions making it clear that the jurisdiction of a State securities commissioner or similar officers is not affected by provisions of those acts, so long as there is no conflict with their provisions. There were very few State statutes regulating investment advisers in 1940. The amendment would express clearly the concurrent jurisdiction in the area of investment advisers, in view of the important role which State authorities must play in the supervision of securities.

Investment counsel. – Section 17 of the bill would amend sections 208(c) and 203(c)(2) of the act, which now provides that a registered adviser may not call himself "investment counsel" unless primarily rendering investment supervisory services (continuous advice based on a client's individual needs). An application for registration must state whether the adviser is so engaged.

This definition would be amended to allow a registered adviser to use the name, if his principal business consists of acting as an adviser and if a substantial part of his business consists of rendering investment supervisory services.

The present law restricts the use of the term "investment counsel" to those who are "primarily engaged in the business of rendering investment supervisory services." This operated to exclude from the field of "investment counsel" outstanding practitioners which happened also to be engaged in related activities. Thus one well-known publisher of financial statistics draws approximately 50 percent of its gross revenues from publishing factual and statistical information, approximately 20 percent from publications expressing opinions on the merits of securities, and approximately 30 percent from rendering investment supervisory services. The same figures for another such publisher are approximately 25 percent, 51 percent, and 24 percent, respectively.

The amendment as reported would permit these organizations and others similarly situated to qualify for use of the name "investment counsel," while still denying such designation to others who do not render investment supervisory services as a substantial part of their business.

A conforming amendment of section 203(c)(2) of the act contained in subsection 3(a) of the bill requires that an application for registration must state whether the adviser is engaged in rendering such service.

CORDON RULE

In the opinion of the committee, it is necessary to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate in order to expedite the business of the Senate in connection with this report.

O

86TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
No. 2179

AMENDMENTS TO THE INVESTMENT ADVISERS ACT OF 1940

AUGUST 26, 1960.– Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. MACK, from the Committee on Interstate and Foreign Commerce, submitted the following

R E P O R T

[To accompany H.R. 2482]

The Committee on Interstate and Foreign Commerce, to whom was referred the bill (H.R. 2482) to amend certain provisions of the Investment Advisers Act of 1940, as amended, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

First page, line 3, strike out " 'Alaska,'".

First page, strike out line 9 and all that follows down through line 5 on page 2, and insert the following:

> "(F) whether such investment adviser, any partner, officer, director, or person performing similar functions, or any person directly or indirectly controlling or controlled by such investment adviser, is subject to any disqualification which would be a basis for denial, suspension, or revocation of registration of such investment adviser under the provisions of subsection (d), and".

SEC. 3. Paragraph (2) of subsection (c) of section 203 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:

> "(2) a statement as to whether the principal business of such investment adviser consists or is to consist of acting as investment adviser and a statement as to whether a substantial part of the business of such investment adviser consists or is to consist of rendering investment supervisory services."

Page 2, line 6, strike out "3" and insert "4".
Page 4, line 1, strike out "4" and insert "5".
Page 4, line 16, strike out "5" and insert "6".
Page 5, line 9, strike out "6" and insert "7".
Page 5, line 15, strike out "(h)" and insert "(b)".
Page 6, line 4, strike out "7" and insert "8".
Page 6, line 15, strike out "8" and insert "9".
Page 6, line 18, strike out "9" and insert "10".
Page 6, line 19, after "is amended" insert "(1) by striking out the semicolons at the end of clauses (1) and (2) and inserting periods in lieu thereof, and (2)".
Page 6, strike out line 21 and all that follows down through line 2 on page 7, and insert the following:

> "(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

Page 7, line 3, strike out "10" and insert "11".
Page 7, after line 6, insert the following:

> SEC. 12. (a) Subsection (c) of section 208 of the Investment Advisers Act of 1940, as amended, is amended to read as follows:
>
> "(c) It shall be unlawful for any person registered under section 203 of this title to represent that he is an investment counsel or to use the name investment counsel as descriptive of his business unless (1) his or its principal business consists of acting as investment adviser, and (2) a substantial part of his or its business consists of rendering investment supervisory services."

Page 7, line 7, strike out "11" and insert "13".
Page 7, line 20, strike out "12" and insert "14".
Page 7, line 24, strike out "engaged or" and insert "engaged, or".
Page 8, line 1, strike out "13" and insert "15".
Page 8, line 5, strike out "(e), of" and insert "(e) of".
Page 8, line 18, insert ", or any committee thereof" after "Congress".
Page 8, line 19, strike out "14" and insert "16".
Page 9, line 5, strike out "15" and insert "17".
Page 9, lines 9 and 10, strike out ", upon conviction,".
Page 9, line 10, strike out comma after "$10,000" and insert "or".
Page 9, line 12, strike out "16" and insert "18".

PURPOSE OF THE BILL

The bill, H.R. 2482, here being reported amends the Investment Advisers Act of 1940 for the purpose of making the enforcement activities of the Securities and Exchange Commission more effective, by giving the Commission additional authority, and by providing additional remedies and eliminating or minimizing various problems which have come to light in the course of the Commission's enforcement of

the act. The more significant of these proposals would, in brief: (1) expand the basis for disqualification of an applicant for registration or a registrant because of misconduct; (2) revise the provisions relating to the postponement of effectiveness and the withdrawal of applications for registration; (3) authorize the Commission by rule to require the keeping of books and records and the filing of reports; (4) permit periodic examinations of a registrant's books and records; (5) empower the Commission by rule to define and prescribe means reasonably designed to prevent fraudulent practices; and (6) extend criminal liability to include a willful violation of a rule or order of the Commission.

HEARINGS

Hearings on H.R. 2482, and four other bills dealing with the various acts administered by the Securities and Exchange Commission, were conducted by the Subcommittee on Commerce and Finance during the months, March to August 1959. The measure was sponsored by the Commission. It was supported by the Investment Counsel Association of America. No one appeared in opposition to the bill, although several witnesses suggested the inclusion of additional amendments (which are contained in the committee amendment). It is supported by the Bureau of the Budget.

BACKGROUND AND NEED FOR LEGISLATION

The general objective of the Investment Advisers Act of 1940 is to protect the public and investors against malpractices on the part of persons engaged for compensation in the business of advising others with respect to securities. The act makes it unlawful for investment advisers registered under the act to engage in practices which constitute fraud or deceit. The act also requires registered investment advisers to disclose the nature of their interest in transactions which they may effect for their clients, prohibits profit-sharing arrangements and, for all practical purposes, prevents the assignment of any investment advisory contract without the consent of the interested client.

The amendments embodied in the bill are recommended by the Securities and Exchange Commission, which is of the opinion that the changes will materially assist it in enforcing the statute.

Administration of the Investment Advisers Act since its adoption in 1940 has indicated to the Commission that it is inadequate in many respects and does not afford the necessary protection to clients of investment advisers and other members of the investing public. The Commission has no authority under the act to inspect the books and records of investment advisers, and cannot even require investment advisers to maintain books and records. It has no adequate means of determining whether investment advisers are engaging in fraudulent or deceptive practices in connection with their business.

The present statute provides for the registration of most investment advisers who use the mails or instrumentalities of interstate commerce in connection with their business. The basis for denial or revocation of registration is very narrow and limited, however, and this makes it possible for undesirable persons to engage in the investment advisory

business, essential elements of which are trust and confidence by the client and scrupulously honest dealing by the adviser.

The provisions of the act prohibiting fraudulent practices apply only to investment advisers who happen to be registered. The investment adviser who evades registration or is exempt from it is not subject to these provisions. The act is inadequate also because it does not give the Commission the power to adopt rules and regulations defining acts and practices which are fraudulent, deceptive, or manipulative, or prescribing means designed to prevent such acts and practices.

COMMITTEE AMENDMENTS

Most of the committee amendments are merely of a typographical or minor technical nature. One amendment of substance has been adopted by the committee to modify the present law which restricts the use of the term "investment counsel" to those who are "primarily" engaged in the business of rendering investment supervisory services, to permit the use of the term where a "substantial" part of the business of an investment adviser consists of rendering such services. This would permit such services as Moody's Investors Service and Standard & Poor's Corp. to use the term. This amendment is embodied in section 3 of the bill as reported amending paragraph (2) of subsection (c) of section 203 , and in section 12 of the bill as reported amending subsection (c) of section 208.

SECTION-BY-SECTION ANALYSIS OF THE BILL AS REPORTED BY THE COMMITTEE

Section 1

Would eliminate the reference to the Philippine Islands in the definition of "State" in section 202(a)(18) of the act.

Sections 2 and 3: Expansion and integration of provisions relating to statutory disqualifications

Present law. – Under seciton [sic] 203(d) registration can be denied, suspended, or revoked because of (1) conviction within 10 years for a felony or misdemeanor involving the purchase or sale of a security, or arising out of activities as an investment adviser, underwriter, banker, or dealer, or as an affiliated person or employee of an investment company, bank, or insurance company; or (2) the existence of an injunction based upon similar conduct or activity; or (3) the willful filing of a false statement in an application for registration or a required report.

Problem. – (1) It should be possible for the Commission to keep out of the investment advisory business not only persons who would be barred under the standards now embodied in section 203(d), but also any person who has been convicted of embezzlement, fraudulent conversion, or misappropriation of funds or securities; or who has violated the mail fraud statute; or who is subject to an injunction based upon such improper activities. In addition, a willful violation of the Securities Act, the Securities Exchange Act, or the Investment Advisers Act should constitute a basis for denial, suspension, or revocation of the registration of an investment adviser.

One case demonstrates the weakness of the Investment Advisers Act. Information was obtained by the staff indicating that a certain

individual was engaged in the securities business relying upon an exemption from registration under the Securities Exchange Act available to persons doing business entirely within one State. Investigation disclosed that this individual actually was engaged in an interstate business, and that the exemption was not available. Upon being advised that registration as a broker-dealer was required, applications for registration were filed not only as a broker-dealer, but also as an investment adviser. Investigation revealed several serious violations of the Securities Act and the Securities Exchange Act. A report of financial condition filed as a part of the broker-dealer application falsely set forth his financial condition. Proceedings were instituted to determine whether an order of denial should be entered with respect to the application for a broker-dealer registration, but since there was no statutory bar to registration as an investment adviser, that registration became effective. The applicant, before the date for hearing on the broker-dealer matter, filed a petition in bankruptcy. From documents filed in that proceeding it appeared that customers and other broker-dealers would sustain substantial losses. In connection with a stipulation of facts in the broker-dealer denial proceeding, the staff succeeded in obtaining a withdrawal of the investment adviser registration. It is an anomalous situation that permits the Commission to deny registration to a broker-dealer applicant based upon willful violations of the Securities Act and the Securities Exchange Act, but leaves it without authority to deny an application for registration as an investment adviser simultaneously filed by the same person.

(2) Section 203(c) should be revised to require disclosure of information necessary to determine whether there exists a basis for denying registration under section 203(d), as proposed to be amended.

Remedy in the bill. – (1) It is proposed to amend section 203(d) to provide that conviction of embezzlement, fraudulent conversion or misappropriation of funds or securities; or violation of the mail fraud statute; or the existence of an injunction based upon such improper activities; or the willful violation of the Securities Act of 1933, the Securities Exchange Act of 1934 or the Investment Advisers Act of 1940, will also constitute bases for statutory disqualification

(2) The proposed amendment would amend section 203(c) to require disclosure of the information necessary to disclose any such disqualification.

Section 4. Provision for postponement of effectiveness of registration when denial proceedings are instituted

Present law. – Section 203(e) now provides that the effectiveness of an application for registration is not postponed by the commencement of a proceeding to determine whether an order of denial should be entered, unless the Commission finds that such postponement is in the public interest.

Problem. – Under section 211(c) such order postponing effectiveness of registration can be entered only after notice and opportunity for hearing, and this procedure has proved administratively unworkable because such an order generally has to be entered within 30 days after the application is filed or the application will become effective under section 203(c). It would ordinarily be a practical impossibility within that limited period, to give adequate notice of a hearing, conduct the

hearing, review the record, and enter an order, all in compliance with the Administrative Procedure Act. Furthermore, if such an effort were undertaken it would usually be necessary to duplicate the conduct of hearings and the taking of evidence on both the postponement question and the denial question.

Remedy in the bill. – Under the proposed amendment to section 203(e), the commencement of a proceeding to deny registration would postpone effectiveness of an application for registration for a period of 90 days, or until final determination in the denial proceeding if that occurs sooner; and if the proceeding extends beyond 90 days, the Commission could postpone effectiveness beyond the 90-day period only after a hearing on the question of further postponement.

Section 5. Addition of provision relating to the right to withdraw an application for registration

Present law. – Section 203(g) provides that a registered investment adviser may withdraw from registration only upon such terms and conditions as the Commission may impose in the public interest or for the protection of investors. The statute does not contain any provision with respect to the withdrawal of an application for registration.

Problem. – Upon receipt of an application for registration, inquiry is made to determine whether there is any bar to such person becoming registered, and whether it is in the public interest to deny the registration. This necessitates investigation concerning many factors, including identity, past history, business experience and affiliations. Frequently, it is necessary to obtain evidence on these matters from various parts of the United States, as well as from outside the country. If the applicant has the right to withdraw after a proceeding has been instituted to deny his registration, the Commission may be in a position where it will be unable to prove a disqualification at a later date if a new application if filed. When much time and effort have been devoted to the matter and expense has been incurred, it is appropriate that a hearing be held so that a determination can be made as to whether or not there is a statutory bar and whether it is in the public interest to enter an order of denial. If an applicant is permitted to withdraw under such circumstances, the Commission at a later date may be required to conduct a new investigation to try to find available evidence under circumstances which may make it much more difficult to make the necessary findings.

Remedy in the bill. – The proposed amendment specifically provides that an application for registration may be withdrawn only with the consent of the Commission if the request for withdrawal is received by the Commission after it has instituted proceedings to deny registration.

Section 6. Addition of power to compel maintenance of books and records and expansion of power to inspect

Present law. – The act now contains no grant of power to inspect the books and records of investment advisers; in fact there is no requirement that they maintain any books or records. The act authorizes investigations concerning violations of the act only when it appears that its provisions have been or are about to be violated.

Problem. – Unless the Commission has sufficient information to bring its investigative powers into play, it has no authority to examine the books and records of investment advisers to determine whether they are engaging in fraudulent, deceptive, or other unlawful practices.

Remedy in the bill. – The proposed amendment to section 204 would require investment advisers subject to registration to maintain the books and records prescribed by Commission rules and regulations and would authorize the Commission to conduct routine inspections of investment advisers. The Commission has similar authority with respect to brokers and dealers under section 17(a) of the Securities Exchange Act of 1934.

This power of inspection would be limited, however, by section 210(c) of the act which provides that the Commission cannot require an investment adviser engaged in rendering investment supervisory services to disclose the identity, investments, or affairs of any client except in a particular proceeding or investigation. Many investment advisers rendering investment supervisory services have in their records some very personal information about their clients and their clients' families, and there is some question as to whether information concerning the investments or affairs of clients should have to be disclosed except in a formal investigation or proceeding. If a routine inspection of the adviser's books and records should indicate possible fraudulent or other improper practices with respect to the affairs of any client the Commission could order a formal investigation to obtain information concerning the adviser's handling of client's accounts.

Section 7. Clarification of prohibitions against performance of certain investment advisory contracts

Present law. – Section 205 of the act now prohibits registered investment advisers from entering into, extending, renewing, or performing certain types of investment advisory contracts.

Problem. – Section 205 is not specifically applicable to investment advisers subject to registration who have not registered.

Remedy in the bill. – The amendment makes section 205 applicable to investment advisers subject to registration, whether or not they have registered.

Section 8. Extension of antifraud provisions

Present law. – Section 206 of the act prohibits certain fraudulent and deceptive practices by registered investment advisers.

Problem. – This section is now applicable only to registered investment advisers. Fraud is no less vicious because it is perpetrated by an unregistered investment adviser. Just as the antifraud provisions of the Securities Exchange Act of 1934 are applicable to brokers and dealers irrespective of registration, so should the antifraud provisions of this act be applicable to all investment advisers.

Remedy in the bill. – The proposed amendment would apply the antifraud provision of section 206 to all investment advisers, whether registered or not.

Section 9. Addition of rulemaking power to implement antifraud provisions

Present law. – Present section 206 contains general prohibitions against fraudulent activities.

Problem. – Because of the general language of section 206 and the absence of express rulemaking power in that section, there has always been a question as to the scope of the fraudulent and deceptive activities which are prohibited and the extent to which the Commission is limited in this area by common law concepts of fraud and deceit.

Remedy in the bill. – It is proposed that a new paragraph (4) be added to section 206 which would empower the Commission, by rules and regulations to define, and prescribe means reasonably designed to prevent, acts, practices, and courses of businesses which are fraudulent, deceptive, or manipulative. This is comparable to section 15(c)(2) of the Securities Exchange Act of 1934 which applies to brokers and dealers.

Section 10

Would amend the caption of section 208 of the act. In view of the proposed addition of new subsection (d) to this section, the Commission believes that the caption "General Prohibitions" would be more descriptive of the content of the section than "Unlawful Representations".

Section 11. Addition of provisions relating to prohibited activities

Present law. – None.

Problem. – There is no provision in the act expressly prohibiting any person, indirectly or through any other person, from violating the act or any rule or regulation thereunder. Furthermore, in the absence of any express statutory provision, there may exist some doubt as to the Commission's authority to obtain an injunction, or to impose administrative sanctions, against persons aiding or abetting violations of the act.

Remedy in the bill. – The proposed amendment would make it unlawful for a person to do indirectly what he cannot do directly, and would also make it unlawful for any person to aid, abet, or procure a violation by another person. It is also designed to make it clear that persons associated with an investment adviser may be liable in civil and administrative proceedings for violation of the prohibitions which by their terms apply only to investment advisers. This provision does not in any manner constitute a limitation with respect to the applicability in criminal proceedings of section 2, title 18, United States Code which deals with the criminal liabilities of aiders and abettors.

Section 12. Clarification of provisions relating to the enjoining of violations of the act

Present law. – Section 209(e) now provides that the Commission may bring an action to enjoin certain practices when it appears to the Commission that any "person has engaged or is about to engage" in such acts or practices.

Problem. – The statute does not specifically provide that the Commission may bring an action for an injunction when it appears that any person *is engaged* in prohibited acts or practices.

Remedy in the bill. – The proposed amendment would modify the quoted clause to read "has engaged, is engaged, or is about to engage."

Section 13. Clarification of Commission's power to make public certain matters pertaining to investigations and inspections

Present law. – Section 210(b) now provides, subject to certain exceptions, that the Commission shall not make public the fact that any investigation under the act is being conducted, or the results of such investigation, or any facts ascertained.

Problem. – As this section now reads, it is not clear that the Commission could disclose to appropriate State officials facts ascertained in an investigation which tends to indicate a violation of State law.

Remedy in the bill. – The proposed amendment would make it clear that the information gathered in an inspection or investigation could be disclosed in certain circumstances, but only with the approval of the Commission itself. The amendment would also make it clear that the prohibitions against disclosure apply not only to the Commission, but also to members, officers, and employees as well.

Section 14. Expansion of rulemaking powers

Present law. – Section 211(a) contains a delegation of rulemaking power and authorizes promulgation by the Commission of "such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this title."

Problem. – This rulemaking power is not cast in as broad language as that contained in the other acts administered by the Commission. Section 19(a) of the Securities Act gives the Commission the right to adopt rules and regulations "necessary to carry out the provisions" of the act; section 23(a) of the Securities Exchange Act gives the Commission the right "to make such rules and regulations as may be necessary for the execution of the functions vested" in it by the act. The power of the Commission under the Investment Advisers Act should be as broad as it is under the other two acts if the Commission is to be able to carry out its powers and functions under this act.

Remedy in the bill. – The proposed amendment would specifically permit the Commission also to adopt rules and regulations necessary for the Commission to carry out its functions under the act.

Section 15. Expansion of penalty provisions

Present law. – Section 217 now provides penalties for willful violations of the act.

Problem. – No provision is made for penalties for violations of rules, regulations, or orders promulgated by the Commission.

CHANGES IN EXISTING LAW

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as introduced, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INVESTMENT ADVISERS ACT OF 1940

* * * * * * *

DEFINITIONS

SEC. 202. (a) When used in this title, unless the context otherwise requires-

* * * * * * *

(18) "State" means any State of the United States, the District of Columbia, **[**Alaska,**]**[1] Hawaii, Puerto Rico, **[**the Philippine Islands,**]** the Canal Zone, the Virgin Islands, or any other possession of the United States.

* * * * * * *

[1] "Alaska" was eliminated by Public Law 96-70, dated June 25, 1959. H.R. 2482 was introduced Jan. 15, 1959.

REGISTRATION OF INVESTMENT ADVISERS

SEC. 203. (a) * * *

* * * * * * *

(c) Any investment adviser, or any person who presently contemplates becoming an investment adviser, may register under this section by filing with the Commission an application for registration. Such application shall contain such of the following information, in such form and detail, as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:

(1) information in respect of-

(A) * * *

* * * * * * *

[(F) whether such an investment adviser or any partner, officer, director, person performing similar function or controlling person thereof (i) within ten years of the filing of such application has been convicted of any felony or misdemeanor of the character described in paragraph (1) of subsection (d), or (ii) is permanently or temporarily enjoined by an order, judgment or decree of the character described in paragraph (2) of subsection (d) and in each case the facts relating to such conviction or injunction; and**]**

(F) whether such investment adviser, any partner, officer, director, or person performing similar functions, or any person directly or indirectly controlling or controlled by such investment adviser, is subject to any disqualification which would be a basis for denial, suspension, or revocation of registration of such investment adviser under the provisions of subsection (d), and

(2) a statement as to whether such investment adviser is engaged or is to engage primarily in the business or rendering investment supervisory services.

Except as hereinafter provided, such registration shall become effective thirty days after receipt of such application by the Commission, or within such shorter period of time as the Commission may determine. Any amendment of an application filed not more than fifteen days after the filing of such application shall be deemed to have been filed with and as a part of such application. Any amendment of an application filed more than fifteen days after the filing of such application and before such application becomes effective shall be deemed a new application incorporating by reference the unamended items of the earlier application. Any amendment filed after the application has become effective shall become effective thirty days after the filing thereof, or at such earlier date as the Commission may order.

[(d) The Commission after hearing may by order deny registration to or revoke or suspend the registration of an applicant under this section, if the Commission finds that such denial, revocation, or suspension is in the public interest and that such investment adviser or any partner, officer, director, person performing similar function, or controlling person thereof-

[(1) within ten years of the issuance of such order, has been convicted of any felony or misdemeanor involving the purchase or

sale of any security or arising out of any conduct or practice of such investment adviser or affiliated person as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank or insurance company;

[(2) at the time of the issuance of such order, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security; or

[(3) has violated the provisions of section 207 of this title.**]**

(d) The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration or suspend for a period not exceeding twelve months or revoke the registration of an investment adviser, if it finds that such denial, suspension, or revocation is in the public interest and that (1) such investment adviser, whether prior to or subsequent to becoming such, or (2) any partner, officer, or director (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, whether prior or subsequent to becoming such (A) has willfully made or caused to be made in any application for registration or report filed with the Commission under this title, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or who has omitted to state in any such application or report any material fact which is required to be stated therein; or (B) has been convicted within ten years preceding the filing of the application or at any time thereafter of any felony or misdemeanor which the Commission finds (i) involves the purchase or sale of any security, (ii) arises out of the conduct of the business of a broker, dealer, or investment adviser, (iii) involves embezzlement, fraudulent conversion, or misappropriation of funds or securities, or (iv) involves the violation of section 1341, 1342, or 1343 of title 18, United States Code, as heretofore or hereafter amended; or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security; or (D) has willfully violated any provision of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of this title, as any of such statutes heretofore have been or hereafter may be amended, or of any rule or regulation under any of such statutes.

[(e) The commencement of a proceeding to deny registration under this section shall not operate to postpone the effective date of registration unless the Commission shall find that such postponement is necessary in the public interest and shall so order, but no such order shall operate to postpone such effective date for more than three months.**]**

(e) The commencement of a proceeding to deny registration under this section shall operate to postpone the effective date of registration for a

provisions shall not constitute a limitation with respect to the applicability to this title of section 2 of title 18, United States Code.

ENFORCEMENT OF TITLE

SEC. 209. (a) * * *

* * * * * * *

(e) Whenever it shall appear to the Commission that any person has **[**engaged or**]** *engaged, is engaged or* is about to engage in any act or practice constituting a violation of any provision of this title, or of any rule, regulation, or order hereunder, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has **[**engaged or**]** *engaged, is engaged or* is about to engage in any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning any violation of the provisions of this title, or of any rule, regulation, or order thereunder, to the Attorney General, who, in his discretion, may institute the appropriate criminal proceedings under this title.

PUBLICITY

SEC. 210. (a) * * *

[(b) Subject to the provisions of subsections (c) and (e), of section 209, the Commission, shall not make public the fact that any investigation under this title is being conducted, nor shall it make public the results of any such investigation, or any facts ascertained during any such investigation, except that the provisions of this subsection shall not apply-**]**

(b) Subject to the provisions of subsections (c) and (e), of section 209, the Commission or any member, officer, or employee thereof, shall not make public the fact that any examination or investigation under this title is being conducted, or the results of or any facts ascertained during any such examination or investigation; and no member, officer, or employee of the Commission shall disclose to any person other than a member, officer, or employee of the Commission any information obtained as a result of any such examination or investigation except with the approval of the Commission. The provisions of this subsection shall not apply-

(1) in the case of any hearing which is public under the provisions of section 212; or

(2) in the case of a resolution or request from either House of Congress.

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RULES, REGULATIONS, AND ORDERS

SEC. 211. (a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the *functions and* powers conferred upon the Commission elsewhere in this title. For the **[**purposes**]** *purpose* of its rules or regulations the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters.

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[PENALTIES**]**

SEC. 217. Any person who willfully violates any provision of this **[**title shall**]** *title, or any rule, regulation, or order promulgated by the Commission under authority thereof, shall*, upon conviction, be fined not more than $10,000, imprisoned for not more than two years, or both.

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STATE CONTROL OF INVESTMENT ADVISERS

SEC. 222. Nothing in this title shall affect the jurisdiction of the securities commissioner (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder.

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