THE INVESTMENT ADVISERS ACT OF 1940—WHO IS AN “INVESTMENT ADVISER”?

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The first step towards federal regulation of persons selling advice about securities was the enactment of the Public Utility Holding Company Act of 1935.1 Section 30 of that Act directed the Securities and Exchange Commission (SEC) to conduct a study of investment trusts and investment companies. As part of this study2 the SEC surveyed investment advisers and advisory services and issued the results in a supplemental report3 in 1939. Although the survey was limited both in the type of persons surveyed4 and the abuses and problems examined,5 the SEC concluded that the activities of investment advisers and advisory services “patently present various problems which usually accompany the handling of large liquid funds of the public.”6 Largely as a result of the SEC’s survey and report,7 the Investment Advisers Act of 1940 (Advisers Act)8 was enacted simultaneously with the Investment Company Act of 1940 (“Investment Company Act”).9

The general objective of the Advisers Act, as summarized by the Senate Report10 on amendments to the Act enacted in 1960,11 is “to protect the public and investors against malpractices by persons paid for advising others about securities.”12 As originally enacted, the Advisers Act required all persons subject thereto to register with the SEC, specified the grounds upon which the SEC could deny an application for registration, prohibited registered investment advisers from entering into contracts with clients that include profit-sharing provisions or permit assignment without consent of the client, and made it unlawful for these persons to engage in practices that constitute fraud or deceit. In addition, registered investment advisers were required to disclose the nature of any interest that they had in transactions effected for clients.

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5 Id. at 28.
6 Id.
7 7 SEC ANN. REP. 29 (1941).
Amendments to the Act add additional grounds for denial of an application for registration, authorize the SEC to adopt rules requiring registered investment advisers to keep certain books and records, permit examination of these books and records by the SEC, permit the SEC to adopt rules defining fraudulent practices, make certain provisions of the Act applicable to persons who are not subject to the Act's registration requirement, and eliminate an exemption from the registration requirement that applied to investment advisers all of whose clients are insurance companies and investment companies. Despite the increased powers granted by the recent amendments, some members of the SEC have indicated that additional strengthening of the SEC's authority under the Advisers Act is desirable.

The provisions of the Advisers Act apply to any person who comes within the definition of the term "investment adviser." Subject to certain exclusions discussed below, this term is defined broadly to include any person who, for compensation, engages in the business of advising others about the value of securities or about the advisability of purchasing or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. Although there has been little litigation with respect to the definition and the exclusions therefrom, the number of requests for "no-action letters" submitted to the staff of the SEC in order to obtain the staff's views on the applicability of the Advisers Act indicates that there are many unresolved questions concerning the scope of the definition. This Article will examine the consequences to a person of being subject to the Advisers Act and will attempt to identify the persons to whom the Act applies or may apply.

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19 See notes 43 and 44 infra for definitions of the terms "insurance company" and "investment company."


23 A member of the public may receive informal advice from the staff of the SEC concerning the interpretation of securities laws by submitting a written request to which the staff will give a written reply indicating whether it will or will not recommend that the SEC take "no-action" if the conduct described in the request occurs. The position taken by the staff in these replies is subject to reconsideration and may not be regarded as precedent binding the SEC. SEC Securities Act Release No. 5073 (July 14, 1970), [1969-1970 Transfer Binder] CCH Fed. Sec. L. REP. ¶ 77,838. The term "no-action request" will be used herein to refer to a letter submitted to the staff of the SEC seeking interpretation of securities laws. The term "no-action letter" will be used herein to refer to the response of the staff. See Lowenthal, SEC "No-Action" Letters: Some Problems and Suggested Approaches, 71 COLUM. L. REV. 1256-58 (1971), for a discussion of the development of the procedure by which "no-action letters" are currently issued by the staff of the SEC.

24 The SEC announced on October 29, 1970, that all "no-action requests" received after December 1, 1970, and related "no-action letters," would be made available to the public. SEC Securities Act Release No. 5098 (Oct. 29, 1970), [1970-1971 Transfer Binder] CCH Fed. Sec. L. REP. ¶ 77,921. "No-Action" letters referred to in this Article are cited to CCH Fed. Sec. L. REP. if available. Otherwise they are cited merely by the name of the requesting party and the date on which the staff of the SEC issued its response. The latter letters are available from the SEC.
I. REGISTRATION AND REGULATORY PROVISIONS OF THE ADVISERS ACT

A. Registration Requirement

Section 203(a) of the Advisers Act\(^a\) provides that it is unlawful for investment advisers to use the mails or any means or instrumentality of interstate commerce in their business unless they have registered with the SEC\(^b\) or are exempted from registration by section 203(b).\(^c\) Registration is sought by filing an application with the SEC on Form ADV.\(^d\) The information called for by this Form includes: name and form of organization; place of organization; location of principal business office and branch offices; names, addresses, education, and business affiliations for the past ten years of partners, officers, and directors; nature and scope of business, including the manner in which advice is given; and the basis of compensation. In addition, applicants must disclose whether they or any person associated with them\(^e\) are subject to disqualification under section 203(e).\(^f\) Reasons for disqualification include the following: willful filing of false or misleading information in an application for registration under the Advisers Act or in a registration proceeding before the SEC, or failure to state in an application or proceeding any material fact required to be stated therein;\(^g\) conviction within the previous ten years of certain crimes that relate to securities or arise out of the conduct of the business of a broker-dealer, municipal securities dealer, investment adviser-bank, investment company, or fiduciary;\(^h\) willful violation of the Securities Exchange Act of 1934,\(^i\) the Investment Company Act of 1940,\(^j\) or the Advisers Act;\(^k\) aiding or abetting violation of these Acts by any other

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\(^b\) The number of investment advisers registered with the SEC has increased from 753 on June 30, 1941, a date eight years after the effective date of the Advisers Act, to 3,014 on June 30, 1974. 7 SEC ANN. REP. 31 (1941); 40 SEC ANN. REP. 109 (1974).
\(^d\) 17 C.F.R. § 275.203-1(a) (1975). Form ADV consists of 24 questions and five schedules. Applicants are required to file three executed copies of the Form and pay a filing fee of $150.
\(^e\) The term "person associated with an investment adviser" is defined in the Advisers Act to mean any partner, officer or director of such investment adviser (or any person performing similar functions) and any person directly or indirectly controlling or controlled by the investment adviser. Persons whose functions are clerical or ministerial are excluded. Advisers Act § 202(a)(17), 15 U.S.C. § 80b-2(a)(17) (1970).
\(^g\) Id. § 203(e)(1), 15 U.S.C. § 80b-3(e)(1).
\(^h\) These include crimes involving the purchase or sale of securities or the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities. Id. § 203(e)(2)(A), (C), 15 U.S.C. § 80b-3(e)(2)(A), (C).
\(^i\) Also included are convictions of crimes involving taking a false oath, making a false report, bribery, perjury, burglary, mail fraud, and concealment of assets in bankruptcy. Id. § 203(e)(2)(A), (D), 15 U.S.C. § 80b-3(e)(2)(A), (D).
person; or failure to reasonably supervise another person who violates any of these Acts if that person was subject to supervision. The SEC may deny an application for registration on the basis of any of these disqualifications.

B. Exemptions From the Registration Requirement

Section 203(b) provides three exemptions from the requirement that investment advisers must register with the SEC. The first exempts any investment adviser whose clients are all residents of the state in which the investment adviser maintains his principal office and place of business, provided no advice is given with respect to securities traded on a national securities exchange. This exemption is of limited applicability because of the condition that advice must be limited to securities that are not traded on a national securities exchange, but there are persons who are able to utilize the exemption. For example, TISE, Incorporated (TISE), a California corporation engaged in providing estate and tax planning services, whose clients are all residents of California and which maintains its main office in California, submitted a “no-action request” in which it sought advice from the staff concerning the exemption. Although TISE rendered investment advice with respect to investment opportunities, this advice was restricted, with one exception, to the desirability of investing in real estate, cattle, beaver, manufacturers, restaurants, mining, oil and gas, and films, all in the form of partnerships, joint ventures, or privately-owned corporations. The staff replied that it would not recommend that the SEC take any action against TISE if it relied on the exemption from registration. The same position was taken by the staff with respect to a proposed company that would render investment advice only about municipal securities, which are not traded on any national securities exchange. The company’s only place of business would be in Pennsylvania and all of its clients would be residents of that state.

Prior to 1970, a second exemption applied to any investment adviser whose

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84 Id.
85 Id. § 203(c)(2), 15 U.S.C.A. § 80b-3(c)(2). Within 45 days of the filing of an application for registration, the SEC must either issue an order granting the application for registration or institute administrative proceedings to determine whether the application should be denied.
89 Id. During its last fiscal year, it derived less than $200 of income from commissions with respect to sales of mutual fund shares, an amount that represented less than .04% of its total income.
90 See section II.C. infra for discussion whether persons providing financial planning and management services are “investment advisers” within the meaning of the term in the Advisers Act.
only clients were insurance or investment companies. The 1970 amendments abolished the exemption for advisers to investment companies so that only advisers whose clients are limited to insurance companies are now covered by this exemption.48

The third exemption from the registration requirement applies to any investment adviser who has had fewer than 15 clients during the course of the preceding 12 months and who neither holds himself out generally to the public as an investment adviser nor acts as an adviser to an investment company registered under the Investment Company Act.49 The limitation upon the number of clients refers to the total number of clients during the preceding 12 months rather than the number of clients at any one time. When an investment adviser has as a client an investment club that falls within one of the exceptions to the definition of “investment company” under the Investment Company Act,49 the staff regards each member of the club as a separate client in determining the number of the investment adviser’s clients.50

An investment adviser who seeks to qualify for this exemption must refrain from holding himself out to the public as an investment adviser. The SEC staff has consistently taken a broad view of what constitutes “holding out” within the meaning of the exemption. In a “no-action letter” issued to Frank T. Hines51 in 1972, the staff stated that any of the following conduct is included among acts that constitute holding out to the public as an investment adviser: maintenance of a listing as an investment adviser in a telephone or business directory, expression of willingness to accept new clients, and use of a letterhead

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48 The term “insurance company” is defined by the Advisers Act to have the same meaning as in the Investment Company Act. Advisers Act § 202(a)(12), 15 U.S.C. § 80b-2(a)(12) (1970). In the Investment Company Act, the term “insurance company” is defined to mean a company organized as an insurance company whose primary business activity is writing insurance or reinsuring risks underwritten by insurance companies and which is subject to supervision by the insurance commissioner or similar official of any state. Investment Company Act § 2(a)(17), 15 U.S.C. § 80a-2(a)(17) (1970).

49 The term “investment company” is defined in the Advisers Act to have the same meaning as in the Investment Company Act. Advisers Act § 202(a)(12), 15 U.S.C. § 80b-2(a)(12) (1970). The term “investment company” is defined in the Investment Company Act to include an issuer that is or holds itself out to be primarily engaged in the business of investing, reinvesting, or trading in securities or proposing to engage primarily in such business, unless an exception to the definition is applicable. Investment Company Act § 3, 15 U.S.C. § 80a-3 (1970).


53 Excluded from the definition of the term “investment company” is an issuer, beneficially owned by not more than 100 persons, who is not making, nor is presently proposing to make a public offering of its securities. Id. § 3(c)(1), 15 U.S.C. § 80a-3(c)(1). The staff of the SEC has traditionally interpreted the term “public offering,” which is not defined in the Investment Company Act, to conform with judicial and administrative interpretations of the substantially identical undefined term in § 4(2) of the Securities Act of 1933. American Equity Corporation, [1974-1975 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,950, at 84,448-49 (May 17, 1974).


indicating any activity as an investment adviser. In a "no-action letter" issued
two years later to Stuart Pahn,62 who stated that he intended to limit himself to
14 or fewer clients in any period of 12 months, the staff indicated that he might
be considered to be holding himself out generally to the public as an investment
adviser if he engaged in any of the conduct specified above or "if by word of
mouth through existing clients or otherwise you let it be known that you are
willing to take on new clients."63

Investment advisers exempted from the registration requirement by section
203(b) are not subject to section 204,64 which imposes certain reporting and
record-keeping requirements, or section 205,65 which regulates certain aspects
of investment advisory contracts to which a registered investment adviser is a
party. Section 206,66 which contains the Act's anti-fraud provisions, applies to
all investment advisers, regardless of whether they are exempt from registration.

C. Record-Keeping Requirements

Prior to the amendment of section 204 in 1960, the SEC did not have
authority to require investment advisers to keep records, nor did it have the
core to examine records that were kept voluntarily.67 The SEC could require
only that investment advisers keep reasonably current the information con-
tained in their applications for registration. The amendment to section 20468
granted the SEC authority to adopt rules prescribing records to be kept by
investment advisers subject to the registration requirement and provided that
these records are subject to reasonable inspection by the SEC.69

Under rules60 adopted by the SEC pursuant to the amendment, all invest-
ment advisers required to register with the SEC are subject to detailed re-
quirements regarding records that must be maintained.61 Required records
include: journals and ledgers reflecting asset, liability, reserve, capital, income
and expense accounts;62 memoranda of orders given for the purchase or sale
of securities on behalf of clients and all instructions received from clients with

63 Id.
of § 204.
was amended again in 1975 to include for the first time a specific definition of the term "records." 15
No. 94-29, § 29(5), 89 Stat. 97). The term is defined to have the same meaning as in § 3(a)(37) of
the Securities Exchange Act of 1934, as amended, which provides that the term "records" means "accounts,
correspondence, memorandums, tapes, discs, papers, books, and other documents or transcribed informa-
tion of any type, whether expressed in ordinary or machine language." Securities Exchange Act §
70 17 C.F.R. § 275.204-2 (1975). See note 119 infra for description of a proposed amendment to
Rule 204.
71 Id. § 275.204-2(a).
72 Id. § 275.204-2(a)(1), (2). In addition, all check books, bank statements, cancelled checks, cash
reconciliations, bills, statements, trial balances, financial statements and internal audit working papers
relating to the investment adviser's business must be kept. Id. § 275.204-2(a)(4) to (6).
respect to the purchase, sale, receipt, or delivery of a security,\textsuperscript{68} original copies of all written communications that relate to recommendations and advice given, the receipt, disbursement or delivery of funds or securities, or the execution of purchase or sales orders;\textsuperscript{64} copies of all written agreements with clients;\textsuperscript{65} copies of all written recommendations for the purchase or sale of a specific security distributed to more than nine persons and a memorandum stating the reason for such recommendation if not stated in the communication,\textsuperscript{66} and records of all transactions in securities in which the investment adviser or any advisory representative\textsuperscript{67} thereof has, or by reason of the transaction acquires, beneficial ownership.\textsuperscript{68} Investment advisers who take possession of clients' funds or securities or who render investment supervisory services are subject to additional record-keeping requirements in order to insure that separate records are maintained for each client.\textsuperscript{69}

D. Regulation of Investment Advisory Contracts

Section 205(1) of the Advisers Act\textsuperscript{70} prohibits investment advisers subject to the registration requirement\textsuperscript{71} from entering into, extending, or renewing any investment advisory contract that provides for compensation based on "a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client,"\textsuperscript{72} unless the client is an Investment Company registered under section 8 of the Investment Company Act\textsuperscript{73} or unless the contract

\textsuperscript{68} Id. § 275.204-2(a)(3). The memoranda must include the terms of each order, the identity of the person connected to the investment adviser who recommended the transaction, the broker or dealer who executed the order, and whether the order was entered pursuant to the exercise of the investment adviser's discretionary power. Id.

\textsuperscript{64} Id. § 275.204-2(a)(7). This requirement is relaxed when the investment adviser sends a written communication prepared by others to more than ten persons. Id.

\textsuperscript{65} Id. § 275.204-2(a)(10).

\textsuperscript{66} Id. § 275.204-2(a)(11). Recommendations to investment supervisory clients or persons connected with the investment adviser are excluded from this requirement. Id. The term "investment supervisory services" is defined in the Advisers Act to mean "the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client." Advisers Act § 202(a)(13), 15 U.S.C. § 80b-2(a)(13) (1970).

\textsuperscript{67} For purposes of this requirement the term "advisory representative" is defined to include any officer, director, or partner of the investment adviser and any employee thereof who either (a) participates in the determination of which securities are to be recommended or has duties related thereto, or (b) obtains any information with respect to securities recommendations prior to the dissemination of the information. 17 C.F.R. § 275.204-2(a)(12) (1975).

\textsuperscript{69} Transactions in securities that are direct obligations of the United States or that are effected in an account neither controlled nor influenced by the investment adviser are excluded from this requirement. Id.

\textsuperscript{68} Id. § 275.204-2(b), (c). With one exception applying to the separate record-keeping requirements of investment advisers who render investment supervisory services, books and records that are required to be maintained must be preserved in an easily accessible place for five years from the end of the fiscal year in which the last entry therein is made. Id. § 275.204-2(c).


\textsuperscript{71} By their terms, §§ 205 and 206 make the conduct specified therein unlawful only when accomplished by use of the mails or any means or instrumentality of interstate commerce. Id. Section 203(d) provides, however, that in the case of a registered investment adviser any act, practice or course of business prohibited by the Advisers Act is unlawful irrespective of any use of the mails or means or instrumentality of interstate commerce. Id. § 203(d), 15 U.S.C. § 80b-3(d) (1970).


relates to the investment of assets in excess of one million dollars.\textsuperscript{74} The purpose of section 205(1) is to prohibit compensation arrangements that allow an investment adviser additional compensation based on a share of his client's profits but do not provide for a penalty when the client suffers losses. The Senate Committee described this type of arrangement as "heads I win, tails you lose,"\textsuperscript{75} and the House Committee believed that these arrangements encouraged investment advisers to take "undue risks" with clients' funds.\textsuperscript{76}

The following "no-action letters" indicate that the staff of the SEC has consistently construed the section 205 prohibition broadly. Robert Reinhart, Jr., a registered investment adviser, proposed to include a provision in his advisory contracts that would call for a refund of the advisory fee "should the stock we have selected for the account prove to be unsatisfactory."\textsuperscript{77} The staff advised him that this would violate section 205 since he would be charging fees only when a client realized capital appreciation as a result of his advice. Sherman-Walker Associates was advised by the staff\textsuperscript{78} that a fee based on the percentage of the redemption price of bonds would violate section 205 since capital appreciation would be reflected in the redemption price. Phillip Bulliard, whose fees were to consist of a percentage of a client's income, was advised by the staff\textsuperscript{79} that his compensation arrangement would violate section 205 unless any amount attributable to realized or unrealized capital gains was excluded from income for purposes of calculating the fee.\textsuperscript{80}

Unless the client is an investment company registered under the Investment Company Act,\textsuperscript{81} section 205 also requires investment advisory contracts to provide that no assignment thereof may be made by the investment adviser without the client's consent.\textsuperscript{82} The term "assignment" is defined in the Act to include direct or indirect transfer or hypothecation of the contract or transfer of a controlling block of the investment adviser's voting securities by the holder thereof.\textsuperscript{83} Badgley & Phelps Inc., which was initially organized as a partnership,\textsuperscript{84}

\textsuperscript{74} Advisers Act § 205, 15 U.S.C. § 80b-5 (1970). The exclusion for contracts relating to assets in excess of $1,000,000 is not applicable if the client is a trust, collective trust fund, or separate account. Contracts excluded from the prohibition may provide for compensation to the investment adviser based upon the capital gains or capital appreciation of the client's funds if the compensation increases and decreases proportionately with the investment performance of the funds measured against the investment record of an appropriate index of securities prices. \textit{Id.}

\textsuperscript{75} S. Rep. No. 1775, 76th Cong., 3d Sess. 29 (1940).

\textsuperscript{76} H.R. Rep. No. 2639, 76th Cong., 3d Sess. 29 (1940).


\textsuperscript{79} Philip Bulliard, June 5, 1974.


\textsuperscript{82} Advisers Act § 205(2), 15 U.S.C. § 80b-5(2) (1970). Moreover, if the investment adviser is a partnership, the contract must require the investment adviser to notify clients of any change in the membership of the partnership within a reasonable time after the change. \textit{Id.} § 205(3), 15 U.S.C. § 80b-5(3).

\textsuperscript{83} \textit{Id.} § 202(a)(1), 15 U.S.C. § 80b-2(a)(1). The definition further provides that if the investment adviser is a partnership, no assignment results from the death or withdrawal of a minority of the members of the partnership. \textit{Id.}
requested the opinion of the staff\textsuperscript{84} whether it was required to obtain the consent of its several hundred clients as a consequence of its incorporation. The company stated that changing its form of organization had not altered its management or business and, therefore, in its opinion there had been no assignment of its contracts. The staff concluded that it could not concur in this opinion “since the legal liabilities of the individual partners to clients may be substantially changed by the incorporation” and advised that it would be necessary to obtain the consent of each client.\textsuperscript{85}

E. Prohibited Transactions by Investment Advisers

Unlike sections 204\textsuperscript{86} and 205,\textsuperscript{87} section 206,\textsuperscript{88} which contains the anti-fraud provisions of the Advisers Act, is applicable to all investment advisers, including those who are exempt from the registration requirement of section 203.\textsuperscript{89} The first two paragraphs of section 206 make it unlawful for an investment adviser either to “employ any device, scheme, or artifice to defraud any client or prospective client”\textsuperscript{90} or to “engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.”\textsuperscript{91} In \textit{SEC v. Capital Gains Research Bureau, Inc.},\textsuperscript{92} the only case in which the Supreme Court has interpreted any provision of the Advisers Act, the Court indicated that broad effect is to be given to the Act’s anti-fraud provisions. Defendant, a registered investment adviser and publisher of a monthly investment advisory service that recommended securities for purchase or sale, on six occasions purchased a security for its own account shortly before recommending that its clients purchase the security for long-term investment. When the market price rose following the recommendation, the corporation sold at a profit, a practice “known in the trade as ‘scalping.’”\textsuperscript{93} The SEC sought to enjoin defendant from engaging in this practice without appropriate disclosure to its clients, claiming that failure to disclose these activities constituted conduct prohibited by section 206. The district court denied the SEC’s request,\textsuperscript{94} holding that the words “fraud” and “deceit” were used in the Advisers Act “in their technical sense” and that without proof that defendant intended to injure its

\textsuperscript{85} Id.
\textsuperscript{88} Id. § 206, 15 U.S.C. § 80b-6.
\textsuperscript{89} Id. § 206, 15 U.S.C. § 80b-6. In the case of investment advisers exempt from the registration requirement by § 203(b), the conduct specified in § 206 is unlawful only when done in conjunction with the use of the mails or any means or instrumentality of interstate commerce, since § 203(d), discussed in note 72 \textit{supra}, is applicable only in the case of investment advisers subject to the registration requirement. With respect to the question whether there is a private right of action for damages under § 206, the cases are divided. See \textit{The Anderson Co. v. John P. Chase, Inc.}, [1974-1975 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,009, at 97,514-15 (S.D.N.Y. Mar. 12, 1975), which notes the cases in which the question has arisen.
\textsuperscript{91} Id. § 206(2), 15 U.S.C. § 80b-6(2).
\textsuperscript{92} 375 U.S. 180 (1963).
\textsuperscript{93} Id. at 181.
\textsuperscript{94} 191 F. Supp. 897 (S.D.N.Y. 1961).
clients or that they had been injured, the conduct was not prohibited by section 206.\textsuperscript{86} The Court of Appeals for the Second Circuit affirmed\textsuperscript{87} and on rehearing \textit{en banc} reaffirmed.\textsuperscript{87} The Supreme Court reversed and held that defendant was required to disclose its practice of “scalping.”\textsuperscript{89} Drawing upon its examination of the legislative history of the Advisers Act, the Court stated that Congress sought to eliminate or expose “all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.”\textsuperscript{90} Congress, therefore, intended the Act to be construed “not technically and restrictively, but flexibly to effectuate its remedial purposes,”\textsuperscript{100} and its purpose would be defeated if proof of intent to injure or actual injury to clients were required as an element of proscribed conduct.\textsuperscript{101} The Court concluded that since an adviser engaging in the practice of “scalping” might be motivated to recommend a given security not because of its potential for a long-run price increase that would benefit its clients, but because of the potential for a short-run price increase from which the adviser would benefit, the adviser’s clients must be permitted to evaluate, by means of appropriate disclosures, the adviser’s overlapping motivations.\textsuperscript{102}

As additional protection against conflicts of interest, section 206 also provides that it is unlawful for any investment adviser, acting as an adviser with respect to a particular transaction, to knowingly effect the transaction with or for a client if he is also acting either as principal or as broker for another person, unless the client is furnished prior written disclosure of the capacity in which the investment adviser is acting and the client consents to the adviser so acting.\textsuperscript{103}

In 1960, section 206 was amended to give the SEC authority to adopt rules that define fraudulent, deceptive, or manipulative practices and prescribe methods for their prevention.\textsuperscript{104} The first use of this authority by the SEC was the adoption of Rule 206(4)-1,\textsuperscript{105} which provides that certain advertising prac-

\textsuperscript{86} Id. at 898-99.
\textsuperscript{87} 300 F.2d 745 (2d Cir. 1961).
\textsuperscript{88} 306 F.2d 606 (2d Cir. 1962).
\textsuperscript{89} 375 U.S. 180 (1963).
\textsuperscript{90} Id. at 191-92.
\textsuperscript{91} Id. at 195.
\textsuperscript{92} Id. at 192.
\textsuperscript{93} Id. at 196.

\textsuperscript{100} Advisers Act § 206(3), 15 U.S.C. § 80b-6(3) (1970). See text at note 283 \textit{infra} for discussion of Rule 206(3)-1(T) adopted by the SEC on August 20, 1975, to provide an exemption from the requirements of § 206(3) for brokers or dealers registered under the Securities Exchange Act of 1934.

In addition to the regulatory provisions of the Advisers Act discussed in the text, § 207 provides that a willful misrepresentation or omission in material filed with the SEC is unlawful, and § 208 prohibits use of the term “investment counsel” by a registered investment adviser unless his principal business consists of acting as an investment adviser and a substantial part of his business consists of rendering “investment supervisory services.” Id. §§ 207, 208, 15 U.S.C. §§ 80b-7, 80b-8. See note 67 \textit{infra} for definition of the term “investment advisory services.” Section 208 also provides that it is unlawful for a registered investment adviser to represent or imply that he has been sponsored, recommended, or approved, or that his abilities and qualifications have been passed upon, by the United States or any agency thereof.


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tices are prohibited by section 206. Forbidden is the publication of any advertisement referring to a “testimonial” with respect to the investment adviser or its past recommendations, mentioning past recommendations that were or would have been profitable to any person unless the advertisement either includes or offers to furnish a list of each recommendation made within the previous year, representing that any graph, chart, formula or other device can be used to determine, or to assist in determining, which securities can be profitably bought or sold unless the limitations and difficulties with respect to its use are disclosed, falsely stating that any service will be furnished without charge, or containing any untrue statement of a material fact or which is otherwise false or misleading.

The second use by the SEC of its rule-making authority under section 206 was the adoption of Rule 206(4)-2, which seeks to increase protection of a client’s funds and securities in the possession or custody of an investment adviser. The Rule provides that it is a fraudulent, deceptive, or manipulative practice for an investment adviser to take any action with respect to these funds or securities unless the funds are deposited in a separate trust account in a bank and the securities are identified, segregated, and placed in safekeeping. In addition, the investment adviser, immediately after receipt of a client’s funds or securities, must notify him in writing of the place and manner in which they will be held, send his client an itemized statement covering the funds and securities at the end of every period of three months, and have the funds or securities verified at least annually by an independent public accountant in an announced examination.

On March 5, 1975, the SEC announced that it is considering adoption of


100 The term “advertisement” is defined to include any written communication addressed to more than one person, or announcement by radio or television, which offers (1) any analysis or evaluation, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.


102 Id. § 275.206(4)-1(a)(1).

103 Id. § 275.206(4)-1(a)(2). The list must include the nature of the recommendations for each security, its price at that time and its most recent price. Id.

104 Id. § 275.206(4)-1(a)(3).

105 Id. § 275.206(4)-1(a)(4).

106 Id. § 275.206(4)-1(a)(5).


109 Id. § 275.206(4)-2(a)(1).

110 Id. § 275.206(4)-2(a)(3).

111 Id. § 275.206(4)-2(a)(4).

112 Id. § 275.206(4)-2(a)(5).

Rule 206(4)-4. The purpose of this proposed Rule is to assure that clients and prospective clients receive written statements from investment advisers describing their qualifications to perform the offered services and explaining certain facets of their business operations. The SEC stated its expectation that these disclosures will enable clients and prospective clients to compare qualifications of different investment advisers and encourage investment advisers to maintain at a high level the qualifications of persons employed. The proposed Rule, which will apply to all investment advisers irrespective of whether registration is required under section 203, will require that investment advisers deliver the written statement to each client and prospective client not less than 48 hours prior to entering into, extending, or renewing any investment advisory contract. Investment advisers providing periodic publications or reports on a subscription basis, however, will be able to comply with the proposed Rule by furnishing the written statement not later than 30 days after entering into, renewing, or extending the investment advisory contract if the contract provides that the client may rescind without penalty within five days after receipt of the statement.

The disclosures about individual qualifications that investment advisers will be required to include in the written statement include a statement of the length of time the adviser has been engaged in the investment advisory business, the number of persons associated therewith whose functions and duties relate to providing investment advice and are not solely ministerial or clerical, the general standards of education and business background required of these persons, and the actual education and business background of each person who determines or approves the investment advice given to clients or who chooses the clients to whom the advice is given. Investment advisers who provide account manage-
II. Persons Subject to the Advisers Act

As noted earlier, the term "investment adviser" is defined broadly by section 202(a)(11) of the Advisers Act:

[A]ny person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956, which is not an investment company; (B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession; (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor; (D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (E) 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; or (F) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.\(^{182}\)

A. Advice or Report Must Relate to Securities

The initial question raised by the definition of the term "investment adviser" relates to the meaning of the term "securities," since a person engaged generally in the business of advising others or issuing reports with respect to investments will not come within the definition unless the advice or reports concern securities. The definition of securities in the Advisers Act, which is identical to the definition in the Securities Act of 1933\(^{183}\) and virtually identical to the definition in the Securities Exchange Act of 1934,\(^{184}\) is as follows:

"Security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security" or any cer-
tificate of interest or participation in, temporary or interim certificate for, receipt for, guaranty of, or warrant or right to subscribe to or purchase any of the foregoing.185

One of the most difficult questions raised by the definition is the meaning of the term "investment contract." The Supreme Court enunciated the following test in 1946 in SEC v. W. J. Howey Co.186 and reaffirmed it as recently as June 1975 in United Housing Foundation, Inc. v. Forman:187 "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."188

In the past several years a number of "no-action requests" have been submitted by persons who offer advice or issue reports about commodities or commodity futures contracts.189 Neither is specifically named in the definition of the term "securities," and it is well settled under case law concerning the other securities acts that commodities and commodity futures contracts per se are not securities. Moreover, an investment contract is not created by arrangements for trading in these items provided the investor makes his own investment decisions.190 Thus the staff advised Commodity Management Service Corporation,191 which sought advice concerning its management of commodities trading accounts, that persons rendering investment advice about commodity futures contracts are not investment advisers within the meaning of the Advisers Act if the following conditions are satisfied:

(1) each client purchases direct ownership of commodities or commodity futures contracts upon his own decision and in reliance solely on the speculative hope that the market price of the commodities or the underlying commodities will vary in his favor and there is no investment in a common enterprise with others; (2) clients are not advised concerning commodity option contracts; and (3) clients receive no advice concerning conventional securities, including advice as to the relative desirability of investing in commodities as compared to conventional securities.192

The question whether an investment contract is created if the client does not make his own investment decisions, but instead allows his adviser discretion to make these decisions for him, has not received uniform treatment in the courts. Some courts,193 including the Court of Appeals for the Seventh Cir-

186 328 U.S. 293 (1946).
187 95 S. Ct. 2051 (1975).
188 Id. at 2060 (1975), quoting, SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946). The Supreme Court noted in Forman that the Court of Appeals for the Ninth Circuit had held in 1973 that the term "solely" should not be read as a strict or literal limitation of the definition of the term "investment contract." The Supreme Court, however, expressed no view on the proposition. 95 S. Ct. 2060 n.15.
192 Id. at 84,183-84.
cuit, have held that a discretionary commodities trading account is not an investment contract, relying upon the absence of a common enterprise. These courts have concluded that the entry by the adviser into similar arrangements with other clients does not establish a common enterprise since success or failure of the other accounts has no direct effect on the profitability of the account in question. Other courts have reached a contrary result, concluding either that the account "may constitute a security even if there is no pooling arrangement or common enterprise" or that the requirement of a common enterprise is satisfied when a single investor commits his funds to a promotor in the hope of making a profit. The Court of Appeals for the Fifth Circuit recently held that neither pro-rata sharing of profits nor congruity of investments is required for the arrangement to constitute a common enterprise when "the success of the trading enterprise as a whole and customer investments individually is contingent upon the sagacious investment counseling of [the adviser]."

In two "no-action letters" issued during the past year, the staff of the SEC declined to take any position on the question whether persons managing discretionary commodities accounts are subject to the Advisers Act, giving as its reason in both instances the unsettled nature of the case law.

Those who advise others about commodities and commodity futures contracts only through periodic newsletters or other publications do not encounter the problems involved in discretionary commodities trading accounts since the adviser's function is clearly limited to offering analysis or recommendations to clients who are expected to make their own investment decisions. The staff has advised at least two persons who proposed to publish weekly newsletters, devoted to analysis of commodities and commodity futures contracts, that registration under the Advisers Act is not required.

As is the case with respect to discretionary commodities trading accounts, there is uncertainty concerning the question whether interests in cooperative

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145 The Court in Milnarik stated, "We find the element of commonality absent here. Although the complaint does allege . . . similar discretionary arrangements with other customers, the success or failure of those other contracts had no direct impact on the profitability of plaintiff's contract. [The] customers were represented by a common agent, but they were not joint participants in the same investment enterprise." 457 F.2d at 276-77.
148 SEC v. Continental Commodities Corp., 497 F.2d 516, 522-23 (5th Cir. 1974).
housing corporations\textsuperscript{184} or condominiums\textsuperscript{185} are securities under the securities acts. Because interests in cooperative housing corporations are represented by stock certificates, there has been support for the position that these interests are necessarily securities since the term “stock” is specifically named in the definition of the term “securities” in the securities acts.\textsuperscript{186} This position, characterized as the “literal approach,” has been challenged on the basis that it exalts form over substance and ignores economic reality.\textsuperscript{187} This conflict was recently resolved by the Supreme Court in \textit{United Housing Foundation, Inc. v. Forman}.\textsuperscript{188} In reversing the court of appeals, the Court held that although the name of an instrument or interest is not wholly irrelevant, it is not dispositive, and the determination whether shares in a non-profit cooperative housing corporation are securities is to be made in accordance with the test set forth in \textit{Howey},\textsuperscript{189} discussed above.\textsuperscript{187}

The conclusion of the court of appeals that the shares in question were securities was based on both the “literal approach” and a determination that the shares constituted investment contracts under the \textit{Howey} test. Since the purchasers invested money in a common enterprise, the critical question was whether they did so with an expectation of profits. Although the shares could not be resold at a profit, the court of appeals found that the purchasers could expect profits in the following ways: reduced carrying charges to the purchasers resulting from income produced by leasing the corporation’s commercial facilities; federal income tax deductions of the portion of each shareholder’s monthly payment allocable to interest on the corporation’s mortgage; and savings based on the fact that comparable housing elsewhere was more expensive.\textsuperscript{188} The Supreme Court rejected this analysis and held that there is no basis for the view that either tax benefits or low rent constitutes profits.\textsuperscript{189} Although the Court acknowledged that net income from the leasing of commercial facilities is the kind of profit traditionally associated with securities, it found that “in the present case this income—if indeed there is any—is far too speculative and insubstantial to bring the entire transaction within the Securities Acts.”\textsuperscript{189} The Court concluded that the purchasers of the shares in question

\textsuperscript{184} For description of cooperative housing corporations see Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 Colum. L. Rev. 118 (1971).

\textsuperscript{185} For description of the condominium form of real estate ownership see Student Symposium—Interpreting the Statutory Definition of a Security: Some Pragmatic Considerations, 6 St. Mary’s L.J. 95, 166, 171 (1974).


\textsuperscript{187} For I. Loss, Securities Regulation 493 (2d ed. 1961) (“just as some things which look like real estate are securities, some things which look like securities are real estate”); Miller, Cooperative Apartments: Real Estate or Security?, 45 B.U.L. Rev. 465, 468 (1965).

\textsuperscript{188} SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946).

\textsuperscript{189} See text at notes 136-48 supra.
"were attracted solely by the prospect of acquiring a place to live, not by financial returns on their investment,"\textsuperscript{161} and thus the element of "profit" was absent.

While the Supreme Court may have answered the question whether all "shares" are necessarily securities, it does not appear that it has resolved the question whether shares in cooperative housing corporations are "investment contracts." The fact situation examined in \textit{Forman} may be unusual insofar as the shares examined could not be disposed of at a profit, and the argument that "profits" are present undoubtedly will be much stronger when the shares can be resold at a profit or when there is substantial income derived from the rental of commercial facilities.

Interests in condominiums normally do not constitute securities under the securities acts, but when these interests are sold in conjunction with some collateral arrangement the interests may be securities. In 1973, the SEC issued a release in which it called attention to the applicability of the securities laws to interests in condominiums when they are coupled with an offer or agreement to perform or arrange certain rental or other services for the purchaser.\textsuperscript{162} Relying on the "investment contract" test established in \textit{Howey}, the SEC expressed the view that if any of the following is present in conjunction with the sale of an interest in a condominium, the interest may be deemed to be an investment contract: (1) sale of an interest with emphasis on the economic benefits to the purchaser accruing from efforts of the promoter or his designee to rent the purchaser's unit; (2) offers to the purchaser to participate in a rental pool whereby the units are rented when not used by the purchasers, and each purchaser receives a share of the receipts regardless of the amount derived from his unit; (3) a requirement that purchasers make their units available for rental during a portion of each year; (4) a requirement that purchasers rent their units through an exclusive rental agent; or (5) any other "material restriction" on a purchaser's occupancy or rental of his units.\textsuperscript{163} The SEC also emphasized that in its view an "investment contract" may be present where purchasers are not wholly inactive but participate to a limited degree.

While recognizing the need for certainty in the area, the SEC acknowledged that all arrangements that may accompany interests in condominiums are not covered by the guidelines set forth in the Release. The SEC stated that the determination of whether interests in condominiums constitute investment contracts "necessarily depends on the facts and circumstances of each particular case," and suggested that individual questions should be handled by submission of "no-action requests."\textsuperscript{164} This source of guidance was eliminated in June

\textsuperscript{161} \textit{Id.} at 2061.
\textsuperscript{163} \textit{Id.}
\textsuperscript{164} \textit{Id.} at 82,540.
1974, however, when the staff of the SEC reported that “no-action letters” would no longer be issued in this “rapidly evolving area.”

The result is that persons seeking to determine the status of particular interests in condominiums are left with little besides the SEC release to inform their decisions. The Forman opinion seems unlikely to provide any substantial clarification for two reasons. First, the Court in Forman was considering a non-profit cooperative rather than a condominium, and secondly, as discussed above, the Court concluded on the facts before it that the purchasers were “solely attracted by the prospect of acquiring a place to live.” In fact, in referring to the SEC’s Release with respect to interests in condominiums, the Court specifically called attention to the fact that the difficult questions raised by transactions in which the purchaser is offered “both a commodity or real estate for use and an expectation of profits” were not before it.

In view of the uncertainty concerning the applicability of the securities acts to interests in cooperative housing corporations and condominiums, the number of “no-action requests” that raise questions about the applicability of the Advisers Act to persons who give advice about these interests is surprisingly low. In 1972, a “no-action request” was submitted by a corporation, Mattco Equities, Inc., engaged in the sale of shares in cooperative housing corporations. It sought advice from the staff whether it would be required to register under the Act if it published a brochure describing the advantages and disadvantages of purchasing shares issued by these corporations. The staff replied that since the advice to be offered in the brochure would involve “securities” and compensation would be received through commissions on sales of the shares, registration would be required.

In 1974, Gunnar/Burkhart/Armstrong & Associates requested advice from the staff concerning its status under the Advisers Act. The firm was a consultant to developers on the financing and marketing of interests in condominiums, some of which the firm acknowledged were deemed to be securities under the SEC’s guidelines. The staff advised the firm that it seemed to fall within the definition of investment adviser because “it would for compensation be advising others about the advisability of selling securities and it would be issuing or promulgating analyses or reports concerning securities.” The staff stated, however, that it would not recommend any action against the firm if it did not register since “we do not presently interpret the statutory language as applicable to persons who are primarily engaged in advising persons who are issuing securities.”

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167 See text at notes 155-61 supra.
168 95 S. Ct. at 2061.
169 Id. at 2061, n.16 (1975).
172 Id.
Also in 1974, Trinity International, Inc. (Trinity) sought the staff's view of Trinity's plan to purchase one hour of television time on a local financial information channel in order to bring together real estate salesmen and property owners with property they wished to exchange for property owned by persons watching the program. Trinity indicated that although no specific investment advice would be given by the program's commentator, he might make comments on the properties such as, "That motel in Sacramento that we had on the show last week might be just the vehicle that you're looking for to exchange for your $200,000.00 house." After first indicating that such comments might involve "advice or analysis," the staff stated it was unable to conclude that the content of the program would relate "solely to transactions in outright interests in real or personal property to the exclusion of transactions in securities." The corporation's attention was specifically directed to the fact that the offer and sale of interests in condominiums might involve the offering of securities depending upon the surrounding circumstances.

Questions concerning the applicability of the securities acts to interests not specifically named in the definitional provisions are not limited to the two areas discussed above. Other areas in which the question has been raised include franchises and pyramid sales operations. Although the staff has not been asked to provide its view of the status of persons who advise or issue reports concerning these interests, to the extent that these interests may be deemed to be securities, such persons certainly are investment advisers within the meaning of the Advisers Act.

In addition to questions about the meaning of the term "securities," many other questions have been raised with the staff concerning the applicability of the Advisers Act. Most of these questions seek to ascertain whether or how the Act applies to particular functions that the questioners perform or propose to

prior years with respect to persons rendering financial advisory services to issuers in connection with the issuance of their own securities. See "no-action letters" issued to Sears, Susey & Co., June 22, 1971, and Alpha Capital Corp., Feb. 2, 1971. Approximately one year prior to the issuance of the "no-action letter" to Gunnar, however, the staff advised a corporation that provided issuers with a monthly summary of information on trading in their own securities, that it was an "investment adviser" within the meaning of the Advisers Act. Corporate Studies, Inc., Oct. 17, 1973, and Dec. 6, 1973. The staff noted that one reason why an issuer would want this information would be to "gauge the proper time to repurchase its own shares or to sell additional securities to the public." Id., Dec. 6, 1973 (emphasis added). It is not clear from the "no-action letter" issued to Gunnar whether the staff presently views all services rendered to issuers as not within the scope of the Advisers Act or whether it continues to draw the apparent distinction based upon the purpose, i.e. issuance or repurchase of shares, for which the service will be used.

174 Id.
175 Id.
176 For discussion of the applicability of the securities laws to franchises and pyramid sales operations see Hannan & Thomas, The Importance of Economic Reality and Risk in Defining Federal Securities, 25 Hastings L.J. 219, 253-68 (1974). Other types of interests that have been held to be securities under certain circumstances are oil and gas drilling programs, farm lands or animals, variable annuities, variable life insurance policies, and whiskey warehouse receipts. D. Ratner, Securities Regulation 196-97 (1975). With respect to whiskey warehouse receipts, a "no-action letter" issued by the staff to a person offering a scotch whiskey advisory service to investors in these interests discloses that he has registered under the Advisers Act. Terry J. McCarthy, [1974-1975 Transfer Binder] CCH Fed. Sec. L. Rsp. ¶ 79,927 (June 10, 1974).
perform. The remainder of this Article attempts to identify these separate functions and examine the questions that have been raised with respect to each.

B. Financial Consultants to Individuals

Any person who has been engaged to make specific recommendations in connection with a client's portfolio of securities is clearly an "investment adviser" as defined in the Advisers Act since implicit in these recommendations is advice both as to the value of the security examined and the desirability of purchasing or selling that security. The term is more comprehensive than that, however, since persons may render advice on the value of securities or make suggestions about investing in securities without making specific recommendations. Moreover, persons who merely publish reports or analyses concerning securities also come within the definition of the term. Therefore, even though a financial consultant does not recommend the purchase or sale of any specific security, he runs a substantial risk that his activities will bring him within the definition of the term "investment adviser" if he provides any advice on investments in securities. Robert B. Sandman proposed formation of a partnership to engage in individual financial planning and asked the staff whether registration under the Advisers Act would be required.\(^\text{177}\) Although his services apparently were to include some advice about investing in securities, he indicated that no recommendations would be made to purchase or sell specific securities. He was advised by the staff that if advice would be given as to the "relative desirability" of investing in non-security investments as compared to investments in securities, the proposed partnership might be considered an "investment adviser" under the Act.\(^\text{178}\) Financial Counseling Corporation informed the staff\(^\text{179}\) that its services consisted of assembling information concerning each client's insurance program, assets, liabilities, and future objectives into a "Coordinated Financial Study," including a thorough life insurance analysis, estate plan, and "suggestions for asset conservation and distribution."\(^\text{180}\) As evidenced by the following statement in its reply, the staff seems to have concluded that suggestions for asset conservation and distribution necessarily would include recommendations as to whether a portion of the client's assets should be invested in interests that constitute securities: "Since the corporation gives its clients advice concerning the advisability of investing in securities as well as analyses or reports concerning securities, it plainly falls within the definition of investment adviser."\(^\text{181}\)

C. Business Managers

As indicated by a "no-action letter" issued to First United Management Corporation\(^\text{182}\) (First United), persons who provide personal and business

\(^{177}\) Robert B. Sandman, Mar. 12, 1974.

\(^{178}\) Id.


\(^{180}\) Id.

\(^{181}\) Id.

management services to professional athletes and entertainers also run a substantial risk of being classified as investment advisers. In addition to advising clients about prevailing rates of compensation and conditions of employment, First United performed business management services that included collection of income, maintenance of bank accounts, establishment of budgets, payment of allowance for living expenses, payment of bills, maintenance of books and records, assistance in commercial exploitation of the client’s name, and assistance in development of a personal savings program. On some occasions First United purchased bank certificates of deposit with cash that had accumulated in the separate account it maintained for each of its clients. Counsel for First United stated that First United’s compensation, based upon a percentage of the client’s annual income, was paid solely for these services. Counsel informed the staff, however, that First United also assisted and advised clients about organizing and establishing what counsel described as “non-security investments,” such as automobile dealerships, sporting goods stores and fast food chain outlets. Counsel also indicated that First United planned to act in the future as the general partner of limited partnerships organized to own real property, interests in which would be sold to its clients and others. Its clients would be required to obtain independent advice as to the desirability of these investments.

In its “no-action request,” counsel stated its opinion that the only aspect of First United’s method of business that raised any issue under the Advisers Act was its proposed organization of limited partnerships. Counsel argued that this would not make it an “investment adviser” since it would neither render advice nor receive additional compensation in connection therewith. Counsel stated in its initial “no-action request” that First United “has a certain latitude in structuring its method of doing business” and wished, if possible, to avoid registration because of the substantial burdens imposed thereby. In a supplemental letter submitted prior to the issuance of the staff’s “no-action letter,” counsel informed the staff that First United had modified its plans and no longer desired to render any business advice. “[S]ince, as you have aptly pointed out, this could involve advice concerning securities . . . [it] has agreed to forego any such advice.” Any client seeking advice concerning investments would be sent to his own investment adviser. Counsel stated, however, that First United did not wish to abandon either its plans to form investment partnerships or its practice of purchasing bank certificates of deposit for clients. Counsel conceded that the practice of purchasing bank certificates of deposit for its clients might constitute investment advisory activity but urged the staff to adopt the view that bank certificates of deposit are not securities within the meaning of the Advisers Act. It was counsel’s position that exemption of these instruments from the registration requirement of the Securities Act of 1933 evidenced a congressional determination that they are not of a nature requiring

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183 Id. at 83,985.
184 Id. at 83,986.
disclosures to prospective purchasers and, therefore, advice concerning them should not be considered within the scope of the Advisers Act.

The staff was unable to conclude that First United need not register under the Act. Speaking of certificates of deposit, the staff stated that there is no support for the view that securities exempt from registration under the Securities Act of 1933 are outside the scope of the Advisers Act. Its view of the proposed investment partnerships was similarly unhelpful to First United. It first indicated that the offer of these interests by First United to its clients would constitute investment advice whether or not independent advice was also required. Secondly, regardless of the specific terms of its contracts, the fees received by First United would be viewed as having been derived in part from any investment advice rendered, including advice concerning interests in the limited partnerships. Finally, the staff stated that “even if no specific securities are recommended, advice concerning the relative desirability of investing or not investing . . . in securities would constitute advice ‘as to the advisability of investing in, purchasing, or selling securities’ within the meaning of section 202(a)(11) of the Act.”

Thus even if First United eliminated its practice of purchasing bank certificates of deposit and abandoned its plans to form investment partnerships, registration under the Advisers Act would nonetheless be required unless it refrained from offering any advice to its clients concerning investment of any funds remaining after payment of their bills and living allowance.

D. Professional Trustees

Clause F of section 202(a)(11) excludes from the definition of the term “investment adviser” such persons as the SEC designates by rules or order as not within the intent of the definition. Although no rules have been adopted pursuant to clause F, the SEC by order has determined that certain persons are not within the intent of the definition. In 1941, an order pursuant to clause F was sought by Augustus P. Loring, Jr. (Loring), an individual who was engaged in the business of serving as a trustee under judicial appointments and irrevocable trust indentures. As trustee, his duties included the management and supervision of trust assets, including securities. In many instances he held legal title to these securities, and when he did not hold legal title, title was carried in his name. The SEC entered an order declaring he was not an investment adviser, reasoning that his advice with respect to the securities was not to others.

In 1973, Brewer-Burner & Associates, Inc. submitted a “no-action request” to the staff in which it disclosed that it proposed to engage in the business of

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180 Id. at 83,984.
183 Id. at 75,749.
advising persons concerning their financial affairs. It would recommend to some of its clients that they establish foreign situus trusts as tax and estate planning devices. In responding to the questions raised in the “no-action request,” the staff advised, without discussion of the Loring order, that the trustee of such trusts would be an investment adviser within the meaning of section 202(a)(11). This conflict between the staff’s view and the earlier order of the SEC was subsequently highlighted in a case brought in Federal court by an individual who had suffered financial losses in connection with a trust he had created under the trusteeship of defendant, a Bermuda bank.\textsuperscript{100} Noting the conflict between the opinions of the SEC and its staff, the court adopted the earlier opinion of the SEC and dismissed plaintiff’s claim under the Advisers Act, holding that a trustee is not an “investment adviser” within the meaning of the Advisers Act. The court reasoned as follows:

A trustee is historically the legal owner of the trust corpus, while the beneficiary is the equitable owner. The trustee does not advise the trust corpus, which then takes action pursuant to his advice; rather the trustee acts himself as principal. While there may be public policy reasons for holding a trustee who deals in securities for its trust to the standards of the Investment Advisers Act, neither the common sense meaning of the word “adviser” nor a comparison with other situations to which the 1940 Act has been held applicable militates in favor of doing so.\textsuperscript{101}

E. Advisers to Family Members

In 1941, the SEC entered an order pursuant to clause F of section 202(a) (11)\textsuperscript{102} declaring that the Advisers Act was not applicable to Donner Estates, Inc.,\textsuperscript{103} a corporation whose stock was held in trust for the benefit of the members of a single family. The corporation furnished investment advice only to trusts created by and for the benefit of members of the family, employees of members of the family, or charitable organizations created by members of the family. Six years later a similar order was obtained by The Pitcairn Company.\textsuperscript{104} In addition to engaging in manufacturing, the company rendered investment advice to most of its fewer than 100 stockholders. With the exception of four churches, which held less than three percent of the outstanding shares of common stock, all stockholders were either members of the same family or trusts for the benefit of members of that family. Although the SEC did not indicate in either of these orders the basis for its conclusion that the companies were not within the intent of the definition of the term “investment adviser,” it apparently determined, consistently with its position in Loring,\textsuperscript{105} that the investment advice was not rendered to others.

\textsuperscript{101} Id. at 420.
F. "Offeree Representations" under Rule 146

In April 1974 the SEC adopted Rule 146,\(^{196}\) designed to provide objective standards by which issuers can determine the availability of the exemption of "transactions by an issuer not involving any public offering"\(^{197}\) from the registration requirement of the Securities Act of 1933.\(^{198}\) Rule 146 provides that transactions by an issuer will not be deemed to involve a public offering if they are part of an offering that meets all conditions of the Rule. These conditions prescribe limitations on the manner of offering, require access to or the furnishing of information about the issuer, limit the number of purchasers, restrict disposition of securities acquired pursuant to the Rule, and establish criteria that each offeree must satisfy.\(^{199}\) Before an issuer may make a sale under Rule 146, this last condition requires that, after reasonable inquiry, the issuer have reasonable grounds to believe and in fact believe either (a) that the offeree has the requisite knowledge and experience in financial matters, or (b) that the offeree and his representative (the offeree representative) together have this knowledge and experience and the offeree is a person who can bear the economic risk of the investment.\(^{200}\) The only reference to the Advisers Act in the Rule or the Release that announced the Rule's adoption\(^{201}\) is a statement in a note following the definition of the term "offeree representative" that the Advisers Act should be "considered."\(^{202}\) Within two months of the adoption of Rule 146, the question of whether the Advisers Act applies to offeree representatives was raised with the staff by Epsilon Lambda Electronics Corporation,\(^{203}\) which was contemplating the issuance of shares in reliance upon the Rule. Because it believed prospective purchasers would require the services of an offeree representative, the corporation arranged for an individual who was a principal in a registered broker-dealer firm to act, at its expense, as those persons' offeree representative. This individual neither held himself out as an investment adviser nor gave investment advice other than incidental to his business as a broker-dealer.\(^{204}\) After first indicating that it was studying the relationship between the Advisers Act and offeree representatives, the staff advised the corporation it would not recommend that any action be taken by the SEC if the offeree representative did not register under the Advisers Act, provided his firm registered under the Advisers Act if it or any of its associated persons acted as an offeree representative in connection with any additional offerings of securities. Later in 1974, a "no-action request" was submitted by a


\(^{198}\) Id. § 5, 15 U.S.C. § 77(e).

\(^{199}\) 17 C.F.R. § 230.146 (1975).

\(^{200}\) Id. § 230.146(d)(2).


\(^{204}\) See section II.M. infra for discussion of the status of brokers and dealers under the Advisers Act.
law firm, Winstead, McGuire, Sechrest & Trimble, asking the staff's view whether including the firm's name in a list of offeree representatives to be furnished by an issuer to potential investors would require registration under the Advisers Act. The staff advised that since performance of the duties of an offeree representative necessarily involves advising others as to the advisability of investing in or purchasing securities, the firm would be required to register under the Act if its name was included in the list of offeree representatives and it received any form of compensation for its services. The staff also stated that, based on the information presented, it did not appear that the firm could rely upon the exclusion from the definition of the term "investment adviser" allowed lawyers whose performance of investment advisory services is solely incidental to the practice of their profession.

G. Finders for Investment Advisers

Another question that has been raised with the staff is whether receipt of a portion of an investment adviser's fee in consideration of the solicitation or referral of new clients to the adviser makes the recipient an investment adviser under the Advisers Act. In 1974, a registered investment adviser, Stralem & Co., Inc., sought the staff's view of a plan under which an individual (Finder) would be paid ten percent of fees received by Stralem from clients introduced by Finder. The staff was informed that Finder would be subject to the supervision and direction of Stralem in all activities connected with the endeavor. This supervision and direction would include prior approval by Stralem of persons that Finder intended to approach and what Finder intended to say to such persons, the right of Stralem to have one of its officers accompany Finder at any time, and furnishing of complete reports of each interview with prospective clients. Relying on a statement by the staff in a "no-action letter" issued two years earlier to Rhodes, King, Ruman & Farber (Rhodes), counsel for Stralem concluded that Finder would not be required to register under the Advisers Act. The staff had stated in its reply to Rhodes, "[U]nless a person is subject to the supervision and direction of a registered investment adviser as an employee or other associated person, he must himself be registered as an investment adviser if he participates in any part of the [adviser's] fee. . . ." The staff agreed with Stralem that Finder would not be required to register, provided that he acted in reliance on the opinion of Stralem's counsel that he was its employee both as "a matter of common law and for purposes of the Act." Although the "no-action letter" to Rhodes did not disclose the

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209 Id. at 82,424.
statutory basis for the staff’s position that independent finders are investment advisers, in a “no-action letter” subsequently issued to Charles L. Hatfield, the staff stated that such persons would be advising clients, for compensation, as to the advisability of investing in securities, and therefore all elements of the definition would be satisfied.

H. Newspapers and Magazines

Excluded from the definition of the term “investment adviser” are publishers of any “bona fide newspaper, news magazine or business or financial publication of general and regular circulation.” The difficult question as to the scope of this exclusion was raised when the SEC initiated an investigation to determine the applicability of the Advisers Act to the publisher of the Wall Street Transcript, a weekly publication printed in the form of a tabloid newspaper that contained reports prepared by others upon specific securities. Upon the refusal of the publisher to comply with a subpoena requiring production of certain documents, the SEC brought an action in federal district court seeking judicial enforcement of the subpoena. The district court refused, concluding that the publisher was expressly excluded from the definition of the term “investment adviser.” On appeal the Court of Appeals for the Second Circuit reversed and remanded, holding that the SEC was entitled to enforcement of the subpoena so that it could determine whether the exclusion was applicable. The lower court had used a test that looked to the number of usual indicia a newspaper exhibits as the determinative factor in deciding whether the Wall Street Transcript was a “bona fide” newspaper. The court of appeals criticized the district court for having applied this rather mechanical formula and stated:

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211 Charles L. Hatfield, July 19, 1974. The staff has also consistently taken the position that the receipt of compensation by finders registered under the Advisers Act may be a violation of § 206 of the Act. For example, the staff stated the following in the “no-action letter” issued to Charles L. Hatfield:

We regard either a one-shot or a continuing referral fee paid to such a finder to be subject to Section 206. Such a fee arrangement may be a fraudulent, deceptive, or manipulative practice or course of business which would operate as a fraud upon such clients. Further, we believe that a continuing referral fee arrangement creates an especially severe conflict of interest problem for an investment adviser because his compensation would be contingent upon his continually inducing the client to remain with your firm. See, e.g., Argus Securities Management Corporation, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,366. Such a conflict of interest cannot be squared with the presumption of Section 206 that an investment adviser is a fiduciary who has a duty of undivided loyalty to his clients and must deal fairly and honestly with them. However, you should be aware that the Advisory Committee on Investment Management Services for Individual Investors [reprinted in BNA SEC. REG. & L. REP. No. 186 at G-1, G-8 (January 23, 1973)] has recommended that a finder be permitted to receive a reasonable, fully-disclosed, one-time, finder's fee to compensate him for services in referring or introducing the client to the adviser. This Report, however, is the work of the Advisory Committee, not the Commission or its staff, and should not be taken as an expression of the Commission position. Indeed, the Commission recently announced that it would soon publish its views on these proposals. . .

The SEC has not announced its views on the proposals discussed in the staff’s “no-action letter” to Charles L. Hatfield.

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25 294 F. Supp. at 302-06.
The determination of whether or not a given publication fits within this exclusion must depend upon the nature of its practices rather than upon the purely formal "indicia of a newspaper" which it exhibits on its face and in the size and nature of its subscription list.

... Determining whether a specific newspaper is "bona fide" for the purposes of the Act requires the delineation of a boundary between the special type of "merchandising" activities which must lead to registration and the publication of expression which lies beyond the Act's regulatory purposes.\textsuperscript{216}

The following year, 1971, Media General Financial Daily sought advice from the staff\textsuperscript{217} on its plans to publish a daily financial and business newspaper that would be similar to the \textit{Wall Street Journal}. In addition to financial and business oriented news, including studies of areas of financial interest such as interest rates and the balance of payments, the paper would provide statistical data on all stocks listed on the New York Stock Exchange and the American Stock Exchange, as well as 630 other stocks. Reports prepared by others on specific securities would not be published. In the staff’s view the exclusion was not applicable. Relying upon the opinion of the court of appeals in \textit{SEC v. Wall Street Transcript Corp.},\textsuperscript{218} the staff stated that the format of the proposed publication was not deterministic and looked instead to what it perceived to be the intended use thereof by subscribers. "[I]t is plain ... that your client’s service is neither of general nor regular circulation nor is it the kind of bona fide newspaper or financial publication envisioned by clause (D) ... of the Act. Manifestly, the service ... has the objectives of assisting subscribers in forming investment judgments and decisions."\textsuperscript{219} Also in 1971, the staff received a “no-action request” from the publisher of \textit{Finance Magazine},\textsuperscript{220} which had been published monthly for a period of 30 years and was distributed to over 50,000 subscribers. The August 1971 issue, which was examined by the staff, included articles on financial automation, a company offering computerized securities data for financial analysts, a company offering optical data processing services, a new investment management company, the performance of bank trust departments compared with that of mutual funds, Japanese business, and a review of analysts’ comments on publishing companies. The publisher planned to add a section entitled "Wall Street Whispers," which would refer to the investment merits of specific securities. Each reference would be attributed to its source. The staff advised, without reference to either \textit{SEC v. Wall Street Transcript Corp.}\textsuperscript{221} or the earlier “no-action letter” to \textit{Media General Financial Daily}, that it would not recommend any action by

\textsuperscript{216} 422 F.2d at 1377, 1379.
\textsuperscript{218} 422 F.2d 1371 (2d Cir. 1970).
\textsuperscript{221} 422 F.2d 1371 (2d Cir. 1970).
the SEC if the publisher did not register under the Advisers Act.222 The staff apparently concluded that the objective of Finance Magazine was other than to assist its readers in making investment judgments and decisions.

I. Other Publishers of Information Related to Securities

As indicated by the “no-action letters” discussed below, the staff has taken the position that anyone who provides information about securities for compensation, whether or not specific recommendations are included,223 comes within the meaning of the term “investment adviser,” unless he is excluded pursuant to clause D of the definition.224 Potomac Federal Corporation (Potomac Federal)225 informed the staff that as part of its business, it rendered evaluation, consulting, and monitoring services for venture capital companies. These services included evaluation of the company’s products and all aspects of its business operations; development of sales, production, and cash requirements forecasts; and preparation of reports and assessments concerning financing alternatives. Potomac Federal also performed these services on behalf of persons who had investments in such companies. Services for these clients were limited to monitoring and reporting, and it neither recommended that clients dispose of any investment nor negotiated the terms of any disposition. In its initial “no-action letter,” the staff advised counsel for Potomac Federal that it did not agree with his conclusion that Potomac Federal was not an investment adviser under the Advisers Act, stating that “clearly your client issues analyses or reports concerning securities.”226 In a later “no-action letter”227 issued in response to a request that the staff reconsider its position, the staff stated that it is not necessary for the purposes of section 202(a)(11) that an analysis or report make specific recommendations to buy, sell, or hold particular securities or that a report serve as the sole basis for an investment decision.228 The staff also noted that Potomac Federal’s institutional clients might make determina-

222 In the view of the staff, the exclusion of certain publishers from the definition of the term “investment adviser” covers only publishing activity. In 1975, the staff advised the publisher of a monthly newspaper who planned to write a column on the stock market for publication therein that, assuming the exclusion was applicable with respect to publication of the newspaper, a bona fide newspaper of general and regular circulation within the meaning of the exclusion would not cover him in his role as a financial columnist. The staff also stated that since the proposed column would discuss the desirability of investing in securities, “in your role as a newspaper financial columnist you would appear to fall within the definition of investment adviser.” Raymond L. Panico, Jan. 7, 1974.

223 See “no-action letter” issued to Investment Research & Management Ltd., Apr. 14, 1972. See also Alphadex Corp., [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,624 (Jan. 21, 1972) (staff advised that sale of a desk top computer, which would provide recommendations to buy or sell a security, would constitute investment advisory activity). In the view of the staff, even persons who publish recommendations of securities previously made by others are required to register under the Act. See Professional Association Consulting Services, Inc., June 1, 1973; Red Edson, Mar. 29, 1972.


228 Id. at 83,982-83.
tions to hold, purchase, or sell securities after considering reports prepared by Potomac Federal.229

"No-action letters" issued by the staff also indicate its view that application of the Advisers Act may not be avoided by limiting the information used in reports to information compiled from public sources.230 Bridge Data Company sought advice from the staff on its plan to establish a data processing service center from which subscribers could obtain information concerning specific issuers and lists of securities trading in unusual volume or showing unusual changes in market price.281 Subscribers would receive the information in the form of standardized computer print-outs or on a cathode ray tube display screen leased from the company. Additional information about an issuer could be obtained only by subscribing to a separate service offered by the company. All information furnished would be gathered by the company from publicly available sources. The staff's response was that it appeared the company would be issuing and promulgating analyses and reports within the meaning of section 202(a)(11). A "no-action letter" issued two years earlier to Interactive Data Corporation232 indicates, however, that the Advisers Act does not apply if information is made available to subscribers simply by providing access to data maintained by the company from which a subscriber may select, by use of computer equipment, the information he desires. Interactive Data Corporation, which provided such a service, was advised by the staff, without discussion or explanation, that no action would be recommended if it did not register under the Act. The staff apparently agreed with the following distinction drawn in the company's "no-action request":

We recognize that the staff has previously adopted the view that the promulgation for compensation of selected information as to securities prices and other financial data is investment advisory activity. However, we believe that the staff has not adopted a view that the mechanical (or electrical) facilitation of the use of such information . . . (where no judgment factor is supplied) constitutes such activity.233

Other "no-action letters" also disclose that the staff believes a publication limited to information concerning trading activity in a particular security may require registration under the Act even though it includes no substantive

229 Counsel for Potomac Federal also argued that even if it were an investment adviser within the meaning of the Act, it was exempt from registration by § 203(b)(3). The staff again disagreed. It informed Potomac Federal that regardless of its ability to satisfy the other conditions of the exemption relating to the number and type of clients, the conditions with respect to holding out to the public as an investment adviser could not be met since announcements containing a description of Potomac Federal's services had been mailed to approximately 120 persons for the apparent purpose of soliciting new clients. Id. at 83,983. For a discussion of section 203(b)(3) see text at notes 47-53 supra.


232 Interactive Data Corp., Nov. 17, 1972.

233 Id.
information about the issuer. 234 In 1971, Martin D. Kanesky was advised by the staff235 that publication of graphs showing only the daily closing price and trading volume of each of the shares most actively traded during the preceding week on the New York and American Stock Exchanges would bring him within the definition of the term “investment adviser.” The staff specifically referred to Kanesky’s statement that the graphs would be “an aid to speculation.”236 The following year similar advice was given to Jon K. Jenkins with respect to the sale of graphs containing data compiled from stock market prices and economic indexes.237 In 1974, however, a “no-action letter” issued to B. W. Barrier238 suggested that it was not the staff’s position that the Advisers Act is applicable to all persons preparing charts or graphs of information concerning securities. Barrier’s request for advice from the staff was as follows:

[1.] I would like the following information. I am planning to offer a stock charting service and would like to know if you have to be registered with the SEC in order to offer this service for sale. I would not recommend any stock to buy or sell, just charts on high, low, close, volume.

[2.] I would also like to know if you offered a chart service that provides a volume price trend you have to be registered . . . .

The staff’s reply to his first inquiry was that it could not advise him without first reviewing a sample chart and his plans for advertising. The staff did advise that the proposal to include a “volume price trend,” based in part on the issuer’s sales and earnings, would constitute investment advisory activity necessitating registration under the Act. Two months later the staff received a “no-action request” from Jack O. Lee, who also planned to sell graphs and charts of information concerning specific issuers.239 He did not indicate what information would be used in preparing the graphs and charts but did state that predictions as to “further growth or decline”240 would not be included. As in the Barrier request, the staff was not provided a sample chart or information concerning proposed advertising. Unlike Barrier, however, Lee was advised that he would be a person who issues or promulgates analyses or reports concerning securities and thus would be required to register under the Advisers Act.

236 Id.
239 Id. at 83,905.
241 Jack O. Lee, Apr. 9, 1974.
Finally, it is the staff's opinion that even publication of information about
the stock market without mentioning specific securities, except for illustrative
purposes, may require registration under the Act. Theory Analysis Group
submitted a "no-action request" in connection with a proposed publication
that would be an "analysis of market indicators for trend analysis." Specific
securities would be mentioned only for illustrative purposes, and accompanying
any reference to a specific security would be a statement that it was not being
recommended for purchase or sale. The staff advised that registration under
the Advisers Act nonetheless would be required.

J. Authors

The staff has often taken the position that the authors of books on securities
may be subject to the Advisers Act. In 1972, Loran K. Lantz disclosed to the
staff that he was writing a book on the functioning of the stock market. The
book would include "methods of charting, market timing and stock
categories," in order to instruct readers on "when and how to select stocks." Specific
securities would not be recommended. In its reply to Lantz, the staff
set forth its position with respect to authors of books on securities as follows:

Generally speaking, the publication and sale of one book containing investment
advice by a person engaging in no other investment advisory activities would not
be considered sufficient to bring him within the term "investment adviser," on the
theory that publication and sale of one book generally would not constitute a
business. However, if the book is one of a series of publications on investing, or
if it contains one or more formulae which are intended to be used by investors in
making determinations as to what specific securities to buy, or when to buy and
sell them, and it appears that the formulae are such as to make it likely that the
book will be sold continuously and indefinitely, then this may be sufficient to
make the author an investment adviser.

The staff advised Lantz that because of the limited information included in
his "no-action request," it could not conclude that he was not required to
register under the Advisers Act.

During the following year, the staff received a "no-action request" from
Bernard Katz, who had written a book about the stock market. This book
was described by Katz as one "on how to select growth stocks" and included
techniques such as "the mathematics used in determining whether a stock is
over-valued or under-valued; the convertible bond hedge; the stock warrant
hedge; the short sale; and point and figure charts." All examples in the
book were taken from previous market history, and no specific recommendations were included. The Commission advised Katz that it would not recommend action against him if he failed to register under the Advisers Act, provided the book was not one of a series of books on the stock market that he had written or would write, and so long as it did not contain one or more formulae intended to be used by the reader in determining which securities to buy or sell.

The following year a third author, James M. Hurst, took the position that the formulae included in his book, on selecting securities, were not intended to be used by investors in determining which securities to purchase or when securities should be purchased or sold.\textsuperscript{281} Hurst described the formulae in his book as “those of classical numerical analysis,”\textsuperscript{282} which could be found in numerous texts. The staff replied that it believed the formulae were intended to be used by investors in determining which securities should be purchased or sold and advised Hurst to register as an investment adviser. In its “no-action letter,” the staff called attention to material in the book’s introduction that described one of the matters to which the reader would be exposed, as “[a] complete trading method: how to select issues, how to analyze them for action signals, and how to improve your chances of turning and keeping a profit.”\textsuperscript{283}

The “no-action letters” issued to Katz and Hurst do not indicate the basis upon which the staff concluded that Hurst’s book contained formulae but Katz’s book “on how to select growth stocks” did not. A subsequent “no-action letter” issued to Forrest G. Allen\textsuperscript{284} suggests one explanation—the staff may be taking a broader view of what constitute formulae since its advice to Katz. Allen described his proposed book as follows: “[A] book on the selection of growth stocks (both high grade and speculative)—addressed to (mainly) young engineers. The main theme will be to show them how to apply their mathematical skills in analyzing stocks for logarithmic growth rate using statistical regression, and in analyzing the efficiency of management by using several management ratios.”\textsuperscript{285} The staff advised Allen, without additional discussion or explanation, that since it traditionally has viewed as investment advisers those authors whose books contain formulae intended for use in selecting securities for purchase, it appeared that he would be required to register under the Advisers Act. It is difficult to identify any distinction between the material included in Katz’s book and the material to be included in Allen’s.

K. Teachers

Clause B of the definition of the term “investment adviser”\textsuperscript{286} excludes

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\textsuperscript{282} Id. at 83,973.
\textsuperscript{283} Id. at 83,972.
\textsuperscript{284} Forrest G. Allen, July 31, 1974.
\textsuperscript{285} Id.
teachers whose performance of investment advisory services is solely incidental to the practice of their profession. As discussed above, an individual may become an investment adviser for purposes of the act by advising on either the value of securities or the advisability of investing in securities, even though he does not recommend specific securities for purchase or sale. As in the case of publishers, the staff has generally taken the position that any person offering instruction concerning securities is an investment adviser, unless he comes within the terms of the exclusion.

In 1972, Paul Hellman sought advice from the staff prior to offering "an instructional service relating to the understanding and use of published investment related information." No specific advice was to be given on the purchase and sale of securities. The staff advised Hellman that his proposed activities would clearly bring him within the definition of the term "investment adviser" because he would be advising others as to the value of securities or the advisability of purchasing or selling securities. Although Hellman presented no evidence that the exclusion for teachers might be applicable, the staff indicated its view that the exclusion applies only to courses that are part of "the regular curriculum of an accredited institution of higher education conducted by a professor or other instructor duly licensed or otherwise qualified." At approximately the same time, the staff also advised Frank T. Hines, who planned to conduct classes containing "general instruction in how to conduct your investment program in all types of stock markets," that registration was required. Like Hellman, he did not intend to recommend specific securities.

In 1974, the American College of Life Underwriters submitted a "no-action request" concerning the proposed offering of a 24 week course designed to provide a general understanding of various topics related to "total financial planning." All students taking the course would be "Chartered Life Underwriters or persons such as accountants, investment managers and attorneys involved in financial services." The staff replied that it would not recommend any action if the organization did not register as an investment adviser and based its position on the fact that the college was an "independent educational institution providing college level training and continuing education for persons in life and health insurance and related fields and that the course [was] designed to improve students' general understanding of various topics related to total financial planning."
L. Banks

Clause A of section 202(a)(11)\textsuperscript{266} excludes from the definition of the term "investment adviser" any "bank" as defined in section 202(a)(2) of the Advisers Act\textsuperscript{267} or "bank holding company" as defined in the Bank Holding Company Act of 1956.\textsuperscript{268} The term "bank" includes any banking institution organized under the laws of the Federal Reserve System or any other banking institution if, (a) a substantial portion of its business consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks, (b) the bank is supervised and examined by state or federal banking authorities, and (c) the bank is not operated for the purpose of evading the provisions of the Advisers Act.

Although banks traditionally have been predominantly engaged in accepting time and demand deposits and making commercial loans, during the past several years they have increasingly offered many additional services including management of individual portfolios.\textsuperscript{269} Were it not for the exclusion in Clause A, banks offering such services would be required to register under the Advisers Act. In April 1974, the SEC announced that it is considering whether it should take action itself or recommend action to other governmental agencies or Congress with respect to the investment advisory services rendered by banks.\textsuperscript{270} It asked for submission of written comments from all interested parties on six specific questions relating to investment advisory services offered by banks. To date, the SEC has not announced its conclusions.

M. Broker- Dealers

The last group this paper will examine consists of brokers\textsuperscript{271} or dealers\textsuperscript{272} who are also excluded from the definition of the term "investment adviser" provided their performance of investment advisory services "is solely incidental to the conduct of [their] business as a broker or dealer and [provided they receive] no special compensation therefor."\textsuperscript{273} Prior to the effective date of the Advisers Act, the opinion of the General Counsel to the SEC was sought

\textsuperscript{271} The term "broker" is defined in the Advisers Act to mean "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." Advisers Act § 202(a)(3), 15 U.S.C. § 80b-2(a)(3) (1970).
\textsuperscript{272} The term "dealer" is defined in the Advisers Act to mean "any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." Id. § 202(a)(7), 15 U.S.C. § 80b-2(a)(7).
on the meaning of the term "special compensation." His opinion, which has been followed consistently by the SEC, was as follows:

Clause (C) of Section 202(a)(11) amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause (C) which refers to "special compensation" amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities . . . . The essential distinction to be borne in mind in considering borderline cases . . . is the distinction between compensation for advice itself and compensation for services of another character to which advice is merely incidental.

The General Counsel concluded that special compensation is not received by a broker or dealer when the amount of the commission or charge is the same "for all transactions of the same size, no matter who the customer is or how much consultation or advice . . . has [been] given him." He concluded, however, that when a charge, although uniform in amount, is made only to customers to whom advice is given, the charge constitutes special compensation. Thus the exclusion applies to a broker or dealer whose customers are all charged uniform commissions, whether or not each customer receives investment advice, so long as rendering such advice is solely incidental to the conduct of the broker or dealer's business.

Many brokers and dealers have relied upon this exclusion. Reliance was greatly facilitated by rules of the national securities exchanges that required each member to charge fixed commissions to all customers. On January 23, 1975, however, the SEC announced adoption of Exchange Act Rule 19b-3, which prohibits national securities exchanges from retaining these rules after May 1, 1975. The SEC stated in the Release announcing adoption of the Rule that the interests of the public will be better served by commission rates determined by the "free play of competition." Shortly before May 1, 1975, the SEC issued another Release, stating that it expects some brokers and dealers may respond to the new competitive environment by charging separately for investment advice furnished to customers. Such charges will constitute special compensation within the meaning of the

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276 Id. at 75,103.


exclusion. The SEC acknowledged, however, that many brokers and dealers have relied upon the exclusion and are unfamiliar either with the provisions of the Advisers Act or its possible impact on their advisory activities and announced adoption of temporary Rule 206A-1(T), which provides that brokers and dealers not registered under the Advisers Act as of May 1, 1975, will be exempt from its provisions until August 31, 1975. The temporary Rule was amended on August 20, 1975, to extend the expiration date for the temporary exemption to November 30, 1975, for brokers and dealers who perform investment supervisory services or investment management services. The expiration date was extended to April 30, 1976, for brokers and dealers who do not perform these services. Since brokers and dealers who continue to charge uniform commissions to all customers after August 31, 1975, will remain excluded from the definition of the term “investment advisers” if all investment advisory services rendered are “solely incidental to the conduct of their business” and no “special compensation” is received in connection therewith, “no-action letters” issued by the staff to brokers and dealers prior to May 1, 1975, remain relevant.

Consistent with its position as to persons who are not broker-dealers, it is the staff’s position that a broker or dealer is required to register under the Advisers Act if he solicits customers for a registered investment adviser and receives a portion of the adviser’s fee. Reinholdt & Gardner (Reinholdt), a broker and dealer registered under the Securities Exchange Act of 1934, proposed to enter into contracts with various registered investment advisers. Under these agreements, Reinholdt’s customers would be able to choose one of the advisers who would provide portfolio management services. Reinholdt was to receive a portion of the advisers’ fees as consideration for securing the accounts and performing certain clerical and administrative functions for the advisers in connection with each account. It was Reinholdt’s opinion that this conduct would not constitute investment advisory activity since all advice concerning securities would be furnished by the investment advisers. The staff replied as follows: “On the basis of the facts you provide, and the entire relationship between Reinholdt and the various investment advisers, including the solicitation of customers and the receipt of a portion of the advisory fee by Reinholdt, we are not able to state that the registration of Reinholdt as an investment adviser would not be required.”

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\(^{281}\) Id. at 85,283.

\(^{282}\) Id. § 56,400B (1975). The SEC has also adopted Rule 206(3)-1, which exempts an investment adviser who is also registered as a broker or dealer from the requirements of § 206(3) of the Advisers Act, discussed in text at note 103 supra, if there is compliance with the conditions of the Rule. SEC Investment Advisers Act Release No. 470 (Aug. 20, 1975), Current CCH Fed. Sec. L. Rep. ¶ 80,268.


\(^{285}\) See section 11.D. supra.


\(^{287}\) Id. at 80,422.
It is also the view of the staff that a broker or dealer is required to register under the Advisers Act if he assists his clients in choosing and evaluating an investment adviser. FPC Securities Corporation (FPC), also registered under the Securities Exchange Act of 1934 as a broker and dealer, planned to assist its customers in selecting an investment adviser by recommending meetings with certain advisers that it deemed to be qualified. After selecting an adviser, each client would receive, without charge, a quarterly report prepared by a separate and unrelated firm that would compare the performance of the client's portfolio with the performance of the Standard & Poor 500 Index, the Dow Jones Industrials Index, and four other indexes. In addition, each adviser's performance would be monitored by FPC, and the firm would recommend that its clients retain a different adviser when it considered this action necessary. FPC's compensation was to be derived from agreements with its clients requiring each client to instruct his adviser to direct his account's brokerage to FPC. In the opinion of FPC's counsel, the firm would not be performing investment advisory activities within the meaning of the Act. It was the staff's position, however, that FPC's conduct would involve advising its clients as to the advisability of investing in securities: "Since the placing of assets under the management of an investment adviser would normally involve investing in securities, advising a client to select or dismiss an investment adviser would inherently involve advising such a client as to the advisability of investing in securities." It was also the opinion of counsel that even if FPC could be considered to be engaging in investment advisory activity, the exclusion was applicable because the activity would be incidental to its function as a broker and dealer, and it would not receive any special compensation since it would receive no fees from its clients or their advisers as consideration for providing the services. The staff again disagreed. In its view, the question of whether the brokerage commissions to be received by FPC would constitute special compensation was irrelevant because the conduct would not be incidental to FPC's normal brokerage activities. "It is evident that FPC has devoted substantial time and effort to developing the Program and that the operation of the Program would be a very significant activity outside the scope of normal brokerage functions." For this reason, the exclusion would not apply.

In the last two "no-action letters" to be discussed herein, the staff has responded unfavorably to broker-dealers who sought to render non-traditional services to their clients without registration under the Advisers Act. Roberts, Scott & Co., Inc. had an arrangement with an investment adviser permitting Roberts to operate as the exclusive agent of the adviser in Southern California. Roberts believed the minimum fee charged by the adviser made it
inefficient for any of its customers to engage the adviser unless the value of the client's account exceeded 40,000 dollars. Thus it proposed to make the adviser's services available to clients with smaller accounts by forming limited partnerships in which these clients might each invest 10,000 dollars. Roberts was to serve as the general partner of each partnership, and each partnership would engage the adviser to serve as its investment adviser. As general partner, Roberts would have the right to accept or refuse the adviser's recommendations but would not have discretion to purchase or sell securities except upon the recommendation of the adviser. Compensation to Roberts was to consist of commissions on the partnership's brokerage transactions and the difference between the total management fees it would receive from the limited partners (Roberts would charge each limited partner 150 dollars annually) and the fee charged the partnership by the adviser. In the view of the staff, Roberts would be acting as an investment adviser within the meaning of the Act, and the exclusion would not apply because the firm would receive special compensation as consideration for its role in the proposed partnership.

Underwood, Neuhaus & Co., Inc. 391 (Underwood) proposed to aggregate clients' funds in order to purchase bank certificates of deposit in the amount of 100,000 dollars or more. Each participating client would pay Underwood a fee of one percent of the amount invested, computed on an annual basis. In a "no-action request" submitted on behalf of Underwood, counsel stated its opinion that the exclusion would be applicable to Underwood since the services would be solely incidental to its business as a broker or dealer and no special compensation would be received. Underwood filed an application for registration under the Advisers Act prior to receiving a reply from the staff, 392 but the "no-action letter" subsequently issued in reply to other questions raised by the proposal expressed the staff's view that the exclusion did not apply. 393

392 Id. at 85,273.
393 Research for this Article was completed on September 1, 1975.