INVESTMENT ADVISER EXAMINATION MANUAL

SEC 1980

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FOREWORD

The federal securities laws administered by the Securities and Exchange Commission were designed to protect the interests of investors and the general public. These laws require that those who deal with the public observe high standards of conduct. The Commission has promulgated rules under the securities laws to assist in carrying out its regulatory and enforcement responsibilities.

The Investment Advisers Act of 1940 was enacted by Congress upon a finding that the activities of persons in the business of furnishing investment advice or investment advisory materials through the use of the mails or any means or instrumentality of interstate commerce were of national concern because of their effect on the securities markets, interstate commerce, the national banking system, and the national economy, and that it was accordingly necessary to regulate such activities. One of the central elements of the regulatory program is the requirement that, unless exempt, such persons should become registered with the Securities and Exchange Commission as investment advisers.

The principles outlined in the manual are expressions of Commission policy. The manual does not contain step by step procedures for making examinations and it does not cover all possible or probable situations that may arise. It does, however, set forth a wide range of areas with which the examiner must be familiar and general procedures which should be followed concerning these areas.

It must be emphasized that the procedures mentioned in the Manual should be carried out only where appropriate and at the express direction of the Regional Administrator or a person to whom he has delegated such supervisory authority. The Regional Administrator further will select the firms to be examined and will determine the scope of the examination. If, in the course of the examination, the examiner uncovers matters of particular significance, he should report them promptly to the Regional Administrator, who will then give specific instructions as to examination procedures to be followed.

The examiner must have sufficient knowledge, alertness and imagination to recognize "danger signals" and "red flags" which may disclose weak spots in a firm and possible violations of the securities laws. He must also possess the ability to follow through and develop all facts necessary to support allegations that violations have occurred. The Manual has been designed to point out many danger areas, close scrutiny of which may produce significant information leading to a recommendation for enforcement action or a referral to self-regulatory bodies or state and local government agencies.

In summary, the Manual provides comprehensive and important guidelines to the examiner so that he will be alert in recognizing possible violations of the securities laws and the rules thereunder and will be able to uncover and develop sufficient pertinent and significant information from an examination of the books and records and operations of the investment adviser to determine whether the registrant is in compliance with the provisions of the securities laws.

A. GENERAL INFORMATION

1. WHO IS AN INVESTMENT ADVISER

With certain exceptions, the term " investment adviser" is defined in Section 202(a)(11) of the Act to include, ". . .[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." This is a very broad definition and applies not only to persons who make recommendations concerning securities, but also to persons whose analyses, reports or other materials are to be used by others in making decisions as to what securities to buy or sell or when to buy or sell them. 1/

It is important to note that the following are specifically excluded from the definition of the term "investment adviser" under Section 202(a)(11) of the Advisers Act:

> a bank; a lawyer, accountant, engineer or teacher whose performance of such services is incidental to the practice of his profession; a broker or dealer whose performance of such services is solely incidental to the conduct of his business and receives no special compensation therefor; 2/ a newspaper publisher, news magazine or business or financial publication of general and regular circulation; and a person whose advice, analyses or reports relate only to exempt securities.

1/ IAA Rel. No. 563 (January 10, 1977) for a discussion of the applicability of the Advisers Act to book authors.

2/ For current staff views on the scope of the broker-dealer exclusion, see IAA Rel. Nos. 626 and 640 (April 27, 1978 and October 5, 1978).

2. EXCEPTIONS FROM REGISTRATION

Section 203(b) provides certain limited exceptions from registration. Of particular interest is the exception contained in paragraph (3) of Section 203(b) for those investment advisers who during the course of the preceding 12 months have had fewer than 15 clients (i.e., 14 clients or less) and who do not hold themselves out generally to the public as an investment adviser. This provision is of very limited application and would not be available unless both conditions contained therein are met. Thus, even if an investment adviser has fewer than 15 clients, this exemption would not be available if he holds himself out to the public as an investment adviser in any manner. 3/ The maintenance of a listing as an investment adviser in a telephone, business, building or other directory, or the expression of willingness to existing clients or others to accept new clients, or the use of a letterhead indicating any activity as an investment adviser, would be included among the acts that would constitute a holding out to the public as an investment adviser and make the exception contained in Section 203(b)(3) unavailable.

3. REGISTRATION REQURIEMENTS

Section 203(a) prohibits any investment adviser, except as provided in Section 203(b) from using the mails or any means or instrumentality of interstate commerce in connection with his investment advisory business, unless registered with the Commission. Section 203(e) sets out the bases on which registration may be denied or revoked and Section 203(f) sets out the bases on which an individual's right to be associated with an investment adviser can be limited or denied.

4. FEES FOR REGISTRATION

Rule 203-3 under the Advisers Act impose the following fees for the registration of investment advisers:

3/ In Abrahamson v. Fleschner, 568 F.2d 862 (2d Cir. 1977) the court held that the general partner of a limited partnership investing in securities was an investment adviser. However, because the case was an action alleging violations of the Act's antifraud provisions, the court did not need to decide whether the general partner was entitled to rely on the Section 203(b)(3) exemption because the partnership was its client or whether the general partner should have registered because individual limited partners, who numbered more than 15, were its clients. This question is still unresolved.

"(a) At the time of filing by an investment adviser of an application for registration under the Act, the applicant shall pay to the Commission a fee of $150, no part of which shall be refunded."

5. APPLICATION FOR REGISTRATION

Application for registration is made by filing three executed copies of Form ADV with the headquarters office of the Commission in Washington, D. C. The application for registration as an investment adviser seeks information concerning the nature of the investment adviser's business; the background, education and experience of the principals, controlling persons and employees of the investment adviser firm; and whether the applicant or persons associated with him are subject to any disqualifications from registration. The form also seeks information concerning the amount of assets the adviser has under management, the types of clients the adviser has, as well as a copy of the adviser's balance sheet. 4/

6. FORM ADV-S

G. FORM ADV-S

Every investment adviser is required to file Form ADV-S no later than 90 days after the end of its fiscal year unless its registration has been withdrawn, cancelled or revoked prior to that date. 5/ The form requires registrants to state whether they are presently engaged in business and whether they have filed the necessary amendments to their Form ADVs. It also requires registrants to file an updated balance sheet and a copy of the disclosure statements they have used to comply with Rule 204-3, the brochure rule, if they have prepared a separate brochure rather than using Part II of Form ADV. Examiners should verify that the registrant has filed Form ADV-S and that the form's questions are correctly answered.

7. MATERIAL MISSTATEMENTS AND OMISSIONS IN CERTAIN REPORTS AND BOOKS AND RECORDS

Section 207 of the Investment Advisers Act prohibits any person from willfully 6/ making any untrue statement of a material fact in any registration application or report filed with the Commission under the provisions of Section 203 or Section 204. It is also a violation of Section 207 to willfully omit to state in any such application

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4/ See Form ADV and Instruction Sheet, Appendix A.

5/ See Form ADV-S and Instruction Sheet, Appendix A.

6/ See Tager v. S.E.C., 344 F.2d 5, 8 (2d Cir. 1965): "It has been uniformly held that 'willfully' in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts."

or report any material fact which is required to be stated. Generally speaking, Section 207 covers applications for registrations, amendments to registrations, the annual report form, Form ADV-S, books and records required to be kept under the Act, and withdrawals from registrations.

8. STATE REQUIREMENTS

Many states have their own requirements with respect to persons conducting business as investment advisers within that state. The Division of Investment Management has provided each Regional Office a copy of the requirements imposed by the states within the region.

B. GENERAL PREPARATION AND EXAMINATION INSTRUCTIONS

1. REVIEW OF REGIONAL OFFICE INVESTMENT ADVISER FILES

A complete review of all material available in the Regional Office not only permits the examiner to familiarize himself with the investment adviser to be examined, but may flag potential problem areas. The following areas should be covered prior to an examination, if possible:

a. Form ADV The Commission's duplicate files of each adviser on file in the Regional Office should be completely reviewed including all amendments and correspondence. The examiner should have a clear idea of the scope of the adviser's activities and how and where they are carried out. As of July 31, 1979, the new Form ADV will give the examiner all the information necessary to have substantial knowledge of the advisers activities. The document should be read and will be carefully compared to what the adviser is actually doing.

b. Complaints The Regional Office records should be reviewed for complaints against the adviser. A review of documents supplied by either the complainant or the adviser may help in determining some of the records that the adviser maintains.

c. Previous Examinations If the adviser has previously been examined, the examiner should review the examination workpapers with particular emphasis on matters discovered in the previous examination. Note the conditions found at that time, whether any advertising, brochures, or recommendations in writing were published or mailed to clients, whether any contracts for service had been cancelled, and whether part of the fee was returned upon request of the client. This information will provide clues as to what to expect to find during the examination and any substantial difference should place the examiner on notice of the necessity to inquire further. It may be a serious matter if prior deficiencies were to be corrected by the adviser and were not. If such a condition is disclosed, it should be brought to the attention of the examiner's supervisor immediately.

d. Computer Search A computer search should be made of the adviser and all partners and officers and directors listed on Form ADV. This may reveal certain matters of which the Regional Office was not aware. If there have been any changes in personnel which are revealed during the examination, then the examiner can make a supplemental search.

e. Affiliation with other registered entities The review of the above items may disclose that the Adviser is affiliated with some other registered entity, i.e., investment company, broker-dealer. In such cases, the examination may need to be expanded to include an examination of those entities, or if the Regional Office is so constituted, to schedule an examination by the appropriate branch. In addition, the examiner would inform all appropriate parties through his supervisor, of any problem areas raised by the examination.

2. EXAMINATION INSTRUCTIONS

a. The Regional Administrator, or his designee, shall instruct the examiner as to the scope of the examination to be made, particularly whether any facts with respect to any specific complaint are to be developed during the course of the examination.

b. The examiner shall not discuss with the adviser novel or intricate matters or those which would require legal interpretations or policy determinations. The adviser should submit any such matters in writing to the Division of Investment Management. The examiner should discuss such matters as the adequacy of the books and records, and the need for filing amendments to Form ADV. It has been found helpful for examiners to carry ADV, ADV-S and ADV-W forms with them, in the event that either are needed.

c. Test checks are a very important part of the examination, not only in the review of clients' accounts, but transactions, fees, etc. The examiner in conjunction with the supervisor will determine the number of tests to be made. Any test checks must be sufficient to afford reasonable assurance that the facts shown by them are indicative of the entire area tested. The examination is a broad sweep through every aspect of the adviser's activities. Should any part reveal areas of possible violation, it is desirable for the examiner to gain as much data in that area as possible before returning to the office. This will give his supervisors sufficient information to determine if any further action is necessary.

d. The initial examination of an adviser should cover a sufficient period of time to afford an accurate picture of the firm's activities, but ordinarily should not cover a period of more than 12 months unless test checks covering a longer period are found to be necessary on specific matters, as in c.

C. QUALIFICATIONS AND PERSONNEL

1. QUALIFICATIONS

Unlike the broker-dealer industry, there are presently no requirements regarding the minimum qualifications of individuals to enter the advisory business. Investment advisers, their principals or employees, are not subject to any statutory standards with respect to training, experience, and other qualifications, except the negative standard of the disqualifying statutory bars set forth in Sections 203(e) and (f) of the Advisers Act. 7/

Although there are no educational qualifications specified in the Act as a condition for becoming registered as an investment adviser, a person holding himself out as such represents that he has adequate qualifications by his educational background or experience to engage in that activity. Absent those standards, he may be violating the anti-fraud provisions of the Act in a manner similar to the approach in applying the "shingle theory" with regard to brokers and dealers.

2. DISCLOSURE REQUIREMENTS

Advisers are required to indicate in response to Item 10 of Form ADV whether or not they have been subject to certain disqualifying actions specified therein. These actions pertain to certain criminal convictions, Commission proceedings, exchange sanctions, NASD sanctions, and securities violations. In addition, certain officers, directors and controlling persons of the adviser as well as certain persons who exercise a significant role in formulatating the adviser's investment advice are required to file a Schedule D to Form ADV stating their business background and education.

3. PROCEDURES

a. The examiner should obtain from registrant a list of the names and addresses of all officers, directors, partners, employees and 5% or more shareholders of registrant designating position and date acquired.

7/ In December 1975, the Commission submitted to the Congress legislation (S. 2849, 94th Cong., 2d Sess.) which would have authorized the Commission to impose qualifications and financial responsibility standards on investment advisers. The legislation was approved by the Senate Committee on Banking, Housing and Urban Affairs and the House Subcommittee on Consumer Protection and Finance, but did not come to a vote in the full Senate or the House Committee on Interstate and Foreign Commerce.

b. The examiner should inquire as to what procedures, if any, registrant utilizes to verify the responses called for in Question 10 in Form ADV. Where appropriate, the examiner shall request that a computer search be made under the name of registrant and "associated persons."

D. RULE 204-3 — WRITTEN DISCLOSURE STATEMENTS

Rule 204-3 under the Act requires registered investment advisers to provide certain written disclosure statements to their clients and prospective clients. These disclosure statements will contain basic information about the adviser including among other things, the types of advisory services provided, the types of clients to whom advice is provided, the methods of securities analysis used, any general standards concerning education and business background the adviser requires of persons associated with the adviser, and the specific educational and business backgrounds of certain associated persons. In addition, those advisers who have custody or possession of clients' funds or securities, or require prepayment of advisory fees six months or more in advance and in excess of $500 per client are required to include as part of their disclosure statement an audited balance sheet as of the end of the adviser's most recent fiscal year. The disclosure statement can either be Part II of the adviser's Form ADV or a separate document containing at least the information required by Part II.

Advisers who do not provide impersonal advisory services, as defined in the rule, must furnish a disclosure statement to their prospective clients. 8/ Once the initial advisory contact has been entered into, the adviser must annually deliver or offer to deliver upon request the disclosure statement.

Those advisers providing impersonal advisory services pursuant to contracts requiring a payment of $200 or more must at the inception of the advisory relationship and annually thereafter deliver or offer to deliver upon request a written disclosure statement. Advisers providing impersonal advisory services pursuant to a contract requiring a payment of less than $200 are totally exempt from the rule.

A thorough review of the adviser's disclosure statement should constitute an important portion of the examination not only because

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8/ The statement must be furnished at least 48 hours prior to entering into the advisory agreement except that it may be furnished at the time the advisory agreement is entered into, provided the client has a right to terminate the contract without penalty within five business days after entering into the contract.

it is a major requirement of the Act but also because it provides an unambiguous record as to some of the representations the adviser has made to his clients and prospective clients. Review of the disclosure statements should have at least two goals. One which can be accomplished at the regional office is a verification that the disclosure statement contains all the information required by Rule 204-3. More importantly, the examiner should verify that the representations the disclosure statement makes concerning the manner in which the adviser conducts his business are consistent with the adviser's day-to-day methods of operation. Of course, examiners should thoroughly pursue any other questions which arise as a result of statements or omissions in the adviser's disclosure statement.

E. EXAMINATION OF BOOKS AND RECORDS

1. STATUTORY AUTHORITY

Examinations of the books and records of registered investment advisers are conducted pursuant to Section 204 of the Act which states:

> "Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser (other than one specifically exempted from registration pursuant to section 203(b) of this title), shall make and keep for prescribed periods such records (as defined in section 3(a)(37) of the Securities Exchange Act of 1934), furnish such copies thereof, and make and disseminate such reports as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors. All records (as so defined) of such investment advisers are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors."

2. DETERMINING THE SCOPE OF REGISTRANT'S BUSINESS

The examiner will find it advantageous to determine both the scope and size of the investment adviser's business activities at the outset of the examination. This information in addition to information

concerning registrant's parent company, subsidiaries and affiliated companies 9/, if any, is usually best obtained from registrant's principal officer or his representative.

At some point during the interview, the examiner should present the Investment Adviser Request Form requesting information and material which will be needed to complete the examination. The Request Form is attached to the Investment Adviser Examination Outline.

3. BOOKS AND RECORDS TO BE MAINTAINED BY INVESTMENT ADVISERS

Rule 204-2 provides that investment advisers ". . . shall make and keep true, accurate and current . . ." certain listed books and records relating to the investment adviser's business. The examiner should familiarize himself with this rule before an examination is made.

Paragraph (a) of the rule specifies the books and records which all investment advisers are required to keep. These include the usual journals and ledger accounts; memoranda 10/ of orders given and instructions received for the purchase, sale, receipt or delivery of securities; originals or copies of certain communications received or sent by the investment adviser; listing of and documents relating to discretionary accounts; all written agreements; copies of publications and recommendations distributed to 10 or more persons and a record indicating the factual basis and reasons for making such recommendations if the publication does not contain the basis for such recommendation; and a record of every transaction in a security in which the adviser or any "advisory representative", as the term is defined in the rule, has, or by reason of such transaction acquires, any direct or indirect beneficial ownership.

Investment advisers are also required to maintain a record of disclosure statements provided under the brochure rule (Rule 204-3)

9/ In any instance where three or more related companies or an investment company "complex" is involved, a block diagram illustrating the relationships between the various entities should be prepared by the examiner.

10/ Such memoranda must indicate the terms and conditions of the order, identify the person connected with the investment adviser who recommended the transaction to the client, the person who placed the order, and who executed the order.

consisting of (1) a copy of each written statement sent to a client or prospective client, and (2) a record of the dates that each written statement was given or offered to be given to any client or prospective client who subsequently becomes a client. 11/

Paragraph (b) of the rule requires investment advisers who have custody or possession of securities or funds of any client to maintain certain additional records. These include a separate ledger account for each such client; copies of confirmations of transactions in the account of any such client; and a position record for each security in which any such client has a position, showing the interest of each such client and the location of the security.

Paragraph (c) of the rule is applicable to investment advisers who render any investment supervisory or management service to any client. Such investment advisers are required to maintain the records indicated with respect to the portfolio being supervised or managed and to the extent that the information is reasonable available to or obtainable by the investment adviser. It is recognized that it may not always be possible for the investment adviser to obtain such information, but the rule contemplates that the investment adviser will try to make some general arrangement under which his client will agree to furnish it to him promptly or direct the broker-dealer effecting the transaction to furnish it to him. Paragraph (c)(2) contemplates that the investment adviser who renders investment supervisory or management service will maintain information from which the investment adviser will be able to furnish promptly the name of each client who has a current position in a particular security, and the amount of interest of such client at that time.

Paragraphs (e) and (f) of the rule specify the period during which the books and records must be preserved. It will be noted that under paragraph (f) an investment adviser, before ceasing to conduct business is required to arrange for and be responsible for the preservation of his books and records for the remainder of the period specified in the rule, and to notify the Commission of the place where such books and records will be maintained.

4. NON-DISCLOSURE OF CLIENTS IDENTITY, INVESTMENTS OR AFFAIRS

> "Section 210. (c) No provision of this title shall be construed to require, or to authorize the Commission to require any invest-

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11/ See discussion of Rule 204-3 at Section D supra.

> ment adviser engaged in rendering investment supervisory services to disclose the identity, investments, or affairs of any client of such investment adviser, except insofar as such disclosure may be necessary or appropriate in a particular proceeding or investigation having as its object the enforcement of a provision or provisions of this title."

In the course of an investment adviser examination an investment adviser who is "engaged in rendering investment supervisory services" may try to use Section 210(c) of the Act as a basis for withholding certain information about his clients. The investment adviser may use this section as a shield from disclosing information to the examiner depending on the facts and circumstances of the situation. Therefore, if a situation arises where the investment adviser refuses to disclose information based on Section 210(c) the examiner should report this to the Regional Administrator for further instructions. However, it should be noted that if the examination is being conducted under a formal order of investigation the prohibition of this section would not apply.

The examiner should also be familiar with Rule 204-2(d) which provides that:

> "Any books or records required by this rule may be maintained by the investment adviser in such manner that the identity of any client to whom such investment adviser renders investment supervisory service is indicated by numerical or alphabetical code or some similar designation."

Since Section 210(c) of the Act provides that an investment adviser shall not be required to disclose, in the course of an ordinary examination conducted by a Commission representative, certain information concerning any clients to whom the investment adviser renders investment supervisory services, Rule 204-2(d) preserves such anonymity.

5. SECTION 13(f) OF THE EXCHANGE ACT

As part of the Securities Act Amendments of 1975, Congress adopted Section 13(f) of the Exchange Act. The reporting system required by section 13(f) was intended to create in the Commission a central repository of historical and current data about

institutional investment managers. In 1978 the Commission, pursuant to Section 13(f), adopted Rule 13(f)-1 implementing the basic institutional disclosure program mandated by Section 13(f). Under the Rule, an institutional investment manager exercising investment discretion, as defined in Section 3(a)(35) of the Exchange Act, with respect to accounts having in the aggregate more than $100 million of exchange-traded or NASDAQ quoted equity securities on the last trading date of a given calendar quarter must file with the Commission within 45 days of each calendar quarter Form 13F. 12/ This form requires, among other things, the reporting of the name of the issuer, number of shares, and the aggregate fair market value of each such equity security held.

An examiner, when conducting an examination, should determine if a particular registrant is required to file Form 13F under the Exchange Act and, if so, if such form was filed within the appropriate time period. A review of these forms will give an examiner an immediate view of any significant transactions in the registrant's clients' portfolios.

F. INVESTMENT ADVISORY CONTRACTS

1. RESTRICTIONS ON ADVISORY CONTRACTS

Section 205 imposes certain restrictions on advisory contracts and fees. Section 205(1) prohibits advisory contracts which provide for compensation to the adviser on the basis of a share of capital gains or appreciation of the funds involved. It is also implied under Section 205(1) that any type of fee based upon the performance of a client's portfolio is prohibited. Under an arrangement for compensation based and payable upon the realization of profits the investment adviser is likely to be in a position of conflict with his client in that he may be inclined to take undue risks with client's funds, since he participates in gains and has no chance of loss. Under such an arrangement, an adviser may have a tendency to time transactions on the basis of considerations relating to his compensation rather than the best

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12/ The Commission publishes a list of Section 13(f) securities to aid institutions in determining which securities are subject to reporting requirements.

interests of his client since the fee would be received only in the event of realized gains. 13/

However, Section 205 does allow "...an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates, or taken as of a definite date ...." Also, Section 205 permits certain performance fee arrangements with an investment company or generally any other person where the contract relates to the investment of assets in excess of $1 million. Such provisions of Section 205 permit a performance fee to be paid an investment adviser where the fee increases or decreases proportionately on the basis of investment performance measured against an appropriate index of securities prices or other appropriate measure of performance. 14/

In analyzing the provisions of investment advisory contracts, it is important that the examiner note whom the investment advisory contract is with because of the different treatment Section 205 affords various categories of clients. Also, it should be noted that Section 205 does not specifically state that investment advisory contracts must be in writing.

Section 205(2) requires that advisory contracts provide that they may not be assigned without consent of the other party (client) to the contract, and under Section 205(3) if an investment adviser is a partnership, the other party to the contract must be informed of any change in the membership of the adviser. For purposes of Section 205(2) and 205(3) the last sentence of Section 205 defines "investment advisory contract"

13/ A fee structure which provides for a waiver of advisory fees if the client's account does not achieve a specified level of performance or provides that the adviser's fee will only be payable out of capital gains earned on the client's account presents the possibility of the same type of abuses Section 205(1) was designed to prevent and may violate Section 205(1) because receipt of compensation is dependent on the realization of capital appreciation upon the client's funds. The Division of Investment Management is in the process of preparing a memorandum to the Commission concerning the applicability of Section 205(1) to waiver of fee provisions. Pending resolution of this question, the Division has been taking a no-action position with respect to such contractual provisions.

14/ See Factors to be Considered in Connection with Investment Company Advisory Contracts Incentive Fee Arrangements, IAA Rel. No. 315; and Survey of Investment Company Incentive Fee Arrangements, Investment Company Act Rel. No. 7130.

to mean "...any contract or agreement whereby a person agrees to act as investment adviser or to manage any investment or trading account of another person other than an investment company...." Therefore, contracts with investment companies are not subject to these provisions.

Investment advisory contracts with investment companies are specifically treated in Section 15 of the Investment Company Act of 1940 and the rules thereunder. Although it is not the intention of this manual to cover the Investment Company Act of 1940 in great detail, the examiner should be familiar with Section 15 as it relates to investment advisory contracts.

Section 15 of the Investment Company Act requires that the investment company's contract with its adviser be in writing and that the adviser's compensation thereunder be precisely described. Before an advisory contract becomes effective, it must be approved by the holders of a majority of the investment company's outstanding voting securities. Investment advisory contracts may be continued beyond two years only if approved annually by either (a) the board of directors as a whole, including a majority of directors, who are not parties to such contract or are not interested persons of any such party, and (b) by the board of directors or the vote of the holders of a majority of the outstanding voting securities. An investment company has the right to terminate an advisory contract on 60 days notice at any time, without penalty, and such a contract is automatically terminated in the event of its assignment.

2. EXCESSIVE FEES

Section 205 of the Investment Advisers Act addresses the contractual requirements of fee arrangements of investment advisers. However, there are no provisions in the Investment Advisers Act regarding the level or amount of advisory fees that an investment adviser may receive from clients. Nevertheless, it may be considered a violation of the antifraud provisions for an investment adviser to charge a fee which is higher than that normally charged for similar services without disclosing that his fee is higher than the norm. With respect to traditional account management services, any fee 3% or higher should be commented upon. Since this 3% guideline may not be appropriate if the adviser is providing a specialized type of advice, such as account management for options portfolios, the examiner should note in detail all services provided by the adviser to clients where the fee is 3% or higher.

3. PRO RATA REFUNDS OF PREPAID FEES

As a general proposition, an investment adviser who provides account management services has a fiduciary obligation to his clients not to

structure his fee schedule in a manner which puts clients who have pre-paid their advisory fees in the position of deciding between forfeiting the unused portion of their pre-paid fees or continuing to receive account management services they no longer desire. Accordingly, such advisers should provide pro rata refunds (less reasonable start up costs) when requested and should not have provisions in their advisory agreements which state that all fees are non-refundable. Advisers who provide advice through uniform publications should also make pro-rata refunds as requested unless they have provided specific, advance notice to their clients that all pre-paid fees are not refundable. Any deviations from these guidelines should be noted.

4. VALIDITY OF CONTRACTS

Section 215 of the Advisers Act provides that any conditions, stipulation, or provision binding any person to waive compliance with any provision, rule, regulation, or order under the Act shall be void, and that every contract made in violation of any provision, rule, regulation or order under the Act shall be void. Section 215 is very broad in scope in protecting investors from waiving these rights of actions and there are similar provisions in all the other Acts administered by the Commission.

5. HEDGE CLAUSES IN CONTRACTS

Any hedge clause or legend in an investment advisory contrct which contains language disclaiming liability is void under Section 215. Moreover, the anti-fraud provisions of Section 206 of the Advisers Act may be violated by the employment of any legend, hedge clause or provision which is likely to lead an investor to believe that he had in any way waived any right of the action he may have. 15/

6. PROCEDURES

a. Obtain sample copies of all contracts, agreements, powers of attorneys, and subscription forms currently in use by registrant.

b. Review these contracts, agreements, and subscriptions at the regional office to determine whether:

1. The fee arrangements set forth are excessive or the fee is based upon performance.

15/ See Opinion of the General Counsel, IAA Rel. No. 58, Appendix F.

2. The investment adviser has access to clients' funds or securities, e.g., a power of attorney may convey right to access, and subject registrant to the Advisers Act's custody or possession requirements. 16/

3. They contain any provision that the contract cannot be assigned without the consent of the client.

4. If the investment adviser is a partnership, clients are informed of any change in the membership of the investment adviser.

5. There are any provisions that would lead a client to believe that he has in any way waived any right of action he may have against the investment adviser.

G. FINANCIAL RESPONSIBILITY OF INVESTMENT ADVISERS

1. OBLIGATIONS TO CLIENTS AND CREDITORS

There is no specific requirement in the Investment Advisers Act that provides for the financial responsibility of investment advisers as there is in Section 15(c)(3) of the Securities Exchange Act of 1934 regarding the financial responsibility of broker-dealers. In addition, there are no bonding requirements under the Investment Advisers Act to protect clients or other creditors in the event of loss. However, it should be noted that it may be a violation of the anti-fraud provisions of Section 206 of the Investment Advisers Act for an investment adviser to continue to do business and solicit new clients while its financial condition is impaired without disclosing its financial difficulties to its clients and prospective clients. 17/

Many investment advisers hold funds and securities for their clients. Rule 206(4)-2 18/ requires clients' funds to be kept in separate bank

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16/ See Chapter O, Custody or Possession of Funds or Securities of Clients, in this manual.

17/ See Intersearch Technology CCH Fed. Sec. L. Rep. [1974-1975 Transfer Binder] Para. 80, 139.

18/ This rule does not apply to certain registrants who are also registered as broker-dealers under Section 15 of Securities Exchange Act. See Rule 206(4)-2(b).

accounts, and clients' securities to be held in segregation as noted in the Chapter on Custody and Possession of Funds and Securities of Clients of this manual. Many investment advisers hold prepaid subscriptions of clients and are obligated to clients on these subscriptions to this extent.

Based upon the nature of the investment adviser's obligation to his clients and creditors, one measure of his ability to meet current obligations which is frequently used by accountants and financial analysts is the current working capital ratio, i.e., total current assets divided by total current liabilities. Current assets are understood to include cash, cash items, the value of securities for which there is a current public market, receivables from customers and others which are collectible within sufficient time that the proceeds may be used to meet current obligations on a timely basis 19/, and such other assets as the investment adviser would ordinarily expect to use to liquidate current obligations. Such items as real estate, buildings, equipment, furniture and other fixed assets by their nature would not be considered current assets because they would not be readily convertible into cash within the normal operating cycle of the business. In addition, such items as prepaid expenses and other prepaid items would not be considered current assets. Current liabilities are those obligations the liquidation of which is expected to necessitate a cash payment within one year. This would include accrued salaries and taxes, current portions of mortgages or other longer term debt, and accrual of any amounts payable to a registered investment company pursuant to an expense guarantee or performance fee arrangement. Deferred income should also be treated as a current obligation to the extent that it must be earned within one year and to the extent that customers are permitted to receive refunds upon cancellation of the agreement which gave rise to the deferred income. A ratio of 2 to 1 of current assets to current liabilities generally would be ample to ensure the ability of the investment adviser to meet current obligations and to ensure the fulfillment of the clients' advisory contracts with the investment adviser. This ratio should be applied only for the purposes of determining whether the registrant can meet his financial obligations to clients and creditors as there are no statutory requirements that any ratio or other financial standards be met by the investment adviser.

2. PROCEDURES

a. Obtain and review the firm's most recent financial statements, where available. 20/

19/ Any receivable included in current asset computation should be net of any uncollectible items.

20/ Where financial statements are not available examiner should obtain a trial balance from registrant's books and records.

b. Compute the firm's current working capital ratio. Determine by reference to the ratio whether the firm can meet its obligations to clients and creditors.

c. Obtain and review a copy of the latest actual examination report and certificate by a certified public account if investment adviser has such examination report or certificate. 21/

d. Obtain and review the firm's procedures of internal control where investment adviser has custody or possession of clients' funds or securities.

H. ANTI-FRAUD PROVISIONS OF THE INVESTMENT ADVISERS ACT

Section 206 of the Advisers Act and the rules thereunder prohibit fraudulent activities by investment advisers. This section applies to all investment advisers whether or not required to be registered.

Section 206 and the other applicable anti-fraud provisions of the federal securities laws (namely, Section 17 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) prohibit misstatements or misleading omissions of material facts and fraudulent acts and practices in connection with the purchase or sale of securities or the conduct of an investment advisory business. However, unlike the other statutes mentioned, the Advisers Act does not require a transaction to have occurred for actionable fraud to have been committed. An investment adviser is a fiduciary who owes his clients undivided loyalty, and is prohibited from engaging in activity in conflict with the interest of any client. A breach of an adviser's fiduciary obligations constitutes a violation of the antifraud provisions of the Advisers Act. This fiduciary obligation imposes upon an investment adviser a duty to deal fairly and act in the best interest of its clients. Such duty imposes upon an investment adviser numerous responsibilities including the duty to render disinterested and impartial advice; to make suitable recommendations to clients in light of their needs, financial circumstances and investment objectives; to exercise a high degree of care to insure that adequate and accurate representations and other information

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21/ Under Rule 206(4)-2 (a) (5) a certificate of such accountant must be filed with the Commission once each calendar year where an investment adviser has custody or possession of client's funds or securities. By this rule the certified public accountant must make a surprise examination and the certificate must state the nature and extent of such examination. See The Nature of the Examination and Certificate Required, IAA Rel. No. 201, Appendix F.

about securities are presented to clients; and, to have an adequate basis in fact for its recommendations, representations and projections. Particularly in light of the Supreme Court's decision (copy attached in Appendix E) in Transamerica Mortgage Advisors v. Lewis, which held that there is no private right of action for damages under the Advisers Act, the examiner should take care through all phases of the examination to determine if the adviser is in any way not dealing in the best interests of its clients since the possibilities for fraud cover the gamut of the adviser's activities.

1. LIMITED PARTNERSHIPS

On occasion investment advisers have been found to function as general partners and advisers with respect to so-called "investment partnerships". Such partnerships are usually organized as limited partnerships, with the general partners responsible for professional management of the assets paid in by the limited partners, or as general partnerships, with the managing partners ordinarily responsible for the investment management function. Not only do these partnerships invest in regularly traded securities, but they frequently will invest in real estate and other tax-shelter arrangements. If a limited partnership agreement provides for remuneration to the general partner in an amount greater than he would realize on a pro rata basis from his capital contribution, it would appear that the adviser's compensation arrangement violates the incentive fee prohibitions in Section 205(1). It is clear from a review of Section 202(a)(11) as well as the last paragraph of Section 205 of the Advisers Act that the general partner of such a limited partnership is an "investment adviser" within the meaning of the Act. The examination of a person who is such an investment adviser should include consideration of the applicability of all provisions of the Act including the registration requirements. Since an investment adviser still has the fiduciary duties of an adviser to his clients when he is acting as the general partner of a partnership in which clients are limited partners, careful attention should be given to such relationships to verify that the adviser has fulfilled his fiduciary obligations.

2. MUTUAL FUND SWITCHING

Switching is a strategy employed by advisers utilizing the exchange or switching privilege offered by many mutual funds. The purpose of this strategy is to allow fund investors to take advantage of major market fluctuations for the purpose of maximizing gains on the upside and minimizing losses on the downside. Many mutual funds belong to a "family of funds." A family consists of a number of funds under the same management and usually includes funds with different investment objectives. In many instances the funds' management will allow investors to exchange funds within a family for little or no charge. In following a switching strategy, an investor invests in growth oriented funds in periods of rising markets and exchanges shares for conservatively invested funds

In advertising a mutual fund switching or timing strategy, the adviser, pursuant to Rule 206(4)-1(a)(3), promulgated under the anti-fraud provisions of the Advisers Act, must prominently disclose all limitations and difficulties with respect to the switching service being offered. Included in the disclosures that should be made are all fees to be paid by a client, potential tax consequences, as well as material risks involved in utilizing a particular switching strategy.

Employment by the adviser of a mutual fund switching strategy may cause operational problems with respect to individual mutual funds and their shareholders. These problems may encompass, but are not be limited to:

a. Disqualification of the Fund from Being Treated as an Investment Company Under Section 851 of the Internal Revenue Code

To be treated as an investment company for tax purposes pursuant to Section 851(b)(3) of the Internal Revenue Code, a fund must receive less than 30 percent of its gross income from the sale or other disposition of stock or portfolio securities held for less than three months pursuant to Section 851(b)(3) of the Internal Revenue Code. An adviser, who recommended a large number of switches per year and affected a significant percentage of a fund's assets, could conceivably cause an agressive growth-oriented fund to receive 30 or more percent of its gross income from the sale of stock held less than three months, thereby disqualifying it from investment company tax treatment.

b. Excessive Portfolio Turnover and Transaction Costs

Where an adviser recommends a large number of annual switches for mutual funds which it monitors, the assets of these funds will fluctuate with the switch recommendations. In order to raise cash for liquidations, and to fully invest money inflows from purchases, a fund may incur significant additional brokerage costs borne by its long term investors who do not switch their investments between funds.

c. Excessive Transfer and Shareholder Service Costs

In some instances an adviser will require a fund to mail a copy of all transaction confirmations to him as well as to his clients. These mailing costs, in addition to the shareholder costs involved in processing redemption and purchase requests caused by switch recommendations, may significantly increase the total mailing and transfer costs of the fund which are borne by the long term investor.

d. Undisclosed Portfolio Manager

Where an adviser's switch recommendations affect a significant percentage of a fund's assets, he may indirectly determine the cash reserve position and other portfolio strategies followed by a fund's portfolio manager. Accordingly, an adviser may, in effect, be operating as a portfolio manager for the benefit of its short term shareholders without the knowledge of the mutual fund's long term shareholders.

Should an examiner find indications of any of the above problems he should contact his supervisor in order to determine the extent to which further investigation should be conducted with respect to the affected funds.

I. TRADING BY ADVISER AND CERTAIN PERSONS ASSOCIATED WITH IT FOR THEIR OWN OR BENEFICIAL INTEREST ACCOUNTS

1. TRADING ON RECOMMENDATIONS

Trading by the investment adviser and certain persons associated with the investment adviser for their own accounts against the recommendations made to clients may be a violation of the anti-fraud provisions of Section 206 of the Investment Advisers Act. Records required to be maintained by Rules 204-2(a)(12) and (13) are designed to reflect transactions in which the adviser or advisory representatives, as defined therein, acquire a direct or indirect beneficial interest in any security. The records maintained under this rule enable the examiner to determine whether or not the adviser or any "advisory representative" have effected transactions for their own account or accounts in which they have a beneficial interest in the same securities recommended or effected on behalf of clients. It should be noted that under this rule the adviser is not deemed to violate this rule because of his failure to record securities transactions of any advisory representative if the adviser has established adequate procedures and used reasonable diligence to obtain promptly reports of all transactions required to be kept. This rule makes it necessary for all investment advisers subject to registration to institute appropriate internal procedures so that they will have the required records maintained under the rule. 22/ Item 9(e) on the new Form ADV requires disclosure whether the adviser imposes any restrictions upon itself or associated persons when effecting transactions for its or their accounts in securities recommended to clients. If there are restrictions, they must be described on Schedule F on the new Form ADV. Another item, Item 9(d) on the new Form ADV asks whether the adviser recommends to clients or prospective clients, the purchase or sale of securities in which the adviser, directly or indirectly, has a position or interest.

22/ See Adoption of Amendment to Rule 204-2, IAA Rel. No. 203 (August 11, 1966).

Every examiner should familiarize himself with the opinion of the Supreme Court in S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). 23/ In this case, the Supreme Court held that "scalping" by an investment adviser is a violation of the anti-fraud provisions of Sections 206(1) and (2) of the Investment Adviser Act. Generally speaking, "scalping" refers to the practice whereby an investment adviser effects transactions for his own account in a security shortly before recommending the purchase or sale of that security to his client and then shortly thereafter effects further transactions for himself to profit from the market activity in the security resulting from his recommendation. Another abuse of this type is when the investment adviser and/or its principals trade against recommendations published in the adviser's market letter. 24/

Some investment advisers impose no restrictions on their advisory representatives or beneficial interest accounts with respect to the buying or selling of recommended securities despite a possible conflict of interests. When an examination discloses that transactions for advisory representatives or beneficial interest accounts have occurred at or about the same time as similar transactions for clients, a conflict of interest may exist. To establish such a conflict of interest further inquiry into the transaction price, executing broker-dealer, and time of order execution is required. If this inquiry develops information that indicates that an advisory representative may have taken advantage of his position, a detailed analysis of all transactions effected by the representative and those of the adviser's clients must be scheduled for an extended (one or two years) period of time. Following such an analysis, action under Section 206 may be recommended.

23/ See Appendix E.

24/ See Dow Theory Letters, Inc. and Richard Lion Russell, IAA Rel. No. 571 (February 22, 1977).

Certain similar types of questionable transactions do not involve trading by the advisory representatives or beneficial interest accounts. In investment adviser/broker-dealer entities, the portfolio manager may also be a registered representative actively engaged in servicing retail brokerage accounts. When the portfolio manager buys recommended securities for his investment advisory clients, a question of conflict may be raised. A similar inquiry to that outlined above must be undertaken and the results analyzed. If it can be determined that the investment advisory clients have been treated unfairly or the portfolio manager/ registered representative has profited unfairly from advisory client transactions, appropriate action under Section 206 should be recommended.

2. PURCHASE FROM OR SALE TO CLIENTS

A conflict of interest may arise when an adviser as principal sells any security to or purchases any security from a client. Section 206(3) of the Advisers Act covers this situation with respect to the adviser by requiring the adviser to disclose to the client in writing that he is acting as a principal and obtain the written consent of his client to the transactions. It should be noted that the prohibitions of this section do not apply to any transaction with a customer of a broker-dealer if such broker-dealer is not acting as an investment adviser in relation to the transaction. In addition, Item 9(a) on the new Form ADV asks whether the adviser, as principal, sells securities to or buys securities from any client.

These kinds of transactions carry a potential for fraud and thereby may involve a violation of Section 206 of the Advisers Act, Section 17 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

3. PROCEDURES

a. Review firm's supervisory procedures concerning the reporting by "advisory representatives" of their security transactions.

b. Determine how and if advisory representatives report security transactions to the firm required by Rule 204-2(a)(12) or (13).

c. Review Item 9 on the new Form ADV to determine if representations on this form conform to actual practices of the firm. Specifically, subsection Item 9(a) should be reviewed to determine whether the adviser has adopted any policy concerning the timing of transactions effected by the adviser and its clients in the same security.

d. Schedule a representative number 25/ of securities transactions effected by the adviser and its "advisory representatives" for their own accounts or accounts in which they directly or indirectly have a "beneficial interest" for the following purposes:

1. to determine if the adviser or its "advisory representatives" traded against recommendations contained in firm publications, 26/

2. to determine if the adviser or its "advisory representatives" traded against securities transactions effected for managed or supervised accounts. 27/

e. Determine what written forms of disclosure of capacity are effected in compliance with Section 206(3) in security transactions between investment advisers and clients and how client consents are recorded.

25/ It is suggested that approximately one hundred transactions be scheduled for each examination. The sampling should be limited to transactions which occurred during the period under review.

26/ Refer to sample schedule, Appendix B.

27/ Refer to sample schedule, Appendix B.

J. USE OF NON-PUBLIC INFORMATION

1. OVERVIEW

The anti-fraud provisions of Section 206 of the Investment Advisers Act of 1940 are expressed generally in terms of prohibiting the investment adviser from defrauding his clients or prospective clients. However, the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder are expressed in all-embracing terms of defrauding any person directly or indirectly in the offer or sale of any security or in connection with the purchase or sale of any security. It is therefore a possibility that the investment adviser could violate the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and not violate the anti-fraud provisions of the Investment Advisers Act of 1940. Therefore, the examiner should be concerned with the situation where an investment adviser through a course of conduct defrauds persons other than his clients or prospective clients.

Such a case of major importance is where the investment adviser by virtue of his position in the business environment obtains non-public information about an investment situation and then uses such information improperly to effect transactions in securities to the detriment of others in the investing public who may not be his clients or prospective clients. In fact this may be a situation where the investment adviser's clients are benefiting from the information to the detriment of the investing public. 28/

An investment adviser may be an officer or director of a corporation, investment company, bank, etc. where in the ordinary course of business he receives "inside", non-public or confidential information pertaining to securities or their issuers. He may obtain non-public information through his associations with insiders of such entities. In these cases, where he obtains or receives such non-public information he has certain duties and obligations under the law generally not to trade on this information until this information becomes public or stated another way if he trades on such information he must disclose such information publicly before such transactions are effected.

28/ See Mates Financial Services, IAA Rel. No. 258 (March 9, 1970), Appendix F.

K. OBTAINING BEST PRICE AND EXECUTION OF CLIENTS' SECURITIES TRANSACTIONS

An investment adviser who manages or supervises clients' accounts is in a position to direct where brokerage transactions are executed. How the investment adviser channels this brokerage is an important concern in the examination of an investment adviser in that the power to direct brokerage transactions should not be used in a way that is inconsistent with the investment adviser's fiduciary duty to its clients. Some investment advisers have taken advantage of the competition among brokers seeking commissions to divert or recapture for the advisers' own use or benefit, portions of the commissions paid these brokers. Investment advisers have been able to obtain cash, services, or other benefits as a result of channeling the execution of clients' transactions to certain firms willing to share brokerage commissions generated therefrom.

Commissions paid to brokers for securities transactions have gone through dramatic changes in recent years. Prior to 1968, commissions were completely fixed by the New York Stock Exchange, but beginning in that year a volume discount was allowed on transactions of 1000 shares or more. At that time the practice of "give ups" was discontinued. "Give ups" were the directing of a portion of the commission to a broker which was not a party to the transaction. Among other uses, they were a way for investment company managements to reward dealers for selling shares of the fund by the mere issuance of a check to the dealer by the executing broker. Discounts were eventually expanded to permit negotiation of commissions on transactions above $300,000. Fixed commissions were entirely eliminated when in May 1975, negotiated commissions were instituted for all transactions. A Commission study, which covered the first year of negotiated commissions, showed that generally institutions were paying commissions which were less than those prior to May 1975, while the general public was paying higher.

With the approach of May 1975, a potential problem presented itself for fiduciaries. Would it be necessary to obtain the cheapest commission no matter what, in order to obtain best price and execution? To answer that, Congress added Section 28(e) to the 1975 amendments of the Securities Exchange Act of 1934. This section allows the fiduciary to "pay up" on transactions with brokers from whom it receives research. "Paying up" is an additional commission over and above what would otherwise be paid. The Commission issued a release (Exchange Act Rel. No. 12251/ March 24, 1976) to explain Section 28(e) and especially what constitutes "research" as the term is used in Section 28(e).

The examiner should carefully review all brokerage directed by advisers. If services are provided to the adviser for which it does not make payment, it may be that the adviser has entered into a "soft dollar" arrangment. The "soft dollar" method of payment is the use of commission dollars approximately two or more times the "hard dollar" (actual) cost. It may also be that the adviser is being paid for its services by a "soft dollar" arrangement. If the services are not research or if the research is readily available to the public, then "paying up" with commissions is not protected by Section 28(e).

Over the years a number of abuses have surfaced in which commission dollars were used for the benefit of fiduciaries and not for the accounts for whom the transactions were executed. "Give ups" have been mentioned. "Rebates" were used to return payment to the fiduciary or his nominee. 29/ Another method is called "interpositioning". 30/ Over the counter securities have usually been the vehicle for this abuse which involves routing a client's transactions through a non-market making broker-dealer when the client could have dealt directly with the market maker.

The following procedures should be applied when examining an investment adviser. The overall guiding principle that should be kept in mind is that the investment adviser acts in the capacity of a fiduciary and as such is under the duty and responsibility to put his clients above his own interests in every aspect of his business including obtaining the best price and execution. Inquiry should be made into all relationships with broker dealers including:

1. Determine who selects the executing brokers, i.e., client or adviser.

29/ See Mates Financial Services, IAA Rel. No. 258 (March 9, 1970), Appendix F.

30/ See (1) Interpositioning, p. 32, Broker-Dealer Examination Manual and (2) Delaware Management Company, Inc., Exchange Act Rel. No. 8128 (July 19, 1967).

2. A schedule should be prepared listing the brokers used to execute the brokerage orders in the managed accounts (Executing Brokers' Schedule) listing names of brokers, amount of brokerage, and names of registered representative handling accounts.

3. Determine who places the orders of the clients of the investment adviser with these brokers.

4. Obtain copies of any agreements the investment adviser has with broker-dealers regarding the handling of brokerage transactions of his clients.

5. Discuss with the trader or other employee of the investment adviser what methods are used to get the best execution on brokerage orders with respect to (1) OTC transactions and (2) listed securities.

6. If certain executing brokers are being used more than others and it does not appear that such brokers are in a position to get the best execution it may be necessary to ask these executing brokers about relationships it has with the investment adviser independent of the investment adviser's statements regarding the matter.

7. Determine what statistical or research services or wire facilities are utilized by the investment advisers. Then determine how payment is being made for such services. It may be that some of these services are being paid for by reciprocal business or other forms of indirect compensation.

8. Ask firm's principals where and how the investment adviser obtains clients other than by advertising. These relationships should be explored for the purpose of identifying unusual relationships or compensation.

9. Ask firm's principals what relationships the investment adviser has with banks. Inquire or determine whether the investment adviser directs business to banks in order that the banks use investment advisory services or refer clients to the investment adviser.

L. ALLOCATION OF SECURITIES AND TIMING OF ADVISORY RECOMMENDATIONS

1. SELECTION AND DISTRIBUTION

An important aspect of an examination is analyzing how the investment adviser allocates purchases and sales of securities among clients. This is particularly important if the security is unusually attractive or unattractive at the time. Of equal concern is determining whether any account or group of accounts is favored by the receipt of purchase or sale recommendations prior to dissemination to the other accounts.

All investment advisers should have some formula for allocating securities among clients. This formula should set forth a fair and equitable basis for distributing investments among clients. Moreover, it should be applied in a consistent basis.

Whether any client of the adviser has received an unfair preference must be determined on a case by case basis because there are numerous variances in circumstances, needs, and financial objectives among clients which may justify the allocation among the adviser's clients. However, a failure to allocate securities or advisory recommendations on an equitable basis may constitute a breach by the adviser of his fiduciary obligation to deal fairly with his clients and a violation of Section 206 of The Advisers Act.

2. PROCEDURES

a. Determine what is the stated policy as to the allocation of securities among the various clients;

b. Determine whether the allocation process is on a fair and equitable basis; and

c. Determine what is the timing policy as to the dissemination of recommendations among the various clients. Where an adviser publishes market recommendations and manages or supervises accounts, a schedule of such recommendations should be prepared for the purpose of determining whether one group is being preferred at the expense of another. 31/

M. ADVERTISING

1. MISLEADING AND DECEPTIVE ADVERTISING

Another area of concern is an investment adviser's advertising practices. In the course of the examination, an examiner may find some advisers are unfamiliar with and operate in disregard of Rule 206(4)-1 under the Act which defines various fraudulent acts and practices with respect to advertisements by investment advisers.

31/ Refer to sample schedule, Appendix B.

In making examinations the examiner or other person reviewing advisers' literature should place considerable emphasis on the advertising practices engaged in by investment advisers, including possible abuses by them in utilizing radio and television campaigns and commercials to obtain clients. In this regard the person reviewing the advisers' advertising materials should give particular consideration to determining if the advisers utilized any type of projections; guarantees, expressed or implied; hypothetical or sample securities portfolios or comparisons of their service with any other service or market index. Utilization of any one or more of these means many involve violations of the anti-fraud provisions of the Advisers Act.

It is also recommended that investigators be aware of the fact that while advertising materials being used by an adviser may not contain any specific item or statement which in and of itself is false or untrue, the materials may, nevertheless, still be objectionable because they give an overall impression of certain, substantial and quick profits by the use of the registrant's service. In this regard, the examiner reviewing the adviser's advertising literature should be constantly mindful of the strong impact upon unsophisticated investors of dramatic, suggestive and overly enthusiastic advertisements.

In considering the provisions of Rule 206(4)-1 it should be borne in mind that investment advisers are professionals and should adhere to a stricter standard of conduct than that applicable to ordinary merchants. Securities are "intricate merchandise", and clients or prospective clients of investment advisers are frequently unskilled and unsophisticated in investment matters. Since it is to such persons that a substantial amount of investment advisory advertising is directed, Rule 206(4)-1 is intended to foreclose the use of certain practices that have a tendency to mislead or deceive such persons. 32/

Subparagraph (1) of paragraph (a) of the Rule prohibits advertisements containing testimonials of any kind concerning the investment adviser or any advice, analysis, report or other service rendered by

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32/ See Paul K. Peers, Inc., IAA Rel. No. 187 (March 22, 1965); Spear & Staff, Inc., IAA Rel. No. 188 (March 25, 1965); Marketlines, Inc., IAA Rel. No. 206 (January 20, 1967; Dow Theory Forecasts, Inc., IAA Rel. No. 223 (July 22, 1968); Appendix F.

the investment adviser. Such advertisements are misleading by their very nature since they emphasize the comments and statements favorable to the investment adviser and ignore those which are unfavorable. This is true even when the testimonials are unsolicited and are printed in full.

Subparagraph (2) of paragraph (a) prohibits an investment adviser from using an advertisement which refers, directly or indirectly, to specific recommendations which the investment adviser has made in the past, except that it does not prohibit an advertisment which sets out, or offers to furnish a list of all recommendations made by the investment adviser within the immediately preceding period of not less than one year if the advertisement, and the list if it is furnished separately, contains specified information with respect to relevant prices and the nature of the recommendation, and a specified cautionary legend. Material of this nature, which may refer only to recommendations which were or would have been profitable and ignores those which were or would have been unprofitable, is inherently misleading and deceptive, and consequently the Rule prohibits this type of advertising unless all recommendations for a specified minimum period are included.

Subparagraph (3) prohibits an advertisement which represents, directly or indirectly, that any graph, formula, or other device being offered can in and of itself be used to make or assist in making an investment determination unless it also prominently discloses the limitations and difficulties encountered in the use of the particular graph, chart, formula or device being offered.

Subparagraph (4) prohibits an advertisement from representing that any report, analysis or other service will be obtained free or without charge unless it is in fact entirely free and subject to no conditions or obligations.

Subparagraph (5) contains a more general provision which makes it unlawful for an investment adviser to use any advertisment if it contains any untrue statement of material fact or is otherwise false or misleading.

The rule defines the term "advertisement" to include notices, circulars, letters or other written communications addressed to more than one person, and notices or other announcements in any publication, or by radio or television, if they offer (1) any analysis, report or publication concerning securities or (2) any graph, chart, formula or other device to be used in making any investment determination, or (3) any other investment advisory service with regard to securities.

2. PERFORMANCE COMPARISONS

Many investment advisers make representations concerning their management performance and historical records when soliciting clients. The Act, and the rules thereunder, do not prohibit an investment adviser from informing prospective clients of the performance of accounts under management so long as the information is not false or misleading. When examining material or advertisements which contain references to an adviser's management performance or "track record", an examiner should be mindful that such material or advertisement must not contain any untrue statement of a material fact or be otherwise false or misleading within the meaning of Section 206(4) of the Act and Rules 206(4)-1(a)(2) and (a)(5) thereunder. 33/

In the absence of a specific statement as to what is the relevance to a prospective client of the performance of accounts under management of an investment adviser, it can be assumed that the implied relevance is that it is an indication of the competence of the investment adviser or an indication of what a prospective client can expect for himself. In this context, information concerning performance may be misleading if it implies something about the experience of advisory clients, when there are additional facts known to the investment adviser which if also provided would cause the implication not to arise. Thus, giving a prospective client performance data concerning only certain periods or about only some accounts under management would not necessarily be misleading if the inclusion of information concerning other periods would not prevent any implication from arising.

33/ See March 14, 1978 letter from Stanley B. Judd to Edward O'Keefe, Appendix F.

The giving of information concerning the average or median performance of all accounts under management is similarly not necessarily misleading but may be misleading under certain circumstances. For example, assume two accounts under management: one with assets of $100,000 and the other with assets of $1,000,000. Assume further that the first account goes up to $150,000 and the second goes down to $500,000. The "performance" of the first account may be described as a 50% gain and the performance of the latter account may be described as a 50% loss. The average or median performance could be described as zero. Such a statement by itself, however, would be misleading.

Providing information as to the percentage change in accounts under management without indicating the respective sizes of such accounts may also be misleading. A mere statement that one account under management increased 50% and the other account decreased 50% may imply an experience which would not be implied if it was also stated that the account which increased 50% went from $100,000 to %150,000 and the the account which decreased 50% went from $1,000,000 to $500,000.

Information concerning performance of accounts over a period or periods attended by special market characteristics may imply an experience which would not arise if such characteristics were also disclosed. For example, the statement to a prospective client that accounts under management appreciated 50% in the last three years may contain an implication about the possibility of the prospective client having a similar experience that would not arise if the last three years represented an unusual period in the history of the market and this fact was also stated. Furthermore, a statement that accounts appreciated 50% may cause an inference to be drawn about advisory competence that would not be drawn if it was stated that the S & P 500 or some other index also increased 50% during the same period. However, a comparison of investment results with a market index or with other portfolios may in and of itself be misleading unless facts bearing on the fairness of any comparison are disclosed such as (1) the inclusion of income and capital gains or losses both realized and unrealized in one of the figures to be compared, (2) the type of security, i.e., equity or debt, composing the account, (3) the object of the account and the stability or volatility of the market prices of the securities in which it is invested, (4) the diversification in the account, and (5) the size of the account. In addition, if accounts are subject to commission, advisory and other expenses and charges, performance figures not reflecting such expenses and charges may convey an impression or give rise to an inference concerning the experience of existing accounts which is misleading.

Information necessary to prevent statements about performance from being misleading include (1) the form as well as the content of the statement, (2) the implications arising out of the statement in its total context and (3) the sophistication of the prospective client.

3. REFERRAL ARRANGEMENTS

Many regulatory questions are raised by referral arrangements, those practices pursuant to which an investment adviser compensates someone who has referred clients to the adviser. When cash referral fees are involved, the problem areas include adequate disclosure of the arrangement to the prospective client and ensuring that the adviser properly supervises the solicitation activities of his solicitors. When the referral fee is being paid to a broker-dealer and takes the form of brokerage directed by the adviser to the referring broker-dealer, these same concerns are present. In addition, there is also the difficulty of disclosing the additional expense a client may incur because his account's securities transactions are being directed to a specific broker rather than the broker the investment adviser has determined is able to provide best cost and execution for the particular transaction. Finally, there is the possibility that advisers will churn their accounts in order to generate the brokerage they need to pay for previous referrals and ensure that referrals will continue.

The staff of the Commission has not maintained a consistent position on the applicability of the federal securities laws to referral arrangements. 34/ In order to resolve any uncertainty which existed concerning cash referral fees, the Commission adopted Rule 206(4)-3 under the Act. 35/ The rule sets forth who can receive referral fees and certain conditions relating to their payment. Solicitors, who are unrelated to the adviser and who are approaching clients seeking other than impersonal advisory services, must furnish each person they solicit a current copy of the adviser's brochure required by Rule 204-3 and a disclosure statement describing the

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34/ See the Division of Investment Management's December 23, 1977 memorandum to the Commission concerning Rule 206(4)-3 for a history of the Commission's position.

35/ See IAA Rel. No. 688, July 12, 1979.

solicitation arrangement. This statement will describe, among other things, the nature of the relationship between the solicitor and the adviser, the terms of the compensation arrangement and any specific charge or higher advisory fee the client will pay because a solicitor recommended the adviser to the client. The rule requires the adviser to have a written agreement with each of its solicitors governing the solicitation arrangement and these agreements must be maintained as part of the adviser's books and records, pursuant to Rule 204-2(a)(10). One major responsibility the adviser has under the rule is to make a bonafide effort to ascertain that the subscriber has complied with the agreement. In addition to verifying that an adviser who is paying cash referral fees has complied with the other provisions of the rule, how the adviser fulfills his monitoring responsibilities should be determined in detail during an examination.

4. MODEL ACCOUNTS

An investment adviser's use of model accounts can raise questions in two distinct aspects of his advisory activities, advertising and actual account management, and should be scrutinized closely if encountered in the course of an examination. Some advisers create for client solicitation purposes model accounts which represent the adviser's opinion on which securities and in what amounts clients with specific investment objectives, e.g., growth or income, should hold. Advisers who maintain such model portfolios frequently will use the performance of these accounts as a solicitation tool. The danger in doing so and the reason such depictions raise serious questions under Rule 206(4)-1(a)(5), the general antifraud provision in the Act's advertising rules, is that these accounts reflect merely hypothetical transactions and therefore may not accurately reflect how the adviser actually would have performed if the model account selections represented actual client funds at risk. This is crucial because it is unquestionably much easier for an adviser to say that he would have maintained his securities positions, even during a market decline, when client funds were not in jeopardy.

Another potential trouble area arises when an investment adviser uses a model portfolio to make securities selections for the accounts under his management. While of course accounts with similar investment objectives cannot be expected to have totally dissimilar portfolios, an investment adviser who strictly follows a model portfolio in making his investmnt decisions and does not provide individualized treatment for his clients has created the functional equivalent of an investment company and may have violated the Securities Act of 1933 and the Investment Company Act of 1940 depending on the precise nature of the adviser's activities. If such a situation is uncovered,

the examiner should obtain as much information as possible about how closely the adviser adheres to the model and what disclosures are made to clients and prospective clients concerning the adviser's use of a model and the level of individualized treatment which will be afforded to clients.

5. HEDGE CLAUSE IN ADVERTISING OR OTHER LITERATURE

Advertisements and other literature generated by investment advisers often contain hedge clauses or other legends as to the reliability and accuracy of the information furnished. Sometimes language is added to indicate that no liability is assumed with respect to such information.

The purpose of such a legend is often to create in the mind of the investor a belief that he has given up some legal rights and is foreclosed from a remedy which he might otherwise have. Section 215 of the Act provides that any condition, stipulation or provision which binds any person to waive compliance with their requirements shall be void. Apart from this provision the anti-fraud provisions of Section 206 of the Act may be violated by an investment adviser if he employs any legend, hedge clause or other provision which is likely to lead an investor to believe that he has in any way waived any right of action he may have. 36/

A legend in common use states in effect that information is obtained from specified sources and is believed to be reliable but that its accuracy is not guaranteed. Assuming the truth of the representations as to the source of the information and the belief that it is reliable the mere use of such a legend in relating information to an investor is not objectionable. However, an investment adviser may not represent to an investor that this relieves him of any liability as noted above under Sections 215 and 206 of the Act.

36/ See Opinion of the General Counsel, IAA Rel. No. 58, Appendix F.

N. FRAUDULENT ACTS AND PRACTICES BY INVESTMENT ADVISERS

It has been considered a violation of Section 206 when an investment adviser:

a. Used statements in a promotional campaign for the sale of subscriptions to an investment newsletter involving puffing and exaggerations of the quality of investment advice. In the Matter of Stones d/b/a Justin Stone & Associates, (1963) 41 S.E.C. 717.

b. Solicited subscriptions to an advisory service which implied that the service would provide information that would enable the investor to realize immediate and substantial profits by following such advice. In the Matter of Dow Theory Forecasts, Inc. (1968) IAA Rel. No. 223. 37/

c. Prepared an article in a book describing and recommending the purchase of investment company shares without disclosing who prepared the article or the amount paid for the recommendation. In the Matter of Axe Securities Corp.; E. W. Axe and Co., Inc. (1964) IAA Rel. No. 176.

d. Circulated letters and certain reports to subscribers and prospective subscribers of a newsletter which contained flamboyant misrepresentations and statements concerning the investment adviser's staff, reputation and history, Paul K. Peers, Inc. (1965), IAA Rel. No. 187). 38/

e. Misrepresented the current trading price of a security recommended to its clients, misrepresented the manner in which the security could be purchased and used a misleading six-month old financial statement of the company whose stock it was recommending. In the Matter of Patrick Clements d/b/a Patrick Clements & Associates; Capital Gains Institute, Inc., (1964) IAA Rel. No. 177.

37/ Opinion Reproduced in Appendix F.

38/ Id.

f. Engaged in misrepresenting to clients that he would guarantee against losses in the stock market and would maintain cash reserves to protect against such losses. SEC v. Seipel, d/b/a Investors Surety Co., 229 F.2d 758.

g. Distributed advertisements which were flamboyant and gave an overall impression of certain substantial and quick profits through the utilization of the registrant's advisory service. Spear & Staff, Inc. (1965) IAA Rel. No. 188. 39/

The aforementioned fact situations are by no means exhaustive but only serve the purpose of identifying acts, practices and courses of business that have been considered "fraudulent, deceptive, or manipulative". The anti-fraud provisions are intended to be "general and flexible" in order to control "the versatile inventions of fraud doers". 40/ Therefore, the examiners should inquire and investigate all acts, omissions and concealments which tend to involve a breach of legal or equitable duty, trust, or confidence confided upon the investment adviser or by which an undue advantage is taken of a client by the investment adviser.

O. CUSTODY OR POSSESSION OF FUNDS OR SECURITIES OF CLIENTS

1. STATUTORY PROVISIONS

Pursuant to the authority in Section 206(4) of the Act, the Commission has adopted Rule 206(4)-2 under the Act which requires an investment adviser who has custody of funds or securities of any client to maintain them in such a way that they will be safe and secure from financial reverses, including insolvency, of the investment adviser. Rule 206(4)-2 makes it a fraudulent, deceptive or manipulative act, practice or course of business for any investment adviser who has custody

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39/ Opinion Reproduced in Appendix F.

40/ Stonemets v. Head, 248 Mo. 243, 263.

or possession of funds or securities of clients 41/ to do any act or to take any action with respect to any such funds or securities unless (1) all such securities of each such client are segregated, marked to identify the particular client who has the beneficial interest in the security, and held in safekeeping in a reasonably safe place; (2) all funds of such clients are deposited in one or more bank accounts which contain only clients' funds; such accounts are maintained in the name of the investment adviser as agent or trustee for such clients and the investment adviser maintains a separate record for each such account showing where it is, the deposits and withdrawals and the amount of each client's interest in the account; the adviser immediately after accepting custody of possession, notifies the client in writing of the place and manner in which the funds and securities will be maintained; (3) the adviser sends each client, at least once every three months, an itemized statement of the funds and securities in his custody or possession at the end of such period and all debits, credits, and transactions in the client's account during the period; and (4) at least once each calendar year the funds and securities are verified by actual examination by an independent public accountant in a surprise examination and a certificate of the accountant, stating that he has made the examination and describing the nature and extent of it, is sent to the Commission promptly thereafter. 42/ In order to conduct an appropriate examination, the independent public accountant should:

a. Conduct a "surprise" examination;

b. Examine clients' securities or make appropriate confirmation of them;

c. Reconcile the physical count and confirmations with the adviser's books and records;

d. Confirm clients' funds on deposit in banks;

e. Obtain written ("positive") confirmation from clients as to the contents of their accounts; and

f. Confirm closed client accounts on a test basis.

41/ For purposes of this Rule an adviser who has access to custody or possession may be deemed to be within this rule.

42/ See The Nature of the Examination and Certificate Required, IAA Rel. No. 201, Appendix F.

Since certain registered broker-dealers and members of national securities exchanges must maintain specified standards of financial responsibility under the Commission's Rule 15c3-1 of the Securities Exchange Act of 1934 or applicable rules of the exchanges of which they are members, the rule exempts from its requirements registered broker-dealers subject to and in compliance with the Commission's Rule 15c3-1 and members of exchanges whose members are exempt from Rule 15c3-1 by paragraph (b) (2) of that Rule provided that ". . . such broker-dealer is in compliance with with all rules and settled practices of such exchange imposing requirements with respect to financial responsibility and the segregation of funds or securities carried for the accounts of customers."

2. PROCEDURES

a. Where an investment adviser has custody or possession of clients' funds and/or securities the examiner should verify that:

1. A record of all client transactions in a journal, separate ledger accounts for each client, copies of confirmations of all transactions in such accounts, and a position record for each security in which a client has an interest is maintained by the investment adviser. 43/

2. All client securities are segregated, marked for identification and held in safekeeping in a reasonably safe place;

3. All client funds are deposited in one or more bank accounts, in the name of the investment adviser as agent or trustee for clients, which contain only clients' funds;

43/ Pursuant to Rule 204-2(b) under the Investment Advisers Act. Ordinarily this verification would be done in a routine examination of registrant's books and records. See Chapter on Examination of Books and Records in this manual.

4. Immediately after accepting client funds and securities the investment adviser notifies the client in writing of the place and manner in which they will be maintained;

5. Not less frequently than once every three-month period each client is sent an itemized statement showing the transactions in his account during the period; and

6. At least once each calendar year all client funds and securities are verified in an unannounced examination by an independent public accountant and a certificate of the accountant reporting on such examination is filed with the Commission in accordance with Investment Advisers Act Release No. 201. 44/

b. Where the investment adviser is an exempt broker-dealer, as described above, it should be determined that the investment adviser is in compliance with the applicable requirements regarding the safeguarding of customers' funds and/or securities under the Securities Exchange Act of 1934 45/ or appropriate exchange rule.

c. The examiner should make a careful review to determine whether the adviser does have custody or possession of clients' funds and securities. 46/ Quite often it has been found, especially with small advisers, that they will have one or more accounts for which they have custody, but, for various reasons, they may not consider it custody and will have answered the Form ADV questions on custody in the negative. This also happens when the adviser is primarily engaged in some other form of business. For example, there is a

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44/ See Appendix F.

45/ See Broker-Dealer Examination Manual, Safeguarding Customers' Funds and Securities.

46/ Indicia for determining whether custody of clients' funds or securities by a bank or trust company which is affiliated with the investment adviser constitutes custody by the investment adviser and therefore is subject to Rule 206(4)-2 are discussed in the Division of Investment Management's March 15, 1978 letter to counsel for Crocker Investment Management Corp. (copy included in Appendix F).

growing number of business agents who manage the affairs of their clients, including paying expenses, taxes, etc. Additionally, they also make investment decisions. They may view the functioning of a manager and adviser as separate and distinct, while, in fact, they are subject to the provisions of Rule 206(4)-2 as registered investment advisers having custody and possession of clients' funds and securities.

d. There have been several instances where advisers who have custody of clients' funds will operate so as to permit clients to maintain debit balances using the cash of those having credit balances. Such an activity operates in violation of Section 206 of the Act. The examiner should take a trial balance of all clients' balances and reconcile this amount to the bank account. Note should be made of the length of time that the debits have been carried particularly if the debits have been incurred by clients who are in any way related to the adviser, a nominee or family. 47/

P. CASH MANAGEMENT

In conducting an investment adviser examination the examiner should place particular emphasis on the area of cash management by the adviser. Throughout the examination the examiner should take into consideration such factors as, whether the adviser has custody and possession of its clients' funds, whether the adviser is affiliated with the custodian of its clients' funds and securities and what internal controls the adviser has developed to monitor its clients' cash accounts to ensure they are earning as high a rate of return as possible consistent with the client's objectives.

An adviser may not avoid his fiduciary duties by delegating to an affiliate, custodian or third party the maintenance of client cash positions or by relying on the normal business practices of that affiliate, custodian or third party. In certain instances what may be an acceptable business practice for another profession may result in violations of applicable securities laws pertaining to the adviser as well as cause a breach of the adviser's common law fiduciary duty. 48/ An adviser who is deemed to have custody and possession of a client's funds and securities (either constructive or otherwise) has an affirmative obligation to make himself aware of all material facts relating to the custodianship of these funds and securities,

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47/ Potomac Investment Advisers, Inc., IAA Rel. No. 634 (July 21, 1978).

48/ E.g., Affiliated custodian bank investing advisory clients' idle cash for its own benefit.

irrespective of whether the funds and securities are maintained at the adviser's principal place of business or placed in trust at another location. To do less will raise serious questions under Section 206 of the Act.

1. ADVISER IN NON-CUSTODIAL CAPACITY

a. Idle Cash

An adviser is under a fiduciary duty to earn the best possible return for a client consistent with that client's objectives. Included in this return is not only the investment of a client's funds in equity securities or bonds but also the investment of any cash in that client's account.

Cash may exist in a client's account for a variety of reasons: a recent sale of securities, a recent deposit by the client, recently matured bonds. The adviser should not allow large amounts of cash to remain idle for periods of time. The examiner, in inspecting the adviser's client cash records and finding indications that client cash has not been invested properly, should make note of certain factors - the amount of cash which is uninvested, small amounts may be acceptable due to administrative or contractual reasons, and the period of time cash has been allowed to remain idle. It is vital that the examiner make note of these factors so a determination can be made as to any fiduciary liability on the part of the adviser. The issue of reasonableness will then come into focus.

Uninvested cash remaining idle for periods of time should serve as a "red-flag" for the examiner to make further inquiries. The examiner should inquire whether the adviser has disclosed his investment policies as they relate to investment of his clients' cash. Questions should be asked of him as to how often he monitors his clients' idle cash; can arrangements be made with his clients' custodians to invest any idle cash on a daily basis either in a savings account or money market fund; are the adviser's clients aware that their accounts may be composed of uninvested cash for periods of time. Only after these and other questions concerning the adviser's practices have been answered can a determination be made as to whether the adviser has breached his fiduciary duty to his clients.

b. Overdrafts

The examiner should determine during the examination not only the amount and time client cash was allowed to remain idle but also whether a client's account has incurred any overdraft positions. An overdraft position would occur when a client does not have sufficient cash in

his account to cover securities purchases on settlement date. The purchase would be made with either the custodian advancing to the client funds to cover the purchase price or the adviser loaning to the client the necessary cash. Should the custodian advance a client funds he will look to the client's securities under his custodianship as collateral should the client not deposit sufficient funds to repay the loan.

An investment adviser who manages his clients' accounts in such a manner so as to incur overdraft positions may cause serious violations of Section 206 of the Act, irrespective of whether an adviser is deemed to have custody and possession of his clients' funds and securities. An adviser who has been given discretionary authority over a client's account has not been impliedly granted permission by that client to trade in securities when sufficient funds of that client are not available. To allow this practice to continue would give rise to potentials for abuse on the part of the adviser and/or custodian, 49/ as well as subjecting the client to unnecessary risks, (e.g., should a client purchase securities without sufficient funds and the price of the securities drops or the issuer declares bankruptcy, the sale by the custodian of the securities will not cover their purchase price, and either the client or the custodian will lose funds in the transaction) which would decisively outweigh any probable benefit to be gained by the client.

The examiner should determine the amount and duration of the overdrafts as well as solicit information from the adviser as to its policy relative to the existence of overdrafts in client accounts. Inquiries may encompass such areas as: does the adviser have adequate control of its own books and records to be able to manage his clients' accounts so that overdrafts do not exist, are clients aware that their accounts are being managed by the adviser in such a manner so as to incur overdrafts, are certain of the adviser's accounts incurring overdrafts more frequently than others, does the client have to pay interest on this cash advance or is it in effect an interest-free loan, does the advisory client have any "special relationship" with the adviser, or to the extent possible to determine, the custodian. These inquiries are not inclusive but will form a basis for further inquiry.

49/ May result in an anti-competitive device in that certain advisers may arrange with client custodians to allow overdrafts to occur when other advisers are not able to achieve such an arrangement; may result in clients who have illiquid portfolio positions gaining an advantage over clients who have sufficient cash on hand to cover all securities purchases; certain clients may be more highly leveraged than their investment objectives would allow.

2. ADVISER HAVING CUSTODY AND POSSESSION

a. Idle Cash

An adviser who has custody and possession of its clients' funds and securities incurs the potential of greater conflicts of interests arising in the management of its clients' accounts. Rule 206(4)-2, as promulgated under Section 206 of the Act, allows the adviser to pool client funds under its custodianship. Records must be kept by the adviser showing his clients' interest in this pool. When inspecting these records the examiner should determine if a client's account shows uninvested cash remaining idle for periods of time. The examiner should determine the amount of cash which is idle as well as the length of time it remains uninvested. Inquiry into the adviser's internal control prcedures for this pool should be made as well as a determination if one client's cash is remaining idle any longer or more frequently than any other clients. The adviser should also be asked why this idle cash cannot be invested on a daily basis in a savings account or money market fund. In addition an inspection of the quarterly reports required to be given advisory clients should be undertaken to see if the cash balances are disclosed. The adviser should also be questioned as to whether its clients were aware that large cash balances existed for periods of time.

b. Overdrafts

The question of overdraft positions existing in client accounts when an adviser has custody and possession takes on greater significance as a client's overdraft may be covered by the adviser through the use of other client funds from the commingled pool. The use of other client funds to finance overdraft positions of certain clients might violate the anti-fraud provisions of the Act. The result of this practice would be an interest-free loan to an advisory client from other clients. Inquiry should be made as to the extent and amount of overdrafts, which client accounts were overdrafted, was sufficient cash available at the time of the overdraft from other investments of the overdrafted client to cover the negative cash balance existing in his account, (e.g., savings account, money market fund), and was this practice and the use of other client funds to cover the overdraft disclosed to all clients of the adviser.

c. Affiliated Custodian

An adviser's affiliation with the custodian of its clients' funds provides the need for closer investigation into the practices being followed by the adviser and the custodian. By virtue of the fact that an adviser is affiliated with the custodian of his clients' funds and

securities, a higher potential for breach of an adviser's fiduciary duty would exist than would normally be present absent an economic and/or legal relationship.

The economic and/or legal relationship between an adviser and a custodian imposes upon the adviser a higher standard of fiduciary responsibility. An investment adviser who is affiliated with a custodian of his clients' funds and securities also has an affirmative obligation to inform himself of the policies of the affiliated custodian as they relate to the holding, investing or general management of his clients' funds located at that custodian. The adviser would then have an affirmative duty to disclose to his clients all material facts relating to the custodian's policies as they would affect relationships between the affiliated custodian and adviser and the custodian and advisory client. 50/

The same issues in regards to idle cash and overdraft positions would exist in this situation. Inquiry should be made of the adviser's internal controls regarding its clients' cash management, the extent of disclosure that had been made to clients concerning any overdrafts, idle cash or material relationships existing of which the advisory client should be made aware.

Q. REPRESENTATIONS AS TO REGISTRATION AND TERM "INVESTMENT COUNSEL"

1. REPRESENTATIONS MADE BY INVESTMENT ADVISERS

Section 208(a) of the Advisers Act prohibits an investment adviser from representing or implying in any manner that the investment adviser has been sponsored, recommended or approved, or that his abilities or qualifications have been passed upon by the United States or any agency or any office thereof. This provision, among other things, seeks to prohibit the investment adviser from representing to clients or prospective clients that by virtue of being registered with the Commission he has the expertise and qualifications necessary to advise them in their investment needs. However, Section 208(b) allows the investment adviser to state or represent that the investment adviser is registered with the Commission provided the statement is true and the effect of such registration is not misrepresented.

50/ E.g., an adviser may manage its clients' accounts so as to allow cash balances to remain idle for periods of time thereby allowing the affiliated custodian use of these funds on an interest-free basis.

Section 208(c) restricts the use of the term "investment counsel." 51/ This section prohibits a registered investment adviser from using the term "investment counsel", unless his principal business consists of acting as an "investment adviser" as defined in Section 202(a)(11) of the Act and a substantial part of his business consists of rendering "investment supervisory services" as defined in Section 202(a)(13) of the Act. 52/

2. PROCEDURES

To determine whether the investment adviser has violated the general prohibitions of Section 208 of the Act the examiner should review advertising, direct mailings, calling cards, correspondence, contracts, etc. to determine whether (1) the investment adviser is representing that he is sponsored, recommended, or approved, or that his qualifications have been passed upon by the Commission or other governmental body, (2) the investment adviser is misrepresenting the fact that he is registered with the Commission in the capacity of an investment adviser and (3) the investment adviser is representing that he is an "investment counsel." If the last is true the examiner should satisfy himself that the registrant's principal business consists of acting as an investment adviser and a substantial part of his business consists of rendering investment supervisory services.

R. WITHDRAWAL FROM REGISTRATION

In the course of an examination or otherwise a registrant may inquire into the possibility of withdrawing from registration. Sometimes a registrant is doing no business and it serves no purpose to be registered. In that case it should be suggested to the registrant that he consider withdrawing from registration and copies of Form ADV-W should be furnished to the registrant.

1. PROVISIONS FOR WITHDRAWING

Rule 203-2 allows the registrant to withdraw his registration under the Act by filing Form ADV-W 53/ in accordance with the instructions contained therein. Form ADV-W requires the investment adviser seeking to withdraw his registration to furnish specified information:

51/ See Use of Term "Investment Counsel", IAA Rel. No. 8.

52/ "'Investment supervisory services' means the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client."

53/ See Appendix A.

(a) whether he owes any money or securities to any client, and if he does, the amount involved and the arrangements made for repayment. Where this happens, the investment adviser would have to furnish a report of his current financial condition; (b) what disposition has been made of his investment advisory contracts and whether refunds were made to all clients whose contracts were not completed or assigned with their consent; (c) whether he is involved in any legal actions or proceedings and whether there are any unsatisfied judgments or liens against him; (d) the name and address of the person who will have custody or possession of the books and records required to be preserved; and (e) the address where such books and records will be located. Also Form ADV-W contains an authorization to the custodian of the investment adviser's books and records to make them available to the Commission.

Rule 203-2 provides that notice of withdrawal will become effective on the 60th day after filing unless the Commission accelerates the effectiveness of the withdrawal, proceedings to revoke or suspend are pending, or the Commission, within the 60-day period, institutes proceedings to suspend or revoke the registration or to impose terms or conditions upon such withdrawal. The rule also provides that each notice of withdrawal constitutes a "report" under Section 204, which subjects the filing to the provisions of Sections 207 and 217 of the Act.

2. PROCEDURES (WHERE SUCH EXAMINATION IS DEEMED APPROPRIATE)

a. Upon receipt of the filing for withdrawal, the examiner should determine whether the business is being terminated in compliance with the Instruction Sheet for Form ADV-W. 54/

b. The examiner should verify that the information stated in the form is true and correct.

c. The examiner should write a report recommending whether (a) registrant is in compliance with applicable requirements and withdrawal should be granted; (b) further formal investigation should be made; or (c) formal proceedings should be instituted. 55/

S. REPORTING INVESTMENT ADVISER EXAMINATIONS

After the completion of an examination, the Division of Investment Management should be sent the following (i) a copy of the Investment

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54/ See Appendix A.

55/ Examiner should keep in mind that procedures should be completed within the 60-day waiting period or withdrawal will become effective automatically.

Adviser Examination Outline, including the Summary Facing Page; (ii) a copy of any additional comments prepared in connection with the examination report; and (iii) a copy of any deficiency letter sent to the registrant. The comments should cover, among other things,

(a) any relevant unusual characteristics of the registrant's business;

(b) all matters discovered during the examination in apparent contravention of the federal securities laws, the rules thereunder or the rules of other regulatory bodies;

(c) any matters which constitute unsound business practices; and

(d) any other matters on which comment is appropriate.

The examiner should follow the outline and comments should be made in the report of all vital information found in the examination. The foregoing reporting requirements do not preclude the inclusion in the report of examination comments on unusual situations, practices, or devices pertinent to the Commission's jurisdiction which reflect important charcteristics of the business or important information concerning its personnel even though such comments may be outside the scope of apparent violations. It is recognized that if the examination program is to be a vital force in the prevention of improper and fraudulent practices and in the enforcement aspects of the Commission's work, there can be no substitution for the exercise of initiative and resourcefulness by the examiner.

T. DEFICIENCY LETTERS

When an examination is completed there are basically three courses of action that can be taken: (1) the examination disclosed no violations and the only remaining item is the writing of the examination report; (2) violations were disclosed that were flagrant and either a formal order of investigation, administrative proceeding or injunction is recommended; and (3) some violations were indicated but further action as noted in (2) above, is not warranted. In this case, the registrant must nevertheless be notified that certain violations have been uncovered during the examination and that the acts of conduct in question must be discontinued. In appropriate instances an agreement or consent can be arranged to ameliorate the effects of the unlawful activities. The letters of notification and warning of violations are known as "deficiency letters" since they, among other things, point out to the registrant certain acts, practices or procedures that have been found to be deficient in the course of the examination.

In order that the examiner becomes familiar with these letters, there is contained in the appendix a number of sample deficiency letters dealing with matters arising under the Act. 56/ These letters may also serve as a guide to the examiner in drafting a deficiency letter involving a similar set of circumstances. However, it should be noted that regional offices may have their own form, style and policies regarding deficiency letters and they should be referred to when a deficiency letter is written. Deficiency letters should be followed up so as to ensure that all deficiencies have been corrected.

The staff has been criticized in the past for the use of unnecessarily threatening language in the deficiency letters. Therefore, it is recommended that language approximating the following be used in the opening and closing paragraphs of all deficiency letters.

Opening paragraph: We appreciate the courtesies extended to (insert names of examiners) of this office during the recent examination of the books and records of your investment advisory business conducted pursuant to Section 204 of the Investment Advisers Act of 1940 ("Advisers Act"). This examination disclosed the need for certain revisions in the practices and procedures of your business. There are set forth below the matters in which corrective action should be taken to the extent that it has not been taken since the time of the examination.57/

Closing paragraph: We would appreciate a reply at your earliest convenience setting forth the steps you have taken or intend to take with respect to the matters discussed in this letter. Please send a copy of your reply together with copies of any enclosures to Mr. Dennis M. Gurtz, Examination Program Coordinator, Division of Investment Management, Securities and Exchange Commission, Washington, D.C. 20549.

56/ See Appendix C.

57/ The following sentence may be added if there really are other matters that have not been discussed in the letter or the regional office is seriously considering additional action on a defficiency discussed in the letter:

> "These matters are brought to your attention for prompt action without regard to any additional action concerning these or other matters which the Commission may take or require to be taken by you as a result of the examination."

This sentence obviously leaves a great deal of uncertainty in the mind of the registrant concerning the final action to be taken as a result of the examination. While the utility of such a cautionary sentence is undeniable in certain cases, because registrants quite reasonably find this uncertainty disquieting, examiners are strongly encouraged not to use this sentence routinely and to eliminate it whenever possible.

U. INTERPRETATIVE AND NO-ACTION LETTERS

Informal advice given by members of the staff to the public as well as registrants frequently takes the form of interpretative letters and no-action letters. The former are opinions of the application of the law to contemplated factual situations. In a no-action letter, an authorized officer of the Commission's staff may state with respect to a specific proposed transaction that the staff will not recommend to the Commission that it take enforcement action if the transaction is consummated exactly as it has been described. However, opinions expressed by members of the staff do not constitute the official expression of the Commission's views. Therefore, it should be recognized that no-action and interpretative letters by the staff are subject to reconsideration and should not be regarded as precedents binding on the Commission. Requests for interpretative advice or no-action letters and written responses to such requests are treated as public records of the Commission after a response is made. 58/

In the course of an examination a registrant may present the examiner with an interpretative or no-action letter in support of certain conduct. If the examiner believes the conduct is questionable he should note or copy the no-action letter and determine whether the fact situation noted in the interpretative or no-action letter is similar to that of the registrant. The examiner should avoid any debate or discussion of the appropriateness of the conduct in question. However, such conduct and the circumstances surrounding the situation should be noted in the examination report.

V. RELATED INVESTMENT COMPANY EXAMINATIONS

An examination of an investment adviser whose advisory activity consists of acting as an investment adviser to a registered investment company is frequently made in conjunction with examinations made of the related investment company as well as the broker-dealer whose broker-dealer activity consists of acting as the principal underwriter for the investment company shares. Accordingly, the examiner may be involved with the examination of the investment adviser as well as the related investment company and the principal underwriter.

58/ See Appendix D for copies of IAA Release Nos. 274 and 281, which describe the Commission's general procedures concerning no-action inquiries.

The following materials would be useful in fimiliarizing the examiner with these types of examinations:

I Characteristics of Various Types of Investment Companies

II Investment Company Inspections and Outline

III Inspection Outline for Investment Adviser Whose Only Advisory Activity is as Investment Adviser to Registered Investment Companies

IV Inspection Outline for Broker-Dealers Whose Only Broker-Dealer Activity is as Principal Underwriter for Investment Companies

Additional consideration of investment companies is beyond the scope of this manual.

W. SECTION 210(b)

Section 210(b) of the Investment Advisers Act of 1940 has essentially two prohibitions: 59/

(1) not making public the fact that any examination or investigation is being conducted, and,

(2) not disclosing to any person, other than an officer, member or employee of the Commission, any information obtained as a result of an examination or investigation, except with the approval of the Commission.

59/ The provisions are subject to narrow qualifications dealing with subpoena enforcement and injunctive actions brought by the Commission (Section 209 (c)), criminal references made to the Attorney General (Section 209(e)), public hearings (Section 210(b)(1); See Section 212, and Congressional requests and resolutions (Section 210(b)(2)).

During the course of certain investment adviser examinations, questions may arise which would require independent verification of facts or representations made by the adviser to the examiner. One common example would encompass the situation of an adviser informing an examiner that disclosure of certain material facts or conflicts of interest relating to that adviser's business was made to an advisory client either orally or in writing. The problem that arises is that in certain instances verification of this disclosure cannot be found either in the adviser's general records or client files. In order for the examiner to verify that adequate disclosure was made, it would be necessary to contact that adviser's clients.

Criminal sanctions may be imposed against a staff member who is found in violation of Section 210(b). As a staff member may be found criminally liable, caution must be exercised before contacting any clients of an adviser. While it can be argued that contacting members of a pre-determined group (i.e., an adviser's clients) is not making public the fact that registrant's books and records were examined, 60/ a serious problem is, nevertheless, presented by the second prohibition of Section 210(b).

Section 210(b) further prohibits disclosure to any person, other than a member, officer or employee of the Commission, any information obtained as a result of an investment adviser examination. If an examiner finds it necessary to interview advisory clients, it is probable that any questions posed to the client will be premised on information obtained from the staff member's examination of the adviser's books and records. It is not illogical for the interviewed client to conclude that the only way an examiner could have sufficient background to ask the questions was from an examination of the adviser's books and records. The mere posing of such questions to advisory clients may thus be deemed to be a disclosure in violation of Section 210(b). Therefore, an examiner who desires to verify information given to him by an adviser with that adviser's clients should first contact his supervisor to determine whether such an inquiry may be made in light of Section 210(b).

60/ Rule 2 of the Commission's Rules of Practice Relating to Investigations provide:

> "that any information or documents obtained by the Commission in the course of any investigation or examination, unless made a matter of public record, shall be deemed non-public."

It is common procedure for the staff to make inquiries of individuals concerning violations of the Securities Act and the Securities Exchange Act and such inquiries have always been considered to be non-public.

X. FREEDOM OF INFORMATION ACT AND PRIVACY ACT

The Freedom of Information Act (FOIA) affords members of the public access to documents in the possession of government agencies, with specified exceptions. The Commission's rules under the FOIA are contained in 17 CFR 200.80. These rules describe the procedures to be followed in filing and processing FOIA requests. A denial of access to records by the Commission's FOIA officer can be appealed to the Commission itself and from there to the federal courts. Relying on the exemption in paragraph (b)(5) of the Commission's rules under the FOIA which permits the Commission to deny access to interagency or intra-agency memoranda or letters, including documents prepared in the course of an examination, the Commission has successfully denied access to investment adviser and investment company examination reports.

Congress adopted the Privacy Act in 1974 in response to the potential threat to the right of individual privacy as a result of the federal government's collection of personal information. The Act restricts the types of information an agency may collect and its methods for maintaining such information. Individuals have certain rights of access to information. The Commission rules under the Privacy Act are contained in 17 CFR 200.301-312. While the Act would appear to provide investment advisers operating as sole proprietors access to inspection reports prepared concerning their firms, it does not. The Office of Management and Budget and the Department of Justice have ruled that individuals doing business as sole proprietorships should be treated as corporations for purposes of the Privacy Act and therefore, like corporations, not have any rights under the Act. In light of this interpretation, the Commision would strongly resist any individual's attempt to gain access to the inspection report on his sole proprietorship investment adviser. However, it is the Commission's policy to provide a Privacy Act Statement and a Routine Use and Information Statement at the beginning of each inspection conducted by its personnel.

Y. FINANCIAL PLANNERS

A financial planner is a person who offers to his clients a comprehensive financial service, giving advice in a variety of financial areas and recommending to each client, according to that client's particular circumstances, a customized mix of financial devices. The areas in which a financial planner renders advice may encompass, among others, real estate, insurance, securities, taxation. Certain financial planners will charge an overall fee for this comprehensive service; others will be compensated by charging a minimum consulting fee and combining this with commissions earned from the sale of certain of the financial products offered the client.

Many individuals holding themselves out as financial planners will argue that the Act would not be applicable in regulating their activities. The primary argument advanced in support of this supposition is that even though certain advice given does relate to securities the fees charged clients are for all services rendered. No differentiation is made between those decisions arguably encompassing securities and those in other financial areas.

It is the staff's position that if part of a financial planner's time is allocated to the giving of advice in securities and his overall compensation includes compensation for time thus spent, the financial planner would fall within the purview of the Act and as such should be registered with the Commission as an investment adviser. The fact that the giving of investment advice as to securities is incidental to the financial planner's business would not qualify him for an exemption from registration such as that available to lawyers or accountants in the practice of their professions.

Other individuals who hold themselves out as financial planners and who give advice as to securities argue they are not subject to the registration provisions of the Act because they receive no compensation other than a brokerage commission for effecting transactions in securities for their clients. Whether or not, under such circumstances, a planner's general financial planning services are solely incidental to his broker-dealer activities, is a question of fact to be determined on a case by case basis. The compensation received from brokerage commissions or mutual fund sales might, under some circumstances, be attributable in part to investment advisor activities and as such would require the financial planner to register as an investment adviser.

A financial planner registered as an investment adviser should be aware that he is a fiduciary, having a duty of undivided loyalty to his investment advisory clients. Should he, or any of his employees, have any adverse interest, (receipt of compensation in connection with broker-dealer or insurance sales activities) in any transaction recommended to an advisory client, the full nature and extent of such adverse interest must be disclosed to the client and his informed consent obtained before any transaction is effected. Failure to do so may involve violations of the anti-fraud provisions of the federal securities laws.

A person who recommends financial products other than securities such as life insurance or real estate should be made aware that his fiduciary duties as an investment adviser may not be able to be meaningfully fragmented between his investment advisory activities and any other activities in which he is engaged. The purposes of the Act would be frustrated if an adviser were able to use his position to obtain advisory clients, gain their confidence, and then use their

funds in non-securities transactions in a way which is not permitted under the Act. Thus, the registration of a financial planner as an investment adviser imposes duties of full disclosure concerning commissions and any other compensation resulting from recommendations made in non-security related products which, absent registration as an investment adviser, would not exist under the federal securities laws.

APPENDIX A

Advisers Act Forms

FORM ADV

INSTRUCTION SHEET

APPLICATION FOR REGISTRATION AS AN INVESTMENT ADVISER OR TO AMEND SUCH AN APPLICATION UNDER THE INVESTMENT ADVISERS ACT OF 1940

General Instructions for Preparing and Filing Form ADV

1. This Form and any Schedules and continuation sheets required in connection with it shall be completed and filed in triplicate with the Securities and Exchange Commission, Washington, D.C. 20549. Retain one additional copy for your records. All information required by Form ADV and any Schedule thereunder must be submitted on the officially prescribed forms (or mechanical reproductions thereof). Additional copies are available at any office of the Commission.

2. Form ADV consists of two parts, Part I and Part II. Both parts shall be completed and filed with the Commission.

3. At the time of the filing of an application for registration under the Act, the applicant shall pay to the Commission a fee of $150, no part of which shall be refunded. There is no fee for the filing of any amendments to Form ADV.

4. Each copy of the execution page must contain an original manual signature of the appropriate duly authorized individual. *Mechanical reproductions of signatures are not acceptable.* All other pages containing correct information may be mechanically reproduced by any method producing clear, legible copies of identical type size. Copies must be on 8½ x 11 inch paper.

5. If Form ADV is filed by a sole proprietor, it shall be signed by the proprietor; if it is filed by a partnership, it shall be signed in the name of the partnership by a general partner; if it is filed by an unincorporated organization or association which is not a partnership, it shall be signed in the name of such organization or association by the managing agent--i.e., a duly authorized person who directs or manages or who participates in directing or managing its affairs; if it is filed by a corporation, it shall be signed in the name of the corporation by a principal officer duly authorized.

6. If the space provided for any answer on the Form is insufficient, the complete answer shall be prepared on Schedule E with respect to Part I of the Form and on Schedule F with respect to Part II of the Form, which shall be attached to the Form. If the space provided for any answer on the Schedules is insufficient, the answer shall be completed on additional copies of the applicable Schedule which shall also be attached to the Form.

7. Individuals' names, except for executing signatures, shall be given in full wherever required (last name, first name, middle name). The full middle name is required. Initials are not acceptable unless the individual legally has only an initial. If this is the case, so indicate by "NMN" after the initial.

8. Definitions: Unless the context otherwise requires:

   a. All terms used in the Form have the same meaning as in the Investment Advisers Act of 1940 and the rules and regulations thereunder.

   b. "Jurisdiction" means a state, a territory, the District of Columbia, the Commonwealth of Puerto Rico, or any subdivision or regulatory body thereof.

   c. "Applicant" means the investment adviser or person which will be the investment adviser and not the individual completing the form unless they are identical. "Applicant" includes a "Registrant."

   d. "Self-Regulatory Organization" means any national securities exchange, national securities association, or clearing agency, registered under the Securities Exchange Act of 1934.

   e. "Client" means an investment advisory client.

9. **Under Sections 203(c), 204, 206, and 211(a) of the Investment Advisers Act of 1940 and the rules and regulations thereunder, the Commission is authorized to solicit the information required by this Form from applicants for registration as investment advisers. The information specified by this Form** *(other than social security numbers)* **must be provided prior to the processing of any application. Disclosure of social security numbers is voluntary. The information will be used for the purpose of determining whether the Commission should grant or deny registration to an applicant and other regulatory purposes. Social security numbers will assist the Commission in identifying applicants and, therefore, in promptly processing applications. Information supplied on this Form will be included in the public files of the Commission and will be available for inspection by any interested person. A Form which is not prepared and executed in compliance with applicable requirements may be returned as not acceptable for filing. Acceptance of this Form, however, shall not constitute any finding that it has been filed as required or that the information submitted is true, current, or complete. Intentional misstatements or omissions of fact constitute Federal criminal violations.** *(See 18 U.S.C. 1001 and 15 U.S.C. 80b-17.)*

Special Instructions for Filing Form ADV as an Application

10. If Form ADV is being filed as an application for registration, all applicable items must be answered in full. If any "item" is not applicable, indicate by "none" or "N/A" as appropriate. Items requiring information relating to the business activities of applicant should be answered to disclose what such activities will be when registration becomes effective.

11. If any non-resident of the United States is named in the Form, consult Rule 0-2 to determine whether he is required to file a consent to service of process and a power of attorney. Non-residents of the United States should also consult Rule 204-2(j) under the Act concerning the notice or undertaking relating to books and records which non-resident investment advisers are required to file with Form ADV.

Special Instructions for Amending Form ADV

12. Rule 204-1(b)(1) requires that if the information contained in response to questions 2, 4, 6, 10, 12(a), 12(b), and 14 of Part I of any application for registration as an investment adviser, or in any amendment thereto, becomes inaccurate for any reason, or if the information contained in response to questions 5, 7, 8, 9, and 11 of Part I or any question in Part II (except question 13) of any application for registration as an investment adviser becomes inaccurate in a material manner, the investment adviser shall promptly file an amendment on Form ADV correcting such information. In addition, if the information contained in response to questions 5, 7, 8, 9, and 11 of Part I or any question in Part II (except question 13) of any application for registration as an investment adviser, or in any amendment thereto, becomes inaccurate, but not in a material manner, or the information contained in response to questions 12(c), 13, 15, and 16 of Part I of any application for registration becomes inaccurate for any reason, the investment adviser shall file an amendment on Form ADV correcting such information no later than 90 days after the end of applicant's fiscal year. In addition, a balance sheet, as required by question 17 of Part I or question 13 of Part II shall be filed no later than 90 days after the end of applicant's fiscal year.

    If the information contained in response to question 3 of Part I becomes inaccurate, the investment adviser shall file an amendment on Form ADV correcting such information no later than 90 days after the end of applicant's fiscal year. However, if the investment adviser's license has been withdrawn or involuntarily terminated, the investment adviser shall promptly file an amendment.

13. When an amendment is necessary, only the pages being amended, the execution page and page 1 of Part I need be filed, although these must be completed in full. Three copies of each of such pages should be filed.

CAUTION: When any item on a page is amended, it is necessary to answer all items on the page being amended. Pages which contain obsolete information are retired to the Commission's inactive files.

Special Instructions as to Specific Items on Form ADV

14. Item 2(a) - Include a street address; post office box numbers alone are not acceptable.

15. Item 3(a) - Key to State Abbreviations

AL - Alabama
AK - Alaska
AZ - Arizona
AR - Arkansas
CA - California
CO - Colorado
CT - Connecticut
DE - Delaware
DC - District of Columbia
FL - Florida
GA - Georgia
HI - Hawaii
ID - Idaho
IL - Illionis
IN - Indiana
IA - Iowa
KS - Kansas
KY - Kentucky
LA - Louisiana
ME - Maine
MD - Maryland
MA - Massachusetts
MI - Michigan
MN - Minnesota
MS - Mississippi
MO - Missouri
MT - Montana
NE - Nebraska
NV - Nevada
NH - New Hampshire
NJ - New Jersey
NM - New Mexico
NY - New York
NC - North Carolina
ND - North Dakota
OH - Ohio
OK - Okahoma
OR - Oregon
PA - Pennsylvania
RI - Rhode Island
SC - South Carolina
SD - South Dakota
TN - Tennessee
TX - Texas
UT - Utah
VT - Vermont
VA - Virginia
WA - Washington
WV - West Virginia
WI - Wisconsin
WY - Wyoming
PR - Puerto Rico

16. Item 8(b) - If a registered partnership is dissolved and a new one is created to continue the business of the old one, the new partnership must file a new or successor application as an investment adviser.

17. Item 10 - Check answers to Items 2(a), 8, and 9 of Part I and the related Schedules for the names of all persons who are covered by any of the subsections of Item 10 of Part I. Similarly, any persons who directly or indirectly control or are controlled by the applicant, including any employee, are covered by Item 10 of Part I. For each affirmative answer, list each person involved on a separate Schedule D and explain these incidents, including, for example, the parties involved, time and place, subject matter, and the outcome of the proceedings.

Special Instructions relating to Schedules

18. Schedule A - Schedule A is for corporations.

(If applicant is owned directly, or indirectly through one or more intermediaries, by a corporation, then such corporation's shareholders should be considered in determining who must be listed on Schedule A.)

19. Schedule B - Schedule B is for partnerships.

20. Schedule C - Schedule C is to be completed only by organizations or associations which are not sole proprietorships, partnerships, or corporations.

21. Schedule D - Schedule D is to be filed for the following classes of persons:

(a) Each natural person named in Items 2(a), 8, or 9 or any Schedule thereunder, except that Schedule D need not be furnished for any person who meets both the following conditions: (1) he owns less than 10% of any class of equity security of the applicant; and (2) he is not an officer, director or person with similar status or functions.

(b) Each person subject to any action reported under Item 10; and

(c) (1) Each member of applicant's investment committee or similar group, if any, which determines or approves what investment advice shall generally be rendered by applicant to any client, or to which clients such investment advice shall be rendered.

(2) In the absence of an investment committee or similar group, each person associated with applicant who determines or approves what investment advice shall be rendered by applicant to any client, or to which clients such investment advice shall be rendered (if more than five such persons, it is necessary to complete a separate Schedule D only for those persons having supervisory responsibility over those persons described in this paragraph).

22. Schedule E - Schedule E may be used (1) where the space provided for any answer in Part I of the Form is insufficient, or (2) in response to each item in Part I of the Form which requires the submission of Schedule E. Schedule E should not be used when the space on any other Schedule is insufficient. In that case use additional copies of the applicable Schedule.

23. Schedule F - Schedule F may be used (1) where the space provided for any answer in Part II of the Form is insufficient, or (2) in response to each item in Part II of the Form which requires the submission of Schedule F. Schedule F should not be used when the space on any other Schedule is insufficient. In that case use additional copies of the applicable Schedule.

24. Schedule G - Schedule G is for the balance sheet required by Item 17 of Part I and Item 13 of Part II.

25. Execution - The execution must include an original manual signature. *(Mechanical reproductions of signatures are not acceptable.)*

FORM ADV PART I Page 2

OFFICIAL USE

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

2. (b) Persons to contact for further information concerning this Form:

(NAME) (TITLE)

(MAILING ADDRESS) (TELEPHONE NO.)

2. (c) Applicant consents that notice of any proceeding before the Commission in connection with its application for or registration as an investment adviser may be given by sending notice by registered or certified mail or confirmed telegram to the person named at the address given.

(LAST NAME) (FIRST NAME) (MIDDLE NAME)

(NUMBER AND STREET) (CITY) (STATE) (ZIP CODE)

2. (d) Does applicant have offices other than that mentioned in Item 2(a)? *(If "yes," state their addresses and telephone numbers on Schedule E.)* YES ☐ NO ☐

2. (e) Applicant's fiscal year ends: (MONTH) (DAY)

3. (a) Applicant is filing or has filed its application for registration or license as an investment adviser with the following: *(Place a code after each applicable jurisdiction in accordance with the following: If application is pending, insert number "1"; if presently or previously registered or licensed, insert number "2".)*

AL__ AK__ AZ__ AR__ CA__ CO__ CT__ DE__ DC__ FL__ GA__ HI__ ID__ IL__ IN__ IA__

KS__ KY__ LA__ ME__ MD__ MA__ MI__ MN__ MS__ MO__ MT__ NE__ NV__ NH__ NJ__ NM__

NY__ NC__ ND__ OH__ OK__ OR__ PA__ RI__ SC__ SD__ TN__ TX__ UT__ VT__ VA__ WA__

WV__ WI__ WY__ PR__ Other _____ (SPECIFY)

3. (b) If any license or registration listed above is of a restricted nature or has been suspended or involuntarily terminated, or withdrawn or voluntarily terminated, explain on Schedule E.

4. Applicant is a:

☐ Corporation ☐ Partnership ☐ Sole Proprietorship

☐ Other _____ (SPECIFY)

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

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5. If applicant is a corporation:

(a) Date and place of incorporation:

Date _____ State: _____
(MONTH - DAY - YEAR)

(b) List below each class of equity security:

CLASS	VOTING	NON-VOTING
_____	☐	☐
_____	☐	☐
_____	☐	☐

6. If applicant is a sole proprietor, state current legal residence address and social security number.

Social Security No.: _____

_____
(NUMBER AND STREET) (CITY) (STATE) (ZIP CODE)

7. (a) Is applicant filing this application as a successor who is taking over all or substantially all of the assets and liabilities and continuing the business of a registered investment adviser? If "yes," state: ..... YES ☐ NO ☐

(1) Date of Succession: _____

(2) Full name, IRS Empl. Ident. No. and SEC File No. of predecessor:

Name: _____

IRS Empl. Ident. No.: _____

SEC File Number: _____

(b) Has applicant, during the previous ten years, merged with or acquired another registered investment adviser? *(If "yes," explain on Schedule E.)* ..... YES ☐ NO ☐

8. (a) If applicant is a corporation, complete Schedule A.

(b) If applicant is a partnership, complete Schedule B.

(c) If applicant is other than a sole proprietorship, partnership, or corporation, complete Schedule C.

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

OFFICIAL USE

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INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

9. (a) Does any person not named in Items 2(a) and 8, or any Schedule thereunder, directly or indirectly through agreement or otherwise, exercise or have the power to exercise a controlling influence over the management or policies of applicant?. . . . . YES ☐ NO ☐

(If "yes," state on Schedule E the exact name of each person (if individual, state last, first, and middle names) and describe the agreement or other basis through which such person exercises or has the power to exercise a controlling influence.)

(b) Is the business of applicant wholly or partially financed, directly or indirectly, by any person not named in Items 2(a) and 8, or any Schedule thereunder, in any manner other than by: (1) a public offering of securities made pursuant to the Securities Act of 1933; (2) credit extended in the ordinary course of business by suppliers, banks and others; or (3) a satisfactory subordination agreement, as defined in Rule 15c3-1 under the Securities Exchange Act of 1934 (17 CFR 240.15c3-1)?. . . . . YES ☐ NO ☐

(If "yes," state on Schedule E the exact name (last, first, middle) of each person and describe the agreement or arrangement through which such financing is made available, including the amount thereof.)

10. State whether the applicant, any person named in Items 2(a), 8 or 9, or any Schedule thereunder, or any other person directly or indirectly controlling, or controlled by applicant, including any clerical or ministerial employee of applicant:

(a) Has been found by the Securities and Exchange Commission or any jurisdiction to have willfully made or caused to be made in any application for registration or report required to be filed with the Commission under the Investment Advisers Act of 1940 or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or to have omitted to state in any such application or report any material fact which is required to be stated therein . . . . . YES ☐ NO ☐

(b) Has been convicted of or has pleaded nolo contendere to, within 10 years preceding the filing of any application for registration or at any time thereafter, any felony or misdemeanor:

(i) involving the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense;. YES ☐ NO ☐

(ii) arising out of the conduct of the business of a broker, dealer, municipal securities dealer, investment adviser, bank, insurance company, or fiduciary;. . . . . YES ☐ NO ☐

(iii) involving the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; or. . . . . YES ☐ NO ☐

(iv) involving the violation of Section 152, 1341, 1342 or 1343 or Chapter 25 or 47 of Title 18, United States Code (concealment of assets, false oaths and claims, or bribery, in any bankruptcy proceeding; mail fraud, fraud by wire, including telephone, telegraph, radio or television; counterfeiting, forgery, fraud, false statements). . . . . YES ☐ NO ☐

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

OFFICIAL USE

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INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

10. (c) Is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, dealer, or municipal securities dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security or arising out of any securities or investment advisory activity . . . . . YES ☐ NO ☐

(d) Has been found by the Securities and Exchange Commission or any other jurisdiction to have willfully violated or willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or to have failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision, or to have been unable to comply with any of the foregoing provisions . . . . . YES ☐ NO ☐

(e) Is subject to an order of the Securities and Exchange Commission entered pursuant to Section 203(f) of the Investment Advisers Act of 1940 barring or suspending the right of such person to be associated with an investment adviser which order is in effect with respect to such person . . . . . YES ☐ NO ☐

(f) Has been denied membership or registration with, or participation in, or has been suspended, revoked or expelled from membership, participation in or registration with any self-regulatory organization registered under the Securities Exchange Act of 1934 . . . . . YES ☐ NO ☐

(g) Has been denied registration (license) with, or suspended, revoked or expelled from registration (license) with the Securities and Exchange Commission or any jurisdiction (or any agency thereof) as a broker, dealer, investment adviser, securities salesman, or municipal securities dealer, or has been barred from being associated with a person engaged in such business . . . . . YES ☐ NO ☐

(h) Has been found to have been a cause of (1) the denial, suspension, or revocation of any person's (a) registration with the Securities and Exchange Commission or any jurisdiction (or any agency thereof), or (b) membership or participation in any self-regulatory organization registered under the Securities Exchange Act of 1934; or (2) any person's expulsion from such self-regulatory organization . . . . . YES ☐ NO ☐

(i) Has been, within the past 10 years, the subject of any cease and desist, desist, and refrain, prohibition, or similar order which was issued by the United States or any jurisdiction arising out of the conduct of the business of a broker, dealer, municipal securities dealer or investment adviser . . . . . YES ☐ NO ☐

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

OFFICIAL USE

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

(j) Has been the subject of any order, judgment, decree or other sanction of a foreign court, foreign exchange, or foreign governmental or regulatory agency arising out of any securities or investment advisory activities . . . . . YES ☐ NO ☐

(k) State whether applicant, any person named in Items 2(a), 8 or 9, or any Schedule thereunder, or any other person directly or indirectly controlling or controlled by applicant, including any employee, is presently the subject of any public proceedings in which an adverse decision would result in any of the foregoing questions being answered "yes." . . . YES ☐ NO ☐

11. Complete a separate Schedule D for each appropriate person in accordance with the instructions thereon and instruction 21 to this Form.

12. Does applicant, or any person associated with applicant, have custody or possession of, or have authority to obtain custody or possession of:

(a) Securities of any client? . . . . . YES ☐ NO ☐

(b) Funds of any client? . . . . . YES ☐ NO ☐

Reminder: Rule 206(4)-2 contains special provisions relating to investment advisers who have custody or possession of securities or funds of their advisory clients.

(c) If the answer to any of the foregoing questions of Item 12 is "yes," provide the approximate value of the clients' funds and securities in applicant's custody or possession as of the end of the last fiscal year . . . . . _____

13. (a) State the number of persons employed by applicant, other than clerical or ministerial employees . . . . . _____

(b) Does a substantial part of applicant's investment advisory business consist of rendering "investment supervisory services" as defined in Section 202 (a)(13) of the Act? . . . . . YES ☐ NO ☐

14. Is applicant a defendant in any material civil litigation relating to its business as an investment adviser? . . . . . YES ☐ NO ☐

(If "yes," explain on Schedule E.)

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

OFFICIAL USE

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

15. (i) Opposite each of the following types of clients for which the applicant generally provides discretionary account management place a numeral indicating its rank (largest = 1) according to the approximate dollar amount under management in each category as of the end of applicant's last fiscal year. Omit any category where the dollar amount under management is less than (a) 10% of the amount stated in response to Item 15(ii) (b) or (b) $50,000, whichever is lesser.

a) Individuals . . . . . _____

b) Registered investment companies . . . . . _____

c) Pension and profit-sharing plans . . . . . _____

d) Banks . . . . . _____

e) Charitable institutions . . . . . _____

f) Educational institutions . . . . . _____

g) Trust accounts . . . . . _____

h) Corporations . . . . . _____

i) Insurance companies . . . . . _____

j) Other (explain on Schedule E) . . . . . _____

(If the applicant imposes any limitations on the types of clients it will accept, explain on Schedule E.)

(ii) (a) Total number of accounts under discretionary management as of the end of the last fiscal year . . . . . _____

(b) Approximate aggregate market value of such accounts as of the end of the last fiscal year. *(Round off to nearest hundred)* . . . . . _____

(iii) Approximate number of accounts under discretionary management in the following size categories as of the end of the last fiscal year:

a) Less than $10,000 . . . . . _____

b) $10,000 – less than $50,000 . . . . . _____

c) $50,000 – less than $200,000 . . . . . _____

d) $200,000 – less than $500,000 . . . . . _____

e) $500,000 – less than $1,000,000 . . . . . _____

f) $1,000,000 or more . . . . . _____

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

OFFICIAL USE

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

16. (i) Opposite each of the following types of clients for which the applicant generally provides account management or supervision on other than a discretionary basis place a numeral indicating its rank (largest = 1) according to the approximate dollar amount under management in each category as of the end of the applicant's last fiscal year. Omit any category where the dollar amount under management is less than (a) 10% of the amount stated in response to Item 16(ii) (b) or (b) $50,000, whichever is lesser.

a) Individuals . . . . . _____

b) Registered investment companies . . . . . _____

c) Pension and profit-sharing plans . . . . . _____

d) Banks . . . . . _____

e) Charitable institutions . . . . . _____

f) Educational institutions . . . . . _____

g) Trust accounts . . . . . _____

h) Corporations . . . . . _____

i) Insurance companies . . . . . _____

j) Other (explain on Schedule E) . . . . . _____

(If the applicant imposes any limitations on the types of clients it will accept, explain on Schedule E.)

(ii) (a) Total number of accounts under management or supervision on other than a discretionary basis as of the end of the last fiscal year . . . . . _____

(b) Approximate market value of such accounts as of the end of the last fiscal year. *(Round off to nearest hundred)* . . . . . _____

(iii) Approximate number of such accounts in the following size categories as of the end of the last fiscal year:

a) Less than $10,000 . . . . . _____

b) $10,000 – less than $50,000 . . . . . _____

c) $50,000 – less than $200,000 . . . . . _____

d) $200,000 – less than $500,000 . . . . . _____

e) $500,000 – less than $1,000,000 . . . . . _____

f) $1,000,000 or more . . . . . _____

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OFFICIAL USE

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INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

17. Every applicant not subject to the requirement of Part II - Item 13 shall provide on Schedule G a balance sheet as of the end of applicant's most recent fiscal year. The balance sheet need not be audited by an independent public accountant. The balance sheet shall be prepared in accordance with generally accepted accounting principles and shall show assets and liabilities related to the advisory business separately from other business and personal assets and liabilities. The statement shall be accompanied by a note stating the accounting principles and practices followed in its preparation, the basis at which securities are included and other notes as may be necessary for an understanding of the statement. If securities are included at cost, their market or fair value shall be shown parenthetically.

	YES	NO
Has applicant provided a balance sheet on Schedule G pursuant to this Item?	☐	☐

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

FORM ADV PART II Page 1

Name of Investment Adviser:

Address:

(NUMBER AND STREET) (CITY) (STATE) (ZIP CODE)

Telephone Number:

(AREA CODE) (NUMBER)

Part II of Form ADV, the application for registration as an investment adviser under the Investment Advisers Act of 1940, contains information relating to the investment adviser and the nature of his business. Items 1 through 4 relate to general information about the adviser's basic operations including the types of services offered and the fees charged, the types of clients advised, the types of investments generally recommended, the methods of analysis, the types of investment strategies employed, and the sources of information used by the adviser in formulating recommendations. Items 5 and 6 provide information concerning any educational and business standards applicable to persons associated with the adviser and the actual educational and business backgrounds of certain persons associated with the adviser. Items 7 through 9 contain information about other business activities of the adviser, other activities or affiliations of the adviser in the securities industry, and his participation in connection with securities transactions of clients. Items 10 through 12 provide additional information for clients whose accounts are managed by the adviser including conditions for managing investment advisory accounts, the nature of the adviser's discretionary authority, if any, with respect to clients' accounts, and the process of reviewing investment advisory accounts. Item 11 also contains information about brokerage placement practices of the adviser. Item 13 contains, for certain advisers, a certified balance sheet.

The information regarding the investment adviser contained in Part II of Form ADV has not been passed upon or approved by the Securities and Exchange Commission nor has the Commission passed upon or approved the qualifications or business practices of the investment adviser described in Part II.

OFFICIAL USE

1. **Advisory Services and Fees.** Does applicant:

		YES	NO
a)	Furnish "investment supervisory services," defined as the giving of continuous advice to clients as to the investment of funds on the basis of individual needs of each client, e.g., the nature and amount of other assets, investments and insurance, and the nature and extent of the personal and family obligations of each client (distinguished from continuous advice of any nature which is not based on consideration of such relevant individual factors)?	☐	☐
b)	Manage investment advisory accounts under circumstances not involving investment supervisory services?	☐	☐
c)	Furnish investment advice through consultations (not as part of (a) or (b) above)?	☐	☐
d)	Issue periodic publications relating to securities on a subscription basis?	☐	☐
e)	Prepare or issue special reports or analyses relating to securities, not included in any service described above?	☐	☐
f)	Prepare or issue, not as part of any service described above, any charts, graphs, formulas, or other devices which clients may use to evaluate securities?	☐	☐
g)	Furnish advice to clients on any matters not involving securities on other than an incidental basis?	☐	☐
h)	Furnish investment advice in any manner not described above?	☐	☐

(In each case in which the answer to the preceding paragraphs is "yes," the applicant shall describe such services and the fees for such services on Schedule F, including the basis or bases of compensation, e.g., a percentage of the assets under management, hourly charges, a fixed fee or an annual subscription fee in the case of a periodic publication for the services which the investment adviser provides, and the amounts charged, e.g., 1% per annum, applicant's basic fee schedule and an indication that its fees are negotiable, if such is the case, and when such compensation is payable. If such compensation is payable prior to the rendering of the services relating thereto, the applicant should expain to what extent and under what conditions such compensation is refundable.

In addition, those applicants who answered "yes" to questions (d) and (e) above should include the name of each publication or analysis issued on a regular basis and a general description of any special reports or analyses to be issued on an irregular basis.

The applicant should set forth the procedures and conditions, if any, pursuant to which the applicant or any client may terminate an investment advisory contract prior to the termination date set forth in the contract.)

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

OFFICIAL USE

2. **Types of Clients.** List the type or types of clients for which the investment adviser generally provides investment advice, including but not limited to, individuals or specified classes of individuals, banks, investment companies and pension and profit-sharing plans.

3. **Types of Securities.** Check the types of securities concerning which the applicant generally provides investment advice:

	YES	NO
a) Equity securities		
1) exchange listed securities	☐	☐
2) securities traded over-the-counter	☐	☐
b) Corporate debt securities	☐	☐
c) Warrants	☐	☐
d) Commercial paper	☐	☐
e) Bank certificates of deposit	☐	☐
f) Municipal securities	☐	☐
g) Investment company securities		
1) variable life insurance	☐	☐
2) variable annuities	☐	☐
3) mutual fund shares	☐	☐
h) United States government securities	☐	☐
i) Options contracts on		
1) securities	☐	☐
2) commodities	☐	☐
j) Interests in partnerships investing in		
1) real estate	☐	☐
2) oil and gas interests	☐	☐
3) other *(explain on Schedule F)*	☐	☐
k) Other *(explain on Schedule F)*	☐	☐

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OFFICIAL USE

4. **Methods of Analysis, Sources of Information, and Investment Strategies.**

a) Relate in a narrative fashion the applicant's method or methods of security analysis, e.g., fundamental analysis, technical analysis, cyclical analysis or charting.

b) Relate in a narrative fashion the principal sources of information applicant uses, e.g., financial newspapers and magazines, company prepared information (i.e., annual reports, prospectuses, filings with the Commission, press releases), inspections of corporate activities, research materials prepared by others, or corporate rating services.

c) Relate in a narrative fashion the types of investment strategies generally recommended or used to implement any investment advice rendered to clients, e.g., long term purchases (securities will be held at least one year except in unusual circumstances), short term purchases (securities will generally be sold within one year after purchase), trading (securities will generally be sold within 30 days after purchase), short sales, margin transactions, or option writing, including covered options, uncovered options, and spreading strategies.

OFFICIAL USE

5. **Education and Business Standards.** Are there any general standards of education and business background which applicant requires of persons associated with applicant (other than persons whose functions are solely clerical or ministerial whose functions or duties relate to providing investment advice to clients? . . . . . YES ☐ NO ☐

(If "yes," describe such standards briefly on Schedule F).

6. **Education and Business Background.**

a) Applicant shall set forth the name, age, formal education after high school, and, for the preceding five years, the business background of each member of the investment adviser's investment committee or similar group, if any, which determines or approves what investment advice shall generally be rendered by the investment adviser to any client or to which client such investment advice shall be rendered.

b) If applicant does not have an investment committee or similar committee, applicant shall set forth the name, age, formal education after high school, and, for the preceding five years, the business background of each person associated with the investment adviser who determines or approves what investment advice shall be rendered by the investment adviser *(if more than five such persons, it shall be sufficient to limit this information to persons having supervisory responsibility over those persons described in this paragraph).*

OFFICIAL USE

7. **Other Business Activities.**

a) Is applicant engaged in any business or profession other than acting as an investment adviser? . . . . . YES ☐ NO ☐

b) Does applicant offer or sell any type of product, other than investment advice concerning securities, to clients? . . . . . YES ☐ NO ☐

(If the answer to item (a) or (b) is "yes," describe briefly on Schedule F such other activities.)

c) Is the principal business of applicant that of an investment adviser? . . . . . YES ☐ NO ☐

8. **Other Securities Industry Activities or Affiliations.**

a) Is applicant registered (or does applicant have an application for registration pending) as broker or dealer? . . . . . YES ☐ NO ☐

b) Is applicant affiliated with any broker, dealer, investment company or another investment adviser? . . . . . YES ☐ NO ☐

(If "yes," state the nature of such affiliation and the business relationship, if any, between such entity and applicant on Schedule F.)

NOTE: Pursuant to Section 202 (a)(12) of the Act [15 U.S.C. 80b-2(a)(12)], the term "affiliated person" has the same meaning as in Section 2(a)(3) of the Investment Company Act of 1940 [15 U.S.C. 80a-2(a)(3)], which, as relevant, means

"(A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, co-partner, or employee of such other person . . . ."

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OFFICIAL USE

9. **Participation or Interest in Securities Transactions.** Does applicant:

(a) As principal, sell securities to or buy securities from any (investment advisory) client? . . . . . YES ☐ NO ☐

(b) Effect securities transactions for compensation as broker or agent for any (investment advisory) client? . . . . . YES ☐ NO ☐

(c) As broker or agent for any person other than a (investment advisory) client, sell securities to or buy securities from clients? . . . . . YES ☐ NO ☐

(d) Recommend to (investment advisory) clients or prospective clients, the purchase or sale of securities in which the applicant, directly or indirectly, has a position or interest? . . . . . YES ☐ NO ☐

(If the answer to any of the foregoing questions of Item 9 is "yes," describe on Schedule F the circumstances in which the investment adviser engages in such transactions and any internal procedures the investment adviser has concerning conflicts of interest in such transactions.)

(e) Impose any restrictions upon itself or any person associated with it in connection with the purchase or sale, directly or indirectly, for its or their account of securities recommended to clients? *(If the answer to this paragraph is "yes," describe such restrictions on Schedule F.)* . . . . . YES ☐ NO ☐

(If applicant provides investment supervisory services (as defined in Section 202(a)(13) of the Act [15 U.S.C. 80b-2(a)(13)] or manages investment advisory accounts for clients under circumstances not involving investment supervisory services, answer Items 10 through 12. If applicant does not provide any of the foregoing services, Item 11 must, nevertheless, be answered if applicant determines or suggests the broker or dealer through which or the commission rates at which securities transactions for client accounts are effected.)

10. **Conditions for Managing Accounts.** Does applicant generally require a minimum dollar amount of assets for or generally impose any other conditions on the establishment or maintenance of an investment advisory account? . . . . . YES ☐ NO ☐

(If "yes," describe such minimum and/or other conditions on Schedule F.)

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OFFICIAL USE

11. **Investment or Brokerage Discretion.** Does applicant or any person associated with applicant have discretionary authority to make any of the following determinations without obtaining the consent of the investment advisory client before the transactions are effected:

	YES	NO
(a) Which securities are to be bought or sold?	☐	☐
(b) The total amount of the securities to be bought or sold?	☐	☐
(c) Through which broker or dealer securities are to be bought or sold?	☐	☐
(d) The commission rates at which securities transactions for client accounts are effected?	☐	☐

(If the answer to any question of Item 11 is "yes" and there are limitations on such authority, describe such limitations on Schedule F.

If applicant or any person associated with applicant determines or suggests the broker or brokers through whom, or the commission rates at which, securities transactions for client accounts are executed, describe on Schedule F how brokers will be selected to effect securities transactions and how evaluations will be made of the overall reasonableness of brokerage commissions paid, including factors considered in these determinations. If the receipt of products or services other than brokerage or research services is such a factor, this description should specify them. If the receipt of research services is such a factor in selecting brokers, this description should identify the nature of such research services.

State on Schedule F if applicant may pay a broker a brokerage commission in excess of that which another broker might have charged for effecting the same transactions, in recognition of the value of (a) brokerage or (b) research services provided by the broker.

If applicable, explain that research services furnished by brokers through whom applicant effects securities transactions may be used in servicing all of applicant's accounts and that not all such services may be used by applicant in connection with the accounts which paid commissions to the broker providing such services; or, if other policies or practices are applicable with respect to the allocation of research services provided by brokers, explain on Schedule F such policies and practices.

If, during the last fiscal year, applicant, pursuant to an agreement or understanding with a broker or otherwise through an internal allocation procedure, directed brokerage transactions to a broker or brokers because of research services provided, identify and briefly describe on Schedule F such arrangements.)

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

OFFICIAL USE

12. **Review of Accounts.**

(a) Describe briefly below the process pursuant to which the applicant reviews investment advisory accounts, including, but not limited to, the category of personnel performing the review, the frequency of review, the number of accounts assigned to account managers, factors which trigger reviews, the sequence in which accounts are reviewed and the matters reviewed.

(b) State below the general frequency and nature of any reports regularly furnished to clients concerning their investment advisory accounts.

13. **Balance Sheet.** Every applicant who has custody or possession of clients' funds or securities, or requires prepayment of advisory fees six months or more in advance and in excess of $500 per client, shall provide on Schedule G a balance sheet as of the end of applicant's most recent fiscal year. The balance sheet shall be audited by an independent public accountant. The balance sheet shall be prepared in accordance with generally accepted accounting principles and shall show assets and liabilities related to the advisory business separately from other business and personal assets and liabilities. The statement shall be accompanied by a note stating the accounting principles and practices followed in its preparation, the basis at which securities are included and other notes as may be necessary for an understanding of the statement. If securities are included at cost, their market or fair value shall be shown parenthetically.

Has applicant provided a balance sheet on Schedule G pursuant to this Item? . . . . . YES ☐ NO ☐

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I. No Schedule required by any item on this page need be filed with an amended item unless the Schedule itself is amended.

Schedule A of FORM ADV ☐ FORM BD ☐

FOR CORPORATIONS

(Answers in response to Item 8(a) of Part I of FORM ADV or Item 8(a) of FORM BD.)

OFFICIAL USE

Date as stated on the execution page of FORM ADV or FORM BD accompanying this Schedule:

I. Full name of applicant exactly as stated in Item 2(a) of Part I of FORM ADV or Item 2(a) of FORM BD:

IRS Empl. Ident. No.:

OFFICIAL USE

II. Name under which business is conducted if different:

III. Complete and mark appropriate columns for (a) each officer, director, and person with similar status or functions, and (b) each other person who is, directly or indirectly, the beneficial owner of 1% or more of the outstanding shares of any class of equity security of applicant unless applicant is the issuer of a security registered pursuant to Section 12 of the Securities Exchange Act of 1934 (or the issuer of a security which is exempted pursuant to Subsections (g)(2)(B) or (g)(2)(G) thereof) in which case each other person who is, directly or indirectly, the beneficial owner of 5% or more of the outstanding shares of any such registered class of equity security of applicant. Thus, if applicant is owned directly, or indirectly through one or more intermediaries, by a corporation, then such corporation's shareholders should be considered in determining who must be listed on Schedule A. Place an asterisk (*) after the names of the persons for whom a change in title, status, or stock ownership is being reported. Place a double asterisk (**) after the names of the persons which are ADDED to those furnished in the most recent previous filing. Designate percentage of ownership as follows: If none, enter "none," above 0% to less than 1%, enter "A," 1% to less than 5%, enter "B," 5% to less than 10%, enter "C," 10% to less than 25%, enter "D," 25% to less than 50%, enter "E," 50% to less than 75%, enter "F," 75% to 100% enter "G."

FULL NAME Last	First	Middle	RELATIONSHIP Beginning Date Mo.	Yr.	Title or Status	Official Use Only		Ownership Code	Class of Equity Security	Social Security Number
							01			
							02			
							03			
							04			
							05			
							06			
							07			
							08			
							09			
							10			
							11			
							12			

IV. List below names reported in the most recent previous filing pursuant to this Item which are DELETED hereby:

FULL NAME Last	First	Middle	Ending Date Mo.	Yr.	Social Security Number	OFFICIAL USE

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page of Form BD or with a completed and signed execution page and Page 1 of Part I of Form ADV.

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

Schedule B of FORM ADV ☐ FORM BD ☐

FOR PARTNERSHIPS

(Answers in response to Item 8(b) of Part I of FORM ADV or Item 8(b) of FORM BD.)

OFFICIAL USE

Date as stated on the execution page of FORM ADV or FORM BD accompanying this Schedule:

I. Full name of applicant exactly as stated in Item 2(a) of Part I of FORM ADV or Item 2(a) of FORM BD:

IRS Empl. Ident. No.:

OFFICIAL USE

II. Name under which business is conducted if different:

III. List all general, limited, and special partners. For each partner, complete and mark appropriate columns below. Place an asterisk (*) after the names of persons for whom a change in title, status, or partnership interest is being reported. Place a double asterisk (**) after the names of persons which are ADDED to those furnished in the most recent previous filing. Designate percentage of capital contribution as follows: If none enter "none," above 0% to less than 1%, enter "A," 1% to less than 5%,enter "B," 5% to less than 10%,enter "C," 10% to less than 25%, enter "D," 25% to less than 50%, enter "E," 50% to less than 75%, enter "F," 75% to 100%, enter "G."

FULL NAME Last	First	Middle	Beginning Date Mo.	Yr.	Type of Partner	Official Use Only		Capital Contribution Code	Social Security Number
							01		
							02		
							03		
							04		
							05		
							06		
							07		
							08		
							09		
							10		
							11		
							12		

IV. List below names reported in the most recent previous filing pursuant to this Item which are **DELETED** hereby:

FULL NAME Last	First	Middle	Ending Date Mo.	Yr.	Social Security Number	OFFICIAL USE

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page of Form BD or with a completed and signed execution page and Page 1 of Part I of Form ADV.

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Schedule D of FORM ADV ☐ FORM BD ☐

(Answers in response to Item 11 of Part I of FORM ADV or Item 12 of FORM BD.)

OFFICIAL USE

Date as stated on the execution page of FORM ADV or FORM BD accompanying this Schedule:

NOTE: (a) Complete a separate Schedule D for each natural person named in Items 2(a), 8 or 9 of Part I of Form ADV or Items 2(a), 8 or 9 of Form BD or any Schedule thereunder, except that Schedule D need not be furnished for any person who meets both of the following conditions: (1) he owns less than 10% of any class of equity security of applicant; and (2) he is not an officer, director, or person with similar status or function.

(b) Complete a separate Schedule D for each person subject to any action reported under Item 10 of Part I of Form ADV or Item 10 of Form BD.

(c) State all names in the order of last name, first name, full middle name. If any person legally has only an initial, so indicate after the initial.

(d) Applicants who are completing Schedule D in response to Item 11 of Part I of Form ADV should also complete a separate Schedule D for: (1) each member of applicant's investment committee or similar group, if any, which determines or approves what investment advice shall generally be rendered by applicant to any client, or to which clients such investment advice shall be rendered; or (2) in the absence of an investment committee or similar group, each person associated with applicant who determines or approves what investment advice shall be rendered by applicant to any client, or to which clients such investment advice shall be rendered (if more than five such persons, it is necessary to complete a separate Schedule D only for those persons having supervisory responsibility over those persons described in this paragraph).

I. Full name of applicant exactly as stated in Item 2(a) of Part I of FORM ADV or Item 2(a) of FORM BD:	IRS Empl. Ident. No.:
II. Full name of person for whom this Schedule is being completed:	IRS Empl. Ident. No. or Soc. Sec. No.:

III. (a) Residence address of person:

(NUMBER AND STREET) (CITY) (STATE) (ZIP CODE)

(b) Date of Birth:	(c) City of Birth:	(d) State or Province:	(e) Country:

IV. NAMES USED: Furnish below a list of all names other than the name stated in Item II of this Schedule the individual is or has been known by or uses or has used, including maiden name if applicable. If applicant is not or has not been known by any other name or does not or has not used any other name, state "None."

(LAST) (FIRST) (MIDDLE)

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page of Form BD or with a completed and signed execution page and Page 1 of Part I of Form ADV.

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INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

Schedule C of

FORM ADV ☐

FORM BD ☐

OFFICIAL USE

FOR APPLICANTS OTHER THAN SOLE PROPRIETORS, PARTNERSHIPS AND CORPORATIONS

(Answers in response to Item 8(c) of Part I of FORM ADV or Item 8(c) of FORM BD.)

Date as stated on the execution page of FORM ADV or FORM BD accompanying this Schedule

I. Full name of applicant exactly as stated in Item 2(a) of Part I of FORM ADV or Item 2(a) of FORM BD:

IRS Empl. Ident. No.:

II. Name under which business is conducted if different:

III. List below any person, including a trustee, who directs, manages, or participates in directing or managing the affairs of applicant. As to each person listed below, state his title or status and describe the nature of his authority and his beneficial interest in applicant. Place an asterisk (*) after the names of persons for whom a change in title, status, or interest is being reported. Place a double asterisk (**) after the names of persons which are ADDED to those furnished in the most recent previous filing.

FULL NAME (Last / First / Middle)	Relationship: Beginning Date Mo.	Relationship: Beginning Date Yr.	Relationship: Title or Status	Social Security Number	Description of Authority and Beneficial Interest

IV. List below names reported in the most recent previous filing pursuant to this Item which are DELETED hereby:

FULL NAME (Last / First / Middle)	Ending Date Mo.	Ending Date Yr.	Social Security Number	OFFICIAL USE

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Schedule D of FORM ADV ☐ FORM BD ☐ Page 2

OFFICIAL USE

I. Full name of applicant exactly as stated in Item 2(a) of Part I of FORM ADV or Item 2(a) of FORM BD:

IRS Empl. Ident. No.:

V. EDUCATION: Furnish below a description of the education of the person named in Item II of this Schedule (include name and location of last high school attended, name and location of any college or university attended, degree received and year it was received).

VI. BUSINESS BACKGROUND: Furnish below a complete consecutive statement of all business experience and employment for the past ten years. List the most recent position first. If none, state "None."

Name of Firm and Address	Kind of Business	Exact Nature of Connection or Employment	Beginning Date		Ending Date	
			Mo.	Yr.	Mo.	Yr.

VII. PROCEEDINGS: If any answer to any paragraph of Item 10 is "Yes" with respect to the person for whom this Schedule is being completed, furnish the following details:

Applicable Part and Question of Item 10	Title or Description of Action	Name and Location of Court, Agency, Jurisdiction or Self-Regulatory Organization	Nature and Date of and Disposition of Proceeding

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page of Form BD or with a completed and signed execution page and Page 1 of Part I of Form ADV.

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

Schedule E of FORM ADV

(CONTINUATION SHEET FOR PART I OF FORM ADV)

(Do not use this Schedule as a continuation sheet for Part II of FORM ADV or Schedules A, B, C, and D.)

OFFICIAL USE

Date as stated on the execution page of FORM ADV accompanying this Schedule:

I. Full name of applicant exactly as stated in Item 2(a) of Part I of Form ADV:

IRS Empl. Ident. No.:

Item of Form (identify)	ANSWER

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I.

Schedule F of FORM ADV

(CONTINUATION SHEET FOR PART II OF FORM ADV)

(Do not use this Schedule as a continuation sheet for Part I of FORM ADV or Schedules A, B, C, and D.)

OFFICIAL USE

Date as stated on the execution page of FORM ADV accompanying this Schedule:

1. Full name of applicant exactly as stated in Item 2(a) of Part I of FORM ADV:

IRS Empl. Ident. No.:

Item of Form (identify)	ANSWER

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I.

Schedule G of FORM ADV

OFFICIAL USE

(Answer in Response to Item 17 of Part I or
Item 13 of Part II of FORM ADV or Item 4 of FORM ADV–S

Date as given on the execution page of FORM ADV accompanying this Schedule:

1. Full name of applicant exactly as stated in Item 2(a) of Part I of FORM ADV:

IRS Emp. Ident. No.:

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

If any item on this page is amended, you must answer in full all other items on this page and file with a completed and signed execution page and Page 1 of Part I.

FORM ADV Execution Page

OFFICIAL USE

EXECUTION: The applicant submitting this Form and its attachments and the person by whom it is executed represent hereby that all information contained therein is true, current and complete. It is understood that all required Items and Schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended Items and Schedules remain true, current and complete as required.

Dated the _____ day of _____ 19___

_____

(Name of Corporation, Partnership or other organization)

_____

(Manual Signature of Sole Proprietor, General Partner, Managing Agent or Principal Officer)

_____

(Title)

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

ALL OF THE ITEMS ON THIS PAGE MUST BE ANSWERED AND COMPLETED IN FULL

☆U.S. GOVERNMENT PRINTING OFFICE: 1979—625-143/1263

APPENDIX B

Sample Schedules

FORM ADV-S

INSTRUCTION SHEET

ANNUAL REPORT FOR INVESTMENT ADVISERS REGISTERED UNDER THE INVESTMENT ADVISERS ACT OF 1940

General Instructions for Preparing and Filing Form ADV-S

1. This Form (or mechanical reproductions thereof) shall be completed and filed in triplicate with the Securities and and Exchange Commission, Washington, D.C. 20549. Additional copies of this Form are available at any office of the Commission.

2. Every investment adviser which is registered under the Act on the last day of its fiscal year is required to file Form ADV-S no later than 90 days after the end of registrant's fiscal year unless registrant's registration has been withdrawn, cancelled, or revoked prior to that date.

3. Failure to file Form ADV-S, in addition to constituting a violation of Rule 204-1(c) under the Act, will result in the taking of appropriate steps by the Commission to determine whether a registrant is still in existence and is still engaged in business as an investment adviser and may, therefore, lead the Commission to order cancellation of a registrant's registration, pursuant to Section 203(h) of the Act [15 U.S.C. 80b-3(h)].

4. Any registrant answering Item 2 in the negative which is not, to its knowledge, the subject of a pending Commission investigation or administrative proceeding, is strongly urged to withdraw from registration by filing a notice of withdrawal on Form ADV-W together with this Form or as soon as possible thereafter. Otherwise, the Commission may order cancellation of registrant's registration solely on the basis of registrant's response to Item 2 of this Form. Copies of Form ADV-W may be obtained from any office of the Commission.

5. It is essential that, before answering Item 3, registrant carefully review its Form ADV which is currently on file with the Commission **and** the provisions of Rule 204-1 under the Act, which sets forth the circumstances in which amendments to Form ADV, the application for registration, are required to be filed. Any registrant which provides an affirmative answer to Item 3(a) should file the required amendment(s) together with this Form or as soon as possible thereafter. Failure to do so could result in appropriate enforcement action by the Commission. Copies of Form ADV may be obtained from any office of the Commission.

   NOTE: A registrant which does not have a copy of its Form ADV which is currently on file with the Commission may inspect the Form at the Commission's Public Reference Section, 1100 L Street, N.W., Washington, D.C. 20005 or the appropriate Regional Office, or may obtain a photocopy at a nominal charge from the Public Reference Section, Securities and Exchange Commission, Washington, D.C. 20549.

   NOTE: Registrants have a continuing obligation to file any amendments to Form ADV within the time limits set forth in Rule 204-1 under the Act and should not postpone such filings until the filing of Form ADV-S. If the information in response to questions 1 or 2 of this Form is different from similar information on Form ADV, registrant must also file an amendment to Form ADV. The filing of Form ADV-S does **not** relieve registrant from any requirement to amend Form ADV.

6. Item 4 is to remind registrant to file with the Commission on Schedule G of Form ADV a balance sheet as of the end of such registrant's most recent fiscal year. The balance sheet must meet the requirements of Item 17 of Part I or Item 13 of Part II of Form ADV.

7. If registrant uses a written disclosure statement other than Part II of Form ADV to satisfy the requirements of Rule 204-3 under the Act, Item 5 requires registrant to file with the Commission as part of Form ADV-S a copy of each such form of written disclosure statement delivered or offered to be delivered by registrant in the preceding fiscal year. Investment advisers who use only Part II of Form ADV as the written disclosure statement required by Rule 204-3 need not file a copy of Part II as part of Form ADV-S.

8. Under Sections 204 and 211(a) of the Investment Advisers Act of 1940 and the rules and regulations thereunder, the Commission is authorized to solicit the information required by this Form from registrants under the Investment Advisers Act of 1940. The information specified by this Form (other than social security numbers) must be provided prior to processing of the Form. Disclosure of social security numbers is voluntary, but social security numbers will assist the Commission in identifying registrants and, therefore, in promptly processing the Forms. The information will be used for the principal purposes of determining whether registrant is presently engaged in business as an investment adviser and whether all information in registrant's Form ADV is current, as well as other regulatory purposes. Information supplied on or enclosed with this Form will be included in the public files of the Commission and will be available for inspection by any interested person. A Form which is not prepared and executed in compliance with applicable requirements may be returned as not acceptable for filing. Acceptance of this Form, however, shall not constitute any finding that it has been filed as required or that the information submitted is true, current, or complete. Intentional misstatements or omissions of fact constitute Federal criminal violations. *(See 18 U.S.C. 1001 and 15 U.S.C. 80b-17.)*

FORM ADV–S

Page 1

ANNUAL REPORT FOR INVESTMENT ADVISERS REGISTERED UNDER THE INVESTMENT ADVISERS ACT OF 1940

Securities and Exchange Commission, Washington, D.C. 20549

OFFICIAL USE

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

GENERAL: Read all instructions before preparing the Form. Please print or type all responses.

1. (a) Registrant's Investment Adviser SEC File Number: 801– _____

(b) Full name of registrant: *(If individual, state last, first, middle name)* IRS Empl. Ident. No. or Social Security No.

_____

(c) Name under which business is conducted, if different:

_____

(d) Address of principal place of business: *(Do not use P.O. Box Number)*

_____
(NUMBER AND STREET) (CITY) (STATE) (ZIP CODE)

(e) Mailing address, if different:

_____
(NUMBER AND STREET) (CITY) (STATE) (ZIP CODE)

2. Is registrant presently engaged in business as an investment adviser? . . . . . YES ☐ NO ☐

3. (a) Is any amendment to registrant's Form ADV required to be filed pursuant to Rule 204-1 under the Act to correct any information contained in registrant's Form ADV currently on file with the Commission? . . . . . YES ☐ NO ☐

(b) If the answer to question 3(a) is "yes," state whether all required amendments are enclosed with this Form. . . . . YES ☐ NO ☐

4. Attach on Schedule G of Form ADV a balance sheet as of the end of registrant's most recent fiscal year, meeting the requirements of Item 17 of Part I or Item 13 of Part II of Form ADV.

ALL OF THE ITEMS ON THIS PAGE MUST BE ANSWERED AND COMPLETED IN FULL

OFFICIAL USE

5. (a) In complying with Rule 204-3 under the Act, has registrant delivered or offered to deliver a written disclosure statement (other than in the form of Part II of Form ADV) during the preceding fiscal year of the registrant ? . . . . . YES ☐ NO ☐

(b) If the answer to Item 5(a) is "yes", attach a copy of each such form of written disclosure statement.

EXECUTION: The undersigned represents that he has executed this Form on behalf of, and with the authority of, said registrant. The undersigned and registrant represent that the information and statements contained herein, including exhibits attached hereto and other information filed herewith, all of which are made a part hereof, are current, true, and complete.

Dated the _____ day of _____ 19__

_____
(NAME OF REGISTRANT)

By: _____
(SIGNATURE AND TITLE)

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

ALL OF THE ITEMS ON THIS PAGE MUST BE ANSWERED AND COMPLETED IN FULL

Form ADV-W

NOTICE OF WITHDRAWAL FROM REGISTRATION
AS INVESTMENT ADVISER
Pursuant To Rule 17 CFR 275.203-2
SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

SEC USE ONLY

Read instruction sheet at end of Form before preparing Form. Please print or type

1. **Full name of registrant:** *(If individual, state last, first, middle name)* IRS Empl. Ident. No.

2. **Name under which business is conducted, if different from above:**

3. **Address of actual location of principal place of business:**
No. and street *City* *State* *Zip Code*

4. **State the reasons in full for withdrawal from registration:**

SEC USE ONLY

5. **Does registrant have custody or possession of any funds or securities of clients?** Yes ☐ No ☐
If answer is "yes," furnish all of the following information on funds or securities of clients in custody or possession of registrant:
(a) Amount of funds $_____
(b) Market value of securities $_____
(c) Arrangement made for return of funds and securities.

6. **Does registrant owe any money to any client for the unexpired portion of prepaid subscription or other fees for investment advisory services or publications, or owe money to any client for any reason other than as stated in answer to question 5?** Yes ☐ No ☐
If answer is "yes," furnish all of the following information:
(a) Amount of money owed $_____
(b) Arrangements made for the payment of the money owed.

DO NOT WRITE BELOW THIS LINE ..... FOR SEC USE ONLY

7. **Has registrant assigned any of its investment advisory contracts to another person?** Yes ☐ No ☐

If answer is "yes," furnish all of the following information:

(a) Name and business address of the person to whom the contracts were assigned.

(b) Did registrant obtain the consent of each client prior to the assignment of his contracts? Yes ☐ No ☐

If answer is "yes," attach a copy of communication sent to clients to obtain their consent.

(c) What alternative was provided with respect to those clients who do not consent to the assignment of their contract?

---

8. **Is registrant involved in any legal action or proceeding? If so, furnish complete information with respect to each.** Yes ☐ No ☐

---

9. **Are there any unsatisfied judgments or liens against registrant? If so, furnish complete information with respect to each.** Yes ☐ No ☐

---

10. **If the answer was "yes" to any questions in paragraphs 5,6,7, 8 or 9 above, attach a statement of financial condition in such detail as will disclose the nature and amount of assets and liabilities and the net worth of registrant as of a date within 10 days of filing (securities of registrant or in which registrant has an interest must be listed in a separate schedule at market price, if any; and if no current independent market exists the basis upon which value has been assigned should be stated).**

11. **(a) Furnish the name and address of the person who has or will have custody or possession of registrant's books and records which are required to be preserved pursuant to Rule 204-2 under the Investment Advisers Act of 1940 (17 CFR 275. 204-2):**

(b) Furnish the address of the place where these books and records will be located:

---

12. EXECUTION : The registrant submitting this Form and its attachments and the person executing it represent hereby that it, and all materials filed in connection with it are true, correct and complete, and contain all required information.

Registrant also consents hereby to make the books and records required to be preserved by Rule 204-2 under the Investment Advisers Act of 1940 (17 CFR 275.204-2) available for examination by authorized representatives of the Securities and Exchange Commission during the period the rule requires these books and records to be preserved; and hereby authorized any person having custody or possession of these books and records to make them available.

Dated this _____ day of _____, 19 _____

ATTENTION

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS CONSTITUTE FEDERAL CRIMINAL VIOLATIONS (See 18 U.S.C. 1001 and 15 U.S.C. 80b-7. 80b-17)

_____

(Name of sole proprietorship, partnership, corporation, or other form of business organization)

_____

(Manual signature of sole proprietor, general partner, principal officer or managing agent)

_____

(Title)

Instruction Sheet for FORM ADV-W
NOTICE OF WITHDRAWAL FROM REGISTRATION AS INVESTMENT ADVISER PURSUANT TO RULE 17 CFR 275.203-2
General Instructions for Preparing and Filing Form ADV-W

1. This Form is required by Rule 203-2 under the Investment Advisers Act of 1940 (17 CFR 275.203-2), which states:

   Rule 203-2. Withdrawal from Registration

   (a) Notice of withdrawal from registration as an investment adviser pursuant to Section 203(g) shall be filed on Form ADV-W in accordance with the instructions contained therein.

   (b) Except as hereinafter provided, a notice to withdraw from registration filed by an investment adviser pursuant to Section 203(g) shall become effective on the 60th day after the filing thereof with the Commission or within such shorter period of time as the Commission may determine. If, prior to the effective date of a notice of withdrawal from registration, the Commission has instituted a proceeding pursuant to Section 203(d) to suspend or revoke registration, or a proceeding pursuant to Section 203(g) to impose terms or conditions upon withdrawal, the notice of withdrawal shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

   (c) Every notice of withdrawal filed pursuant to this Rule shall constitute a "report" within the meaning of Sections 204 and 207 and other applicable provisions of the Act.

2. This Form must be executed and filed in triplicate with the Securities and Exchange Commission, Washington, D. C. 20549. An exact copy should be retained by the registrant.

3. If the space provided for any answer is insufficient, the complete answer shall be prepared on a separate sheet which shall be identified as "Answer to Item ..." and attached to the Form and reference thereto shall be made under the item on the Form.

4. Individuals' names shall be given in full, and all other items must be answered in full.

5. All copies of this Form filed with the Commission shall be executed with a manual signature in Item 12. If the Form is filed by a sole proprietor, it shall be signed by the proprietor; if it is filed by a partnership, it shall be signed in the name of the partnership by a general partner; if filed by an unincorporated organization or association which is not a partnership, it shall be signed in the name of such organization or association by the managing agent--i.e., a duly authorized person who directs or manages or who participates in the directing or managing of its affairs; if filed by a corporation, it shall be signed in the name of the corporation by a principal officer duly authorized. If signed by an officer of a corporation, organization or association, his title must be given.

6. A Form which is not prepared and executed in compliance with applicable requirements may be returned as not acceptable for filing. However, acceptance of this Form shall not constitute any finding that it has been filed as required or that the information submitted is true, correct or complete.

7. Unless the context clearly indicates otherwise, all terms used in the Form have the same meaning as in the Investment Advisers Act of 1940 and in the General Rules and Regulations of the Commission thereunder (17 Code of Federal Regulations 275).

FORM ADV Execution Page

OFFICIAL USE

EXECUTION: The applicant submitting this Form and its attachments and the person by whom it is executed represent hereby that all information contained therein is true, current and complete. It is understood that all required Items and Schedules are considered integral parts of this Form and that the submission of any amendment represents that all unamended Items and Schedules remain true, current and complete as required.

Dated the _____ day of _____ 19___

_____

(Name of Corporation, Partnership or other organization)

_____

(Manual Signature of Sole Proprietor, General Partner, Managing Agent or Principal Officer)

_____

(Title)

WARNING: Failure to keep this form current and failure to keep accurate books and records as required by the Federal securities laws would violate such Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

ALL OF THE ITEMS ON THIS PAGE MUST BE ANSWERED AND COMPLETED IN FULL

☆U.S. GOVERNMENT PRINTING OFFICE: 1979—625-143/1263

SCHEDULE OF INVESTMENT ADVISER'S OR ADVISORY REPRESENTATIVE'S SECURITIES TRANSACTIONS
NAME OF ADVISORY REPRESENTATIVE (OR INVESTMENT ADVISER FIRM ACCOUNT)

TRADE DATE	NUMBER OF SHARES BOUGHT AND SOLD	NAME OF SECURITY	PRICE	TOTAL COST OR NET PROCEEDS	PROFIT OR (LOSS)	DATE SECURITY RECOMMENDED IN PUBLICATION (B) BUY OR (S) SELL	DATE SECURITY BOUGHT OR SOLD FOR CLIENTS 1/

1/ See Supplemental Schedule.

SCHEDULE OF INVESTMENT ADVISER'S PUBLISHED RECOMMENDATIONS VS. TRANSACTIONS EFFECTED BY ADVISER FOR ITS MANAGED AND/OR SUPERVISED ACCOUNTS

NAME OF SECURITY	DATE RECOMMENDED (B) BUY OR (S) SELL	DATE SECURITY BOUGHT OR SOLD FOR CLIENTS 1/	TYPE OF CLIENT

1/ See Supplemental Schedule.

SUPPLEMENTAL SCHEDULE

NAME OF CLIENT

TRADE DATE	NUMBER OF SHARES BOUGHT AND SOLD	NAME OF SECURITY	PRICE	TOTAL COST OR NET PROCEEDS	PROFIT OR (LOSS)

APPENDIX C

Sample Deficiency Letters

IN REPLYING PLEASE QUOTE

_____

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
REGIONAL OFFICE
26 FEDERAL PLAZA
NEW YORK, N.Y. 10007

Registrant

Re:
File No. 801-_____

Dear Mr. _____:

The examination of the books and records of _____ _____ conducted pursuant to Section 204 of the Investment Advisers Act of 1940 ("Investment Advisers Act"), disclosed the need for certain revisions in the practices and procedures of _____. There are set forth below the matters in which corrective action should be taken to the extent that it has not been taken since the time of the examination. These matters are brought to your attention for immediate action without regard to any additional corrective action concerning these or any other matters which the Commission may take or require to be taken by _____ as a result of the examination.

Contracts

It was noted that written advisory agreements with _____ clients state, among other things, ". . .You also understand and agree that the Adviser will not be liable for errors of judgment in acting or failing to act, or for mistakes of opinion, if made in good faith; provided however, that nothing herein contained shall limit the duties and obligations of the Adviser to which it is or may become subject under the Investment Advisers Act of 1940 and the Rules and Regulations promulgated thereunder." It appears that this "hedge clause" is not in accordance with the requirements of Section 206(4) of the Act in that it might lead an investor to believe that he has waived certain rights of action not related

to the Investment Advisers Act when such might not be the case.

Books and Records

The examination disclosed that Section 204 of the Investment Advisers Act and subparagraph (3) of Rule 204 thereunder was violated in that _____ failed to keep memoranda of orders given for the purchase and sale of any security.

Other Comments

It was further noted that _____ client's written discretionary authority related to securities transactions takes the form of an addendum to the custody agreement betwen _____ clients custodian banks. In view of a lack of visible client approval of this addendum, (i.e., signature or initials) granting discretion, a letter from _____ counsel to this office stating that the copy of the agreement in the possession of the registrant is in fact a true copy of the agreement as maintained by the custodian banks would be advisable.

Kindly advise this office as soon as practicable of the steps you have taken or intend to take with respect to these matters. A copy of your reply together with copies of any enclosures should be sent to the Commission's Division of Investment Management in Washington, D.C. 20549 for the attention of Dennis M. Gurtz, Examination Program Coordinator.

Sincerely yours,

Regional Administrator

By _____

IN REPLYING PLEASE QUOTE

_____

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
REGIONAL OFFICE
26 FEDERAL PLAZA
NEW YORK, N.Y. 10007

Registrant

Re:
File No. 801-_____

Dear Mr. _____:

The examination of your books and records and advisory activities, conducted pursuant to Section 204 of the Investment Advisers Act of 1940 ("the Advisers Act"), disclosed the need for certain revisions in your practices and procedures. There are set forth below the matters in which corrective action should be taken to the extent that it has not been taken since the time of the examination. These matters are brought to your attention for immediate action without regard to any additional corrective action concerning these or other matters which the Commission may take or require to be taken by you as a result of the examination.

1. Rule 204-1(b)

A review of your application for registration as an Investment Adviser, Form ADV, did not reflect recent changes in both your business and residence addresses, as required by Rule 204-1(b) of the Advisers Act.

2. Section 206(4)

The examination disclosed that your written investment advisory contracts with clients contain the following statement:

> "It is understood that I will extend by best efforts in the supervision of the portfolio but I cannot assume any responsibility for action

taken or omitted in good faith in what is believed to be the proper performance of these services."

Such a "Hedge Clause" violates Section 206(4) in that it might lead a client to believe that he/she has waived a right of action which may not be the case.

Kindly advise this office as soon as practicable of the steps you have taken or intend to take with respect to these matters. A copy of your reply together with copies of any enclosures should be sent to the Commission's Division of Investment Management in Washington, D.C. 20549 for the attention of Dennis M. Gurtz, Examination Program Coordinator.

Sincerely yours,

Regional Administrator

By _____

IN REPLYING PLEASE QUOTE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
REGIONAL OFFICE
26 FEDERAL PLAZA
NEW YORK, N.Y. 10007

Registrant

Attention:

Re:
File No. 801-

Dear Mr. _____:

The examination of the books and records of your investment advisory business conducted pursuant to Section 204 of the Investment Advisers Act of 1940 ("the Adviser's Act"), disclosed the need for certain revisions in the practices and procedures of your business. There are set forth below the matters in which corrective action should be taken to the extent that it has not been taken since the time of the examination. These matters are brought to your attention for immediate action without regard to any additional corrective action concerning these or other matters which the Commission may take or require to be taken by you as a result of the examination.

1) Books and Records - Rule 204-2

The examination revealed that the Corporation's books and records were not kept true, accurate and current as required by Rule 204-2(a)(2) in that the general ledger and auxiliary ledgers were not posted since _____. In addition, you failed to establish adequate procedures to obtain reports of all advisory representatives' transactions, as required by Rule 204-2(a)(12).

2) Advertising - Rule 206(4)-1

Brochure

The Corporation's advertising in the form of a 4 page brochure contained statements which were false and misleading within the meaning of paragraph (a)(5) of the Rule in that they portrayed an unbalanced picture to prospective clients raising illusory hopes of profit without pointing out the risks associated with any investment such as:

> "To profit in today's market calls for more than the ruthlessness of _____, the canniness of _____ or the high-handedness of _____.
>
> "Profit-making in the unruly market of today calls for the singular services of the _____.
>
> ". . .you belong to that discerning group of investors who would be interested in such exceptional profit opportunities. . . . Special Situations just coming into their own, ready to burst out of their plain cocoons and fly high.
>
> "This recovery market can mean the emergence of new leaders, the foundations of new fortunes."

The brochures mailed to potential subscribers also offered a sample copy of _____, but failed to furnish a list or to offer to furnish a list of all recommendations made within the immediately preceding 1-year period, as required by paragraph (a)(2) of the Rule. The brochure also violated paragraph (a)(1) of the Rule in that it contained the following testimonial: "_____ held out. . . despite entreaties from many readers--who now bless us for our disapproval of this chaotic craze whose bubble has burst." It also offered to furnish a hypothetical model portfolio to subscribers. It should be noted that the staff has consistenly considered the use of hypothetical model portfolios to be false and misleading within the meaning of paragraph (a)(5) of the Rule.

Publications

An advertisement you placed in _____ on _____ did not list all recommendations, or offer to furnish such a list, as required by paragraph (a)(2) of the Rule. The advertisement contained an average gain of all listed recommendations which was in substantially larger print than the print used in the body of the text, in contravention of paragraph (a)(2) of the Rule and the use of an average gain, as used in your advertisement, has been deemed by the staff to be false and misleading within the meaning of paragraph (a)(5) of the Rule. In addition, your advertisement did not indicate the nature ("Buy or Sell") of the recommendation as required by paragraph (a)(2) of the Rule.

For your guidance and information there is enclosed Findings and Opinions of the Commission in the Matters of Spear & Staff Incorporated (Investment Advisers Act Release No. 188) and Dow Theory Forecasts, Inc. (Investment Advisers Act Release No. 233). Both of these releases discuss, among other things, the Commission's views concerning the application of the advertising rule under Section 206.

3) Repetition of Certain Previous Violations

An examination of your advertising on _____ disclosed violations of Rule 206(4)-1(a)(2) and (5). You were informed of those violations and gave assurances that steps would be taken to prevent their recurrence. In addition, on _____, in a conference with members of the staff of the _____ Office, you were advised that three of your personal security transactions were perilously close to the dates on or about which recommendations of such stocks appeared in your publications, and that there should be a wider time span between your purchase dates and the dates of recommendations. It appears, according to the latest examination, that at least three of the registrants' transactions were executed shortly before the same securities were recommended in your publications.

Kindly advise this office as soon as practicable of the steps you have taken or intend to take with respect to these matters. A copy of your reply together with copies of any enclosures should be sent to the Commission's Division of Investment Management in Washington, D.C. 20549 for the attention of Dennis M. Gurtz, Examination Program Coordinator.

Sincerely yours,

Regional Administrator

By _____

Enclosures:
As noted.

IN REPLYING PLEASE QUOTE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
REGIONAL OFFICE
26 FEDERAL PLAZA
NEW YORK, N.Y. 10007

Registrant

Dear Sirs:

You have reported under item 22 of your registration as an investment adviser on Form ADV, that you or a person connected with you has authority to obtain custody or possession of securities and/or funds of investment advisory clients.

In the event that you, or any person connected with yourself did not use that authority to obtain custody or possession of your clients' funds or securities during the reporting period, you should advise this office, in writing, of that fact.

If, on the other hand, you, or any person connected with you, used that authority to obtain custody or possession of your clients' funds or securities during the reporting period, it will be necessary for you to comply with the requirements below.

All registrants having custody or possession of clients' funds or securities are subject to the requirements of Rule 206(4)-2 of the Investment Advisers Act of 1940 unless exempted by subsection (b) of said Rule.

Rule 206(4)-2 requires, among other things, that all funds and securities of clients be verified by actual examination at least once during each year by an independent public accountant at a time chosen by such accountant without prior notice to the registrant. Said Rule further provides that a

certificate of such accountant stating that he has made an examination of such funds and securities shall be filed with the Commission promptly after each examination. Your attention is directed to Investment Advisers Act of 1940, Release Number 201, dated May 26, 1966 which prescribes specific information that is to be included in the required accountant's certificate. Failure to include all such information would render such certificate unacceptable.

Our records indicate that you have not filed with this office a certificate of examination for the calendar year 19 and that the exemption from such reporting requirement afforded by Rule 206(4)-2 is not applicable.

If you have not already done so, it is suggested that you arrange to have an independent public accountant make a surprise audit of all funds and securities held for clients for the purpose of making a report, to this office, showing your compliance or noncompliance with Rule 206(4)-2 of the Investment Advisers Act of 1940. Your report should be filed, in duplicate on or before January 15, 19 . If you have any questions, please feel free to call Mr. _____.

Your immediate attention to this matter is very important.

Sincerely yours,

Regional Administrator

By _____

cc: Division of Investment Management

IN REPLYING PLEASE QUOTE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
REGIONAL OFFICE
26 FEDERAL PLAZA
NEW YORK, N.Y. 10007

Registrant

Dear Sirs:

You have reported under item 23 of your registration as an investment adviser on Form ADV, that you or a person connection with you has regularly or periodically custody or possession of securities and/or funds of investment advisory clients.

All registrants having custody or possession of clients' funds or securities are subject to the requirements of Rule 206(4)-2 of the Investment Advisers Act of 1940 unless exempted by subsection (b) of said Rule.

Rule 206(4)-2 requires, among other things, that all funds and securities of clients be verified by actual examination at least once during each year by an independent public accountant at a time chosen by such accountant without prior notice to the registrant. Said Rule further provides that a certificate of such accountant stating that he has made an examination of such funds and securities shall be filed with the Commission promptly after each examination. Your attention is directed to Investment Advisers Act of 1940, Release Number 201, dated May 26, 1966 which prescribes specific information that is to be included in the required accountant's certificate. Failure to include all such information would render such certificate unacceptable.

Our records indicate that you have not filed with this office a certificate of examination for the calendar year 19 and that the exemption from such reporting requirement afforded by Rule 206(4)-2 is not applicable.

If you have not already done so, it is suggested that you arrange to have an independent public accountant make a suprise audit of all funds and securities held for clients for the purpose of making a report, to this office, showing your compliance or noncompliance with Rule 206(4)-2 of the Investment Advisers Act of 1940. Your report should be filed, in duplicate on or before January 15, 19 . If you have any questions, please feel free to call Mr. _____.

Your immediate attention to this matter is very important.

Sincerely yours,

Regional Administrator

By _____

cc: Division of Investment Management

IN REPLYING PLEASE QUOTE

_____

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
REGIONAL OFFICE
26 FEDERAL PLAZA
NEW YORK, N.Y. 10007

Registrant

Attention:

Re:
File No. 801-_____

Dear Mr. _____:

In your _____ letter, you expressed the view that, notwithstanding the fact that _____ holds a broad power of attorney from each of its clients and retains possession of their savings account passbooks, _____ should not be deemed to have custody or possession of its clients' funds and securities. Your letter states that your view is based on the following practices and procedures instituted by _____ (i) all withdrawals from the savings accounts, to which the passbooks relate, are effected in the form of official checks of the savings bank payable to the order of either the client or the particular investment company in which the client's funds are to be invested; and (ii) the proceeds realized from the sale of a client's investment company shares are represented by checks payable to the order of the client which are then deposited in the client's savings account.

We believe that the practices and procedures instituted by an investment adviser to safeguard clients' funds and securities are not determinative of the question whether the adviser has custody or possession of clients' funds or securities. The examination by an independent public accountant, required by Rule 206(4)-2(a)(5) under the Investment Advisers Act of 1940 ("Advisers Act"), in our view, is intended to provide independent verification that clients' funds and securities have been safeguarded. Thus, we again conclude that _____ does have custody or possession of its

clients' funds or securities by virtue of its practice of having clients sign-in-blank undated stock powers and execute powers of attorney with unlimited discretionary authority together with _____ possession of clients' savings bank passbooks permitting the withdrawal of securities or funds from clients' accounts at any time.

Your letter also states that the practices and procedures of _____ described in your letter have been reviewed by representatives of this office and found to be acceptable. Although our files do not disclose any such review, we are not questioning the propriety of such practices and procedures. Our comments are directed solely toward the need for the independent verification of the safeguarding of clients' funds and securities as required by Rule 206(4)-2(a)(5).

Consequently, _____ should take immediate steps to comply with the requirements of Rule 206(4)-2(a)(5) of the Advisers Act. Please advise this office in writing as to the steps your client has taken or proposes to take with respect to this matter. In addition, you are requested to send a copy of such letter to:

Mr. Dennis M. Gurtz
Examination Program Coordinator
Division of Investment Management
U.S. Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Sincerely yours,

Regional Administrator

By _____

APPENDIX D

Releases concerning Requests for No-Action and Interpretative Letters and the Public Availability of Such Letters

For RELEASE Thursday, October 29, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Release No. 5098
SECURITIES EXCHANGE ACT OF 1934
Release No. 9006
HOLDING COMPANY ACT OF 1935
Release No. 16875
TRUST INDENTURE ACT OF 1939
Release No. 281
INVESTMENT COMPANY ACT OF 1940
Release No. 6220
INVESTMENT ADVISERS ACT OF 1940
Release No. 274

ADOPTION OF SECTION 200.81(17 CFR 200.81), CONCERNING PUBLIC AVAILABILITY OF REQUESTS FOR NO-ACTION AND INTERPRETATIVE LETTERS AND THE RESPONSES THERETO BY THE COMMISSION'S STAFF, AND AMENDMENT OF SECTION 200.80(17 CFR 200.80)

The Securities and Exchange Commission has adopted a new Section 200.81 of the Code of Federal Regulations (17 CFR 200.81) concerning public availability of requests for no-action and interpretative letters and the responses made by the Commission's staff to such requests, and has amended the provisions of Section 200.80 (c)(4) to reflect the changes therein necessitated by the Commission's action. Notice of the proposed action was published July 14, 1970 (see Securities Act Release No. 5073). Section 200.81 provides generally that requests for interpretative advice or no-action letters and written responses to such request shall be treated as public records of the Commission after a response has been made.

Section 200.81 provides that no-action and interpretative letters and the responses thereto will be available for public inspection or copying 30 days after the staff has given or sent the responses to the person requesting it. In particular cases where it appears that a further delay in publication would be appropriate, the letter and response thereto will be given confidential treatment for a reasonable period not exceeding an additional 90 days upon application therefor. The burden will be on the person requesting the no-action position or interpretation to establish the need for confidential treatment and it will not be granted unless such need is clearly shown. Moreover, requests for confidential treatment should be limited to the minimum period necessary under the circumstances. Only in exceptional situations, such as mergers or acquisition programs, will the full 90-day period be allowed.

It is contemplated that from time to time where the subject matter of a no-action or interpretative letter is of particular interest or importance, such letter and response thereto will be published in summarized form in the Commission's daily News Digest. This will call attention to the position taken in the staff's response and interested persons can, if they so desire, inspect the full text of the letter and response thereto in the public file.

In addition, copies of the letter and response may be purchased at prescribed rates by writing to the Public Reference Room, Securities and Exchange Commission, Washington, D. C. 20549

A note to paragraph (b) of the rule requires that all requests for interpretative advice or a no-action position shall indicate in a separate caption at the beginning of the request each section of the Act or rule involved. If more than one section or rule is involved, a separate copy of the request must be submitted for each such section or rule and an additional copy for the use of the staff of the Commission. Comments on the proposed rule indicated concern that the requests and responses thereto should be available in a form which will facilitate reference to those relating to a particular section or rule. Cooperation of the bar and other persons in complying with the note to paragraph (b) will aid in accomplishing this result.

The rule will operate prospectively and will apply to all requests submitted on or after December 1, 1970.

It should be recognized that no-action and interpretative responses by the staff are subject to reconsideration and should not be regarded as precedents binding on the Commission.

To avoid possible confusion as a result of the adoption of the foregoing Section, the Commission has amended Section 800.80 of the Code of Federal Regulations (17 CFR 200.80) to delete subparagraph (i) of paragraph (c)(4) of the section, relating to the confidential treatment of interpretative and no-action letters. Subparagraphs (ii), (iii) and (iv) of paragraph (c)(4) have been renumbered (i), (ii) and (iii) respectively.

The text of Section 200.81 follows:

Sec. 200.81. Publication of Interpretative and No-Action Letters and Other Written Communications.

(a) Except as provided in paragraphs (b) and (c), every letter or other written communication requesting the staff of the Commission to provide interpretative legal advice with respect to any statute administered by the Commission or any rule or regulation adopted thereunder, or requesting a statement that, on the basis of the facts stated in such letter or other communication, the staff would not recommend that the Commission take any enforcement action, together with any written response thereto, shall be made available upon request for inspection and copying by any person 30 days after the response has been sent or given to the person requesting it.

(b) Any person submitting such letter or other written communication may also submit therewith a request that it be accorded confidential treatment for a specified period of time, not exceeding 90 days after the expiration of such 30 days, together with a statement setting forth the considerations upon which the request for such treatment is based. If the staff determines that the request is reasonable and appropriate it will be

granted and the letter or other communication will not be made available for public inspection or copying until the expiration of the specified period. If it appears to the staff that the request for confidential treatment should be denied the staff shall so advice the person making the request and such person may withdraw the letter or other communication within 30 days thereafter. In such case, no response will be sent or given and the letter or other communication shall remain in the Commission's files but will not be made public. If such letter or other communication is not so withdrawn, it shall be deemed to be available for public inspection and copying together with any written response thereto.

Note. All letters or other written communications requesting interpretative advice or a no action position shall indicate prominently, in a separate caption at the beginning of the request, each section of the Act and each rule to which the request relates. If more than one section or rule is involved, a separate copy of the request shall be submitted for each such section or rule involved and an additional copy for the use of the staff of the Commission.

(c) This rule shall not apply, however, to letters of comment or other communications relating to the accuracy or adequacy of any registration statement, report, proxy or information statement or other document filed with the Commission, or relating to the extent to which such statement, report or document complies or fails to comply with any applicable requirement.

The foregoing rule shall be effective with respect to requests for interpretative advice or a no-action position submitted to the Commission on or after December 1, 1970.

By the Commission.

Orval L. DuBois
Secretary

For RELEASE Monday, January 25, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Release No. 5127
SECURITIES EXCHANGE ACT OF 1934
Release No. 9065
HOLDING COMPANY ACT OF 1935
Release No. 16972
TRUST INDENTURE ACT OF 1939
Release No. 289
INVESTMENT COMPANY ACT OF 1940
Release No. 6330
INVESTMENT ADVISORS ACT OF 1940
Release No. 281

PROCEDURE APPLICABLE TO REQUESTS FOR NO ACTION OR INTERPRETATIVE LETTERS

The Commission in Securities Act Release 5098 announced the adoption, effective December 1, 1970, of a rule (17 CFR 200.81) providing for the public availability of requests for no action and interpretative letters and the responses thereto. The purpose of this release is to indicate more specificially the procedures to be followed by persons submitting such requests in order to facilitate their processing and so that the letter containing the request and the response thereto will be conveniently available for public use in the Public Reference Room in the principal office of the Commission in Washington. To meet these needs the following procedure should be followed:

1. An original and two copies of each letter requesting a no action position or interpretation should be submitted. If the inquiry involves more than one subsection of a statute, or subsections of more than one statute, an additional copy of the letter should be submitted for each subsection involved.

2. The specific subsection of the particular statute to which the letter pertains should be indicated in the upper right-hand corner of the original and each copy of the letter submitted pursuant to paragraph 1 above. Thus, for example, a letter requesting an interpretation of the intrastate exemption would be captioned "1933 Act/3(a)(11), and a letter requesting an interpretation of Rule 10b-6 under the Securities Exchange Act of 1934 would be captioned "1934 Act/Rule 10b-6.

3. The names of the company or companies and all other persons involved should be stated. Letters relating to unnamed companies or persons, or to hypothetical situations, will not be answered.

4. Letters should be limited to the particular situation involving the problem at hand, and should not attempt to include every possible type of situation which may arise in the future.

5. While it is essential that letters contain all of the facts necessary to reach a conclusion in the matter, they should be concise and to the point.

6. The writer should indicate why he thinks a problem exists, his own opinion in the matter and the basis for such opinion.

7. If a request for confidential treatment is made, this request and the basis therefor should be included in a separate letter and submitted with the no action request letter.

Because of the volume of letters received, letters which are not prepared in accordance with the procedures set forth above may be returned to the sender for compliance with such procedures.

By the Commission.

Orval L. DuBois
Secretary

APPENDIX E

Court Decisions

SUPREME COURT OF THE UNITED STATES

No. 42.—October Term, 1963.

Securities and Exchange Commission, Petitioner, v. Capital Gains Research Bureau, Inc., et al. } On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[December 9, 1963.]

Mr. Justice Goldberg delivered the opinion of the Court.

We are called upon in this case to decide whether under the Investment Advisers Act of 1940 [1] the Securities and Exchange Commission may obtain an injunction compelling a registered investment adviser to disclose to his clients a practice of purchasing shares of a security for his own account shortly before recommending that security for long-term investment and then immediately selling the shares at a profit upon the rise in the market price following the recommendation. The answer to this question turns on whether the practice—known in the trade as "scalping"—"operates as a fraud or deceit upon any client or prospective client" within the meaning of the Act.[2] We hold that it does and that the Commission may "enforce compliance" with the Act by obtaining an

[1] 54 Stat. 847, as amended, 15 U. S. C. § 80b–1 *et seq.*

[2] 54 Stat. 852, as amended, 15 U. S. C. § 80b–6, provides in relevant part that:

"It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud any client or prospective client; [*Footnote 2 continued on p. 2*]

injunction requiring the adviser to make full disclosure of the practice to his clients.[3]

The Commission brought this action against respondents in the United States District Court for the Southern District of New York. At the hearing on the application for a preliminary injunction, the following facts were established. Respondents publish two investment advisory services, one of which—"A Capital Gains Re-

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"(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

"(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction . . . ."

[3] 54 Stat. 853, 15 U. S. C. § 80b–9, provides in relevant part that:

"(e) Whenever it shall appear to the Commission that any person has engaged, is engaged, or is about to engage in any act or practice constituting a violation of any provision of this subchapter, or of any rule, regulation, or order hereunder, or that any person has aided, abetted, counseled, commanded, induced, or procured, is aiding, abetting, counseling, commanding, inducing, or procuring, or is about to aid, abet, counsel, command, induce, or procure such a violation, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this subchapter or any rule, regulation, or order hereunder. Upon a showing that such person has engaged, is engaged, or is about to engage in any such act or practice, or in aiding, abetting, counseling, commanding, inducing, or procuring any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond."

port"—is the subject of this proceeding. The Report is mailed monthly to approximately 5,000 subscribers who each pay an annual subscription price of $18. It carries the following description:

> "An Investment Service devoted exclusively to (1) The protection of investment capital. (2) The realization of a steady and attractive income therefrom. (3) The accumulation of Capital Gains thru [*sic*] the timely purchase of corporate equities that are proved to be undervalued."

Between March 15, 1960, and November 7, 1960, respondents, on six different occasions, purchased shares of a particular security shortly before recommending it in the Report for long-term investment. On each occasion, there was an increase in the market price and the volume of trading of the recommended security within a few days after the distribution of the Report. Immediately thereafter, respondents sold their shares of these securities at a profit.[4] They did not disclose any aspect of these transactions to their clients or prospective clients.

On the basis of the above facts, the Commission requested a preliminary injunction as necessary to effectuate the purposes of the Investment Advisers Act of 1940. The injunction would have required respondents, in any future Report, to disclose the material facts concerning, *inter alia*, any purchase of recommended securities "within a very short period prior to the distribution of a recommendation . . . ," and "the intent to sell and the sale of said securities . . . within a very short period after distribution of said recommendation . . . ."[5]

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[4] See Appendix, *infra*, p. 22.

[5] The requested injunction reads in full as follows:

"WHEREFORE the plaintiff demands a temporary restraining order, preliminary injunction and final injunction:

"1. Enjoining the defendants Capital Gains Research Bureau, Inc., and Harry P. Schwarzmann, their agents, servants, employees, at-

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The District Court denied the request for a preliminary injunction, holding that the words "fraud" and "deceit" are used in the Investment Advisers Act of 1940 "in their technical sense" and that the Commission had failed to show an intent to injure clients or an actual loss of money to clients. 191 F. Supp. 897. The Court of Appeals for the Second Circuit, sitting *en banc*, by a 5 to 4 vote accepted the District Court's limited construction of "fraud" and "deceit" and affirmed the denial

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torneys and assigns, and each of them, while the said Capital Gains Research Bureau, Inc., is an investment adviser, directly and indirectly, by the use of the mails or any means or instrumentalities of interstate commerce from:

"(a) Employing any device, scheme or artifice to defraud any client or prospective client by failing to disclose the material facts concerning

"(1) The purchase by defendant, Capital Gains Research Bureau, Inc., of securities within a very short period prior to the distribution of a recommendation by said defendant to its clients and prospective clients for purchase of said securities;

"(2) The intent to sell and the sale of said securities by said defendant so recommended to be purchased within a very short period after distribution of said recommendation to its clients and prospective clients;

"(3) Effecting of short sales by said defendant within a very short period prior to the distribution of a recommendation by said defendant to its clients and prospective clients to dispose of said securities;

"(4) The intent of said defendant to purchase and the purchase of said securities to cover its short sales;

"(5) The purchase by said defendant for its own account of puts and calls for securities within a very short period prior to the distribution of a recommendation to its clients and prospective clients for purchase or disposition of said securities.

"(b) Engaging in any transaction, practice and course of business which operates as a fraud or deceit upon any client or prospective client by failing to disclose the material facts concerning the matters set forth in demand 1 (a) hereof."

of injunctive relief.[4] 306 F. 2d 606. The majority concluded that no violation of the Act could be found absent proof that "any misstatements or false figures were contained in any of the bulletins"; or that "the investment advice was unsound"; or that "defendants were being bribed or paid to tout a stock contrary to their own beliefs"; or that "these bulletins were a scheme to get rid of worthless stock"; or that the recommendations were made "for the purpose of endeavoring artificially to raise the market so that [respondents] might unload their holdings at a profit." *Id.*, at 608–609. The four dissenting judges pointed out that "the common-law doctrines of fraud and deceit grew up in a business climate very different from that involved in the sale of securities," and urged a broad remedial construction of the statute which would encompass respondents' conduct. *Id.*, at 614. We granted certiorari to consider the question of statutory construction because of its importance to the investing public and the financial community. 371 U. S. 967.

The decision in this case turns on whether Congress, in empowering the courts to enjoin any practice which operates "as a fraud or deceit upon any client or prospective client," intended to require the Commission to establish fraud and deceit "in their technical sense," including

[4] The case was originally heard before a panel of the Court of Appeals, which, with one judge dissenting, affirmed the District Court. 300 F. 2d 745. Rehearing *en banc* was then ordered.

The Court of Appeals purported to recognise that "federal securities laws are to be construed broadly to effectuate their remedial purpose." 306 F. 2d 606, 606. But by affirming the District Court's "technical" construction of the Investment Advisers Act of 1940 and by requiring proof of "misstatements," unsound advice, bribery, or intent to unload "worthless stock," the court read the statute, in effect, as confined by traditional common-law concepts of fraud and deceit.

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intent to injure and actual injury to clients, or whether Congress intended a broad remedial construction of the Act which would encompass nondisclosure of material facts. For resolution of this issue we consider the history and purpose of the Investment Advisers Act of 1940.

I.

The Investment Advisers Act of 1940 was the last in a series of acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's.[7] It was preceded by the Securities Act of 1933,[8] the Securities Exchange Act of 1934,[9] the Public Utility Holding Company Act of 1935,[10] the Trust Indenture Act of 1939,[11] and the Investment Company Act of 1940.[12] A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.[13] As we recently said in a related context, "It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail"

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[7] See generally Douglas and Bates, The Federal Securities Act of 1933, 43 Yale L. J. 171 (1933); Loomis, The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940, 28 Geo. Wash. L. Rev. 214 (1959); Shulman, Civil Liability and the Securities Act, 43 Yale L. J. 227 (1933). Cf. Galbraith, The Great Crash (1955).

[8] 48 Stat. 74, as amended, 15 U. S. C. § 77a *et seq.*

[9] 48 Stat. 881, as amended, 15 U. S. C. § 78a *et seq.*

[10] 49 Stat. 838, as amended, 15 U. S. C. § 79 *et seq.*

[11] 53 Stat. 1149, as amended, 15 U. S. C. § 77aaa *et seq.*

[12] 54 Stat. 789, as amended, 15 U. S. C. § 80a-1 *et seq.*

[13] See H. R. Rep. No. 85, 73d Cong., 1st Sess. 2, quoted in *Wilko* v. *Swan*, 346 U. S. 427, 430.

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in every facet of the securities industry. *Silver* v. *New York Stock Exchange*, 373 U. S. 341, 366.

The Public Utility Holding Company Act of 1935 "authorized and directed" the Securities and Exchange Commission "to make a study of the functions and activities of investment trusts and investment companies . . . ." [14] Pursuant to this mandate, the Commission made an exhaustive study and report which included consideration of investment counsel and investment advisory services.[15] This aspect of the study and report culminated in the Investment Advisers Act of 1940.

The report reflects the attitude—shared by investment advisers and the Commission—that investment advisers cannot "completely perform their basic function—furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments—unless all conflicts of interest between the investment counsel and the client were removed." [16] The Report stressed that affiliations by invest-

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[14] 49 Stat. 837, 15 U. S. C. § 79z–4.

[15] While the study concentrated on investment advisory services which provide personalized counseling to investers, see Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utilities Holding Company Act of 1935, on Investment Trust and Investment Companies, H. R. Doc. No. 447, 76th Cong., 2d Sess. 1 (hereinafter cited as SEC Report) the Senate Committee on Banking and Currency did receive communications from publishers of investment advisory services, see, *e. g.*, Hearing on S. 3580 before Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess., pt. 3 (Exhibits) 1063, and the Act specifically covers "any person who, for compensation, engages in the business of advising others, either directly or through publication or writings . . . ." 54 Stat. 847, 15 U. S. C. § 80b–2.

[16] SEC Report, at 28.

ment advisers with investment bankers, or corporations might be "an impediment to a disinterested, objective, or critical attitude toward an investment by clients . . . ." [17]

This concern was not limited to deliberate or conscious impediments to objectivity. Both the Advisers and the Commission were well aware that whenever advice to a client might result in financial benefit to the adviser—other than the fee for his advice—"that advice to a client might in some way be tinged with that pecuniary interest [whether consciously or] subconsciously motivated . . . ." [18] The report quoted one leading investment adviser who said that he "would put the emphasis . . . on subconscious" motivation in such situations.[19] It quoted a member of the Commission staff who suggested that a significant part of the problem was not the existence of a "deliberate intent" to obtain a financial advantage, but rather the existence "subconsciously [of] a prejudice" in favor of one's own financial interests.[20] The report incorporated the Code of Ethics and Standards of Practice of one of the leading investment counsel associations, which contained the following canon:

> "[An investment adviser] should continuously occupy an impartial and disinterested position, as free as humanly possible from the *subtle* influence of prejudice, *conscious or unconscious;* he should scrupulously avoid any affiliation, or any act, which subjects his position to challenge in this respect." [21] (Emphasis added.)

Other canons appended to the report announced the following guiding principles: that compensation for in-

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[17] *Id.*, at 29.
[18] *Id.*, at 24.
[19] *Ibid.*
[20] *Ibid.*
[21] *Id.*, at 66–67.

vestment advice "should consist exclusively of direct charges to clients for services rendered"; [22] that the adviser should devote his time "exclusively to the performance" of his advisory function; [23] that he should not "share in profits" of his clients; [24] and that he should not "directly or indirectly engage in any activity which may jeopardize [his] ability to render unbiased investment advice." [25] These canons were adopted "to the end that the quality of services to be rendered by investment counselors may measure up to the high standards which the public has a right to expect and to demand." [26]

One activity specifically mentioned and condemned by investment advisers who testified before the Commission was "*trading by investment counselors for their own account in securities in which their clients were interested . . .*" [27]

This study and report—authorized and directed by statute [28]—culminated in the preparation and introduction by Senator Wagner of the bill which, with some changes, became the Investment Advisers Act of 1940. [29] In its "declaration of policy" the original bill stated that

> "upon the basis of facts disclosed by the record and report of the Securities Exchange Commission . . . it is hereby declared that the national public interest and the interest of investors are adversely affected— . . . (4) when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients.

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[22] *Id.*, at 66.
[23] *Id.*, at 65.
[24] *Id.*, at 67.
[25] *Id.*, at 29.
[26] *Id.*, at 66.
[27] *Id.*, at 29–30. (Emphasis added.)
[28] See text accompanying note 14, *supra*.
[29] S. 3580, 79th Cong., 3d Sess.

> "It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is presently practicable to eliminate the abuses enumerated in this section." S. 3580, 79th Cong., 3d Sess., § 202.

Hearings were then held before Committees of both Houses of Congress.[30] In describing their profession, leading investment advisers emphasized their relationship of "trust and confidence" with their clients [31] and the importance of "strict limitation of [their right] to buy and sell securities in the normal way if there is any chance at all that to do so might seem to operate against the interests of clients and the public." [32] The president of the Investment Counsel Association of America, the leading investment counsel association, testified that the

> "two fundamental principles upon which the pioneers in this new profession undertook to meet the growing need for unbiased investment information and guidance were, first, that they would limit their efforts and activities to the study of investment problems from the investor's standpoint, not engaging in any other activity, such as security selling or brokerage, which might directly or indirectly bias their investment judgment; and, second, that their remuneration for this work would consist solely of definite, professional fees fully disclosed in advance." [33]

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[30] Hearings on S. 3580 before Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess. (hereinafter cited as Senate Hearings). Hearings on H. R. 10065 before Subcommittee of the House Committee on Interstate and Foreign Commerce, 76th Cong., 3d Sess. (hereinafter cited as House Hearings).

[31] Senate Hearings, at 719.

[32] *Id.*, at 716.

[33] *Id.*, at 724.

Although certain changes were made in the bill following the hearings,[34] there is nothing to indicate an intent to alter the fundamental purposes of the legislation. The broad proscription against "any . . . practice . . . which operates . . . as a fraud or deceit upon any client or prospective client" remained in the bill from beginning to end. And the Committee Reports indicate a desire to preserve "the personalized character of the services of investment advisers," [35] and to eliminate conflicts of interest between the investment adviser and the clients [36] as safeguards both to "unsophisticated investors" and to "bona fide investment counsel." [37] The Investment Advisers Act of 1940 thus reflects a congressional recognition "of the delicate fiduciary nature of an investment advisory relationship," [38] as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—

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[34] The bill as enacted did not contain a section attributing specific abuses to the investment adviser profession. This section was eliminated apparently at the urging of the investment advisers who, while not denying that abuses had occurred, attributed them to certain fringe elements in the profession. They feared that a public and general indictment of all investment advisers by Congress would do irreparable harm to their fledgling profession. See, *e. g.*, Senate Hearings, at 715–716. It cannot be inferred, therefore, that the section was eliminated because Congress had concluded that the abuses had not occurred, or because Congress did not desire to prevent their repetition in the future. The more logical inference, considering the legislative background of the Act, is that the section was omitted to avoid condemning an entire profession (which depends for its success on continued public confidence) for the acts of a few.

[35] H. R. Rep. No. 2639, 76th Cong., 3d Sess. 28 (hereinafter cited as House Report). See also S. Rep. No. 1775, 76th Cong., 3d Sess. 22 (hereinafter cited as Senate Report).

[36] See Senate Report, at 22.

[37] *Id.*, at 21.

[38] 2 Loss, Securities Regulation (2d ed. 1961), 1412.

consciously or unconsciously—to render advice which was not disinterested. It would defeat the manifest purpose of the Investment Advisers Act of 1940 for us to hold therefore, that Congress, in empowering the courts to enjoin any practice which operates "as a fraud or deceit," intended to require proof of intent to injure and actual injury to clients.

This conclusion moreover, is not in derogation of the common law of fraud, as the District Court and the majority in the Court of Appeals suggested. To the contrary, it finds support in the process by which the courts have adapted the common law of fraud to the commercial transactions of our society. It is true that at common law intent and injury have been deemed essential elements in a damage suit between parties to an arms-length transaction.[39] But this is not such an action.[40] This is a

[39] See cases cited in 37 C. J. S. Fraud (1943) 210.

Even in a damage suit between parties to an arms-length transaction, the intent which must be established need not be an intent to cause injury to the client, as the courts below seem to have assumed. "It is to be noted that it is not necessary that the person making the misrepresentation intend to cause loss to the other or gain a profit for himself; it is only necessary that he intend action in reliance on the truth of his misrepresentations." 1 Harper and James, The Law of Torts (1956), 531. "[T]he fact that the defendant was disinterested, that he had the best of motives, and that he thought he was doing the plaintiff a kindness, will not absolve him from liability, so long as he did in fact intend to mislead." Prosser, Law of Torts (1955), 538. See 3 Restatement, Torts (1938), § 531, Comment *b*, illustration 3. It is clear that respondents' failure to disclose the practice here in issue was purposeful, and that they intended that action be taken in reliance on the claimed disinterestedness of the service and its exclusive concern for the clients' interests.

[40] Neither is this a criminal proceeding for "willfully" violating the Act, 54 Stat. 857, as amended, 15 U. S. C. § 80b–17, nor a proceeding to revoke or suspend a registration "in the public interest," 54 Stat. 850, as amended, 15 U. S. C. § 80b–3. Other considerations may be relevant in such proceedings. Compare *Federal Communications Comm'n* v. *American Broadcasting Co.*, 347 U. S. 284.

suit for a preliminary injunction in which the relief sought is, as the dissenting judges below characterized it, the "mild prophylactic," 306 F. 2d. at 613, of requiring a fiduciary to disclose to his clients, not all his security holdings, but only his dealings in recommended securities just before and after the issuance of his recommendations.

The content of common-law fraud has not remained static as the courts below seem to have assumed. It has varied, for example, with the nature of the relief sought, the relationship between the parties, and the merchandise in issue. It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages.

> "Law had come to regard fraud . . . as primarily a tort, and hedged about with stringent requirements, the chief of which was a strong moral, or rather immoral element, while equity regarded it, as it had all along regarded it, as a conveniently comprehensive word for the expression of a lapse from the high standard of conscientiousness that it exacted from any party occupying a certain contractual or fiduciary relation toward another party." [41]

> "Fraud has a broader meaning in equity [than at law] and intention to defraud or misrepresent is not a necessary element." [42]

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[41] Hanbury, Modern Equity (8th ed. 1962), 643. See Letter of Lord Hardwicke to Lord Kames, dated June 30, 1759, printed in Parkes, History of the Court of Chancery (1828), 508, quoted in Snell, Principles of Equity (25th ed. 1960), 496:

"Fraud is infinite, and were a Court of Equity once to lay down rules, how far they would go, and no farther, in extending their relief against it, or to define strictly the species or evidence of it, the jurisdiction would be cramped, and perpetually eluded by new schemes which the fertility of man's invention would contrive."

[42] De Funiak, Handbook of Modern Equity (2d ed. 1956), 235.

> "Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another." [43]

Nor is it necessary in a suit against a fiduciary, which Congress recognized the investment adviser to be, to establish all the elements required in a suit against a party to an arms-length transaction. Courts have imposed on a fiduciary an affirmative duty of "utmost good faith, and full and fair disclosure of all material facts," [44] as well as an affirmative obligation "to employ reasonable care to avoid misleading" [45] his clients. There has also been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and that accordingly, the doctrines must be adapted to the merchandise in issue.[46] The 1909 New York case of *Ridgely* v. *Keene*, 134 App. Div. 647, 119 N. Y. Supp. 451, illustrates this continuing development. An investment adviser who, like respondents, published an investment advisory service, agreed, for compensation, to influence his clients to buy shares in a certain security. He did not disclose the agreement to his client but sought "to excuse his conduct by asserting that . . . he honestly believed, that his subscribers would profit by his ad-

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[43] *Moore* v. *Crawford*, 130 U. S. 122, 128, quoting 1 Story, Equity Jur. § 187.

[44] Prosser, Law of Torts (1955), 534–535 (citing cases). See generally Keeton, Fraud—Concealment and Non-Disclosure, 15 Texas L. Rev. 1.

[45] 1 Harper and James (1956), The Law of Torts, 541.

[46] See generally Shulman, Civil Liability and the Securities Act, 43 Yale L. J. 227 (1933).

vice . . . ." The court, holding that "his belief in the soundness of his advice is wholly immaterial," declared the act in question "a palpable fraud."

We cannot assume that Congress, in enacting legislation to prevent fraudulent practices by investment advisers, was unaware of these developments in the common law of fraud. Thus, even if we were to agree with the courts below that Congress had intended, in effect, to codify the common law of fraud in the Investment Advisers Act of 1940, it would be logical to conclude that Congress codified the common law "remedially" as the courts had adapted it to the prevention of fraudulent securities transactions by fiduciaries, not "technically" as it has traditionally been applied in damage suits between parties to arms-length transactions involving land and ordinary chattels.

The foregoing analysis of the judicial treatment of common-law fraud reinforces our conclusion that Congress, in empowering the courts to enjoin any practice which operates "as a fraud or deceit" upon a client, did not intend to require proof of intent to injure and actual injury to the client. Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation "enacted for the purpose of avoiding frauds," [47] not technically and restrictively, but rather flexibly to effectuate its remedial purposes.

II.

We turn now to a consideration of whether the specific conduct here in issue was the type which Congress intended to reach in the Investment Advisers Act of 1940. It is arguable—indeed it was argued by "some investment

[47] 3 Sutherland, Statutory Construction (3d ed. 1943), 382 *et seq.* (citing cases). See Note, 38 N. Y. U. L. Rev. 985; Comment, 30 U. of Chi. L. Rev. 121, 131–147.

counsel representatives" who testified before the Commission—that any "trading by investment counselors for their own account in securities in which their clients were interested . . . ." [48] creates a potential conflict of interests which must be eliminated. We need not go that far in this case, since here the Commission seeks only disclosure of a conflict of interests with significantly greater potential for abuse than in the situation described above. An adviser who, like respondents, secretly trades on the market effect of his own recommendation, may be motivated—consciously or unconsciously—to recommend a given security not because of its potential for long-run price increase (which would profit the client), but because of its potential for short-run price increase in response to anticipated activity from the recommendation (which would profit the adviser).[49] An investor seeking the advice of a registered investment adviser must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether an adviser is serving "two masters" or only one, "especially . . . if one of the masters happens to be economic self interest." *United States* v. *Mississippi Valley Co.*, 364 U. S. 520, 549.[50] Accord-

[48] See text accompanying note 27, *supra*.

[49] For a discussion of the effects of investment advisory service recommendations on the market price of securities, see Note, 51 Calif. L. Rev. 232, 233.

[50] This Court, in discussing conflicts of interest, has said:

"The reason of the rule inhibiting a party who occupies confidential and fiduciary relations toward another from assuming antagonistic positions to his principal in matters involving the subject matter of the trust is sometimes said to rest in a sound public policy, but it also is justified in a recognition of the authoritative declaration that no man can serve two masters; and considering that human nature must be dealt with, the rule does not stop with actual violations of such

ingly, we hold that the Investment Advisers Act of 1940 empowers the courts, upon a showing such as that made here, to require an adviser to make full and frank disclosure of his practice of trading on the effect of his recommendations.

III.

Respondents offer three basic arguments against this conclusion. They argue first that Congress could have, but did not, make failure to disclose material facts unlawful in the Investment Advisers Act of 1940, as it did in the Securities Act of 1933 [41] and that absent specific language, it should not be assumed that Congress intended to include failure to disclose in its general proscription of any practice which operates as a fraud or deceit. But considering the history and chronology of the statutes, this omission does not seem significant. The Securities

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trust relations, but includes within its purpose the removal of any temptation to violate them. . . .

"In *Hazelton* v. *Sheckells*, 202 U. S. 71, 79, we said: 'The objection . . . rests in their tendency, not in what was done in the particular case . . . . The Court will not inquire what was done. If that should be improper it probably would be hidden and would not appear.'" *United States* v. *Mississippi Valley Co.*, 364 U. S. 520, 550, n. 14.

[41] 48 Stat. 84, as amended, 15 U. S. C. § 77q (a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Act of 1933 was the first experiment in federal regulation of the securities industry. It was understandable therefore, for Congress, in declaring certain practices unlawful, to include both a general proscription against fraudulent and deceptive practices and, out of an abundance of caution, a specific proscription against nondisclosure. It soon became clear, however, that the courts, aware of the previously outlined developments in the common law of fraud, were merging the proscription against nondisclosure into the general proscription against fraud, treating the former, in effect, as one variety of the latter. For example, in *Securities & Exchange Comm'n* v. *Torr*, 15 F. Supp. 315 (D. C. S. D. N. Y. 1936), rev'd on other grounds, 87 F. 2d 446, Judge Patterson held that suppression of information material to an evaluation of the disinterestedness of investment advice "operated as a deceit on purchasers." 15 F. Supp., at 317. Later cases also treated nondisclosure as one variety of fraud or deceit.[52] In light of this, and in light of the evident purpose of the Investment Advisers Act of 1940 to substitute a philosophy of disclosure for the philosophy of *caveat emptor*, we cannot assume that the omission in the 1940 Act of a specific proscription against nondisclosure was intended to limit the application of the antifraud and deceit provisions of the Act so as to render the Commission impotent to enjoin suppression of material facts. The more reasonable assumption, considering what had transpired between 1933 and 1940, is that Congress, in enacting the Investment Advisers Act of 1940 and proscribing

[52] See *Archer* v. *Securities & Exchange Comm'n*, 133 F. 2d 795 (C. A. 8th Cir.), cert. denied, 319 U. S. 767; *Charles Hughes & Co.* v. *Securities & Exchange Comm'n*, 139 F. 2d 434 (C. A. 2d Cir.), cert. denied, 321 U. S. 786; *Arleen Hughes* v. *Securities & Exchange Comm'n*, 174 F. 2d 969 (C. A. D. C. Cir.); *Norris & Hirshberg* v. *Securities & Exchange Comm'n*, 177 F. 2d 228 (C. A. D. C. Cir.); *Speed* v. *Transamerica Corp.*, 235 F. 2d 369 (C. A. 3d Cir.).

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any practice which operates "as a fraud or deceit," deemed a specific proscription against nondisclosure surplusage.

Respondents also argue that the 1960 amendment [53] to the Investment Advisers Act of 1940 justifies a narrow interpretation of the original enactment. The amendment made two significant changes which are relevant here. "Manipulative" practices were added to the list of those specifically proscribed. There is nothing to suggest, however, that with respect to a requirement of disclosure, "manipulative" is any broader than fraudulent or deceptive.[54] Nor is there any indication that by adding the new proscription Congress intended to narrow the scope of the original proscription. The new amendment also permits the Commission "by rules and regulations [to] define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative." The legislative history offers no indication, however, that Congress intended such rules to substitute for the "general and flexible" antifraud provisions which have long been considered necessary to control "the versatile inventions of fraud-doers." [55] Moreover, the intent of Congress must be culled from the events surrounding the passage of

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[53] 74 Stat. 887, 15 U. S. C. § 80b–6 (4).

The amendment, as it is relevant here, made it unlawful for an investment adviser:

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

[54] See, *e. g.*, 48 Stat. 895, as amended 15 U. S. C. § 78o (c)(1), which refers to such devices "as are manipulative, deceptive or otherwise fraudulent." (Emphasis added.)

[55] *Stonemets* v. *Head*, 248 Mo. 243, 263, 154 S. W. 108, 114. See also note 41, *supra*.

the 1940 legislation. "[O]pinions attributed to a Congress twenty years after the event cannot be considered evidence of the intent of the Congress of 1940." *Securities & Exchange Comm'n* v. *Capital Gains Research Bureau, Inc.*, 306 F. 2d 606, 615 (dissenting opinion). See, *United States* v. *Philadelphia Nat. Bank*, 374 U. S. 321, 348–349.

Respondents argue, finally, that their advice was "honest" in the sense that they believed it was sound and did not offer it for the purpose of furthering personal pecuniary objectives. This, of course, is but another way of putting the rejected argument that the elements of technical common-law fraud—particularly intent—must be established before an injunction requiring disclosure may be ordered. It is the practice itself, however, with its potential for abuse, which "operates as a fraud or deceit" within the meaning of the Act when relevant information is suppressed. The Investment Advisers Act of 1940 was "directed not only at dishonor, but also at conduct that tempts dishonor." *United States* v. *Mississippi Valley Co.*, 364 U. S. 520, 549. Failure to disclose material facts must be deemed fraud or deceit within its intended meaning, for, as the experience of the 1920's and 1930's amply reveals, the darkness and ignorance of commercial secrecy are the conditions upon which predatory practices best thrive. To impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute. Reading the Act in light of its background we find no such requirement commanded. Neither the Commission nor the courts should be required "to separate the mental urges." *Peterson* v. *Greenville*, 373 U. S. 244, 248, of an investment adviser, for "the motives of man are too complex . . . to separate . . . ." *Mosser* v. *Darrow*, 341 U. S. 267, 271.

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The statute, in recognition of the adviser's fiduciary relationship to his clients, requires that his advice be disinterested. To insure this it empowers the courts to require disclosure of material facts. It misconceives the purpose of the statute to confine its application to "dishonest" as opposed to "honest" motives. As Dean Shulman said in discussing the nature of securities transaction, what is required is "a picture not simply of the show window, but of the entire store . . . not simply truth in the statements volunteered, but disclosure." [58] The high standards of business morality exacted by our laws regulating the securities industry do not permit an investment adviser to trade on the market effect of his own recomdations without fully and fairly revealing his personal interests in these recommendations to his clients.

Experience has shown that disclosure in such situations, while not onerous to the adviser, is needed to preserve the climate of fair dealing which is so essential to maintain public confidence in the securities industry and to preserve the economic health of the country.

The judgment of the Court of Appeals is reversed and the case is remanded to the District Court for proceedings consistent with this opinion.

Reversed and remanded.

MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case.

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[58] Shulman, Civil Liability and the Securities Act, 43 Yale L. J. 227, 242.

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APPENDIX.

On one occasion respondents sold short some shares of a security immediately before stating in its Report that the security was overpriced. After the publication of the Report, respondents covered their short sales.

Respondents' transactions are summarized by the Commission as follows:

Stock	Purchased	Purchase price	Recommended	Sold	Sale price	Profit
Continental Insurance Co.	3/15/60	47¾–47⅞	3/18/60	3/29/60	50⅛	$1,125.00
United Fruit Co.	5/13, 16, 19, 20/60	21¼–22⅛	5/27/60	6/6, 7, 9, 10/60	23⅝–24½	10,725.00
Creole Petroleum Corp.	7/5, 14/60	25¼–28¾	7/15/60	7/20, 21, 22/60	27⅛–29	1,762.50
Hart, Schaffner & Marx.	8/8/60	23	8/12/60	8/18, 22/60	24⅞–25¼	837.00
Union Pacific.	10/28, 31/60	25⅜ 25⅝	11/1/60	11/7/60	27	1,757.00
Frank G. Shattuck Co.	10/11/60 (purchased calls).	16.83 (2.53 call cost, plus 14.30 option price).	10/14/60	10/25/60 (exercised calls and sold).	19½–20¼	695.17
Chock Full O'Nuts.	10/4/60 (sold short).	68¾–69 (sale price).	10/14/60 (disparaged)	10/24/60 (covered short sale).	62–62½ (purchase price).	2,772.33

Although some of the above figures relating to profits are disputed, respondents do not substantially contest the remaining figures.

SUPREME COURT OF THE UNITED STATES

No. 42.—October Term, 1963.

Securities and Exchange Commission, Petitioner, v. Capital Gains Research Bureau, Inc., et al.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[December 9, 1963.]

Mr. Justice Harlan, dissenting.

I would affirm the judgment below substantially for the reasons given by Judge Moore in his opinion for the majority of the Court of Appeals sitting *en banc*, 306 F. 2d 606, and in his earlier opinion for the panel. 300 F. 2d 745. A few additional observations are in order.

Contrary to the majority, I do not read the Court of Appeals' *en banc* opinion as holding that either § 206–(1) of the Investment Advisers Act of 1940, 54 Stat. 847 (prohibiting the employment of "any device, scheme, or artifice to defraud any client or prospective client"), or § 206–(2), 54 Stat. 847 (prohibiting the engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client"), is confined by traditional common-law concepts of fraud and deceit. That court recognized that "federal securities laws are to be construed broadly to effectuate their remedial purpose." 306 F. 2d, at 608. It did not hold or intimate that proof of "intent to injure and actual injury to clients" (*ante*, p. 6) were necessary to make out a case under these sections of the statute. Rather it explicitly observed: "Nor can there be any serious dispute that a relationship of trust and confidence should exist between the advisor and the advised," *ibid.*, thus recognizing that no such proof was required. In effect the

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Court of Appeals simply held that the terms of the statute require, at least, some proof that an investment adviser's recommendations are not disinterested.

I think it clear that what was shown here would not make out a case of fraud or breach of fiduciary relationship under the most expansive concepts of common law or equitable principles. The nondisclosed facts indicate no more than that the respondents personally profited from the foreseeable reaction to sound and impartial investment advice.[1]

The cases cited by the Court (*ante*, p. 18) are wide of the mark as even a skeletonized statement of them will show. In *Securities & Exchange Comm'n* v. *Torr*, 15 F. Supp. 315, reversed on other grounds, 87 F. 2d 446, defendants were in effect bribed to recommend a certain stock. Although it was not apparent that they lied in making their recommendations, it was plain that they were motivated to make them by the promise of reward. In the case before us, there is no vestige of proof that the reason for the recommendations was anything other than a belief in the soundness of the investment advice given.

Charles Hughes & Co. v. *Securities & Exchange Comm'n*, 139 F. 2d 434, involved sales of stock by customers' men to those ignorant of the market value of the stocks at 16% to 41% above the over-the-counter price. Defendant's employees must have known that the customers would have refused to buy had they been aware of the actual market price.

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[1] According to respondents' brief (and the fact does not appear to be contested), the annual gross income of Capital Gains Research Bureau from publishing investment information and advice was some $570,000. Even accepting the S. E. C.'s figures, respondents' profit from the trading transactions in question was somewhat less than $20,000. Thus any basis for an inference that respondents' advice was tainted by self-interest, which might have been drawn had respondents' buying and selling activities been more significant, is lacking on this record.

The defendant in *Norris & Hirshberg, Inc.*, v. *Securities & Exchange Comm'n*, 177 F. 2d 228, dealt in unlisted securities. Most of its customers believed that the firm was acting only on their behalf and that its income was derived from commissions; in fact the firm bought from and sold to its customers, and received its income from mark-ups and mark-downs. The nondisclosure of this basic relationship did not, the court stated, "necessarily establish that petitioner violated the anti-fraud provisions of the Securities and Securities Exchange Acts." *Id.*, at p. 231. Defendant's trading practices, however, were found to establish such a violation; an example of these was the buying of shares of stock from one customer and the selling to another at a substantially higher price on the same day. The opinion explicitly distinguishes between what is necessary to prove common law fraud and the grounds under securities legislation sufficient for revocation of a broker-dealer registration. *Id.*, at 233.

Arleen Hughes v. *Securities & Exchange Comm'n*, 174 F. 2d 969, concerned the revocation of the license of a broker-dealer who also gave investment advice but failed to disclose to customers both the best price at which the securities could be bought in the open market and the price which she had paid for them. Since the court expressly relied on language in statutes and regulations making unlawful "any omission to state a material fact," *id.*, at p. 976, this case hardly stands for the proposition that the result would have been the same had such provisions been absent.

In *Speed* v. *Transamerica Corp.*, 235 F. 2d 369, the controlling stockholder of a corporation made a public offer to buy stock, concealing from the other shareholders information known to it as an insider which indicated the real value of the stock to be considerably greater than the price set by the public offer. Had shareholders been aware of the concealment, they would undoubtedly have

refused to sell; as a consequence of selling they suffered ascertainable damages.

In *Archer* v. *Securities & Exchange Comm'n*, 133 F. 2d 795, defendant copartners of a company dealing in unlisted securities concealed the name of Claude Westfall, who was found to be in control of the business. Westfall was thereby enabled to defraud the customers of the brokerage firm of Harris, Upham & Co., for which he worked as a trader. Securities of the customers of the latter firm were bought by defendants' company at under the market level, and defendants' company sold securities to the clients of Harris, Upham & Co. at prices above the market.

In all of these cases but *Arleen Hughes*, which turned on explicit provisions against nondisclosure, the concealment involved clearly reflected dishonest dealing that was vital to the consummation of the relevant transactions. No such factors are revealed by the record in the present case. It is apparent that the Court is able to achieve the result reached today only by construing these provisions of the Investment Advisers Act as it might a pure conflict of interest statute, cf. *United States* v. *Mississippi Valley Co.*, 364 U. S. 520, something which this particular legislation does not purport to be.

I can find nothing in the terms of the statute or in its legislative history which lends support to the absolute rule of disclosure now established by the Court. Apart from the other factors dealt with in the two opinions of the Court of Appeals, it seems to me especially significant that Congress in enacting the Investment Advisers Act did not include the express disclosure provision found in § 17 (a)(2) of the Securities Act of 1933, 48 Stat. 84,[2] even

[2] That section makes it unlawful "to obtain money or property by means of . . . any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. . . ."

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though it did carry over to the Advisers Act the comparable fraud and deceit provisions of the Securities Act.[3] To attribute the presence of a disclosure provision in the earlier statute to an "abundance of caution" (*ante*, p. 18) and its omission in the later statute to a congressional belief that its inclusion would be "surplusage" (*ante*, p. 19) is for me a singularly unconvincing explanation of this controlling difference between the two statutes.[4]

However salutary may be thought the disclosure rule now fashioned by the Court, I can find no authority for it either in the statute or in any regulation duly promulgated thereunder by the S. E. C. Only two Terms ago we refused to extend certain provisions of the Securities Exchange Act of 1934 to encompass "policy" considerations at least as cogent as those urged here by the

[3] Section 17 (a) of the 1933 Act makes it unlawful "(1) to employ any device, scheme, or artifice to defraud . . . (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." Compare the language of these provisions with that of § 206–(1), (2) of the Investment Advisers Act, *supra*, p. —.

[4] The argument is that by the time of enactment of the Investment Advisers Act in 1940 Congress had become aware that the courts "were merging the proscription against nondisclosure [contained in the 1933 Securities Act] into the general proscription against fraud" also found in the same act. *Ante*, p. 18. However, the only federal pre-1940 case cited is *Securities & Exchange Comm'n* v. *Torr*, *ante*, p. 18, and *supra*, p. —. There the failure of a fiduciary to disclose that his advice was prompted by a "bribe" was equated by the trial judge with deceit. Such a decision can hardly be deemed to establish that *any* nondisclosure of a fact material to the recipient of investment advice is fraud or deceit. Saying the least, it strains credulity that a provision expressly proscribing material omissions would be thought by Congress to be "surplusage" when it came to enacting the 1940 Act. This is particularly so when it is remembered that violation of the fraud and deceit section is punishable criminally (§ 217 of the Investment Advisers Act of 1940, 54 Stat. 857); Congress must have known that the courts do not favor expansive constructions of criminal statutes.

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S. E. C. *Blau* v. *Lehman*, 368 U. S. 403. The Court should have exercised the same wise judicial restraint in this case. This is particularly so at this interlocutory stage of the litigation. It is conceivable that at the trial the S. E. C. would have been able to make out a case under the statute construed according to its terms.

I respectfully dissent.

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SUPREME COURT OF THE UNITED STATES

No. 77-1645

Transamerica Mortgage Advisors, Inc. (TAMA), et al., Petitioners, v. Harry Lewis.	On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[November 13, 1979]

MR. JUSTICE POWELL, concurring.

I join the Court's opinion, which I view as compatible with my dissent in *Cannon* v. *University of Chicago*, — U. S., at —. *Ante*, at 8, 9.

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

TRANSAMERICA MORTGAGE ADVISORS, INC. (TAMA), ET AL. *v.* LEWIS

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 77-1645. Argued March 20, 1979—Reargued October 2, 1979—Decided November 13, 1979

Respondent, a shareholder of petitioner Mortgage Trust of America (Trust), brought this suit in Federal District Court as a derivative action on behalf of the Trust and as a class action on behalf of the Trust's shareholders, alleging that several trustees of the Trust, its investment adviser, and two corporations affiliated with the latter, had been guilty of various frauds and breaches of fiduciary duty in violation of the Investment Advisers Act of 1940 (Act). The complaint sought injunctive relief, rescission of the investment advisers contract between the Trust and the adviser, restitution of fees and other considerations paid by the Trust, an accounting of illegal profits, and an award of damages. The District Court ruled that the Act confers no private right of action and accordingly dismissed the complaint. The Court of Appeals reversed, holding that "implication of a private right of action for injunctive relief and damages in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation."

Held:

1. Under § 215 of the Act, which provides that contracts whose formation or performance would violate the Act "shall be void . . . as regards the rights of" the violator, there exists a limited private remedy to void an investment advisers contract. The language of § 215 itself fairly implies a right to specific and limited relief in a federal court. When Congress declared in § 215 that certain contracts are void, it intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission or for an injunction against continued operation of the contract, and for restitution. Pp. 7-8.

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Syllabus

2. Section 206 of the Act—which makes it unlawful for any investment adviser "to employ any device, scheme, or artifice to defraud . . . or to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client," or to engage in specified transactions with clients without making required disclosures—does not, however, create a private cause of action for damages. Unlike § 215, § 206 simply proscribes certain conduct and does not in terms create or alter any civil liabilities. In view of the express provisions in other sections of the Act for enforcing the duties imposed by § 206, it is not possible to infer the existence of an additional private cause of action. And the mere fact that § 206 was designed to protect investment advisers' clients does not require the implication of a private cause of action for damages on their behalf. Pp. 8–12.

575 F. 2d 237, affirmed in part, reversed in part, and remanded.

STEWART, J., delivered the opinion of the Court, in which BURGER, C. J., and BLACKMUN, POWELL, and REHNQUIST, JJ., joined. POWELL, J., filed a concurring statement. WHITE, J., filed a dissenting opinion, in which BRENNAN, MARSHALL, and STEVENS, JJ., joined.

SUPREME COURT OF THE UNITED STATES

No. 77–1645

Transamerica Mortgage Advisors, Inc. (TAMA), et al., Petitioners, *v.* Harry Lewis. } On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[November 13, 1979]

MR. JUSTICE STEWART delivered the opinion of the Court.

The Investment Advisers Act of 1940, 15 U. S. C. § 80b–1 *et seq.*, was enacted to deal with abuses that Congress had found to exist in the investment advisers industry. The question in this case is whether that Act creates a private cause of action for damages or other relief in favor of persons aggrieved by those who allegedly have violated it.

The respondent, a shareholder of petitioner Mortgage Trust of America (Trust), brought this suit in a federal district court as a derivative action on behalf of the Trust and as a class action on behalf of the Trust's shareholders. Named as defendants were the Trust, several individual trustees, the Trust's investment adviser, Transamerica Mortgage Advisers, Inc. (TAMA), and two corporations affiliated with TAMA, Land Capital, Inc. (Land Capital), and Transamerica Corporation (Transamerica), all of which are petitioners in this case.[1]

[1] Hereinafter "the petitioners" refers to the petitioners other than the Trust. The Trust is a real estate investment trust within the meaning of §§ 856–858 of the Internal Revenue Code. TAMA, in addition to advising the Trust, managed its day-to-day operations. Transamerica is the sponsor of the Trust and the parent of Land Capital. Land Capital is the parent of TAMA, through a subsidiary, and sold the Trust its initial

The respondent's complaint alleged that the petitioners in the course of advising or managing the Trust had been guilty of various frauds and breaches of fiduciary duty. The complaint set out three causes of action, each said to arise under the Investment Advisers Act of 1940.[2] The first alleged that the advisory contract between TAMA and the Trust was unlawful because TAMA and Transamerica were not registered under the Act and because the contract had provided for grossly excessive compensation. The second alleged that the petitioners breached their fiduciary duty to the Trust by causing it to purchase securities of inferior quality from Land Capital. The third alleged that the petitioners had misappropriated profitable investment opportunities for the benefit of other companies affiliated with Transamerica. The complaint sought injunctive relief to restrain further performance of the advisory contract, rescission of the contract, restitution of fees and other considerations paid by the Trust, an accounting of illegal profits, and an award of damages.

The trial court ruled that the Investment Advisers Act confers no private right of action, and accordingly dismissed the complaint.[3] The Court of Appeals reversed, 575 F. 2d 237, holding that "implication of a private right of action for injunctive relief and damages in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation." *Id.*, at 239.[4] We granted certiorari to con-

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portfolio of investments. Several of the individual trustees were at the time of suit affiliated with TAMA, Transamerica, or other subsidiaries of Transamerica.

[2] Each cause of action was stated as a derivative shareholder's claim and restated as a shareholders class claim.

[3] The pertinent orders of the District Court are unreported.

[4] The District Court was of the view that it was without subject-matter jurisdiction of the respondent's suit. The Court of Appeals recharacterized the District Court's order dismissing the suit as properly based upon the respondent's failure to state a claim upon which relief can be granted, Fed. Rule Civ. Proc. 12 (b)(6), noting that the respondent's suit was

sider the important federal question presented. — U. S. — (1978).

The Investment Advisers Act nowhere expressly provides for a private cause of action. The only provision of the Act that authorizes any suits to enforce the duties or obligations created by it is § 209, which permits the Securities Exchange Commission (Commission) to bring suit in a federal district court to enjoin violations of the Act or the rules promulgated under it.[5] The argument is made, however, that the clients

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apparently within the District Court's general federal-question jurisdiction under 28 U. S. C. § 1331. 575 F. 2d, at 239, n. 2.

The Court of Appeals in this case followed the Courts of Appeals for the Fifth and Second Circuits, which also have held that private causes of action may be maintained under the Act. See *Wilson* v. *First Houston Investment Corp.*, 566 F. 2d 1235 (CA5 1978); *Abrahamson* v. *Fleschner*, 568 F. 2d 862 (CA2 1977).

[5] Section 209, 15 U. S. C. § 80b–9, provides in part as follows:

"(e) Whenever it shall appear to the Commission that any person has engaged, is engaged, or is about to engage in any act or practice constituting a violation of any provision of this subchapter, or of any rule, regulation, or order hereunder, or that any person has aided, abetted, counseled, commanded, induced, or procured, is aiding, abetting, counseling, commanding, inducing, or procuring, or is about to aid, abet, counsel, command, induce, or procure such a violation, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this subchapter or any rule, regulation, or order hereunder. Upon a showing that such person has engaged, is engaged, or is about to engage in any such act or practice, or in aiding, abetting, counseling, commanding, inducing, or procuring any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning any violation of the provisions of this subchapter, or of any rule, regulation, or order thereunder, to the Attorney General, who, in his discretion, may institute the appropriate criminal procedings under this subchapter."

The language in § 209 (e) that authorizes the Commission to obtain an injunction against persons "aiding, abetting, . . . or procuring" violations of the Act was added to the statute in 1960. 74 Stat. 887.

of investment advisers were the intended beneficiaries of the Act and that courts should therefore imply a private cause of action in their favor. See *Cannon* v. *University of Chicago*, — U. S. —, —; *Cort* v. *Ash*, 422 U. S. 66, 78; *J. I. Case* v. *Borak*, 377 U. S. 426, 432.

The question whether a statute creates a cause of action, either expressly or by implication, is basically a matter of statutory construction. *Touche Ross & Co.* v. *Redington*, 442 U. S. —, —; *Cannon* v. *University of Chicago*, *supra*, at —; see *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U. S. 453, 458 (hereinafter *Amtrak*). While some opinions of the Court have placed considerable emphasis upon the desirability of implying private rights of action in order to provide remedies thought to effectuate the purposes of a given statute, *e. g.*, *J. I. Case Co.* v. *Borak*, *supra*, what must ultimately be determined is whether Congress intended to create the private remedy asserted, as our recent decisions have made clear. *Touche Ross & Co.* v. *Redington*, *supra*, at —; *Cannon* v. *University of Chicago*, *supra*, at —. We accept this as the appropriate inquiry to be made in resolving the issues presented by the case before us.

Accordingly, we begin with the language of the statute itself. *Touche Ross & Co.* v. *Redington*, *supra*, at —; *Cannon* v. *University of Chicago*, *supra*, at —; *Santa Fe Indust., Inc.* v. *Green*, 430 U. S. 462, 472; *Piper* v. *Chris-Craft Indus., Inc.*, 430 U. S. 1, 24. It is asserted that the creation of a private right of action can fairly be inferred from the language of two sections of the Act. The first is § 206, which broadly proscribes fraudulent practices by investment advisers, making it unlawful for any investment adviser "to employ any device, scheme, or artifice to defraud . . . or to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client," or to engage in specified transactions with clients without

making required disclosures.[6] The second is § 215, which provides that contracts whose formation or performance would violate the Act "shall be void . . . as regards the rights of" the violator and knowing successors in interest.[7]

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[6] Section 206, 15 U. S. C. § 80b–6, reads as follows:

"§ 80b–6. Prohibited transactions by investment advisers.

"It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

"(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

"(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

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

Section 206 (4) was added to the statute in 1960. 74 Stat. 887. At that time Congress also extended the provisions of § 206 to all investment advisers, whether or not such advisers were required to register under § 203 of the Act. *Ibid.*

[7] Section 215, 15 U. S. C. § 80b–15, reads in part as follows:

"§ 80b–15. Validity of contracts

. . . . . .

"(b) Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order,

It is apparent that the two sections were intended to benefit the clients of investment advisers, and, in the case of § 215, the parties to advisory contracts as well. As we have previously recognized, § 206 establishes "federal fiduciary standards" to govern the conduct of investment advisers, *Santa Fe Indus., Inc.* v. *Green*, 430 U. S., at 471, n. 11; *Burks* v. *Lasker*, — U. S. —, —, n. 10; *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 191–192. Indeed, the Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations. See H. R. Rep. No. 2639, 76th Cong., 3d Sess., 28 (1940); S. Rep. No. 1775, 76th Cong., 3d Sess., 21 (1940); SEC, Report on Investment Trusts and Investment Companies (Investment Counsel and Investment Advisory Services), H. R. Doc. No. 477, 76th Cong., 2d Sess., 27–30 (1939). But whether Congress intended additionally that these provisions would be enforced through private litigation is a different question.

On this question the legislative history of the Act is entirely silent—a state of affairs not surprising when it is remembered that the Act concededly does not explicitly provide any private remedies whatever. See *Cannon* v. *University of Chicago*, *supra*, at —. But while the absence of anything in the legislative history that indicates an intention to confer any private right of action is hardly helpful to the respondent, it does not automatically undermine his position. This Court has held that the failure of Congress expressly to consider a private remedy is not inevitably inconsistent with an intent on its part to make such a remedy available. *Cannon* v. *University of Chicago*, *supra*, at —. Such an

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shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision."

intent may appear implicitly in the language or structure of the statute, or in the circumstances of its enactment.

In the case of § 215, we conclude that the statutory language itself fairly implies a right to specific and limited relief in a federal court. By declaring certain contracts void, § 215 by its terms necessarily contemplates that the issue of voidness under its criteria may be litigated somewhere. At the very least Congress must have assumed that § 215 could be raised defensively in private litigation to preclude the enforcement of an investment advisers contract. But the legal consequences of voidness are typically not so limited. A person with the power to avoid a contract ordinarily may resort to a court to have the contract rescinded and to obtain restitution of consideration paid. See *Deckert* v. *Independence Corp.*, 311 U. S. 282, 289; Williston, Contracts, 3d edition, § 1525; Pomeroy, Equity Jurisprudence, 4th edition, §§ 881 and 1092. And this Court has previously recognized that a comparable provision, § 29 (b) of the Securities Exchange Act of 1934, 15 U. S. C. § 77cc (b), confers a "right to rescind" a contract void under the criteria of the statute. *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375, 388. Moreover, the federal courts in general have viewed such language as implying an equitable cause of action for rescission or similar relief. *E. g., Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (DCED Pa. 1946); see III Loss, Securities Regulation 1758–1759 (2d ed. 1961). Cf. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723, 735.

For these reasons we conclude that when Congress declared in § 215 that certain contracts are void, it intended that the customary legal incidents of voidness would follow, including the availability of a suit for rescission or for an injunction against continued operation of the contract, and for restitution.[8] Accordingly, we hold that the Court of Appeals was

[8] One possibility, of course, is that Congress intended that claims under

correct in ruling that the respondent may maintain an action on behalf of the Trust seeking to void the investment advisers contract.[9]

We view quite differently, however, the respondent's claims for damages and other monetary relief under § 206. Unlike § 215, § 206 simply proscribes certain conduct, and does not in terms create or alter any civil liabilities. If monetary liability to a private plaintiff is to be found, it must read it into the Act. Yet it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it. "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." *Botany Mills* v. *United States*, 278 U. S. 282, 289 (1929). See *Amtrak*, *supra*, 414 U. S., at 458; *Securities Protection Investment Corp.* v. *Barbour*, 421 U. S. 412, 419; *T. I. M. E., Inc.* v. *United States*, 359 U. S. 464, 471. Congress expressly provided both judicial and administrative means for enforcing compliance with § 206. First, under § 217 willful violations of the Act are criminal offenses, punishable by fine or imprisonment, or both. Second, § 209 authorizes the Commission to bring civil actions in federal courts to enjoin compliance with the Act, including, of course, § 206. Third, the Commission is authorized by § 203 to impose various administrative sanctions on persons who violate the Act, including § 206. In view of these express provisions for enforcing the duties imposed by § 206, it is highly improbable that "Congress absentmindedly forgot to mention an intended private action." *Cannon* v. *University of Chicago*, — U. S., at — (POWELL, J., dissenting).

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§ 215 would be raised only in state court. But we decline to adopt such an anomalous construction without some indication that Congress in fact wished to remit the litigation of a federal right to the state courts.

[9] Jurisdiction of such suits would exist under § 214 which, though referring in terms only to "suits in equity to enjoin violations," would equally sustain actions where simple declaratory relief or rescission is sought.

Even settled rules of statutory construction could yield, of course, to persuasive evidence of a contrary legislative intent. *Securities Protection Investor Corp.* v. *Barbour*, 421 U. S. 412, 419; *Amtrak*, *supra*, 414 U. S., at 458. But what evidence of intent exists in this case, circumstantial though it be, weighs against the implication of a private right of action for a monetary award in a case such as this. Under each of the securities laws that preceded the Act here in question, and under the Investment Company Act which was enacted as companion legislation, Congress expressly authorized private suits for damages in prescribed circumstances.[10] For example, Congress provided an express damage remedy for misrepresentations contained in an underwriter's registration statement in § 11 (a) of the Securities Act of 1933, and for certain materially misleading statements in § 18 (a) of the Securities Exchange Act of 1934. "Obviously, then, when Congress wished to provide a private damage remedy, it knew how to do so and did so expressly." *Touche Ross & Co.* v. *Redington*, —— U. S., at ——. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S., at 734; see *Amtrak*, *supra*, 414 U. S., at 458; *T. I. M. E., Inc.* v. *United States*, *supra*, at 471. The fact that it enacted no analogous provisions in the legislation here at issue strongly suggests that Congress was simply unwilling to impose any potential monetary liability to a private suitor. See *Abrahamson* v. *Flechsner*, 568 F. 2d 862, 883 (Gurfein, J., dissenting).

The omission of any such potential remedy from the Act's substantive provisions was paralleled in the jurisdictional sec-

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[10] See Securities Act of 1933, §§ 11 and 12, 15 U. S. C. §§ 77k and 771; Securities Exchange Act of 1934, §§ 9 (e), 16 (b), and 18, 15 U. S. C. §§ 71i (e), 78p (b), and 78r; Public Utility Holding Company Act of 1935, §§ 16 (a) and 17 (b), 15 U. S. C. §§ 79p (a) and 79q (b); Trust Indenture Act of 1939, § 323 (a), 15 U. S. C. § 77www (a); Investment Company Act of 1940, § 30 (f), 15 U. S. C. § 80a-29 (f).

tion, § 214.[11] Early drafts of the bill had simply incorporated by reference a provision of the Public Utility Holding Company Act of 1935, which gave the federal courts jurisdiction "of all suits in equity and *actions at law* brought to enforce any *liability* or duty created by" the statute (emphasis added). See S. 3580, 76th Cong., 3 Sess., § 203 (introduced by Sen. Wagner, Mar. 14, 1940); H. R. 8935, 76th Cong., 3d Sess., § 203 (introduced by Rep. Lea, Mar. 14, 1940). After hearings on the bill in the Senate, representatives of the investment advisers industry and the staff of the Commission met to discuss the bill, and certain changes were made. The language that was enacted as § 214 first appeared in this compromise version of the bill. See Confidential Committee Print, S. 3580, 76th Cong., 3d Sess., § 213. That version, and the version finally enacted into law, S. 4108, 76th Cong., 3d Sess. § 214, both omitted any references to "actions at law" or to "liability."[12]

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[11] Section 214, 15 U. S. C. § 80b–14, provides:

"§ 80b–14. Jurisdiction of offenses and suits.

"The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7, as amended, of the Act entitled 'An Act to establish a court of appeals for the District of Columbia,' approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court."

[12] The respondent argues that the omission of any reference in § 214

The unexplained deletion of a single phrase from a jurisdictional provision is, of course, not determinative of whether a private remedy exists. But it is one more piece of evidence that Congress did not intend to authorize a cause of action for anything beyond limited equitable relief.[13]

Relying on the factors identified in *Cort* v. *Ash*, *supra*, the respondent and the Commission, as *amicus curiae*, argue that our inquiry in this case cannot stop with the intent of Congress, but must consider the utility of a private remedy, and

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to "actions at law" is without relevance because jurisdiction over such cases as this would often exist under 28 U. S. C. § 1331, the general federal-question jurisdiction statute, and because there was no express statement that the omission was intended to preclude private remedies. But the respondent concedes that the language of § 214 was probably narrowed in view of the absence from the Advisers Act of any express provision for a private cause of action for damages. We agree, but find the omission inconsistent more generally with an intent on the part of Congress to make such a remedy available.

[13] Congress amended the Investment Company Act in 1970 to create a narrowly circumscribed right of action for damages against investment advisers to registered investment companies. Act of Dec. 14, 1970, Pub. L. 91–547, § 20, 84 Stat. 1428, 15 U. S. C. § 80a–35 (b). While subsequent legislation can disclose little or nothing of the intent of Congress in enacting earlier laws, see *SEC* v. *Capital Gains Research Bureau*, 375 U. S., at 199–200, the 1970 amendments to the companion Act is another clear indication that Congress knew how to confer a private right of action when it wished to do so.

In 1975 the Commission submitted a proposal to Congress that would have amended § 214 to extend jurisdiction, without regard to the amount in controversy, to "actions at law" under the Act. See S. 2849, 94th Cong., 2d Sess., § 6 (1976). The Commission was of the view that the amendment also would confirm the existence of a private right of action to enforce the Act's substantive provisions. See Hearings on S. 2849 before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, 94th Cong., 2 Sess., 17; Hearings on H. R. 12981 and H. R. 13737 before the Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce, 94th Cong., 2d Sess., 36–37. The Senate Committee reported favorably on the provision as proposed by the Commission, but the bill did not come to a vote in either House.

the fact that it may be one not traditionally relegated to state law. We rejected the same contentions last Term in *Touche Ross & Co.* v. *Redington, supra*, where it was argued that these factors standing alone justified the implication of a private right of action under § 17 (a) of the Securities Exchange Act of 1934. We said in that case:

> "It is true that in *Cort* v. *Ash, supra*, the Court set forth four factors that it considered "relevant" in determining whether a private remedy is implicit in a statute not expressly providing one. But the Court did not decide that each of these factors is entitled to equal weight. The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action. Indeed, the first three factors discussed in Cort—the language and focus of the statute, its legislative history, and its purpose, see 422 U. S., at 78—are ones traditionally relied upon in determining legislative intent." — U. S., at —, —.

The statute in *Touche Ross* by its terms neither granted private rights to the members of any identifiable class, nor proscribed any conduct as unlawful. *Touche Ross & Co.* v. *Redington, supra*, at —. In those circumstances it was evident to the Court that no private remedy was available. Section 206 of the Act here involved concededly was intended to protect the victims of the fraudulent practices it prohibited. But the mere fact that the statute was designed to protect advisers' clients does not require the implication of a private cause of action for damages on their behalf. *Touche Ross & Co.* v. *Redington, supra*, at —; *Cannon* v. *University of Chicago, supra*, at —; *Securities Investor Protection Corp.* v. *Barbour, supra*, at 421. The dispositive question remains whether Congress intended to create any such remedy. Having answered that question in the negative, our inquiry is at an end.

For the reasons stated in this opinion, we hold that there

exists a limited private remedy under the Investment Advisers Act of 1940 to void an investment advisers contract, but that the Act confers no other private causes of action, legal or equitable.[14] Accordingly, the judgment of the Court of Appeals is affirmed in part and reversed in part, and the case is remanded to that Court for further proceedings consistent with this opinion.

It is so ordered.

[14] Where rescission is awarded, the rescinding party may of course have restitution of the consideration given under the contract, less any value conferred by the other party. See 5 Corbin, Contracts § 1114 (1964). Restitution would not, however, include compensation for any diminution in the value of the rescinding party's investment alleged to have resulted from the adviser's action or inaction. Such relief could provide by indirection the equivalent of a private damage remedy that we have concluded Congress did not confer.

SUPREME COURT OF THE UNITED STATES

No. 77-1645

Transamerica Mortgage Advisors, Inc. (TAMA), et al., Petitioners, v. Harry Lewis.	On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[November 13, 1979]

MR. JUSTICE WHITE, with whom MR. JUSTICE BRENNAN, MR. JUSTICE MARSHALL, and MR. JUSTICE STEVENS join, dissenting.

The Court today holds that private rights of action under the Investment Advisers Act (Act) of 1940 are limited to actions for rescission of investment advisers contracts. In reaching this decision, the Court departs from established principles governing the implication of private rights of action by confusing the inquiry into the existence of a right of action with the question of available relief. By holding that damages are unavailable to victims of violations of the Act, the Court rejects the conclusion of every Circuit Court of Appeals that has considered the question. *Abrahamson* v. *Fleschner*, 568 F. 2d 862 (CA2 1977); *Wilson* v. *First Houston Investment Corp.*, 566 F. 2d 1235 (CA5 1978); *Lewis* v. *Transamerica Corp.*, 575 F. 2d 237 (CA9 1978). The Court's decision cannot be reconciled with our decisions recognizing implied private actions for damages under securities laws with substantially the same language as the Act.[1] By resurrecting

[1] The provisions of § 206 of the Investment Advisers Act of 1940, 15 U. S. C. § 80b-6, are substantially similar to § 10 (b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j (b), and Rule 10b-5, 17 CFR § 240.10b-5, both of which have been held to create private rights of action for which damages may be recovered. *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 404 U. S. 6, 13, n. 9 (1971); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723, 730 (1975). The provisions of

distinctions between legal and equitable relief, the Court reaches a result that, as all parties to this litigation agree, can only be considered anomalous.

I

This Court has long recognized that private rights of action do not require express statutory authorization. *Texas & Pacific R. Co.* v. *Rigsby*, 241 U. S. 33 (1916); *Tunstall* v. *Brotherhood of Locomotive Firemen & Enginemen*, 323 U. S. 210 (1944).[2] The preferred approach for determining whether a private right of action should be implied from a federal statute was outlined in *Cort* v. *Ash*, 422 U. S. 66, 78 (1975). See *Cannon* v. *University of Chicago*, — U. S. — (1979). Four factors were thought relevant; [3] and although subsequent

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§ 215 (b) of the Act, 15 U. S. C. § 80b–15, are substantially similar to other provisions in the Securities Exchange Act of 1934, 15 U. S. C. § 78cc (b).

[2] *Rigsby* marked the first time this Court implied a private right of action. There the Court recognized that implied rights of action were not novel and had been a feature of the not infrequent common law. *Texas & Pacific R. Co.* v. *Rigsby*, 241 U. S. 33, 39–40 (1916) (citing *Couch* v. *Steel*, 118 Eng. Rep. 1193, 1196 (Q. B. 1854)). See *Cannon* v. *University of Chicago*, — U. S. —, —, n. 10.

[3] "First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted,' *Texas & Pacific R. Co.* v. *Rigsby*, 241 U. S. 33, 39 (1916) (emphasis supplied)—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? See, *e. g.*, *National Railroad Passenger Corp.* v. *National Assn. of Railroad Passengers*, 414 U. S. 453, 458, 460 (1974) (*Amtrak*). Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? See, *e. g.*, *Amtrak*, *supra*; *Securities Investor Protection Corp.* v. *Barbour*, 421 U. S. 412, 423 (1975); *Calhoon* v. *Harvey*, 379 U. S. 134 (1964). And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law? See *Wheeldin* v. *Wheeler*, 373 U. S. 647, 652 (1963); cf. *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 434 (1964); *Bivens* v. *Six Unknown Federal Narcotics Agents*, 403 U. S. 388, 394–395

decisions have indicated that the implication of a private right of action "is limited solely to determining whether Congress intended to create the private right of action," *Touche Ross & Co.* v. *Redington*, — U. S. —, (1979), these four factors are "the criteria through which this intent could be discerned." *Davis* v. *Passman*, — U. S. —, — (1979). Proper application of the factors outlined in *Cort* clearly indicates that § 206 of the Act, 15 U. S. C. § 80b–6, creates a private right of action.

II

In determining whether respondent can assert a private right of action under the Act, "the threshold question under *Cort* is whether the statute was enacted for the benefit of a special class of which the plaintiff is a member." *Cannon* v. *University of Chicago*, *supra*, at —. The instant action was brought by respondent as both a derivative action on behalf of Mortgage Trust of America and a class action on behalf of Mortgage Trust's shareholders. Respondent alleged that Mortgage Trust had retained Transamerica Mortgage Advisers, Inc. (TAMA) as its investment adviser and that violations of the Act by TAMA had injured the client corporation. Thus the question under *Cort* is whether the Act was enacted for the special benefit of clients of investment advisers.

The Court concedes that the language and legislative history of § 206 leave no doubt that it was "intended to benefit the clients of investment advisers," *ante*, at —, as we have previously recognized. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 191–192 (1963); *Santa Fe Industries, Inc.* v. *Green*, 430 U. S. 462, 471, n. 11 (1977).[4] Because

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(1971); *id.*, at 400 (Harlan, J., concurring in judgment)." *Cort* v. *Ash*, 422 U. S. 66, 78 (1975).

[4] The statutory language clearly indicates that the intended beneficiaries of the Act are the clients of investment advisers. Section 206 makes it unlawful for any investment adviser "(1) to employ any device, scheme,

respondent's claims were brought on behalf of a member of the class the Act was designed to benefit, *i. e.*, the clients of investment advisers, the first prong of the *Cort* test is satisfied in this case.

III

The second inquiry under the *Cort* approach is whether there is evidence of an express or implicit legislative intent to negate the claimed private rights of action. As the Court noted in *Cannon:*

> "the legislative history of a statute that does not expressly create or deny a private remedy will typically be equally silent or ambiguous on the question. Therefore, in situations such as the present one 'in which it is clear that federal law has granted a class of persons certain rights, it is not necessary to show an intention to *create* a private cause of action, although an explicit purpose to *deny* such cause of action would be controlling.' *Cort, supra,* 422 U. S., at 82 (emphasis in original)." *Cannon* v. *University of Chicago, supra,* at —.

I find no such intent to foreclose private actions. Indeed, the statutory language evinces an intent to create such actions.[5] In § 215 (b) of the Act Congress provided that con-

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or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client"; and (3) to engage in certain transactions with "a client" or "for the account of such client," without making certain written disclosures "to such client" and "obtaining the consent of the client to such transaction." Statements in the House and Senate committee reports that accompanied the original legislation reinforce the conclusion that the Act was designed to protect investors against fraudulent practices by investment advisers. See, *e. g.*, H. R. Rep. No. 2639, 76th Cong., 3d Sess., 28 (1940); S. Rep. No. 1775, 76th Cong., 3d Sess., 21 (1940).

[5] Also, as the Court recognizes, the legislative history of the Act is "entirely silent" on the question of private rights of action; it neither explicitly nor implicitly indicates that Congress intended to deny private

tracts made in violation of any provision of the Act "shall be void." As the Court recognizes, such a provision clearly contemplates the existence of private rights under the Act. Similar provisions in the Investment Company Act, 15 U. S. C. § 80a–46 (b), the Securities Exchange Act of 1934, 15 U. S. C. § 78cc (b), and the Public Utility Holding Company Act, 15 U. S. C. § 79z (b), have been recognized as reflecting an intent to create private rights of action to redress violations of substantive provisions of those acts. *Brown* v. *Bullock*, 194 F. Supp. 207, 225–228 (SDNY), aff'd, 294 F. 2d 415 (CA2 1961); *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (ED Pa. 1946); *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783, 787, n. 4 (CA2 1951); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723, 735 (1975); *Goldstein* v. *Groesbeck*, 142 F. 2d 422, 426–427 (CA2 1944).

The Court's conclusion that § 215, but not § 206, creates an implied private right of action ignores the relationship of § 215 to the substantive provisions of the Act contained in § 206. Like the jurisdictional provisions of a statute, § 215 "creates no cause of action of its own force and effect; it imposes no liabilities." *Touche Ross & Co.* v. *Redington*, *supra*, at —. Section 215 merely specifies one consequence of a violation of the substantive prohibitions of § 206. The practical necessity of a private action to enforce this particular consequence of a § 206 violation suggests that Congress contemplated the use of private actions to redress violations of § 206. It also indicates that Congress did not intend the powers given to the SEC to be the exclusive means for enforcement of the Act.*

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damage actions to clients victimized by their investment advisers. Every court that has considered the question has come to this conclusion.

* The Court concludes that because the Act expressly provides for SEC enforcement proceedings, Congress must not have intended to create private rights of action. This application of the oft-criticized maxim *expressio unius est alterius* ignores our rejection of it in *Cort* v. *Ash*, 422 U. S. 66, 82–83, n. 14 (1975), in the absence of specific support in the legislative history for the proposition that express statutory remedies are

The Court's holding that private litigants are restricted to actions for contract rescission confuses the question whether a cause of action exists with the question of the nature of relief available in such an action. Last Term in *Davis* v. *Passman*, — U. S. —, —, we recognized that "the question of whether a litigant has a 'cause of action' is analytically distinct and prior to the question of what relief, if any, a litigant may be entitled to receive." Once it is recognized that a statute creates an implied right of action, courts have wide discretion in fashioning available relief. *Sullivan* v. *Little Hunting Park, Inc.*, 396 U. S. 229, 239 (1969) ("The existence of a statutory right implies the existence of all necessary and appropriate remedies."). As the Court stated in *Bell* v. *Hood*, 327 U. S. 678, 684 (1946), "where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal court may use any available remedy to make good the wrong done." Thus, in the absence of any contrary indication by Congress, courts may provide private litigants exercising implied rights of action whatever relief is consistent with the congressional purpose. *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964); *Securities Investor Protection Corp.* v. *Barbour*, 421 U. S. 412, 424 (1975); cf. *Texas & Pacific R. Co.* v. *Rigsby*, *supra*, at 39. The very decisions cited by the Court to support implication of an equitable right of action from contract voidance provisions of a statute, indicate that the relief available in such an action need not be restricted to equitable relief. *Deckert* v. *Independence Shares Corp.*, 311 U. S. 282, 287–288 (1940); *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375, 388 (1970) ("Monetary relief will, of course, also be a possibility."); *Kardon* v. *National Gypsum Co.*, *supra*, at 514 ("Such suits would include not only actions

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to be exclusive. Moreover, the Court ignores the fact that the enforcement powers given the SEC under the Investment Advisers Act are virtually identical to those embodied in other securities acts under which implied rights of action have been recognized *Abrahamson* v *Fleschner*, 568 F 2d 862, 874, n. 19 (CA2 1977).

for rescission but also for money damages."). As the Court recognized in *Porter* v. *Warner Holding Co.*, 328 U. S. 395, 399 (1946), "where, as here, the equitable jurisdiction of the court has properly been invoked for injunctive purposes, the court has the power to decide all relevant matters in dispute and to award complete relief even though the decree includes that which might be conferred by a court of law." Thus if a private right of action exists under the Act, the relief available to private litigants may include an award of damages.

The Court concludes that the omission of the words "actions at law" from the jurisdictional provisions of § 214 of the Act and the failure of the Act to expressly authorize any private actions for damages reflect congressional intent to deny private actions for damages. Section 214 provides that federal district courts "shall have jurisdiction of violations of [the Act]" and "of all suits in equity to enjoin any violation of" the Act. 15 U. S. C. § 80b–14. Although other federal securities acts have provisions expressly granting federal court jurisdiction over "actions at law," the significance of this omission is delphic at best. While a previous draft of the bill that became the Investment Advisers Act incorporated by reference the jurisdictional provisions of the Investment Company Act and the Public Utility Holding Company Act, there is no indication in the legislative history as to why this draft was replaced with the language that became § 214.[7] The only reference to the jurisdictional provisions of the Act is the statement in the House committee report that §§ 208–221 "contain provisions comparable to those in [the Act]." H. R. Rep. No. 2639, 76th Cong., 3d Sess., 30 (1940). As the Second Circuit concluded in *Abrahamson* v. *Fleschner*, *supra*, at 875:

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[7] Petitioners' suggestion that this change may have been the product of industry pressure is at odds with the legislative history. Industry objections to the original draft of the legislation focused on matters unrelated to the jurisdictional provisions of the bill. See, *e. g.*, Hearings on H. R. No. 10065 before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 76th Cong., 3d Sess., 92 (1940).

"There is not a shred of evidence in the legislative history of the Advisers Act to support the assertion that Congress intentionally omited the reference to 'actions at law' in order to preclude private actions by investors." See *Wilson* v. *First Houston Investment Corp.*, *supra*, at 1242. The Court recognizes that the more plausible explanation for the failure of § 214 expressly to include a reference to actions at law is that, unlike other federal securities acts, the Act did not include other provisions expressly authorizing private civil actions for damages. See *Abrahamson* v. *Fleschner*, *supra*, at 874; *Bolger* v. *Laventhol, Krekstein, Horwath & Horwath*, 381 F. Supp. 260, 264-265 (SDNY 1974). But as our cases indicate this silence of the Act is not an automatic bar to private actions.[8]

The fundamental problem with the Court's focus on § 214 is that it attempts to discern congressional intent to deny a private cause of action from a jurisdictional, rather than a substantive, provision of the Act. Because § 214 is only a jurisdictional provision, "[i]t creates no cause of action of its own force and effect; it imposes no liabilities." *Touche Ross & Co.* v. *Redington*, *supra*, at —. Since the source of implied rights of action must be found "in the substantive provisions of [the Act] which they seek to enforce, not in the jurisdictional provision," *ibid.*, § 214's failure to refer to "actions at law" does not indicate that private actions for damages are unavailable under the Investment Advisers Act. The subject-matter jurisdiction of the federal courts over respondent's

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[8] Congressional failure to make express provision for private actions for damages is not surprising in light of Congress' traditional reliance on the courts to determine whether private rights of action should be implied and to award appropriate relief. See *Cannon* v. *University of Chicago*, *supra*, at — (REHNQUIST, J., concurring). Although recent decisions of the Court have contained admonitions for Congress to legislate with greater specificity in the future, *id.*, at — (REHNQUIST, J., concurring) and — (POWELL, J., dissenting); *Touche Ross & Co.* v. *Redington*, *supra*, at —, Congress cannot be faulted for failing to anticipate these admonitions when the Act was enacted in 1940.

action is unquestioned, regardless of how § 214 is interpreted, because jurisdiction is provided by the "arising under" clause of 28 U. S. C. § 1331. Cf. *Abrahamson* v. *Fleschner, supra,* at 880, n. 5 (Gurfein, J., dissenting). Where federal courts have jurisdiction over actions to redress violations of federal statutory rights, relief cannot not be denied simply because Congress did not expressly provide for independent jurisdiction under the statute creating the federal rights.[9]

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[9] If Congress provided no indication of any intent to deny private rights of action when § 214 was enacted, the subsequent failure of Congress to amend § 214 likewise offers none. The 1960 amendments to the Investment Advisers Act expanded the scope of § 206 and strengthened the authority of the SEC. Pub. L. No. 86-750 (1960). These amendments were not addressed to the private right of action question, nor is there any indication that Congress considered the question when the amendments were passed. Moreover, as the Court has noted in reviewing the legislative history of the Investment Advisers Act on a prior occasion: "the intent of Congress must be culled from the events surrounding the passage of the 1940 legislation. '[O]pinions attributed to a Congress twenty years after the event cannot be considered evidence of the intent of the Congress of 1940.'" *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 199–200 (1963).

This admonition applies with equal force with respect to the 1970 amendments to the Act. Although the 1970 amendments were part of legislation that created a new private right of action under the Investment Company Act, "it would be odd to infer from Congress' actions concerning the newly created provisions of [a companion act] any intention regarding the enforcement of a long-existing statute." *Cort* v. *Ash, supra,* 422 U. S., at 83, n. 14. Moreover, the committee reports accompanying the 1970 amendments clearly indicated that the provision of express rights of action was not intended to affect the availability of implied rights of action elsewhere. H. R. Rep. No. 91-1382, 91st Cong., 2d Sess., 38 (1970); S. Rep. No. 91-184, 91st Cong., 1st Sess., 16 (1969).

The failure of Congress during its 1976 and 1977 sessions to adopt an SEC proposal to add the words "actions at law" to § 214 of the Act also does not foreclose private enforcement. The proposal, which was favorably reported on by a Senate committee, S. Rep. No. 94-910, 94th Cong., 2d Sess. (1976), was intended only to confirm the existence of an implied right of action and not to create one. *Lewis* v. *Transamerica Corp.*, 575 F. 2d 237, 238, n. 1. The failure of Congress to enact legislation is not

IV

The third portion of the *Cort* standard requires consideration of the compatibility of a private right of action with the legislative scheme.[10] While a private remedy will not be implied to the frustration of the legislative purpose, "when that remedy is necessary or at least helpful to the accomplishment of the statutory purpose, the Court is decidedly receptive to its implication under the statute." *Cannon* v. *University of Chicago*, *supra*, at —.

The purposes of the Act have been reviewed extensively by the Court in *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*. A meticulous review of the legislative history convinced the Court that the purpose of the Act was "to prevent fraudulent practices by investment advisers." *Id.*, at 195. The Court concluded that "Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purposes." *Id.*, at 195 (footnote omitted).

Implication of a private right of action for damages unquestionably would be not only consistent with the legislative goal of preventing fraudulent practices by investment advisers, but also essential to its achievement. While the Act empowers the SEC to take action to seek equitable relief to prevent offending investment advisers from engaging in future viola-

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always a reliable guide to legislative intent, *Red Lion Broadcasting Co.* v. *FCC*, 395 U. S. 367, 382, n. 11 (1969); *Fogarty* v. *United States*, 340 U. S. 8, 13–14 (1950). It is a totally inadequate guide when, as here, Congress may have deemed the proposed legislation unnecessary, given the adequacy of existing legislation to support an implied right of action.

[10] The Court ignores the third and fourth prongs of the *Cort* test on the ground that they were ignored in *Touche Ross & Co.* v. *Redington*, — U. S. —. However, in *Touche Ross* the Court found it unnecessary to consider these factors only because the other portions of the *Cort* standard could not be satisfied. By contrast, the Court here concludes that at least the first part of the *Cort* test is satisfied.

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tions,[11] in the absence of a private right of action for damages, victimized clients have little hope of obtaining redress for their injuries. Like the statute in *Cannon*, the Act does not assure that the members of the class it benefits are able "to activate and participate in the administrative process contemplated by the statute." *Cannon* v. *University of Chicago*, *supra*, at —, n. 41. Moreover, the SEC candidly admits that, given the tremendous growth of the investment advisory industry, the magnitude of the enforcement problem exceeds the Commission's limited examination and enforcement capabilities.[12] The Commission maintains that private litigation therefore is a necessary supplement to SEC enforcement activity. Under the circumstances of this case, this position seems unassailable. Cf. *J. I. Case Co.* v. *Borak*, *supra*, at 432; *Cannon* v. *University of Chicago*, *supra*, at —.

V

The final consideration under the *Cort* analysis is whether the subject matter of the cause of action has been so traditionally relegated to state law as to make it inappropriate to infer a federal cause of action. Regulation of the activities of investment advisers has not been a traditional state concern.

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[11] See, *e. g.*, § 209 (e) of the Act, 15 U. S. C. § 80b–9 (e) (authorizing the SEC to seek injunctive relief against violations of the Act); § 203 (e), 15 U. S. C. § 20b–3 (e) (empowering the SEC to revoke the registration of investment advisers).

[12] As of December 31, 1978, a total of 5,385 investment advisers were registered with the SEC. The Commission estimates that for the fiscal year ending October 30, 1980, more than $200 billion in assets will be under advisement by registered investment advisers. (SEC Brief, at 32–33). In 1977, the SEC was able to conduct only 459 inspections of investment advisers. SEC, 43d Annual Report 234 (1979). As the Court recognized in *Cannon*, in many cases the enforcement agency may be unable to investigate meritorious private complaints, and even when the few investigations do uncover violations, the private victims of the violations need not be included in the relief. *Cannon* v. *University of Chicago*, *supra*, at —, n. 41.

During the Senate hearings preceding enactment of the Act, Congress was informed that only six States had enacted legislation to regulate investment advisers. Hearings on S. 3580 before a Subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess., 996–10017 (1940). Most of the state statutes subsequently enacted have been patterned after the federal legislation. See Note, Private Causes of Action Under Section 206 of the Investment Advisers Act, 74 Mich. L. Rev. 308, 324 (1975).

Although some practices proscribed by the Act undoubtedly would have been actionable in common-law actions for fraud, "Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers." *Santa Fe Industries, Inc.* v. *Green, supra,* at 471, n. 11; *SEC* v. *Capital Gains Research Bureau, supra,* at 191–192. While state law may be applied to parties subject to the Act, "as long as private causes of action are available in federal courts for violations of the federal statutes, [the] enforcement problem is obviated." *Burks* v. *Lasker, supra,* — U. S. —, —, n. 6 (1979).

VI

Each of the *Cort* factors point toward implication of a private cause of action in favor of clients defrauded by investment advisers in violation of the Act. The Act was enacted for the special benefit of clients of investment advisers and there is no indication of any legislative intent to deny such a cause of action, which would be consistent with the legislative scheme governing an area not traditionally relegated to state law. Under these circumstances an implied private right of action for damages should be recognized.

APPENDIX F

Compilation of Releases and Interpretative Letters

Compilation of Releases and Interpretative Letters

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For IMMEDIATE Release Tuesday, April 10, 1951

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

SECURITIES ACT OF 1933
Release No. 3411
SECURITIES EXCHANGE ACT OF 1934
Release No. 4593
INVESTMENT ADVISERS ACT OF 1940
Release No. 58

The Securities and Exchange Commission released today the following opinion of its General Counsel, Roger S. Foster, relating to the use of "hedge clauses" by brokers, dealers, investment advisers, and others.

"My opinion has been requested concerning the legality of various types of 'hedge clauses' which are used in the literature of brokers, dealers, investment advisers and others. While the language of these hedge clauses varies considerably, in substance they state generally that the information furnished is obtained from sources believed to be reliable but that no assurance can be given as to its accuracy. Occasionally language is added to the effect that no liability is assumed with respect to such information.

"All the statutes administered by the Commission provide that any condition, stipulation or provision which binds any person to waive compliance with their requirements shall be void. Apart from these provisions, moreover, the courts have repeatedly held that a hedge clause or legend disclaiming liability has little, if any, legal effect as protection against civil liability where a person makes a representation which he knows, or in the exercise of reasonable care could have discovered, is false or misleading. See Equitable Life Insurance Co. of Iowa v. Halsey, Stuart & Co., 312 U. S. 410 (1941); People v. Federated Radio Corporation, 244 N. Y. 33, 154 N. E. 655 (1926); Tone v. Halsey, Stuart & Co., 286 Ill. App. 169, 3 N. E. 2d 142 (1936); Continental Insurance Co. v. Equitable Trust Co., 127 Misc. 45, 215 N.Y.S. 281 (1926); Wolfe v. A. E. Kusterer & Co., 269 Mich. 424, 257 N. W. 729. The question arises, therefore, whether the result, if not the purpose, of such a legend is to create in the mind of the investor a belief that he has given up legal rights and is foreclosed from a remedy which he might otherwise have either at common law or under the SEC statutes.

"In my opinion, the anti-fraud provisions of the SEC statutes are violated by the employment of any legend, hedge clause or other provision which is likely to lead an investor to believe that he has in any way waived any right of action he may have, assuming, of

course, that the mails or other jurisdictional elements are involved. I refer to Section 17 (a) of the Securities Act of 1933, Section 10 (b) of the Securities Exchange Act of 1934 and Rule X-10B-5 thereunder, Section 15 (c) (1) of that Act and Rule X-15C1-2 thereunder in the case of a broker or dealer effecting a transaction over the counter, and Section 206 of the Investment Advisers Act of 1940 in the case of a registered investment adviser.

"A legend in common use states in effect that the information is obtained from specified sources and is believed to be reliable but that its accuracy is not guaranteed. Assuming the truth of the representations as to the source of the information and the belief that it is reliable, it is my opinion that the mere use of this legend in connection with a communication supplying information is not objectionable. This does not mean, of course, that there would be any justification for representing to the investor, either when the information is supplied or thereafter, that the effect of the legend is to relieve the person using it from a liability under the above-mentioned statutory provisions and rules."

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(Investment Advisers Act Release No. 188)

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
March 25, 1965

In the Matters of	
SPEAR & STAFF, INCORPORATED 8 Babson Park Avenue Babson Park, Wellesley Hills, Massachusetts File No. 801-83	FINDINGS AND OPINION OF THE COMMISSION
ROGER E. SPEAR 8 Babson Park Avenue Babson Park, Wellesley Hills, Massachusetts File No. 801-2233	
Investment Advisers Act of 1940 Section 203(d)	

INVESTMENT ADVISER REGISTRATION

Grounds for Disciplinary Action

Deceptive Advertisements

Where registered investment adviser's advertisements implied that it possessed ability to select securities certain to increase in price substantially and rapidly and did not adequately disclose uncertainties inherent in forecasting security prices and, referred to certain past recommendations without giving information as to those and other recommendations by registrant or including cautionary legend as required by Rule 206(4)-1(a) under Investment Advisers Act of 1940, held, willful violations of anti-fraud provisions of Act and of Rule.

Public Interest

Where registered investment adviser had used misleading advertising material in violation of Investment Advisers Act of 1940, but it and its president had been engaged in number of investment advisory activities for many years, violations related to one aspect of such activities, and record showed efforts to comply with statutory standards, held, acceptance of offer of settlement by which registrant undertook to refrain from advertising for new subscribers for 90 days and to institute new controls aimed at prevention of future violations was appropriate in the public interest under all the circumstances.

APPEARANCES:

Edward P. Delaney and Willis L. Riccio, of the Boston Regional Office of the Commission, Frederick Moss and Sven L. Johanson, for the Division of Trading and Markets.

Roland A. Cormier, of Ely, Bartlett, Brown & Proctor, for respondents.

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We heretofore issued an order accepting an offer of settlement submitted in these proceedings by respondents Spear and Staff, Inc. ("registrant") and Roger E. Spear. 1/ In that order we found, on the basis of the offer and a stipulation of facts accompanying it, that the registrant willfully violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Act") as well as Rule 206(4)-1 thereunder, 2/ and that such violations were aided and abetted by Roger E. Spear ("Spear"), registrant's president and majority stockholder. The order directed, as provided in the offer of settlement, that registrant refrain for 90 days from advertising for new subscribers to its publications and that during that period registrant should undertake to establish new controls for the purpose of preventing future violations of the Act. We set forth below our findings and opinion with respect to the issues in the case.

Registrant and its Advertisements

Registrant was formed in 1948 to succeed to an investment advisory business which Spear had conducted since 1940. Spear is registrant's president and majority stockholder and exercises general supervision over all of its activities. 3/ A major activity of registrant, which also acts as an investment manager for others, is the sale to subscribers of three market letters: Spear Market and Group Trend Letter, a weekly which discusses current economic conditions and makes recommendations concerning securities; Science and Electronic Investment Letter, a bi-weekly which discusses developments in the science and

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1/ Investment Advisers Act Release No. 174 (July 14, 1964).

2/ Section 206(2) forbids an investment adviser from engaging in "any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Section 206(4) prohibits investment advisers from engaging "in any act, practice or course of business which is fraudulent, deceptive or manipulative." Rule 206(4)-1 deals with advertisements, and subdivision (a)(5) thereof provides that any advertisement "which contains any untrue statement of a material fact, or which is otherwise false or misleading" is fraudulent under that Section.

3/ Spear, who is himself registered as an investment adviser, is also the president and controlling stockholder of Oil Statistics Co., a registered corporate investment adviser with which he has been associated since 1924. He also publishes, with the assistance of registrant's staff, a syndicated newspaper column on the stock market which he began in 1960.

electronics industries and makes recommendations as to securities in those industries; and Special Situation Reports, a monthly which advises with respect to securities selected by registrant as having special features. 4/ To induce persons to enter or renew subscriptions for these services, registrant engaged in a large-scale program of direct mail and newspaper advertising. 5/ It is with that advertising that these proceedings are concerned.

The record includes a large number of advertisements which were used by registrant beginning January 1, 1962. Pervading and dominating this literature, which was couched in enthusiastic and dramatic language, was the insistent implication that registrant possessed the ability to select stocks that were certain to appreciate in price quickly and substantially, and that a certain road to riches was at hand for those who availed themselves of registrant's guidance. Caution and conservatism were scorned as attributes of people who "are still thinking small." 6/ Of such people registrant said: "They are mentally back in the 19th Century, worrying about a 3%, 5% or 8% annual return on their money. They are missing out on the very few but very rewarding opportunities to earn 100%, 200% or even more profit in one-to-two years." . . . "And there is no reason why sophisticated investors should be satisfied with 5% or 10% return on their money, when certain Special Situations are rewarding others with gains of 50%, 100% and more, regardless of the action of the rest of the market."

Registrant's most extensively used advertisement dealt with "special situation investing." It defined a special situation as "a security whose primary characteristic is its 'built-in' capacity to bring extraordinarily large capital gains," and it described special situation investing as "A BRILLIANT AND PROFITABLE INVESTMENT CONCEPT . . . a proven, highly professional approach to making money in the stock market . . . that is both bold and simple, yet technically sound, intrinsically safe, and completely practical." The advertisement stated that Wall Street experts had for years virtually monopolized that "profit-making market approach, using it with remarkable success," but that "Now" the chance was open to the subscriber to add to his wealth through special situations and that they could bring him "the greatest profit at the smallest risks." Another frequently used advertisement asked the prospective subscriber whether his ambition was to double his money in perhaps 12 to 24 months and urged that if it was he should learn about special situation investing from registrant right away.

4/ As of January 1962 registrant had a staff of 84, and the three market letters had a total of over 17,000 subscribers. In August of 1963 registrant began the publication of a fourth market letter called Computer Stock Analysis Technique, a bi-weekly.

5/ Registrant advertised frequently in the New York Times, and some of its direct mail advertising went to as many as 150,000 people. Four of registrant's employees devoted themselves to its advertising program.

6/ All of the quotations from registrant's advertisements that appear in this opinion retain the original punctuation, underscoring, italics and capitalization.

A technique used extensively in registrant's literature was to recount outstanding success stories and attribute the success of the selected individuals to investments in "special situations," thereby furthering the impression that registrant was able to uncover for its subscribers opportunities for outstanding profits comparable to those which the described individuals had been able to realize. Thus, advertisements directed to those "tired of working so hard to squeeze out $1000 or only $100 profits from stocks," told of three men who had applied "certain investing principles" to lift themselves "out of the muck of poverty up into the golden sunlight of wealth, power and fame" and became millionaires by detecting and exploiting "special situations." The three men were Cornelius Vanderbilt, who was stated to have begun his financial ascent by investing a borrowed $1,000 in a barge of his own; Andrew Carnegie, whose rise to riches was attributed to a $217.50 investment made in a "special situation" with borrowed funds; and John D. Rockefeller, whose career was briefly sketched and whose first investment in oil was described as "a shrewd special situation investment." 7/ Other advertisements described the career of a teacher who had never earned more than $6,000 a year but who nevertheless amassed $1,000,000 by successful operations in the depressed securities markets of the 1930's, and they attributed such success to the teacher's ability to select "special situations" and spoke of registrant's own abilities along the same line.

The over-all impression of certain, substantial, and quick profits through the utilization of registrant's advisory services was additionally fostered by the excessive optimism with which registrant described its securities selections. For example, various of the advertisements referred to unnamed stock selections made by registrant's staff which were most likely to show large and quick profits. One stated that the selections included a "Young Stock That May Be A Pay-For-Your-Grandson's College Education Investment." Another spoke of a forthcoming report by registrant in which three very low-priced science stocks that could offer big profits were to be described, and not-too-modestly said of the report that "its every word is pure gold." Still another told the prospective subscriber that registrant offered "a plan aimed at helping you make an extra $300 or $3,000 - and perhaps raise your standard of living." Several letters to prospective subscribers announced that registrant had come across a "Special Situation profit opportunity which appears to be so exceptional that we have difficulty in believing our good fortune in discovering it" and as to which registrant had "projected a profit objective of 75% within 10 months." Each of the letters stated that it was "the last opportunity we can give you to receive this recommendation with your membership."

Registrant's advertisements also contained references to various securities that had experienced considerable price appreciation. Such references were closely coupled to registrant's flamboyant self-laudatory claims, and their effect was to imply that the stocks recommended in registrant's advisory letters would duplicate the record of the securities referred to.

In our opinion, registrant's advertisements were calculated to arouse, in an excessive and unwarranted manner, illusory hopes of immediate and substantial profit, and were violative of the Act's anti-fraud provisions and of Rule 206(4)-1(a) thereunder. They were deceptive and misleading in their over-all effect even though it might be argued

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7/ Occasional references were also made to the elder J. Pierpont Morgan and to "Bet a million" John W. Gates.

that when narrowly and literally read, no single statement of a material fact was false. 8/ In appraising advertisements such as those now before us we do not look only to the effect that they might have had on careful and analytical persons. We look also to their possible impact on those unskilled and unsophisticated in investment matters.

By the securities acts Congress sought to protect "those who do not know . . . from the overreachings of those who do." 9/ To attain that objective, persons engaged in the securities business must be held to rigorous standards of full and fair disclosure in their dealings with investors. The rendition of investment advice is an integral part of the securities business, and the Act evidences Congressional recognition of that fact and of the need to protect those who seek such advice. 10/ In passing upon the propriety of securities selling techniques we have repeatedly held that lax merchandising standards epitomized by such terms as "puffing" are antithetical to the anti-fraud provisions of the securities statutes. 11/ Similarly high standards

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8/ Fraud within the meaning of the Act can be established without proof of false statements. S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 185-195 (1963). And Rule 206(4)-1(a)(5) prohibits both advertisements that contain any untrue statement of material fact and those that are otherwise false and misleading.

9/ Charles Hughes & Co. v. S.E.C., 139 F.2d 434, 437 (C.A. 2, 1943), cert. denied 321 U.S. 786. See also Norris & Hirshberg v. S.E.C., 177 F.2d 228, 233 (C.A.D.C., 1949), cert. denied 339 U.S. 867 ("The investing and usually naive public needs special protection in this specialized field."). Cf. F.T.C. v. Standard Education Society, 302 U.S. 112, 116 (1937) ("Laws are made to protect the trusting as well as the suspicious."); Donaldson v. Read Magazine, 333 U.S. 178, 185-189 (1948); F.T.C. v. Sterling Drug, Inc., 317 F.2d 669, 674 (C.A. 2, 1963); Parker Pen Co. v. F.T.C., 159 F.2d 509, 511 (C.A. 7, 1946); Charles of the Ritz Dist. Corp. v. F.T.C., 143 F.2d 676, 679-680 (C.A. 2, 1944) ("The important criterion is the net impression which the advertisement is likely to make upon the general populace"); Aronberg v. F.T.C., 132 F.2d 165, 167 (C.A. 7, 1942); The Private Investment Fund for Government Personnel, 37 S.E.C. 484, 487-488 (1957); National Securities & Research Corporation, 12 S.E.C. 167, 171-172 (1942).

10/ See S.E.C. v. Capital Gains Research Bureau, supra, at pp. 186-192. It was judicially recognized long prior to the Act that investment advisers stand in a fiduciary relation to their clients. See Ridgely v. Keane, 134 App. Div. 647, 119 N.Y.S. 451, 453 (1909). The Act reflects the existence of such relationship. See S.E.C. v. Capital Gains Research Bureau, Inc., supra, at 194-195; Arleen W. Hughes, 27 S.E.C. 629, 635-638 (1948), aff'd sub nom. Hughes v. S.E.C., 174 F.2d 969 (C.A.D.C., 1949); Frank Payson Todd, 40 S.E.C. 303, 307 (1961).

11/ See e.g., Mac Robbins & Co., Securities Exchange Act Release No. 6846, p. 4 (July 11, 1962), aff'd sub nom. Berko v. S.E.C., 316 F.2d 137 (C.A. 2, 1963); Alexander Reid & Co., Inc., 40 S.E.C. 986, 989-991 (1962); Leonard Burton Corporation, 39 S.E.C. 211, 214 (1959); Batkin & Co., 38 S.E.C. 446, 449 (1958).

of truthfulness and disclosure must also govern the propriety and legality of investment advisers' efforts to induce others to purchase their services. 12/ They are particularly applicable to advertisements of the type involved here which by their tenor show that they were designed to appeal to people who were anxious to secure quick profits and were not especially sophisticated in security analysis. Many such persons are either unaware of or prone to overlook the limitations and the uncertainties necessarily inherent in any attempt to forecast stock prices. They tend to be unduly influenced by advertisements representing or implying that the advertiser can make profitable forecasts and to subscribe to the advertiser's advisory services in reliance on them. 13/

Appraised in the light of the foregoing considerations and standards, registrant's advertisements were clearly deceptive. They obscured and misleadingly minimized the numerous uncertainties and imponderables inherent in any attempt to forecast security prices. There were occasional caveats, but they were unobtrusively worded and placed, being generally preceded and followed by highly optimistic statements that offset any cautionary effect. Illustrative was a sentence which read: "Like all stocks, these situations often call for calculated risks." That sentence was preceded by three pages emphasizing the large profits that could be made by those who read and heeded registrant's Special Situation Reports, and was countered immediately by the next sentence which again spoke of the "unusual profits" that could be made with Special Situation stocks and the almost exclusive investment in such stocks by "knowledgeable investors . . . to build their capital."

Another advertisement, after describing the outstanding increase in the price of Zenith Radio Corporation stock made the following ostensibly sobering qualification "But by and large, experience has taught us that it is more prudent to set modest goals for special situations . . . perhaps a 100% profit in 18 months. Then, if developments turn out more favorably than we conservatively anticipated, and if a stock turned out to be a long-term fortune-builder (or the nature of Zenith), then your surprise would be a pleasant one. Far better, we believe, to try and set modest goals and exceed them occasionally, than to set unrealistic goals and fall short of them continuously." This language, rather than modifying registrant's optimism, suggested to the reader that the "modest" and "conservative" goal of a 100% profit in 18 months was surely attainable under registrant's "prudent" securities selections. 14/ In our view registrant's optimism was so extravagant that even an explicit caveat could not have brought this advertisement up to the statutory standard. 15/ Nor did registrant adequately

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12/ As noted, Section 206 of the Act bars conduct that defrauds or deceives "any client or prospective client," and we have held that the solicitation of clients is part of the activity of an investment adviser. Ralph Seward Seipel, 38 S.E.C. 256, 257 (1958).

13/ See REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H. R. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess. (1963) p. 368 [hereinafter cited as "SPECIAL STUDY REPORT."]

14/ Cf. Doman Helicopters, Inc., Securities Act Release No. 4594, p. 5 (March 27, 1963).

15/ Cf. Advanced Research Associates, Inc., Securities Act Release No. 4630, Securities Exchange Act Release No. 7117, p. 5 (August 16, 1963).

qualify its glowing recitals of extraordinary past successes by selected individuals and stocks so as to place them in a realistic perspective.16/

Registrant, aided and abetted by Spear, also willfully violated Rule 206(4)-1(a)(2) 17/ by one advertisement which referred to securities that it had previously recommended, and by various "Progress Reports" which registrant had distributed to subscribers to its Special Situation Reports. These materials contained neither a list of all of registrant's recommendations for at least one year preceding nor the cautionary legend prescribed by that Rule. 18/ Although the advertisement in question did not expressly refer to the fact that registrant had recommended the securities discussed, it went on to say that registrant wished it could state that its staff had come up with "another stock which we are sure will be another winner." The use of the word "another" indicated that the securities discussed had been recommended by registrant, and we accordingly view the advertisement as one making reference to past recommendations within the meaning of Rule 206(4)-1(a)(2) and therefore subject to the requirements of that Rule. The "Progress Reports" listed only those securities which had been the subject first of "buy" and later of "sell" recommendations by registrant, and did not include all securities recommended by registrant. The information in the Progress Reports, which consisted of a chart showing the name of the security, the prices at the time of the recommendations to

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16/ See Irving Grubman, 40 S.E.C. 671, 672-673 (1961); G. J. Mitchell Co., 40 S.E.C. 409, 413 (1961); Stratford Securities Co., Inc., 39 S.E.C. 826, 828 (1960); The Whitehall Corporation, 38 S.E.C. 259, 266-267 (1958); American Republic Investors, Inc., 37 S.E.C. 287, 290 (1957).

17/ Rule 206(4)-1(a)(2) provides that it is fraudulent within the meaning of Section 206(4) for any investment adviser to distribute any advertisement "which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person," but permits advertisements that set out (or offer to furnish a list of) all of the adviser's recommendations within the immediately preceding period of not less than one year if such advertisements (or such list, if it is furnished separately) "(A) state the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (B) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: 'it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list.'"

18/ It may be noted that under the Rule an advertisement which contains a list of only a portion of the investment adviser's past recommendations would not be cured by an offer in the same advertisement to furnish a complete list upon request.

purchase and to sell and the percentage gain or loss which would have resulted, was not of a kind to aid the subscribers in making any current investment decisions. We think it apparent that the Reports' primary, if not sole, purpose was to induce those to whom they were sent to renew their subscriptions. Accordingly they were advertisements within the meaning of the Rule and had to comply with the specific requirements of subdivision (a)(2). 19/

Conclusions

Registrant's sensational advertisements featuring the get-rich-quick theme were incompatible with responsible methods of obtaining clients for investment advisory services. Advertisements of this kind have a substantial adverse effect on the public interest. Not only do they tend to mislead and deceive investors, they also tend to debase the standards of the investment advisory industry by creating a competitive environment that tempts advisers to vie with each other in making unsupportable claims to prophetic insight. 20/ Our Special Study of Securities Markets found that "The impact of such advertising is apparently considerable and thus a cause for concern." 21/

We determined to accept respondents' settlement offer despite the seriousness with which we viewed the violations in this case because our review of the record led us to concur with our staff's conclusion that under the circumstances the public interest was adequately served by the sanction proposed under the offer. In reaching our decision we took into account that this is one of the first administrative proceedings in which we have dealt with the question of improper investment advisory advertising material, that respondents have been in the investment advisory business for many years, that their violations related to one aspect of their diversified advisory activities, and the indications in the record that they had during the latter portion of the period relevant to these proceedings attempted to conform registrant's advertisements to the statutory standards. Registrant voluntarily discontinued all newspaper advertising in April of 1962, after members of our staff had informally advised it that they were of the opinion that its newspaper advertisements were violative of the Act, and its direct mail materials during the later portion of 1962 and in 1963 were more moderate in tone and of a higher caliber than those of early and mid-1962. In light of those factors we also gave weight to registrant's undertaking to further reexamine its past practices with a view to the

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19/ Moreover, it may be noted that even aside from the specific prohibitions of Rule 206(4)-1(a)(2) applicable to advertisements, a list showing only gains and losses which would have been realized by following an adviser's past buy-and-sell recommendations and does not disclose the effect of other recommendations that the adviser has not seen fit to close out prior to the publication of the list, may be a deceptive guide to an investment adviser's over-all performance record.

20/ See SPECIAL STUDY REPORT, supra, 367-8.

21/ Ibid.

prevention of future violations. However, the relative leniency of the sanction that we impose in this case should not be misconstrued. In light of the admonitions of this opinion we shall be disposed to deal more severely with any future instances of false and misleading advertising by investment advisers.

By the Commission (Commissioners WOODSIDE, OWENS, BUDGE and WHEAT), Chairman COHEN absent and not participating.

Orval L. DuBois
Secretary

For RELEASE Thursday, May 26, 1966

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

INVESTMENT ADVISERS ACT OF 1940
Release No. 201
ACCOUNTING SERIES
Release No. 103

THE NATURE OF THE EXAMINATION AND CERTIFICATE REQUIRED BY PARAGRAPH (a)(5) OF RULE 206(4)-2 UNDER THE INVESTMENT ADVISERS ACT OF 1940

Review of accountants' certificates filed under paragraph (a)(5) of Rule 206(4)-2 under the Investment Advisers Act of 1940, which requires that at least once a year an independent public accountant shall verify by actual examination all funds and securities of clients held by an investment adviser, indicates a wide variation in the scope of the examinations made and the content of the accountants' certificates. Under the circumstances, the Securities and Exchange Commission deems it appropriate to describe the nature of the examination to be made and the content of the accountant's certificate.

Rule 204-2(b) under the Investment Advisers Act of 1940 specifically requires that an investment adviser who has custody or possession of funds and/or securities of any client must record all transactions for such clients in a journal and in separate ledger accounts for each client and must maintain copies of confirmations of all transactions in such accounts and a position record for each security in which a client has an interest. In addition, Rule 206(4)-2(a) provides, in general, that it shall constitute a fraudulent, deceptive or manipulative act or practice for any investment adviser who has custody or possession of funds or securities of clients to do any act or to take any action with respect to any such funds or securities unless (1) all such securities are segregated, marked for identification, and held in safekeeping in a reasonably safe place; (2) the funds are deposited in one or more bank accounts, in the name of the investment adviser as agent or trustee for clients, which contain only clients' funds and certain appropriate records with respect thereto are maintained; (3) immediately after accepting such funds and securities the investment adviser notifies the client in writing of the place and manner in which they will be maintained; (4) not less frequently than once every three-month period each client is sent an itemized statement showing the debits, credits, and transactions in his account during the period and the funds and securities held at the end of the period; and (5) at least once each calendar year all such funds and securities are verified in an unannounced examination by an independent public accountant and a certificate of the accountant reporting on such examination is filed with the Commission.

1/ Rule 206(4)-2(a) is not applicable, however, to any investment adviser who is also registered as a broker-dealer under Section 15 of the Securities Exchange Act of 1934 if (1) such broker-dealer is subject to and in compliance with Rule 15c3-1 under the Securities Exchange Act of 1934, or (2) such broker-dealer is a member of an exchange whose members are exempt from Rule 15c3-1 under the provisions of paragraph (b)(2) thereof, and such broker-dealer is in compliance with all rules and settled practices of such exchange imposing requirements with respect to financial responsibility and the segregation of funds or securities carried for the account of customers.

In order to make an appropriate examination the independent public accountant, at a date chosen by him and without prior notice to the investment adviser, should make a physical examination of securities and obtain confirmation as appropriate; should obtain confirmation of funds on deposit in banks; and should reconcile the physical count and confirmations to the books and records. These books and records should be verified by adequate examination of the security records and transactions since the last examination and by obtaining from clients written confirmation of the funds and securities in the clients' accounts as of the date of the physical examination. If clients' accounts have been closed or securities or funds of such clients have been returned since the last examination, these should be confirmed on a test basis. Such additional audit procedures as the accountant deems necessary under the circumstances should, of course, also be performed.

The accountant's certificate should comply with the usual technical requirements as to dating, salutation, and manual signature and should include in general terms an appropriate description of the scope of the physical examination of the securities and examination of the related books and records. In addition, the certificate should set forth:

(a) the date of the physical count and confirmation of balances of clients' accounts;

(b) a clear designation of the place and manner in which funds and securities are maintained;

(c) whether the examination was made without prior notice to the adviser; and

(d) the results of the examination including an expression of opinion as to whether, with respect to the rules under the Investment Advisers Act of 1940, the investment adviser was in compliance with paragraphs (a)(1) and (a)(2) of Rule 206(4)-2 as at the examination date and had been complying with Rule 204-2(b) during the period since the prior examination date; and whether, in connection with the examination, anything came to the accountant's attention which caused him to believe that the investment adviser had not been complying with paragraphs (a)(3) and (a)(4) of Rule 206(4)-2 during the period since the prior examination date. Any material inadequacies found to exist in the books, records, and safekeeping facilities referred to in this paragraph (d) should be identified and any corrective action taken or proposed should be indicated.

The rule requires that the accountant's certificate be filed with the Commission promptly after the completion of the examination. It is suggested that the certificate be filed in duplicate at the regional office of the Commission for the region in which the adviser has his principal place of business.

(Investment Advisers Act Release No. 223) ADMINISTRATIVE PROCEEDING
FILE NO. 3-1175

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
July 22, 1968

In the Matter of DOW THEORY FORECASTS, INC. Hammond, Indiana (801-440) LEROY BENJAMIN EVANS Investment Advisers Act of 1940 - Section 203(d)	FINDINGS AND OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDINGS

Grounds for Remedial Action

Deceptive Advertisements

Where registered investment adviser's advertisements soliciting subscriptions to its advisory service were false and misleading in that they implied that service would provide information enabling subscriber to secure immediate and substantial profit or protection against loss and represented or implied, among other things, that Dow Theory, a method for ascertaining bull or bear market trends, was principal or sole basis for adviser's selection of individual securities to be bought, sold or held, that subscribers would receive warning bulletins between regular publication dates whenever warranted by conditions of market, that drastic market declines were imminent, that certain stocks, as to which stock splits had already been announced, were candidates for stock splits, and that its method of forecasting was better than methods used by other investment advisers, held, registrant, aided and abetted by its president, willfully violated anti-fraud provisions of Investment Advisers Act of 1940 and suspension of advertising by registrant for new subscribers for period of 120 days, as provided by offer of settlement, appropriate in public interest taking into consideration all circumstances including facts that violations did not relate to investment advisory services and that registrant and president had been in investment advisory business for long period of time and had taken steps to comply with statutory standards.

APPEARANCES:

Stanley Sporkin, Leonard H. Rossen and Morris Simkin, for the Division of Trading and Markets of the Commission.

W. McNeil Kennedy, Herbert S. Wander, and Michael A. Warner, of Pope, Ballard, Uriell, Kennedy, Shepard & Fowle, for respondents.

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We heretofore issued an order accepting an offer of settlement submitted by Dow Theory Forecasts, Inc. ("registrant"), a registered investment adviser, and LeRoy Benjamin Evans, its president and majority stockholder, in disciplinary proceedings instituted pursuant to Section 203(d) of the Investment Advisers Act of 1940 ("Act"). 1/ In that order we found, on the basis of the offer and a stipulation of the parties submitted solely for the purpose of these proceedings or any other proceedings pursuant to Section 203(d) of the Act and without admitting the allegations in the order for proceedings, that between January 1963 and July 1967 registrant, aided and abetted by Evans, published and distributed materially false and misleading advertisements of its investment advisory service, in willful violation of Sections 206(1), 206(2), and 206(4) of the Act and Rule 17 CFR 275.206(4)-1 thereunder. 2/ The order, as provided in the offer of settlement, suspended all advertising and solicitation for new subscribers by registrant for a period of 120 days from May 1 to August 28, 1968, inclusive. In accordance with our order we now issue our findings and opinion with respect to the issues in the case.

Registrant, an Indiana corporation organized in 1946, has been registered as an investment adviser since January 1947. Evans has at all times exercised general supervision over all activities of registrant. Registrant prepares and distributes two investment advisory publications, a weekly service entitled Dow Theory Business and Stock Market Forecasts ("Forecasts") and a bi-weekly service entitled Dow Theory Digest. 3/ These publications render advice as to investing in and purchasing or selling securities, give opinions as to the value of securities, and present reports or analyses concerning securities. The type and quality of investment advice rendered by registrant are in no way involved in these proceedings.

Regular subscriptions to these publications run for six months or longer, and in order to induce subscriptions to Forecasts, respondents offer to the public a four weeks' trial subscription for $1. In soliciting trial subscriptions, respondents advertise extensively in newspapers and magazines and mail form letters and other material to individuals. 4/ Trial subscribers receive five weekly issues of Forecasts

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1/ Investment Advisers Act Release No. 219 (April 30, 1968).

2/ Sections 206(1), (2) and (4) make it unlawful for an investment adviser to engage in a scheme to defraud or transaction, practice, or course of business which operates as a fraud upon any client or prospective client, or in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. Rule 206(4)-1 defines the last mentioned conduct to include the publication and distribution of any advertisement which "contains any untrue statement of a material fact, or which is otherwise false or misleading."

3/ During the period covered by the order for proceedings, subscriptions for Forecasts cost $37.50 for six months and $65 for one year, and subscriptions for the bi-weekly service cost $15 for six months and $22.50 for one year.

4/ Rule 206(4)-1(b) under the Act defines "advertisement" to "include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication" which offers an investment advisory service with regard to securities.

and, commencing with the first issue, they are solicited by mail once each week for 14 weeks to purchase a regular subscription. 5/

Deceptive Advertisements

For convenience of discussion, we have divided the false and misleading representations made in the numerous advertisements into five categories.

1. Implication of Imminent Profits

A substantial number of registrant's advertisements implied in enthusiastic language that the advisory service offered or the specific recommendation made in it would return immediate profits to the subscriber, often within a specified period. For example, one representative advertisement headed, "BUY THESE 6 STOCKS for gains next 30 days," stated that the stocks were "Bargain Stocks" having inherent price rise potential and selected for immediate short term buying consideration. Another proclaimed, "YOUR PROFIT OPPORTUNITY IS AT HAND DON'T LET IT PASS YOU BY . . . Take it from one whose business it is to know -- a dependable profit opportunity in the stock market is at hand, in our opinion." Others announced, "28 ACTION STOCKS TO BUY THIS WEEK (While Price Is Still Favorable)"; "7 'BIG MOVERS' TO BUY NOW" out of 18 "action stocks" listed that were "explosive candidates for sweeping wide price swings"; "2 LOW PRICED STOCKS FOR SPRING PROFITS"; and "10 STOCKS THAT COULD BE THE FAVORITES OF 1966, Selected For Highest Gain Potential."

Similarly, letters soliciting trial subscriptions urged immediate action to take advantage of the opportunities or avoid the pitfalls in the current "fast-changing" market. One stated, "WHAT ACTION SHOULD YOU TAKE NOW ON THESE 60 LOW PRICED STOCKS? Low priced stocks are gaining fast. Many of those listed below . . . can make higher percentage gains in the months ahead . . . Find out what DOW THEORY FORECASTS recommends for each of the issues now." Another referred to "'Two Exciting Recommendations.' Two issues that show promise of making unusual gains in the next market rally." And it spoke of the need for an investor to secure the aid of competent analysis as found in Forecasts.

In one type of solicitation letter addressed to trial subscribers, a weak warning followed the initial emphasis on expectable profits. The letter read:

> "JOIN THE THOUSANDS SEEKING EXCEPTIONAL PROFITS IN 'DOLLAR' STOCKS . . .
>
> "If you have never investigated the possibilities of 'dollar' stocks, you're overlooking a type of speculation that could be richly rewarding, percentagewise. Often low priced speculative stocks selling below $10 a share offer remarkable opportunities.
>
> ***

5/ Over 23% of the income earned from subscriptions in the year ending October 31, 1966 was expended in the purchase of advertising space and mailing lists. Over $600,000 worth of newspaper and magazine advertising was purchased in that year. Letters and other materials soliciting trial subscriptions to Forecasts are mailed to persons on the mailing lists and to former trial subscribers. The number of subscribers at the end of 1965 almost doubled by the end of 1966 and registrant's gross income increased over 60% in that period.

"We try to find the most promising issues available. Naturally, most of these are highly speculative and recommended only for those who have other sound equities of high quality in their portfolios."

The letter then promised to rush information on "three 'sleepers' that we especially like from a list of 8 promising 'dollar' stocks . . . as a BONUS for becoming only a half-year subscriber to Dow Theory Forecasts." The warning as to speculative risks was clearly inadequate to offset the dominant implication of the letter that the subscriber would be shown the way to ready profits and its tendency to attract persons seeking large returns on small investments.

Letters soliciting former subscribers to purchase a regular subscription similarly were in so highly promising a vein as to make ineffective such cautionary language as they contained. One form letter offered, as an inducement, a list of "12 Atomic Stocks. Blue Chip Security Plus Sensational NEW Growth Possibilities," and stated, "Seldom, if ever, are investors given an opportunity to participate in real growth situations without running high risks. However, that is just what is available in these 'blue chip' atomic stocks." 6/ It stated, as did other letters, "You must literally 'strike while the iron is hot.'" Another letter stated, "Thousands of people like yourself have made money in this way [in stocks]. Their degree of success has depended on their willingness to take calculated risks based on sound, usable information. Your own key to fortune is in following in their footsteps, and the rewards can be great in a relatively short time under the proper conditions." An advertising circular, after offering to subscribers the names of "2 INTRIGUING 'SPACE AGE' Speculations," stated, "Are these going to be the Texas Instruments; the I.B.M.'s; the du Ponts of the Sixties? There is growing evidence to indicate that they deserve serious consideration for rapid growth and possible profit during the exciting developments bound to come in the months and years ahead."

The dramatic and suggestive form of these overly enthusiastic advertisements could be expected to have a strong impact upon unsophisticated investors desirous of making money quickly. Even an unqualified statement to the effect that no advisory service can assure a profit to its subscribers would not suffice to overcome the assurance of profit they conveyed. Indeed, the cautionary language used in some of the soliciting material served only to strengthen the impact of the message regarding registrant's expertise in selecting profitable stocks. For example, it used such statements as "We don't claim to be right all the time - no one ever has been yet - but we have been right frequently enough to become one of the leading Investment and Financial Forecasts in less than 20 years," or, usually in red ink, "But you've got to be on the right ones at the right time to come up with capital gains that are above average."

6/ The letter referred to six unidentified companies variously engaged in the chemical, uranium and electronic fields, which "have become leaders in the new atomic field." It also referred to "speculative issues that are dominating the atomic field" for the investor "who wishes to take added risk with, perhaps, compensating capital appreciation possibilities."

2. Assurance of Protection Against Loss - Overnight Warning System

One type of solicitation material represented that subscribers could be assured of protection against losses that would otherwise result from a bear market decline because registrant was able to predict market turns through its use of the Dow Theory. 7/

One representative circular, employing the technique of suggestive and colorful rhetorical questions to convey the implication of registrant's ability to provide the right answers, stated:

"WHERE WILL YOU BE AFTER THE NEXT DECLINE?"

* * *

"Will you be sitting cozily and securely with your debts all paid ... your cash safe in the bank ... without a fear or worry about the future of your capital ... your business ... your home?

"Or will you be like the majority - greatly disillusioned; money wiped out in a tremendous stock market decline; business and home in danger of being lost because of inadequate warning of the crisis; worrying and fearful of the coming months?

"YOU CAN MAKE THE CHOICE RIGHT NOW. It is entirely up to you ....

"For there is a method that, based on actual past performance, will help you sidestep a good part of these bear market declines.

"That method is the age-old Dow Theory which has signalled every major bear market since the beginning of the twentieth century, through the interpretation of various analysts including our own since 1946, when we were organized.

"No one with $500 or more in stock ... with a home ... with a business ...can afford to be without this time-tested method of anticipating possible future stock trends."

7/ The Dow Theory, which was first developed in the early 1900's and is based upon the action of the Dow Jones industrial and rail averages, is a method for ascertaining bull or bear market trends. These averages do not forecast the duration of such markets but only indicate when they are under way. When both the industrials and rail stocks in the Dow Jones averages penetrate previous highs in successive rallies, a primary bullish trend is considered as established. A primary bearish trend is viewed as confirmed when both averages continue breaking through previous lows in spite of a succession of minor rallies. Later students of the Dow Theory stress the importance of the volume of trading in forecasting major trends.

The circular cited the "PROTECTION" afforded by the warning of Dow Theorists and, later, of Forecasts against the 1929 "panic," the 1938 "depression," the "panic in stock prices" in 1946, the "drastic" decline in 1953, the declines in 1957 and 1960, the "largest collapse in stock price since 1929" in May 1962, and the declines in September 1962 and in 1965. Although this presentation was followed by a statement that "Successful prediction of certain past market turns is, of course, no assurance that we will be able to do the same in the future," we do not consider that such disclaimer cured the misleading implications of dependable protection against loss which were contained in the preceding text and made the initial impression on the prospective subscriber. 8/

Respondents repeatedly used scare or panic headlines in periods of declining markets to attract potential subscribers to read their advertisements and soliciting material and to alarm them as to the current and future state of the securities markets and thereby induce them to subscribe. This "bear scare" campaign was frequently conducted by means of full-page advertisements in the financial sections of leading newspapers throughout the country, in many instances with bold headlines in two-inch block letters, which though introduced in question form inferred that the securities markets were in extremely perilous condition. Constantly emphasized was the need for registrant's advisory service if the reader were to pass safely through the critical days ahead. Some of the headlines used were:

"BIG STOCK MARKET DROP JUST AHEAD?
400 Common Stocks to Sell Now"

"ANOTHER BIG STOCK DROP BEFORE NOVEMBER 1st?
450 STOCKS TO SELL NOW"

"DROP IN STOCK PRICES ONLY THE BEGINNING?
450 STOCKS, WE BELIEVE, SHOULD BE SOLD NOW"

"STOCK MARKET AT MOST CRITICAL STAGE SINCE
1929? 181 Stocks to Sell NOW"

"NEW STOCK MARKET DECLINE JUST AHEAD?
Will You Recognize the Danger Signals?"

"STOCK MARKET CRISIS Within 30 [or 45 or 60]
DAYS? DOW THEORY GIVES WARNING INDICATIONS! ***
SELL THESE 143 STOCKS NOW!"

"IS A MAJOR STOCK MARKET DECLINE IN THE
MAKING? With 'Danger Signals' Flying, You
Should get List of 143 Stocks to Sell Now!"

During periods of declining markets, registrant's advertisements also emphasized with bold lettering its promise to provide to all subscribers an "OVERNIGHT WARNING SYSTEM" in "crucial periods." A

8/ See Marketlines, Inc., Investment Advisers Act Release No. 206, p. 4 (January 20, 1967), aff'd 384 F.2d 264 (C.A. 2, October 9, 1967), cert. denied 390 U.S. 947; Spear & Staff, Incorporated, Investment Advisers Act Release No. 188, p. 6 (March 25, 1965); cf. The Private Investment Fund for Governmental Personnel, Inc., 37 S.E.C. 484, 490 (1957); Del Consolidated Industries, Inc., Securities Act Release No. 4795, pp. 2-3 (July 26, 1965).

representative advertisement described this feature as consisting of special bulletins mailed between regular publication dates, whenever warranted, without extra charge. An "URGENT MESSAGE" sent by Evans to trial subscribers stated:

> "It Could be Very Costly If You Should Miss The Next Dow Theory BEARISH (Down) SIGNAL When It Comes
>
> "Those who lived through the great stock market crash of 1929, the drastic collapse of 1962 and the declines of 1965 can fully appreciate how losses can build up in a matter of hours. To protect the money you have in your investments, it is just good sense to keep in touch with an organization with a 'built-in' warning system!"

It went on to state that while regular weekly mailings of Forecasts are adequate in normal situations, the Overnight Warning System is an added precaution in crucial periods.

While this special bulletin feature, which respondents elsewhere characterised as "invaluable," fostered the impression that registrant would bring vital information to its subscribers on an emergency basis, in fact not only was the special bulletin rarely issued, 9/ but, except for one bulletin in 1962, it was not distributed between regular publications dates but was included in the regular mailing of Forecasts.

3. Use of Dow Theory to Select Individual Stocks

Notwithstanding the fact that the Dow Theory, as classically interpreted and as used by respondents, cannot predict the market price movement for individual stocks and purports only to indicate the presence or reversal of existing primary market trends for stocks generally, registrant's advertisements implied that the Dow Theory was the principal or even sole basis for its selection of individual securities to be bought, sold, or held. For example, a form solicitation letter announced: "400 STOCKS TO SELL NOW BEFORE NEXT MARKET DROP ... DOW THEORY IMPLIES DANGER AHEAD." The letter then stated that a list of 95 stocks for immediate sale had been prepared, bringing Forecasts' "sell" list to over 400 issues, and concluded, "Don't take unnecessary risks with your capital. Find out at once what the Dow Theory indications, according to our interpretation, are for the weeks just ahead."

This letter created the misleading impression that registrant's selection of the 400 stocks to be sold "now" or "immediately" was based upon the Dow Theory as interpreted by registrant. In fact, while respondents consider the theory in determining the nature of their recommendations, the actual tools which respondents stated they used in arriving at their recommendations to buy, sell, or hold particular securities were described elsewhere in solicitation circulars. For example, one circular, after stating that "Every week, the proven Dow Theory method is interpreted for thousands of investors" in Forecasts, observed that a "combination of standard statistical data [such as a company's indebtedness, dividends, sales, earnings growth, profit margins, markets, and industry trends] and technical information obtained through the use of modern computers and modern charting techniques has

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9/ As noted in one of the undated solicitation circulars, registrant sent two warning bulletins in 1962 and one in June 1965.

been the basis of Dow Theory Forecasts' stock selection for many years and will continue to be in the future."

Similar misleading statements concerning the use of the Dow Theory appeared in other form letters sent to trial subscribers. The following examples will suffice:

> "This same dependable theory plays an important part in helping us advise you when to buy, sell or hold specific stocks."
>
> "These model growth portfolios [based on assumed original investments of different amounts with selected changes of which subscribers are regularly informed] ... are guided as carefully as we know how to take fullest advantage of market movements. We continually apply our interpretation of the principles of the famous DOW THEORY ...."
>
> "[The Dow Theory] is not used by many Investment Advisers (thank goodness, or we would all be buying and selling the same stocks at the same time!) ...."

Other soliciting material asked, "DO YOU WANT TO INCREASE YOUR BANK ACCOUNT?" and went on to say, "What you need to know is WHEN and WHAT to buy or sell!" and then advised that the answer is in the Dow Theory as interpreted by Forecasts. And one advertisement representative of others placed in newspapers and magazines was headlined, "You Should Know What Action to Take on these 522 STOCKS," and the text offered during the next four weeks "comments and advice on hundreds of individual stocks published by Dow Theory analysts."

4. Stock Split Candidates

Respondents frequently offered to readers of their advertisements who subscribed to Forecasts a list of "STOCK SPLIT CANDIDATES." Some of the lists registrant supplied were of stock splits that had already been publicly announced and were to be effected thereafter whereas others were of stocks as to which splits were predicted by Forecasts. The first type was referred to in advertisements with the headline, "6 STOCKS to SPLIT BY DECEMBER 1," whereas the second type was referred to in advertisements headlined "WHEN THESE 30 STOCKS SPLIT." Both types of advertisements indiscriminately referred to a list of companies which were "expected" to split their stock, and stated that "many investors like to know, in advance, which stocks are going to split." The advertisements state that stock splitting reduces a stock's price per share to a more popular buying level, so that more investors are attracted, and often, but not always, prices and dividends go up. However, in the case of stock splits already formally announced, the advertisements failed to disclose that fact, and in the case where the list was of predicted stock splits, there was no effective qualification of the inference in the advertisement that registrant could accurately predict them.

5. Comparisons With Other Investment Advisory Services

Respondents made misleading comparisons between registrant's method of forecasting and the methods used by other investment advisers. The following excerpt appeared in a solicitation letter used continually from 1963 through 1966:

"OTHER METHODS INADEQUATE -

"Too early or too late

"Other methods ... men ... and organizations have tried to give such warnings [of market declines] in all sincerity but, as the record shows, they have failed to do it consistently. They have been too early or too late.

"Exactly the same is true today. The Dow Theory, as interpreted by Dow Theory Forecasts, has guided investors during bull (up) markets and based on what has happened before, will be the source that will give vital sell indications at the proper time.

"For the good of your hard earned money ... your business ... your family ... your health ... depend on the Dow Theory as interpreted by Dow Theory Forecasts."

The above excerpt clearly implied that registrant, unlike all other services, was neither too early nor too late in forecasting changes in market trends and that such forecasts coincided with actual shifts in market trends. In fact, substantial periods of time elapsed between the actual market high and the announcement to subscribers that a change in the previous trend had occurred. For example, registrant signalled the existence of a "bear market" on August 27, 1946, about 75 days after the market had begun its decline and after the Dow Jones industrial average had suffered 46%, and the Dow Jones rail average 44%, of their loss for the year. Again, in 1966, three months elapsed between the market high and registrant's announcement of the existence of a "bear market," and after the industrial average had suffered 41%, and the rail average 38%, of their year's decline.

In addition, in some advertising registrant compared its own performance with the performance of other investment advisory services without indicating which services were compared, the time period involved, the methods used, or the limitations in making such comparisons.

Conclusions

As we have seen, registrant's advertisements, by their use of such devices and practices as the rhetorical question, the emphasis on the Dow Theory and overnight warning system, and the scare headline, were calculated to arouse illusory hopes of immediate and substantial profit or of protection against loss and we have found them violative of the anti-fraud provisions of the Act and related rules. "In appraising advertisements ... we do not look only to the effect that they might have had on careful and analytical persons. We look also to their possible impact on those unskilled and unsophisticated in investment matters." 10/ Investment advisers hold themselves out as professionals who occupy a relationship of trust and confidence with their clients, 11/

10/ Spear & Staff, Incorporated, supra, at p. 5 of cited Release; cf. Ward Laboratories, Inc. v. F.T.C., 276 F.2d 952, 954 (C.A. 2, 1960), cert. denied, 364 U.S. 827.

11/ See S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 190 (1963).

and because of the expertise which they claim and the service they offer, statements made in their advertisements have a significant appeal especially for persons inexperienced in securities. Such advertisements should fairly present the services that are being offered and should not be couched in terms that appeal to the investor's quest for instant riches or fear of impoverishment. Registrant's advertisements were deceptive in content and dramatic in their tone and form of presentation, particularly in the wording, size, and color of their headlines. They were obviously of a character to whet the appetite of the gullible and the unsophisticated and disregarded the restraint and qualification that the intricate and complicated nature of securities requires. 12/ Indeed, because of respondents' emphasis on the Dow Theory and the Overnight Warning System, their advertisements doubtless appealed also to so-called sophisticated investors unfamiliar with the principles of the Dow Theory and relying on the promise of "overnight" warnings of market declines. Moreover, as we stated in the Spear case:

> "Advertisements of this kind have a substantial adverse effect on the public interest. Not only do they tend to mislead and deceive investors, they also tend to debase the standards of the investment advisory industry by creating a competitive environment that tempts advisers to vie with each other in making unsupportable claims to prophetic insight." 13/

As stated in the offer of settlement, registrant did not publish or circulate any advertisement until it had secured an opinion from counsel that the advertisement complied with Rule 206(4)-1. Reliance upon the advice of counsel does not, of course, negate willfulness. 14/ An investment adviser cannot shift his duty of compliance with the Act to counsel. 15/ The investing public is entitled to the fullest

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12/ Cf. Ward Laboratories, Inc. v. F.T.C., supra, at pp. 954-55.

13/ Supra, at page 8 of cited Release. See also our Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong. 1st Sess., Pt. 1, p. 368: "The impact of such advertising is apparently considerable, and thus a cause for concern .... The head of [one advisory firm] told the study that 'florid' advertising tends to 'keep the fire going' in a period of 'speculative frenzy,' but stated that his own firm was compelled by competitive necessity to resort to it."

14/ Gearhart & Otis, Inc., Securities Exchange Act Release No. 7329, p. 34 (June 2, 1964), aff'd 348 F.2d 798 (C.A.D.C., 1965).

15/ Respondents were aware of the requirements of the Act and had made modifications in its advertisements following warnings by and conferences with our staff, commencing in 1950, with respect to registrant's advertising techniques considered objectionable by the staff, the disciplinary action taken against registrant in 1959 by the National Association of Securities Dealers, Inc. which described its investment adviser advertising as flamboyant and misleading, and the criticism of registrant's advertisements, as well as those of Spear & Staff, in our Special Study of Securities Markets, supra, at p. 368.

protection of the law regardless of what counsel's view may have been. Moreover, there is no claim that counsel was informed of certain of the facts that made the advertisements false or misleading in particular respects. Counsel might not have been aware, as Evans presumably was, whether, for example, the Overnight Warning System was operated as represented in the advertisements, or the stock splits had already been announced, or the comparison to other services with respect to the timeliness of registrant's warnings of drastic bear market declines was consistent with the facts. 16/

In determining to accept respondents' settlement offer we considered the facts that the advertisements and other soliciting materials in question were submitted to experienced counsel for review before they were used, and that, after our staff began its investigation, the entire advertising program was reviewed by respondents and their counsel and many advertisements were discarded or rewritten. In addition, all advertising practices considered by our staff to be in possible violation of the Act were discontinued. We also took into account the substantial financial loss to registrant and its personnel which would result from a 120-day suspension of advertising for new subscribers, 17/ the long period of time respondents had been engaged in the investment advisory business, the fact that registrant's advisory publications were not involved in these proceedings, and our staff's position that the public interest was adequately served by the sanction proposed by the offer under the circumstances, including the benefits to be derived from a prompt disposition and the issuance of an early opinion which could have a salutary effect upon the industry.

By the Commission (Chairman COHEN and Commissioners OWENS, BUDGE, WHEAT and SMITH).

Orval L. DuBois
Secretary

16/ Cf. Gearhart & Otis, Inc., supra, at p. 9, n. 13, of cited Release.

17/ In March 1968, registrant had 94 full-time and 8 part-time employees.

(Securities Exchange Act Release No. 8836)
(Investment Advisers Act Release No. 258)

ADMINISTRATIVE PROCEEDING
FILE NO. 3-2024

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
March 9, 1970

In the Matters of MATES FINANCIAL SERVICES (801-4964) MATES MANAGEMENT COMPANY FREDERIC S. MATES 15 William Street New York, New York Securities Exchange Act of 1934 - Section 15(b) Investment Advisers Act of 1940 - Section 203(d)	FINDINGS AND OPINION OF THE COMMISSION

INVESTMENT ADVISERS ACT PROCEEDINGS
BROKER-DEALER PROCEEDINGS

Grounds for Remedial Sanctions

Misrepresentations Concerning Investments in Restricted Securities and Performance of Fund

Misstatements to Clients and Prospective Clients Concerning Fees and Commissions of Registered Investment Adviser

Use of Inside Information in Purchase of Securities

Manipulation

Where officer and director of registered investment company, who was also officer and director of its investment adviser, caused company to acquire contrary to representation to shareholders, securities which could not be publicly offered for sale without first being registered under the Securities Act of 1933, to value such securities improperly under the Investment Company Act, and to redeem securities at prices based on such improper valuation; and held out performance of investment company to attract clients to registered investment adviser of which he was sole proprietor; and where such investment adviser received payments from brokers for directing brokerage business of managed accounts to them, effected purchases of stock prior to public release of material information relating to issuer, and engaged in manipulative activities with respect to such stock, held, in public interest to impose sanctions upon respondents pursuant to offer of settlement.

APPEARANCES:

Allan S. Mostoff, David M. Butowsky and Herbert E. Milstein, and Michael S. Leo of the New York Regional Office, for the Division of Corporate Regulation, and Stanley Sporkin, Leonard H. Rossen and Stephen W. Arky, for the Division of Trading and Markets, of the Commission.

Milton V. Freeman and Werner J. Kronstein, of Arnold and Porter, and Harvey J. Klaris and Sheldon Curtis, of Feiner, Klaris & Curtis, for respondents.

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We heretofore in these proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(d) of the Investment Advisers Act of 1940 accepted an offer of settlement submitted by Mates Financial Services ("MFS"), a registered investment adviser; Mates Management Company ("MMC"), the investment adviser until August 5, 1968 to Mates Investment Fund, Inc. ("Fund"), a registered investment company; 1/ and Frederick S. Mates, sole proprietor of MFS and president and a director of Fund and MMC. The order for proceedings alleged that in the period beginning in April 1968, among other things, Mates, contrary to representations to Fund shareholders, caused Fund to purchase substantial amounts of "restricted securities" which could not be offered for sale to the public without first being registered under the Securities Act of 1933, valued such securities improperly, and then held out to the public that the performance of the Fund was caused solely by the investment advice he furnished. The order further alleged that MFS and Mates allocated execution of securities transactions on behalf of MFS advisory clients to brokers who gave MFS and Mates substantial rebates, and that MMC and Mates purchased certain stock without disclosing material non-public information concerning the issuer and engaged in manipulative activities with respect to that stock.

Pursuant to the offer of settlement, an order was issued finding, for the sole purpose of these proceedings, that respondents willfully violated or willfully aided and abetted violations of various statutory provisions and rules as alleged in the order for proceedings. As provided in the offer of settlement, the order directed that Mates shall not become associated with a broker-dealer without our approval; suspended the registration of MFS as an investment adviser for a period of 100 days commencing at the opening of business on June 16, 1969, subject to the terms and conditions specified in the offer; prohibited MFS and Mates from issuing research reports and performing similar services for broker-dealers for compensation without our prior approval; and prohibited the receipt by MMC of any fees from Fund for the first 60 days of any investment advisory contract which may be concluded between MMC and Fund. 2/

1/ Prior to August 5, 1968 Mates owned approximately 50% of the stock of MMC and on that date he acquired the balance. As a result, an assignment of the advisory contract between the Fund and MMC occurred and, as a consequence, the advisory contract terminated. Thereafter, Fund was managed by its officers and directors.

2/ Securities Exchange Act Release No. 8626; Investment Advisers Act Release No. 247 (June 12, 1969).

Respondents in their offer of settlement further consented to findings of violations as alleged in the order for proceedings, and we now issue our findings and opinion with respect to the issues in the case. 3/

Investment in and Valuation of Restricted Securities

Fund registered with us under the Investment Company Act on June 9, 1967 as a no-load diversified open-end management investment company. Since its inception Mates dominated the investment policies of the Fund. On February 7, 1968 Mates sent to Fund's shareholders along with the Fund's financial report dated January 31, 1968, a letter by him as president of Fund stating:

> "In recent months, there has been a tendency among several mutual funds to take positions via 'investment letter' directly from the issuing companies or principal stockholders. This limits the liquidity of these positions since the shares so purchased must be registered with the Securities & Exchange Commission or held for a period of time before they can be resold to the public. Since 'investment letter' stock is generally available at a substantial discount from market, mutual funds which engage in this sort of activity can show quite remarkable results over the shorter term. Although we would not hesitate to step off the beaten path in search of unusual investment values, we believe that deliberately locking oneself into a position delegates too much of management's responsibilities to the vagaries of the market. Thus, you may be pleased to know that there is nothing in our portfolio that we could not sell immediately if we so choose."

Mates continued to mail the letter to new Fund shareholders through May 1968.

Despite the representations in the letter, between April 15 and July 23, 1968, Mates acquired for the Fund substantial amounts of various issues of restricted securities. Six of those issues, which had an aggregate cost of $3,610,000, 4/ were assigned a value of

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3/ Respondents have consented that in making our findings we may take notice of and use our public files and the testimony, exhibits and other materials obtained by our staff in its investigation of this matter.

4/ These six issues were:

Issuer	Securities	Cost
Bell Television, Inc.	15,000 shares	$ 90,000
	$60,000 bond convertible into 6,000 shares	60,000
Longchamps, Inc.	45,000 shares	405,000
Process Plants Corp.	$25,000 bond convertible into 3,000 shares	125,000
Zimmer Homes, Inc.	50,000 shares	875,000
Omega Equities Corp.	300,000 shares	975,000
Giffen Industries, Inc.	36,000 shares	1,080,000
		$3,610,000

(CONTINUED)

$7,161,250 when first placed in the pricing sheets for the purpose of determining the net asset value of the Fund. Four of the six securities were valued at the market price for unrestricted securities of the same issuer and class. Two, shares of stock of Omega Equities Corporation and of Giffen Industries, Inc., were valued pursuant to certain methods, which in effect resulted in a constant dollar discount from the fluctuating market price for the corresponding unrestricted shares. 5/

Because of bookkeeping and administrative difficulties, the Fund in June 1968 stopped issuing its own shares and undertook in the ensuing months to reconstruct its books and records. At about the same time the Fund borrowed more than $7,000,000 from two banks and collateralized the loans with the Fund's entire portfolio. The borrowed money was used in part to purchase the restricted securities and in addition to satisfy Fund shareholders who presented their shares for redemption.

At no time during the period of April 18 through December 20, 1968, when as discussed below Fund applied to us for an order permitting it to suspend the right of redemption of its outstanding shares, was any disclosure made to the investing public of Fund's acquisition of restricted securities or its valuation procedures. Letters sent to the Fund shareholders in August and September 1968 made no mention of these facts, or of the Fund's borrowing of over $7,000,000. During the April-December 1968 period, Mates gave at least three press interviews in which he referred to the market performance of Fund without adverting to the restricted securities. Thus, a story carried in the New York Times on July 28, 1968, reported that Mates pointed out that Fund had appreciated more than 100% during the period of August 1967 through July 28, 1968. 6/ During this same period Mates caused the Fund to publish its net asset value on a daily basis in various news publications throughout the country.

Mates continued through November 1968 to value the restricted securities as if they were unrestricted, except for the Omega and Giffen shares which, as noted, were valued at constant dollar amount discounts from the market price for unrestricted shares. As of November 26, 1968, the six issues of restricted securities were carried in Fund's portfolio at a value of $13,459,000, more than $10,000,000 in excess of

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4 Continued/

Fund had in April 1968 also purchased 15,000 restricted shares of Oxford Financial Company for $240,000, approximately 5.2% of Fund's assets at that time.

5/ During the period May 20 to November 28, 1968, the Omega stock was valued at a discount not exceeding $2.75 per share from the market price of unrestricted Omega stock, and the Giffen stock was valued at a discount of $6 per share. During this period brokers offered as much as $34 and $67 per share, respectively, for unrestricted shares of Omega and Giffen.

6/ During the entire year 1968 Fund was widely heralded as the country's leading performance Fund. Certain indices quoted Fund's appreciation during 1967 and 1968 as in excess of 170%.

their cost. As of that date, more than $10,800,000 of the more than $13,600,000 of indicated unrealized appreciation on all securities in Fund's portfolio represented indicated appreciation in restricted securities on the basis of the valuation procedures used by Mates.

On November 18, 1968 the accountants certified Fund's financial statements as of May 31, 1968. 7/ On November 20, 1968 certain individuals brought suit against Mates and Fund alleging violations of the securities laws in connection with the Fund's acquisition of certain other securities. As a result of the ensuing publicity, the Fund's independent accountants, on about November 21, 1968, withdrew their certification of Fund's financial statement as of May 31, 1968. Thereafter Mates informed the accountants for the first time of the substantial acquisitions of restricted securities subsequent to May 31, 1968. Following this disclosure the accountants began a study of Fund's acquisition and valuation of restricted securities and at about this time the board of directors first gave special consideration to the valuation of Fund's restricted securities, and lowered the valuation of the six restricted securities on December 19, 1968 to $11,576,085, or $3,223,165 below the market price of the corresponding unrestricted shares. 8/

On December 20, 1968, we announced the issuance of an order temporarily suspending trading in the securities of Omega pending clarification of information relating to Omega's financial condition, product lines and acquisition program and pending further inquiry with respect to whether that company's recent offers and issuances of its unregistered securities were in violation of the registration and antifraud provisions of the securities laws. 9/ On the same day upon the application of Fund we issued an order permitting it to suspend the right of redemption of its outstanding redeemable securities. 10/ In support of that application Fund referred to our suspension of trading in Omega securities and stated that such securities represented a substantial portion of Fund's portfolio and were held by Fund pursuant to investment letter, 11/ and that such factors created a situation

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7/ Pursuant to the request of the accountants, Mates and two other officers of the Fund provided the accountants on November 18 with a statement purporting to describe events subsequent to May 31, 1968 which would materially affect the Fund's financial position, but which did not mention the Fund's acquisitions of restricted securities after May 31, 1968.

8/ In the portfolio valuation as of November 26, 1968, the restricted securities had been valued at a discount of only $882,000 from the market price of the corresponding unrestricted securities.

9/ Securities Exchange Act Release No. 8474 (December 20, 1968).

10/ Mates Investment Fund, Inc., Investment Company Act Release No. 5571 (December 20, 1968).

11/ Restricted securities are sometimes referred to as "investment letter" securities because of the practice frequently followed by an issuer or a person in control of an issuer in selling such securities, - in order to substantiate the claim that the transaction does not involve a public offering and is within the so-called "private offering" exemption from registration under Section 4(2) of the Securities Act, - of requiring the buyer to furnish a so-called "investment letter" representing that the purchase is for investment and not for resale to the general public.

contemplated by Section 22(e) of the Investment Company Act of 1940. 12/ Subsequently, we permitted resumption of trading in Omega securities, following the entry of a consent decree permanently enjoining Omega from violations of the Federal securities laws. 13/ Thereafter, we rescinded the order permitting Fund to suspend the right of redemption of its shares, effective July 22, 1969, 14/ and on the same date Fund resumed sales of its shares.

We have recently commented on the problems raised by the acquisition of restricted securities by investment companies. 15/ Among other things, such acquisitions present problems of valuation, with the dangers that distortion in valuation will distort the prices at which the companies' shares are sold or redeemed and will indicate an investment performance that will mislead investors. In addition, since restricted securities may not be publicly sold unless they are first registered under the Securities Act, the acquisition of such securities reduces the flexibility and liquidity needed particularly by open end companies which are required to redeem shares within seven days on demand. These factors underscore the importance of full disclosure of an investment company's policy and practice with respect to the acquisition and valuation of restricted securities.

Section 2(a)(39) of the Investment Company Act and Rule 2a-4 thereunder require that in determining net asset value, "securities for which market quotations are readily available" must be valued at current market value while other securities and assets must be valued at "fair value as determined in good faith by the board of directors." Readily available market quotations means reports of current public transactions or current public offers for securities similar in all respects to the securities in question. No current public transactions or current public offers can exist in the case of restricted securities. For valuation purposes, therefore, restricted securities constitute securities for which market quotations are not readily available. Accordingly, their fair values must be determined in good faith by the board of directors. Such a determination includes more than looking at the market values of the unrestricted securities of the same class. It requires an attempt to determine the inherent value of the securities, taking into consideration all relevant material and data, including current financial data of the issuer, and making adjustments for any

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12/ Section 22(e) of the Investment Company Act provides, insofar as here relevant, that the right to redeem shares may be suspended for any period during which an emergency exists as a result of which disposal by an investment company of securities owned by it is not reasonably practicable or it is not reasonably practicable for such company fairly to determine the value of its net assets, or for such period as we may permit for the protection of securities holders of the company.

13/ Securities Exchange Act Release No. 8584 (April 24, 1969).

14/ Investment Company Act Release No. 5706 (June 12, 1969).

15/ Investment Company Act Release No. 5847 (October 21, 1969).

diminution in value resulting from the restrictive feature. 16/ The board of directors has a continuing obligation to make that determination at appropriate intervals throughout the period the restricted securities are retained in the investment company's portfolio.

In the instant case, during the period of April through August 1968 the Fund's board of directors did not even purport to value the Fund's holdings in restricted securities. In August 1968 the directors apparently were advised of Mates' valuation methods and made no objections. Mates continued through November 1968 to value those holdings at the market price for unrestricted securities of the same class or at a small discount from such prices, without regard for other factors which might have indicated lower valuations. Thus, it does not appear that Mates gave adequate consideration to the price paid by the Fund, the relationship between the amount of the restricted securities in Fund's portfolio and that of the freely traded securities, or the possible difficulties in reselling the restricted securities. Moreover, insofar as the Fund's Omega stock was concerned -- which, as valued, comprised more than 20% of the value of Fund's portfolio by late November 1968 17/ -- Mates knew that Omega was making other private placements of its restricted securities. 18/ Prior to November 28, 1968 Mates valued Fund's holding in Omega at a discount of not more than $2.75 per share, which at times during this period was less than 10% of the market price for unrestricted Omega stock.

In acquiring the securities described above, Mates followed a policy of orally committing Fund to purchase restricted securities, and then having the Fund value such securities in its portfolio at some subsequent date. During the period of April 15 through July 26 there were intervals of between 6 to 53 days between the time the Fund committed itself to purchase a restricted security and when it first included that security in its portfolio. In such intervals, the market prices of the unrestricted shares of several of the securities increased significantly, and such increases were reflected in the first valuations of the restricted securities in Fund's portfolio. Thus, Fund on July 8 agreed to purchase 300,000 restricted shares of Omega for $3.25 a share, reflecting a discount of about 46% from the market price of approximately $6 a share for the unrestricted stock of Omega. 19/ However, Fund

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16/ The data and information considered and the analysis thereof should be retained, so that they may be available for inspection by the company's independent auditors and our staff.

17/ As of November 26, 1968, Fund reported net assets of $25,378,798.

18/ See Securities Exchange Act Release No. 8584 (April 24, 1969). The private placements were generally at discounts of 50% from the market price for unrestricted securities. Because of increases in market prices in the intervals between the times agreements to purchase Omega shares were signed and the dates sales were actually consummated, the prices actually paid were approximately 25% of market prices on the dates the stock was acquired.

19/ The market price for unrestricted Omega stock increased from approximately 60¢-70¢ a share on April 30, 1968 to about $33-$35 per share on December 9, 1968. In February 1970 such stock was at about $.75-$1.00 per share.

valued these securities in its portfolio for the first time on July 18, 1968, giving them a value of $5.75 per share, the market price for the unrestricted securities having risen by that date to approximately $8.125 a share. On May 31, 1968, Fund agreed to purchase 36,000 restricted shares of Giffen at $30 a share, reflecting a premium over the then market price for the unrestricted stock of Giffen of approximately $23.00 a share. However, Fund did not value these securities for portfolio purposes until July 23, 1968 when the market value for unrestricted stock had increased to $58.00 a share, at which time the restricted stock was assigned a value of $49.00 per share. 20/

The valuation of restricted securities at the market quotations for unrestricted securities of the same class, or at slight discounts from such quotations, is improper except in most unusual circumstances not present here. The valuation procedures followed by Mates not only gave the Fund, whose investment policy and attendant publicity stressed performance, the appearance of a greater appreciation in value than was justified had proper valuation procedures been followed, but the delay in valuing the restricted securities in the Fund's portolio showed such appreciation to have been achieved over shorter periods of time than was actually the case. There was thus created a distorted picture of the Fund's performance which affected investors' decisions to redeem or to continue to hold their shares. The Fund's reported net asset value rose from approximately $9 a share in early June 1968, when the Fund stopped sales of its shares because of the back office problems, to $16.88 a share in early December of that year. To the extent that such asset values were inflated by the Fund's improper valuation procedures, holders who did not redeem their shares were also adversely affected as a result of redemptions that were made by some 300 shareholders during this period at redemption prices based on those asset values. 21/

The importance of a full disclosure with respect to the acquisition of restricted securities and the possible consequences thereof is further underlined by the other serious problems which confronted the Fund in this case. By November 1968, more than 20% of the Fund portfolio assets as valued by Mates were in Omega stock and an additional 22% were in other restricted securities. The Fund thereby became dependent upon developments in the affairs of several of its portfolio companies and at the same time lost much of its flexibility with respect to choosing securities which could best be sold where necessary to meet redemptions. Moreover, on December 20, 1968, when we suspended trading in Omega stock, the Fund was unable to value its portfolio. As we already noted, it therefore had to suspend redemptions of its outstanding shares.

Thereafter, in order to put itself in a more liquid position and also to obtain cash to pay off the bank loans of approximately $7,000,000, the Fund was forced to sell a number of restricted securities at prices

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20/ Portfolio valuations of the Giffen stock on all other dates through November 26, 1968 were at a discount of only $6 per share from the market price, in accordance with the method used by Mates.

21/ In this period approximately 160,000 shares were redeemed for about $2,100,000.

substantially less favorable than the portfolio values previously assigned to them. 22/ For example, Fund sold its Giffen holdings at $41 per share on December 31, 1968, only a little over a month before a registration statement which included those holdings became effective under which Giffen shares were offered at $55 per share. The $41 price obtained by Fund on December 31 was approximately $11 per share less than the portfolio figure as of December 19 (the day before the suspension of redemption rights) and only about two-thirds of the market price of unrestricted Giffen shares as of December 31. Also on December 30, 1968, the Fund sold its holding in Longchamps, Inc. at $25 per share, being almost $12 less than their portfolio valuation as of December 19 and reflecting a substantial discount from the market value of the unrestricted stock as of December 30.

In July 1968, after the Fund ceased selling its shares, MFS, a sole proprietorship wholly owned by Mates, registered as an investment adviser. Wide publicity accompanied the opening of this business. In addition, Mates provided prospective clients of MFS with material emphasizing the performance of the Fund. Mates and MFS continually brought to the attention of prospective clients of MFS that Fund had the highest reported performance of any registered investment company in the United States. During the period of July through December 1968, MFS and Mates told investors who inquired about investing in the Fund that the Fund was not then selling its shares but that MFS would provide the investor with management similar to that provided to the Fund. The Fund's apparent performance was thus used to lead investors to believe that with MFS's advisory management their own investments would also produce spectacular results. In the period of July through December 20, 1968, a total of 717 individuals became clients of MFS, entrusting to MFS and Mates more than $17,000,000.

In summary, contrary to his representation to Fund shareholders that the Fund would not acquire securities which could not be sold without registration under the Securites Act, Mates caused the Fund to acquire substantial amounts of such securities. In so doing, he created a situation which could adversely affect the ability of the Fund to comply with the requirements of the Investment Company Act relating to the Fund's shareholders' rights of redemption, contrary to the representations with respect thereto. Thereupon Mates improperly valued such restricted securities in the Fund's portfolio in violation of the valuation provisions of Sections 2(a)(39)(B) and 22(e) of the Investment Company Act and Rule 2a-4 thereunder, and thereby misrepresented to Fund shareholders and to clients and prospective clients of MFS the extent and the cause of the reported increase in the Fund's net assets and net asset value per share. We conclude that in these respects, Mates and MFS willfully violated or willfully aided and abetted violations of the antifraud provisions of Sections 206(1) and 206(2) of the Investment Advisers Act and of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Rebate Practices

During the period July - October 1968, MFS and Mates also willfully violated Sections 206(1) and (2) of the Investment Advisers Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in that

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22/ We have recently pointed out some of the dangers of acquiring restricted securities. See Investment Company Act Release No. 5846, supra, p. 6.

they allocated the execution of securities transactions on behalf of MFS advisory clients to brokerage firms which gave MFS and Mates rebates. These rebates took the form of payments purportedly for an investment advisory publication of MFS and were made contrary to representations to the clients with respect to fees and commissions.

By October 1968 MFS was the investment adviser to over 700 clients for whom Mates made investment decisions on a discretionary basis. A brochure distributed to clients and prospective clients of MFS stated that MFS was not a broker and collected no commissions on clients' accounts; that MFS's fee was based on the net value of a client's portfolio; and that such fee was paid out of the client's account every quarter at rates of 1/4 of 1% to 1/2 of 1% of the client's equity depending on the amount of such equity.

MFS also published an advisory service for brokers for a monthly fee of $5,000 (subsequently reduced to $3,000) which offered subscribers five or six research reports per month, individual reports on specific securities on request, and seminars to be conducted by Mates. However, very few brokers requested special reports and no seminars were held. The advisory reports that were furnished were merely rather brief market letters, each of which covered one recommended security and presented a very general description of the issuer and its assets with a minimum of financial information. The principal aspect of the arrangement with brokers subscribing to the service was that they were given to understand that if they subscribed to the Mates advisory service, they would be allocated brokerage business arising from the accounts managed by MFS from which they could realize substantial commissions. During the relevant period, MFS allocated a substantial number of brokerage transactions in the accounts of its clients to seven broker-dealer firms and two registered representatives who subscribed to the Mates advisory service. During that period the subscription payments received from such firms and representatives exceeded $90,000, which was more than twice as much as MFS received during the same period from the fees charged clients for managing their investment accounts.

It is evident that the subscriptions offered to brokers were a subterfuge for obtaining rebates from such subscribers in connection with commissions generated by transactions in the portfolios of clients whose accounts were managed by MFS, and the omission to disclose such commission rebates made misleading the representations to clients that no commissions would be collected on their accounts and that MFS annual investment advisory fees would not exceed 2% of the equity in their accounts. Moreover, MFS and Mates were fiduciaries in their relationship to their clients in that they acted as investment adviser and directed the execution of securities transactions for them. The arrangement with subscribers to the broker advisory service that they would receive orders for transactions in the accounts of MFS clients enabled MFS and Mates to derive undisclosed personal benefits from the clients. It gave MFS and Mates a personal interest in the volume of the transactions and the selection of executing broker which conflicted with the duty of serving only the clients' best investment interests. The abuse of position and conflict of interests inherent in the making of such arrangements were inimical to the MFS clients. 23/

23/ Cf. Consumer-Investor Planning Corporation, Securities Exchange Act Release No. 8542 (February 20, 1969).

Use of Inside Information

During April 1968, MMC and Mates willfully violated Section 17(a) of the Securities Act and Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the purchase of shares of common stock of Ramer Industries, Inc., which were listed on the American Stock Exchange. MMC and Mates obtained through a Ramer director certain non-public material information concerning a rise in the sales, earnings and earnings projections of Ramer. They thereupon purchased Ramer stock without disclosing the information, then disclosed the information to certain registered representatives and others who also purchased Ramer stock without disclosure, and engaged in manipulative activities with respect to Ramer stock.

During the first quarter of 1968, Ramer's financial position and prospects improved significantly, Ramer's sales for that quarter being its highest on record. Whereas Ramer had shown a $.03 per share loss for the first quarter of 1967, a press release issued April 16, 1968 estimated first quarter 1968 earnings for Ramer at $.15 per share, and on April 17, 1968 actual first quarter earnings of $.16 per share were announced.

The minutes of the April 3, 1968 meeting of the Board of Directors of Ramer recited that the treasurer of the company reported on the first quarter's earnings and that the Board expressed pleasure with the results. A director of Ramer, who had attended the meeting, began purchasing Ramer stock for his own account the following day. On April 9, 1968, Mates met with that director, who was a registered representative with a broker-dealer firm and with whom Mates had a close relationship, and in the three following business days, Mates placed orders with the director for the purchase of a total of 27,000 shares of Ramer stock on behalf of the Fund and two other mutual funds. Prior to this time none of the three funds had ever transacted any business with the Ramer director.

Mates also spoke to certain registered representatives who generally followed his recommendations, and told them that he was buying Ramer stock, that Ramer's earnings would be up and that Ramer was a turn-around situation. As a result of this recommendation and the purchase activity that had already taken place, Mates was able, directly or indirectly, to induce the purchase by these representatives for their clients of approximately 65,000 shares of Ramer prior to the public announcement of the 1968 first-quarter earnings. Thereafter Mates continued to recommend Ramer stock and induced purchases of the stock.

Ramer had approximately 750,000 shares of stock outstanding as of April 1, 1968. During March 1968 and the first few days of April, trading in Ramer stock on the American Stock Exchange amounted to about 1,000 shares or less per day. In the three week period ending May 3, 1968, the total volume of trading in Ramer stock on the exchange was 1,169,000 shares, and during this period the price of the stock rose from about $5-3/8 to $14 per share. Mates through his own transactions and his recommendations to others was responsible directly and indirectly for the purchase of at least 151,000 shares of Ramer stock during the last three weeks of April 1968 and was thereby able to affect appreciably the market value of the Fund's portfolio holdings of Ramer stock.

It is clear that through his relationship with a director of Ramer, Mates had access to non-public material information which he

used for his own advantage and that of his clients. 24/ This information was of such importance that it could reasonably be expected to affect the judgment of investors whether to buy, sell, or hold the stock. If generally known, such information could reasonably be expected to affect materially the market price of the stock. 25/ We concluded that Mates' and MMC's advance use in market purchases of the favorable information concerning Ramer for their own or their customers' benefit and to the detriment of public investors to whom the information was not known constituted conduct violative of the designated antifraud provisions. 26/

We further concluded that by directly and indirectly effecting a series of transactions on the exchange which created active actual and apparent trading in Ramer stock and which raised the price of such stock for the purpose of inducing purchases by others, Mates engaged in conduct which constituted a manipulation of securities prices in violation of Section 9(a)(2) of the Exchange Act.

Conclusion

In view of the foregoing, we concluded that it was in the public interest to accept the offer of settlement and to impose the sanctions permitted under such offer, as recommended by our staff.

By the Commission (Chairman BUDGE and Commissioners OWENS, SMITH and NEEDHAM), Commissioner HERLONG not participating.

Orval L. DuBois
Secretary

24/ Following public disclosure of the information on April 16, 1968 the price of the stock generally rose from 7-7/8 on that date to 13-1/4 on April 29, 1968.

25/ Merrill Lynch, Pierce, Fenner & Smith, Inc., Securities Exchange Act Release No. 8459, p. 5 (November 25, 1968). See also Blyth & Co., Securities Exchange Act Release No. 8499 (January 17, 1969); Van Alstyne, Noel & Co., Securities Exchange Act Release No. 8511 (January 31, 1969).

26/ S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833 (C.A. 2, 1968), cert. denied, 394 U.S. 976 (1969); Cady, Roberts & Co., 40 S.E.C. 907 (1961); Merrill Lynch, Pierce, Fenner & Smith, Inc., supra; Blyth & Co., supra; Van Alstyne, Noel & Co., supra.

Act IAA-40
Section
Rule 206(4)-1(a)(5)
Public Availability 4/13/78

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October 17, 1977

Office of Chief Counsel
Division of Investment Management
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Re: Investment Advisors Act of 1940:
Reg. Section 275.206(4)-1;
Request for No-Action Response

Gentlemen:

Morrill-Stanfill & Co. is a Colorado corporation located at Suite 700, 600 South Cherry Street, Denver, Colorado 80222. The corporation is registered as an investment advisor pursuant to the Investment Advisors Act of 1940. The corporation has two principal officers and employees, Mr. James R. Morrill and Mr. William D. Stanfill. This writer serves as counsel for the firm.

By letter to the Division of Investment Management dated August 31, 1976, Morrill-Stanfill & Co. attempted to solicit comment from the Commission Staff with regard to certain items of sales literature then being utilized by the corporation in its solicitation of clientele. In response to that letter, the Assistant Chief Counsel of the Division of Investment Management advised that because of budget and manpower limitations, the Division would be unable to review the said sales material and to comment thereon. The suggestion was given that a more appropriate method to be utilized in soliciting a response from the SEC Staff with regard to the corporations's sales literature would be through the medium of a no-action letter (please refer to your Ref. No. 76-474CC; Morrill-Stanfill & Co.; File No. 801-10445-3).

This letter constitutes a no-action request to the SEC staff.

Since no specific guidelines have been adopted by the SEC relating to the utilization of sales literature by investment advisors (with exception of Rule 206(4)-1 under Section 206 of the Investment Advisors Act), it is impossible for this writer

to determine whether the enclosed items of sales literature would, or would not, be deemed acceptable by the Commission. It is this writer's opinion, however, that the items do not violate any of the provisions of Rule 206(4)-1.

The absence of any such guidelines, and the resultant difficulty in determining whether a particular item of sales literature may, or may not, be deemed to be objectionable by the Commission or by the SEC Staff, is the prime precipitant for the no-action request made herein.

The enclosed items of sales and advertising materials which are utilized by Morrill-Stanfill & Co. in its solicitation of clientele are as follows:

Exhibit A: Morrill-Stanfill & Co. brochure entitled "Statement of Policy and Investment Philosophy."

Exhibit B: Document entitled Revised Fee Schedule, which accompanies the brochure entitled "Statement of Policy and Investment Philosophy."

Exhibit C: Introductory letter, a hypothetical example of which is the enclosed letter to Mr. Homer Price dated September 13, 1977;

Exhibit D: Becker performance data, which accompanies Exhibit C. This performance data relates to the portfolio management efforts of Morrill-Stanfill & Co. from June, 1974 through a recent date in 1977, in providing service to one of the corporation's investment advisory clients.

Exhibit E: Performance data containing information relating to Hamilton Income Fund, Inc., a publicly-offered, registered investment company, for which Mr. James R. Morrill, the President of Morrill-Stanfill & Co., served as portfolio manager from 1971 through October, 1974. This also accompanies Exhibit C.

Exhibit F: A narrative page containing no heading, which provides an explanation of the performance data included on Exhibits D and E, and which outlines the restrictive nature of the conclusions which should be drawn from the said performance information. This page always accompanies Exhibits D and E.

Exhibit G: Three data sheets, comparing the performance of two trust accounts managed by Morrill-Stanfill & Co. with the leading market indices. Exhibit G-1 provides current year-to date data, Exhibit G-2 provides data for the preceding year, and Exhibit G-3 provides data from the date of inception of management of the accounts by Morril-Stanfill & Co. through the most recent quarter-years. These exhibits are rarely mailed to prospects or to clients; instead, they may be shown to prospects or clients during personal meetings.

In its consideration of the enclosed materials, the SEC Staff should be advised of the following:

1. Morrill-Stanfill & Co. deals primarily with sophisticated investors. For example, although the company will agree to manage smaller accounts in efforts to accomodate existing clientele or for similar reasons, its solicitation efforts are generally limited to accounts having an asset base of at least $500,000 and generated additional cash flow.

2. The performance results of the accounts about which performance information is provided in Exhibits D and G are representative of the results achieved by Morrill-Stanfill & Co. in providing investment advisory services to similar clients during the indicated periods of performance.

3. Where such performance results are provided to a prospective client, Morrill-Stanfill & Co. can justify the applicability of the results to the account being solicited: i.e., the accounts will be similar in investment objectives, in the investment approach to be utilized in the management thereof, in the types of securities to be purchased for and on behalf of the solicited account, and in other particulars which Morill-Stanfill & Co. might deem relevant.

4. Morrill-Stanfill & Co. is prepared to provide similar performance records for any other accounts upon request, and so states in the narrative information which accompanies the performance materials (Exhibit F).

5. The Becker performance data is updated on a quarterly basis; the most recent quarterly summary data provided by Becker is utilized by Morrill-Stanfill & Co. as the item of sales literature corresponding to that enclosed as Exhibit D.

Morrill-Stanfill & Co. requests a response from the SEC Staff that, on the basis of the facts stated in this letter and on the basis of the Exhibits enclosed herewith, the Staff would

not recommend that the Commission take any enforcement action against Morrill-Stanfill & Co. if the corporation continues to utilize the sales literature enclosed herewith in the solicitation of investment advisory clients.

Thank you for your assistance and cooperation.

Very truly yours,

Edward F. O'Keefe

EFO/mjt

Enclosures

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 77-1029CC
Edward F. O'Keefe
File No. 132-3

March 14, 1978

Section 206(4) of the Investment Advisers Act of 1940 (the "Act") makes it unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative. Rule 206(4)-1(a)(5) (the "rule") under the Act provides that it shall constitute a fraudulent, deceptive or manipulative act for any investment adviser to distribute, directly or indirectly, any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

The Act, and the rules thereunder, do not prohibit an investment adviser from informing prospective clients of the "performance" of accounts under management so long as such information is not false or misleading. Care, therefore, should be taken in providing prospective clients with information about the "performance" of accounts under management.

. In the absence of a specific statement as to what is the relevance to a prospective client of the "performance" of accounts under management of an investment adviser, we assume that the implied relevance of such information is that it is an indication of the competence of the investment adviser or the experience of the adviser's clients and, thus, an indication of the competence that a prospective client can expect to be exercised on his behalf or an example of an investment experience that is possible for him.

Information concerning performance is misleading if it implies something about, or is likely to cause an inference to be drawn concerning, the experience of advisory clients, the possibilities of a prospective client having an investment experience similar to that which the performance data suggests was enjoyed by the adviser's clients, or the adviser's competence when there are additional facts known to the investment adviser, or which he ought to know, which if also provided would cause the implication not to arise or prevent the inference from being drawn.

Thus, giving a prospective client performance data concerning only certain periods or about only some accounts under management would not necessarily be misleading if the inclusion of information concerning other periods, or the experience of any of the accounts whose experience is omitted, would not prevent any implication from arising or inference being drawn that is based on the information that has been provided and concerns advisory competence, the experience of the adviser's clients or the possibility of the client or prospective clients having a similar experience.

The giving of information concerning the average or median performance of all accounts under management or of all accounts meeting the fully disclosed selection criteria for a designated category of accounts under management is similiarly, not necessarily misleading but may be misleading under certain circumstances. For example, assume two accounts under management: one with assets of $100,000 and the other with assets of $1,000,000. Assume further that the first account goes up to $150,000 and the second goes down to $500,000. The "performance" of the first account may be described as a 50% gain and the performance of the latter account may be described as a 50% loss. The average or median performance could be described as zero. Such a statement by itself, however, would be misleading.

Providing information as to the percentage change in accounts under management without indicating the respective sizes of such accounts may also be misleading. A mere statement with respect to the foregoing example that one account under management increased 50% and the other account decreased 50% may imply or cause an inference to be drawn about advisory competence or the experience of advisory accounts which would not arise if it was also stated that the account which increased 50% went from $100,000 to $150,000 and that the account which decreased 50% went from $1,000,000 to $500,000.

Information concerning performance of accounts over a period or periods attended by special market characteristics may imply or cause an inference to be drawn about the competence of the adviser or the possibility of a client enjoying a similar experience which would not arise if such characteristics were also disclosed. For example, the statement to a prospective client that accounts under management appreciated 50% in the last three years may contain an implication or give rise to an inference about the possibility of the prospective client having a similar experience that would not arise if the last three years represented an unusual period in the history of the market and this fact was also stated. The inclusion of a statement that the adviser does not guarantee that future results will equal past results or that a prospective client should not assume that future results will equal past results may not, by itself, deal effectively with what is misleading about the statement which is that it implies something about, or gives rise to an inference concerning, the possibility of a prospective client having a similar experience that would not be implied or inferred if all of the relevant facts known to the adviser, or which he should have known, had been stated. Furthermore, a

statement that accounts appreciated 50% may cause an inference to be drawn about advisory competence that would not be drawn if it was the fact and it was stated that the S & P 500 also increased 50% during the same period. However, comparisons of investment results with a market index or with other portfolios may be misleading unless facts bearing on the fairness of any comparison are disclosed such as (1) the inclusion of income and capital gains or losses both realized and unrealized in one of the figures to be compared, (2) the type of security, i.e., equity or debt, composing the account, (3) the object of the account and the stability or volatility of the market prices of the securities in which it is invested, (4) the diversification in the account, and (5) the size of the account.

In addition, if accounts are subject to commission, advisory and other expenses and charges, performance figures not reflecting such expenses and charges may convey an impression or give rise to an inference concerning the experience of existing accounts which is misleading.

While we have attempted to indicate, generally, what kind of information is necessary to prevent information about performance from being misleading, whether or not any communication is or is not misleading will depend on all the particular facts including (1) the form as well as the content of a communication, (2) the implications or inferences arising out of the communication in its total context and (3) the sophistication of the prospective client. Accordingly, we cannot and do not "clear" specific advertising materials for use.

Stanley B. Judd, Assistant Chief Counsel
Division of Investment Management

EJT/hbg

CC:DRO

F-43

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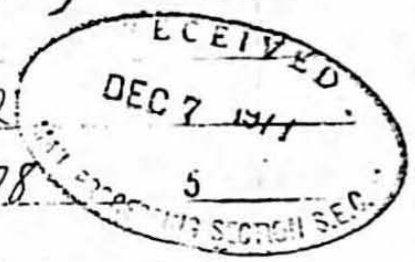
December 5, 1977

Act IAA-40
Section 206(4)-2
Public Availability 4/14/78



Office of Chief Counsel
Division of Investment Management
Securities & Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Re: Rule 206(4)-2

Gentlemen:

We serve as legal counsel to Crocker Investment Management Corporation ("CIMCO"), a registered investment adviser under the Investment Advisers Act of 1940. CIMCO is a wholly owned subsidiary of Crocker National Corporation. CIMCO's primary activity is the investment management of employee benefit plan assets for large institutional investors. CIMCO does not offer custodial services and will not accept custody or possession of its customers' funds or securities. In several instances, however, its customers have elected to entrust custody of the securities portfolio being managed by CIMCO to Crocker National Bank ("the Bank"), which also is a wholly-owned subsidiary of Crocker National Corporation.

During the course of the routine examination of CIMCO conducted by personnel from the San Francisco regional office of the Securities and Exchange Commission ("the Commission") earlier this year, a question arose as to the need for CIMCO to comply with Rule 206(4)-2 of the Investment Advisers Act of 1940. Specifically, it was the opinion of the examiner that since CIMCO and the Bank are both wholly-owned subsidiaries of the same corporation, compliance with the rule is necessary in any situation in which CIMCO acts as investment adviser for a client and the Bank serves as custodian for that client. In support of his position, the examiner referred us to certain correspondence between the Commission Staff and the Office of Chief Counsel and legal counsel to Columbia Advisory Corporation (your reference number 74-1230). In addition, he suggested that we review an August 21, 1973 interpretive opinion of the Chief Accountant to Myron J. Hubler Jr. of the American Institute of Certified Public Accountants with regard to Section 17(d) and 17(f) of the Investment Company Act of 1940.

After a careful review of the reference materials noted above and the applicable laws and regulations, we are unable to conclude that the position taken by the Office of the Chief Counsel in the Columbia Advisory Corporation correspondence is supported by law. For this reason, we have advised the San Francisco regional office that we intended to submit to your office this request for reconsideration of the position taken in that earlier correspondence.

As an initial point, we note that under a literal reading of Rule 206(4)-2, it applies only in situations in which the investment adviser itself has custody or possession of funds or securities of its clients. There is no language in the rule which suggests that it applies in situations in which an affiliated person of the investment adviser has custody or possession of client's funds. This lack of specificity is particularly significant when one examines other regulations of the Commission that are intended to encompass affiliated persons. For example, Rule 206(3)-2, which deals with the situation in which an adviser is acting in the dual capacity of adviser and broker, explicitly states that it applies to any transaction in which the adviser "or any person controlling, controlled by, or under common control with such investment adviser" acts in a dual capacity. Similarly, the definition of "advisory representative" in Rule 204-2(a) expressly includes not only the investment adviser, but also "(i) any person in a control relationship to the investment adviser, (ii) any affiliated person of such controlling person and (iii) any affiliated person of such affiliated person." In proposed rule 204-4(d)(9), the Commission explicitly indicates its intention to encompass broker-dealers affiliated with the investment adviser by including a specific cross reference to the term "affiliated person" as defined in Section 2(a)(3) of the Investment Company Act of 1940. This comparison of the clear language of these other regulations and proposed regulations suggests quite strongly that the Commission did not intend rule 206(4)-2 to apply in situations in which an affiliated person of the Investment Adviser has custody or possession of funds or securities of the adviser's clients. If the Commission did intend to include affiliated persons within the scope of Rule 206(4)-2, it would have done so explicitly, as it has in its other rules and regulations.

In this connection, we note that item 23 of Form ADV, which is intended to elicit information from applicants concerning custody and possession of their clients' securities and funds, is somewhat more broadly worded than Rule 206(4)-2. It asks whether the applicant, "or any person connected with" the applicant, has custody or possession of clients' funds. There is no definition of the phrase "person connected with" in the Investment Advisers Act or its implementing regulations. However, the Guide for Form ADV issued by the Commission after Form ADV was revised on September 1, 1968 directs applicants to answer item 23 for itself "and for associated persons as well." It thus equates the phrase "person connected with" in item 23 with the term "person associated with an investment adviser", which is defined at section

202(17) of the Investment Advisers Act of 1940. Interestingly, the definition of "person associated with an investment adviser" includes persons directly or indirectly controlling of controlled by the investment adviser, but does not include persons under common control with the investment adviser. Therefore, CIMCO and the Bank would not be defined as associated persons under section 202(17). Since the Commission's own Guide for Form ADV equates the phrase "person connected with" to associated persons, it also seems reasonable to conclude that the Bank is not a "person connected with "CIMCO under the Commission's published interpretations.

We believe that the above analysis demonstrates quite clearly that there is no language in the Investment Advisers Act, or in its implementing regulations issued by the Commission, to support the applicability of Rule 206(4)-2 to situations in which a bank under common control with a registered investment adviser has custody of securities of a client of the adviser. The only other support for such an extension of rule 206(4)-2 offered by the Office of Chief Counsel in the Columbia Advisory Corporation correspondence and by the Commission Staff during its examination of CIMCO is the August 21, 1973 interpretive opinion of the Office of the Chief Accountant. At the outset, we note that this correspondence deals not with Rule 206(4)-2 under the Investment Advisers Act of 1940, but rather with Rule 17f-2 under the Investment Company Act of 1940. Therefore, the views expressed in this letter would be applicable only by analogy. Having examined Rule 17f-2 and the Chief Accountant's letter, we have concluded that they are not determinative of the issue at hand.

Rule 17f-2 establishes certain specific independent verification procedures that must be followed in situations in which a registered investment company has custody or possession of securities and investments. It explicitly provides, however, that investments of a registered investment company that are in the custody of a bank are deemed to be in the custody of the investment company if there is an arrangement allowing the directors, officers, employees or agents of the investment company to withdraw such investments upon mere receipt. Thus, the rule itself contains language extending its scope beyond the situation in which the investment company itself has custody or possession. As we have noted above, Rule 206(4)-2 contains no language extending its scope beyond the situation in which the investment adviser itself has custody or possession of its clients funds or securities.

With respect to the Chief Accountant's correspondence, we note that the letter from the American Institute of Certified Public Accountants requesting the Chief Accountant's opinion states that "a considerable number of bank-sponsored, closed-end bond funds to be registered as investment companies under the 1940 Act are presently being organized by commercial banking institutions themselves or a newly incorporated subsidiary which will act as adviser to such fund." The letter thus presumes a situation in which a commercial bank is acting as custodian

and the same bank, or a subsidiary of the bank, is acting as adviser. Later in the correspondence, the AIPCA letter also mentions the situation in which an affiliate of the Bank custodian is acting as adviser. The response from the Office of the Chief Accountant is much more vaguely worded with respect to affilates and subsidiaries of the Bank custodian. In its opening paragraph, it presumes that the Bank itself is providing both investment advisory and depository services. Later, the letter states "we presently interpret the provisions of Rule 17f-2 as applying to any arrangement between and investment company and its adviser bank whereby such bank (emphasis added) provides custodian or depository services . . .". Nowhere in the Chief Accountant's response is there any indication that this interpretation was intended to apply to situations in which it is not the bank custodian itself that serves as the adviser, but rather an affiliate of the bank custodian. Indeed, a literal reading of the Chief Accountant's letter suggests quite strongly that the interpretation applies only when the Bank itself is acting in the dual capacities of custodian and adviser. In particular, the August 21, 1973 interpretive opinion does not state that "there can be no assurance of independent scrutiny and safekeeping of clients' funds and securities by a bank where such bank is a 100% subisidary of a parent who is also 100% owner of the investment adviser;" yet the January 28, 1975 response of Martin Lybecker on behalf of Alan Rosenblat, Chief Counsel of the Division of Investment Management Regulation, cites the Chief Accountant's opinion for this proposition.

In summary, we find no legal support for the position taken by the Commission Staff in the Columbia Advisory Corporation correspondence and during its examination of CLMCO. If the Commission desires Rule 206(4)-2 to apply in situations in which an affiliated person of a registered investment adviser has custody or possession of funds or securities of clients of that adviser, the Commission clearly has the power to amend Rule 206(4)-2 to so provide. Any such amendment, of course, would have to be proposed for public comment in accordance with normal administrative law procedures. These procedures would put interested parties on notice of the Commission's intentions and would allow an opportunity for such parties to make their views known to the Commission on this question. As legal counsel to a registered investment adviser that has attempted and will continue to attempt to comply with all duly promulgated laws of Congress and regulations of the Commission applicable to its business affairs, we request a clarification from the Commission that Rule 206(4)-2, as presently in effect, does not apply to situations in which an affiliated person of the registered investment adviser has custody of funds or securities of clients of that adviser.

If you require any further information or have any questions concerning this request, please contact John Kelly of our office or me.

Very truly yours,

Joseph E. Terracciano

cc: Robert G. Wade, Jr.
O. J. Brubaker
Wayne Secore, San Francisco Regional Office

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 77-1219CC
Crocker Investment Management Corp.
File No. 801-09248-3

March 15, 1978

You have requested a reconsideration of the staff position taken in Columbia Advisory Corporation, January 28, 1975, that Rule 206(4)-2 under the Investment Advisers Act of 1940 applies to a situation in which funds and securities of clients of an investment adviser are in the custody of a bank which is affiliated with the adviser through their both being wholly-owned subsidiaries of the same parent. You have requested our concurrence in your opinion that Rule 206(4)-2 does not apply to situations in which an affiliated person of a registered investment adviser has custody of funds or securities of clients of that adviser.

Whether an adviser has custody or possession of clients' funds or securities when an affiliated company of the adviser holds such property, under custodial agreements with the clients, is a question of fact. The answer to this question will depend upon the following:

1) Whether clients' property in the custody of the affiliated company might be subject, under any reasonably foreseeable circumstances, to the claims of the adviser's creditors.

2) Whether advisory personnel have the opportunity to misappropriate clients' property.

3) Whether advisory personnel ever have custody or possession of or direct or indirect access to clients' property or the power to control the disposition of such property to third parties for the benefit of the advisor or its affiliated persons.

4) Whether advisory personnel and personnel of the affiliated company who have possession or custody of, or control over, or access to, advisory clients' property are under common supervision.

5) Whether advisory personnel hold any position with the custodian or share premises with the custodian and, if so, whether they have, either directly or indirectly, access to or control over clients' property.

Whether Crocker Investment Management Corporation ("CIMCO") has custody of its clients' funds or securities when they are held by Crocker National Bank as custodian, is, therefore, a question which depends upon the facts. Since the pertinent facts are not stated in your letter, we express no opinion on this question and cannot advise you of what we would recommend to the Commission if CIMCO does not comply with Rule 206(4)-2.

Stanley B. Judd, Assistant Chief Counsel
Division of Investment Management

cc: Wayne M. Secore, San Francisco Branch Office
Edward I. Hamelin, Chicago Regional Office

TDM:hbg

CC:LA RO