

M E M O R A N D U M

TO: Chairman Ruder

FROM: Kathie McGrath *Kathie McGrath*

RE: NASD "offer" to take on self-regulatory responsibilities under the Investment Advisers Act for its broker-dealer members who are also registered investment advisers.

DATE: February 2, 1988

Once the Financial Planners report is sent to the Congress, the Division will begin developing a recommendation to the Commission on whether to seek legislation that would provide for the establishment of self-regulatory organizations for investment advisers. The NASD, last year, studied the feasibility of becoming an SRO for its broker-dealer/investment adviser members and decided that it would be willing to take on this task, if enabling legislation were enacted. Attached is a June 22, 1987 Information Memorandum we sent to the Commission briefly summarizing the NASD's proposal. The Commission now needs to decide what to do about this. Although the proposal has many pros and cons, my current inclination is to recommend that we seek enabling legislation, since I doubt we'll ever get the staff or salary levels we would need to conduct enough inspections and adequately enforce the Advisers Act and our rules entirely on our own. NASD coverage for at least part of our adviser population would be better than nothing. Our staff would oversee the NASD's efforts, as we do now in the broker-dealer area. We would continue to directly regulate and inspect non-NASD advisers, unless one or more competing SRO's were formed for other classes of advisers, or the law required SRO membership of all advisers, forcing them to join the NASD if no other SRO were formed.

I propose to proceed as follows, starting this month:

1. Meet with NASD staff to see where they stand on the draft of legislation they promised to prepare and on a response to our question whether they'd be willing to pick up advisers that are corporate affiliates of NASD members but that don't employ the same people.
2. Solicit the views of our own Regional Office staff on the idea. They would no longer be directly inspecting as many advisers and instead would move into the NASD oversight business.

3. Discuss the idea with NASAA's investment adviser committee, chaired by Bob Lamm, who is also Chairman of the Pennsylvania Securities Commission. NASAA's reaction will be important and its support may be critical. It's likely that NASAA and the NASD will use this proposal to continue to bicker over SROs' responsiveness (or lack thereof) to state regulators.

I don't know where the other Commissioners will come out on this. At one point, Charles expressed concern about the anti-competitive impact of a new SRO. Aulana also voiced concern about whether new SROs should be established since we're never 100% satisfied with the job done by existing SROs.

There also may be opposition from other groups in the investment adviser industry, which is a very diverse bunch of people. The International Association for Financial Planning has pushed for an SRO for planners only, but hasn't liked the idea of the NASD doing it, notwithstanding the fact that most IAFP members earn most of their money selling securities as registered reps of NASD member firms. Other planner organizations oppose more regulation in any form, and have urged the SEC to do more inspections (Ha! - these guys apparently haven't heard of the Federal budget deficit!). I'm sure others with conflicting views will surface once word gets out that we're looking at the idea again.

I'd be pleased to discuss this with you further, and hope that you'll let me know if you want me to do something different or in addition to what I've outlined above.

Attachment

cc: Linda Fienberg

INFORMATION MEMORANDUM

IM-6-87

June 22, 1987

TO: The Commission

FROM: The Division of Investment Management

SUBJECT: NASD Resolution on Becoming a Self Regulatory
Organization for Investment Advisers

Kathryn B. McGatti

Attached is the resolution passed by the National Association of Securities Dealers' ("NASD") Board of Governors on May 11, 1987, proposing that the NASD take steps to become a self-regulatory organization ("SRO") with jurisdiction over the investment advisory activities of NASD members and affiliates who are registered investment advisers.

The SRO would bring under the NASD's regulation those investment advisers who are members of the NASD, associated persons of NASD members, and entities, not NASD members, whose personnel are associated persons of NASD members. This would cover about one-half of the investment advisers who are registered with the SEC. Investment advisers to investment companies would not be covered. The resolution states enabling legislation would be required, which legislation should permit the NASD to set financial responsibility standards for advisers, charge fees to cover expenses, establish qualifications standards for advisers, and use NASD facilities for registering advisers.

We have also attached a press release issued by the International Association for Financial Planning (IAFP) reacting to the NASD announcement. During 1985 the IAFP proposed setting up an SRO for financial planners. The IAFP professes to be "pleased" with the NASD resolution, but states that consumers need a specific definition of financial planning, and uniform federal regulation of financial planners, which it hopes could be incorporated into any legislation connected with the NASD proposal.

We have met with the staff of the NASD on the Board's resolution and asked them to reconsider the scope of their proposal to also include investment advisers who are owned by the same holding company that also owns a broker-dealer, even though the investment adviser has no staff who are associated persons of NASD members. Since a key component of our ongoing study of the financial planning industry is an evaluation of the NASD pilot program to regulate investment advisers and financial planners,

we suggest the Commission defer action on the NASD resolution until that study is completed at the end of this year. In the meantime, the NASD staff is continuing to work on the idea and intends to draft enabling legislation.

If you have any comments or additional areas that you would like explored, please contact us as soon as possible.

Prepared by: John H. Komoroske 272-2751

ATTACHMENTS

NASD Board of Governors resolution on investment adviser regulation

IAFP's Response to NASD Proposal to Regulate Financial Planners

BE IT RESOLVED that:

The Board of Governors accepts the report of the pilot program Study Group and authorizes the NASD to proceed to take whatever action is necessary to establish the NASD as the self-regulatory organization for registered investment advisers subject to the following conditions:

- 1) The registered investment advisers who will be subject to the NASD's regulatory authority will only be those who (a) are members of the NASD, (b) are associated persons of NASD members, and (c) are entities, not members of the NASD, whose personnel are associated persons of NASD members.
- 2) Investment advisory activities of registered investment advisers pursuant to investment management agreements with registered investment companies shall not be subject to NASD regulatory authority.
- 3) Amendments to the Federal Securities Laws that will be necessary to permit the NASD to become the self-regulatory organization for registered investment advisers shall, amongst other things necessary to the regulatory and disciplinary process, include authority for the NASD:
 - a) to establish financial responsibility standards for registered investment advisers;
 - b) to establish fees payable by registered investment advisers to defray the costs of regulation;
 - c) To establish minimum experience, training, educational or other qualification standards for registered investment advisers, and
 - d) to utilize the NASD's facilities for capturing and maintaining the registration records of registered investment advisers.



IAFP'S RESPONSE TO NASD PROPOSAL
TO REGULATE FINANCIAL PLANNERS

The IAFP is pleased that the NASD Board of Directors has announced its support for uniform federal regulation of Investment Advisors, which would include financial planners. The decision of the NASD Board to accept a request to provide standards and regulation in this area is a positive development and further indicates our industry's strong movement toward providing true consumer protection.

The IAFP, however, feels that financial planning is such a growing part of the financial services market place that consumers need a specific definition of financial planning and uniform federal regulation of financial planners. According to recent significant market research, 13% of all Americans now use financial planners, and that number should double during the next two to three years. The IAFP believes that consumers should have assurance that people who hold themselves out as financial planners have met basic, minimum standards of conduct and competence. It is hoped that the definitions necessary to accomplish this can be incorporated in the development of any proposed legislation.

The IAFP urges other organizations in the financial services industry to join with it in efforts to enact uniform federal regulation for financial planners. These efforts should tie in to efforts at the state level to avoid overlapping and duplicative regulations.