Investment Advisers in the Internet Age

Roundtable on Investment Adviser Regulatory Issues
Technology and Investment Adviser Regulation

Investment Advisory Services in the Internet Age—Ensuring Investor Protection

Investment Company Institute

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Introduction and Summary

The Roundtable on Investment Adviser Regulatory Issues provides an opportunity to consider developments in the investment adviser industry and their possible implications for federal oversight. The continued effectiveness of the Investment Advisers Act of 1940 ("Advisers Act" or "Act") is very important to the Investment Company Institute and its members, and the Institute is pleased to participate in the Commission’s consideration of these issues.[1] The topic of this panel, "Technology and Investment Adviser Regulation," is particularly timely. Modern technology, including the Internet, offers enormous benefits and efficiencies for consumers. It is revolutionizing how individuals obtain products and services, including financial services. According to a recent study, approximately 34 million U.S. households had Internet access as of the end of 1999.[2] This number is expected to grow to approximately 107 million households by 2003.[3] The number of households that use the Internet to access financial products and services also is growing.[4] At the same time that technology is producing these changes, average Americans are relying more heavily on professional investment advice. Nearly half of all US households invest in securities, placing equity ownership by individual investors at an all-time high.[5] Almost two-thirds of these individual investors rely on the advice of professional financial advisers in making their purchase and sale decisions.[6]

The convergence of these factors—technological advances and increased reliance by average Americans on professional advice—may affect the SEC’s oversight of the investment adviser industry. It is widely acknowledged that the Internet is growing in importance as a medium by which the average investor obtains investment advice.[7] There have been few studies, however, of the number and variety of online advisory services. Chairman Levitt recently testified, "While the Internet has brought significant benefits to investors, it also has created significant dangers for the unwary."[8] This paper will describe how technology may affect the manner in which investment advice is provided to investors and raise questions concerning the possible implications of these changes for federal oversight of investment advisers and the various advisory services they provide. Part II discusses whether the Internet revolution should cause us to rethink the Advisers Act regulatory regime. Part III focuses on the impact that technology has had on discretionary investment advisory programs exempted from regulation under the Investment Company Act of 1940 ("Investment Company Act"). In light of these developments, the Institute respectfully suggests that the SEC consider whether it would be appropriate to review how technology is changing the way Americans receive investment advice, focusing on online investment advisory services and the status of discretionary investment advisory programs under the Investment Company Act. Such a review would enable the SEC to explore the issues that these advisory services raise for investors and the SEC, and how the issues affect the current regulatory structure.

Do Advances in Technology Suggest a Need to Re-Assess the Current Regulatory Framework for Investment Advisers?

The Advisers Act has served investors well for over sixty years in large part because of the SEC's ongoing commitment to re-evaluate the Act's effectiveness and seek statutory or regulatory changes that serve investor interests.9 Technological advances may present issues that justify such a re-examination to ensure both that the Act continues to address the abuses that it was designed to prevent, and that the current regulatory system does not unnecessarily inhibit the development of new products and services that benefit investors.

At present, the impact of technology, especially the flow of investment advice through the Internet, on U.S. markets and investors simply is not known. The discussion below is intended to focus attention on some of the questions posed by these developments.

How Is Technology Changing the Way Investors Obtain Investment Advice?

The Advisers Act became law in a paper-based environment, decades before computers and other features of modern technology became commonplace. Evidence suggests that the industry served a fairly narrow segment of society, and consisted primarily of individuals and firms that provided highly personalized advice and asset management services to fairly wealthy individuals and institutions. A number of industry representatives participating in the Congressionally-mandated SEC study that preceded the Advisers Act observed that the industry generally served "only a limited group of investors—those individuals and institutions with substantial funds who require continuous supervision of their investments and a program of investment to cover their entire economic needs." 10 The services provided by investment advisers of that era also were narrower in scope. As industry representatives also observed, the main function of advisers was to "render to clients, on a personal basis, competent, unbiased, and continuous advice regarding the sound management of their investments."11 Of course, the types of advisory services offered to investors have changed gradually over time. For example, an SEC study that preceded the 1975 amendments to the Advisers Act noted that the advisory industry in the late 1960s consisted primarily of "those publishing advisory services and periodic market reports for subscribers, and those offering supervision of individual clients' portfolios."12

Still, the environment today is very different than it was in 1940 or 1975. Advisory services are widely marketed to average American investors through a variety of media, and the types of services available are far broader than the personal, individualized and continuous advice that appears to have dominated the industry sixty years ago.

Fueled by the Internet and other technological advances, as well as by increased investment in equities by middle class investors, a wide variety of online personal finance and investment-related services have flourished. To the best of the Institute's knowledge, the number of online services is unknown. A search for "personal finance" or "investment advice" on a number of Internet search engines, however, reveals many thousands of sites, a substantial percentage of which may offer some level of financial advice to individual investors.

Who Sponsors Online Investment-Oriented Services?

The sponsors of online services vary widely. Many services are provided by registered investment advisers; many are provided by unregistered entities. In many cases, the sponsors provide online services only. In others, online services are an adjunct to an organization’s more traditional products and services. For example, many traditional registered investment advisers and mutual fund sponsors now include some level of online education or advice in the menu of products and services offered to their clients. Services designed especially for participants in 401(k) defined contribution plans are among the most common offered by traditional money management firms, although the types of online services offered by these firms is expected to grow. 13

Sponsors run the gamut from major corporations, news organizations and other entities to one–person operations. Many sites are devoted entirely to personal finance or investment issues. Others include investment and personal finance among a broad range of topics covered, from health to sports to real estate. Many sites, devoted to issues concerning a particular segment of society (e.g., women’s issues or senior citizens), include a personal finance or investment issues section.

What New Types of Investment-Oriented Services Are Available?

The type of information available varies tremendously. Much is educational in nature; other information is advice-oriented. Where advice is offered, the personalized nature of the advice, as well as the level of person-to-person contact available, also varies tremendously. Many services are free of charge; many others are not. The services offered by these sites are equally varied. Some include:

- Educational materials that help investors understand the risks and rewards of investing.
- Directories that provide various categories of information and links to other financial service sites, often with reviews and comments on different sites.
- Financial news that may provide the day’s top financial news stories, analysis of trends, articles about specific stocks or industries.
- Online "newsletters" that provide advice about securities both free of charge and for compensation.
- Bulletin boards, message boards and chat rooms that facilitate discussions about securities among Internet users.
- Research that may include stock quotes, information about issuers, ratings of analysts, etc.
- Financial models and calculators that may include model portfolios, portfolio tracking, screening tools, financial and retirement planning and asset allocation guides. These services assist individuals in making investment decisions, based on financial information provided by the investor. Tools may include software, provided on the website, that incorporates certain assumptions and projections about inflation, interest rates and projected investment returns for different asset classes. In some cases, tools assist the investor in making specific investment decisions.
- Computerized investment advice, including so-called "neural networks."
- Personalized investment advisory services that, in many cases, supplement computer interaction with periodic telephone consultation between the customer and a representative of the adviser.
- Portals that provide some form of investment advice or information, with the ability to immediately access, online, one or more financial service providers, including broker-dealers, mutual fund

companies and investment managers that may compensate the operator of the portal for the referral.

What Are the Advantages and Disadvantages for Investors?

These and other types of services have the potential to offer investors many important advantages. Many services further the SEC's goal of improving investor education and may lead to more informed decisions. By giving investors easy access to almost unlimited financial information, the Internet allows investors to obtain a variety of information and opinions regarding an investment decision. The Internet also enables investors to learn about and respond quickly to breaking market events. Internet access may improve the quality of advice given by advisers and other market professionals and enable them to engage in more sophisticated market and stock analyses. Internet advisers may be able to offer investors nearly seamless access to other products and services, including the ability to instantaneously implement investment advice. Yet another advantage may be lower costs and reduced paperwork.

At the same time, the Internet may reduce an investor's ability to understand the source and quality of advice received. Investors may be less likely to know—or less able to find out—with whom they are dealing. As a result, they may be less able to evaluate the qualifications and experience of the individual or entity providing the advice, including whether they are dealing with a registered investment adviser. And, while the Internet may improve the quality or timeliness of investment advice in some instances, in other instances the lack of face-to-face contact may make it difficult for both the investor and the adviser to perceive when advice is ill-considered or stale. Because of various customization features, an investor may be led to believe that he or she is receiving personalized advice when in fact the advice is impersonal. Indeed, the Internet may blur the distinction between impersonal and personal advice and give an investor a false sense of security that advice received truly is tailored to his or her individual needs and circumstances.

The Internet also may increase opportunities for fraud, and strain the SEC's scarce enforcement resources.[14] For example, unregistered entities may be influenced by factors that present serious conflict of interest concerns, unbeknownst to investors. In addition, the Internet may make it easier to enter the advisory business with little overhead or organizational costs. While this may benefit investors by encouraging competition, it also could increase the likelihood that an investor may receive advice from a "fly-by-night" operation. Advice may be given from anywhere in the world, in a manner that makes it difficult to determine the precise physical location or identity of the provider. An individual or entity may be able to set up and close up shop quickly and with few traces, thus potentially hampering the ability of regulators to detect and deter fraud. Bulletin and message boards may increase the opportunities for various types of stock manipulation.[15]

Does Technology Challenge the Existing Regulatory Regime?

Any consideration of the implications of online advisory services and technology on the Advisers Act regulatory system must be grounded in an understanding of the abuses that the Act was designed to address and the current parameters of the statute.

Does Technology Increase Opportunities for the Abuses that the Advisers Act Was Designed to Deter?

Prior to the Advisers Act, the investment advisory business largely was unregulated. The SEC Study, though over sixty years old, remains relevant as a reminder of the abuses that may take place when investment advisory activities occur unchecked. The SEC Study stated that the problems in the unregulated investment adviser industry could be divided into two broad categories. First were the problems associated with the inability of the public to distinguish between illegitimate "tipster" organizations and legitimate advisory firms. The second broad category of abuses was conflicts of interest and other problems in the operation of otherwise legitimate advisory organizations. 16

Tipster organizations were perceived to include individuals and organizations likely to "make exaggerated claims" and to lack "the requisite qualifications and training and background and financial resources and financial responsibility."17 The SEC Study and witnesses before Congress were both concerned that a distinction be made between tipsters and bona fide firms, and that tipster services be prevented from masquerading as legitimate firms. With regard to the organization and operation of advisory firms, one of the primary goals of the Act was to eliminate the conflicts of interest that could taint an adviser’s ability to provide unbiased advice to an advisory client. 18

The House Report accompanying the final version of the bill states that the:

> essential purpose of title II is to protect the public from the frauds and misrepresentation of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful. 19

The ease with which personal finance and investment-related services may be offered online has the potential to increase the opportunities for precisely the types of abuses that the Advisers Act was designed to address. As noted earlier, investors may be limited in their ability to distinguish legitimate sites from others. An investor might rely on an online service in making important investment decisions, but have no means to assess the type or quality of entity providing the advice or the manner in which the advice was determined. In some circumstances, the SEC might be unable to obtain records of, or trace the provider of, the advice given over the Internet, thus potentially hampering the Commission’s ability to combat fraudulent practices such as scalping and front-running.

An SEC review of online services would enable the SEC to determine whether these abuses exist and, if so, whether it needs additional statutory authority to address investor protection concerns. The SEC may also wish to consider other prophylactic action to protect investors. Examples might include working with other agencies, like the FTC, to develop guidelines designed to combat fraud on the Internet; undertaking an investor education initiative to inform investors of some of the potential risks associated with online advisory services; and developing ways (perhaps in conjunction with SROs) to detect any unusual trading patterns that are preceded or followed by Internet trading recommendations.

How Do Online Services Fit Within the Current Regulatory Scheme?

The Advisers Act established a comprehensive scheme for federal regulation of investment advisers that has been flexibly administered by the SEC to accommodate changes in both investor needs and industry operations. The cornerstone of the Act is the definition of "investment adviser" set forth in Section 202(a)(11).20 The scope of the definition is critically important, because all individuals and entities that fall within the Act's definition, whether or not registered with the SEC, are subject to the broad antifraud proscriptions set forth in Section 206 of the Act.

In addition, each individual or entity that meets the definition must register with the SEC unless specifically excepted from registration. Registered advisers are subject to extensive disclosure requirements about the adviser's background and business experience, recordkeeping requirements, and restrictions on custody of client assets, advertising, principal transactions, types of fees that may be charged to investors and the terms of each advisory contract.

The definition of "investment adviser" is the starting point for any analysis of the status of an individual or entity under the Act. Generally, the term includes any person who:

- **For compensation** (The SEC staff generally construes "compensation" to mean any direct or indirect economic benefit, including benefits or compensation received from someone other than the recipient of the advice.)
- **Is engaged in the business** (It is not necessary that giving advice be a primary or major activity to satisfy this element of the definition. The SEC staff generally takes the view that this element is satisfied unless all of the following three conditions are met: the advice is solely incidental to a nonadvisory business; the advice does not relate to specific securities; and no special compensation is received for the advice. This element of the definition may be satisfied even if no separate fee is charged for the advice.)
- **Of providing advice to others or issuing reports or analyses about securities** (The SEC staff takes the position that this element may be satisfied even if the advice does not relate to specific securities. Advice need not be in the form of buy or sell recommendations. This element may be satisfied through analyses or valuations of securities or the securities markets in general.) 21

The Advisers Act definition sets forth a number of broad exclusions, including:

- Section 202(a)(11)(D), which excludes "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation." The Supreme Court has stated that this exclusion is available to any bona fide newsletter of general or regular circulation that offers only "impersonal" advice. 22 Since 1985, the SEC and its staff generally have declined

to express an opinion on the scope and availability of the publisher's exclusion to particular situations because of the fact-specific analysis required to make this determination.
- Section 202(a)(11)(C), which excludes any broker or dealer whose advice is solely incidental to its brokerage business and who receives no special compensation for the investment advice. 23

The SEC should consider whether the application of the definition of "investment adviser" is clear in the context of online advisory services. Some online services may register with the SEC out of an overabundance of caution, in circumstances where the SEC may deem registration unnecessary. Other providers may be unregistered due to similar confusion or uncertainty as to the Act's requirements. The SEC may wish to consider whether it should, by rule or interpretation, provide further guidance as to its views on how online services may or may not come within the current definition. For example, are current interpretations of when an individual or entity is providing "advice" or receiving "compensation" adequate?

One potential question is the application of the publisher's exclusion to online services. The SEC may wish to provide guidance on the scope of the publisher's exclusion post Lowe, in light of Internet developments. For example, under what circumstances is a subscription-based Internet service a publication of "general and regular circulation"? To the extent such a service offers computer-assisted investment allocation advice, does this constitute "impersonal" advice for purposes of the exclusion? Should conditions be imposed to ensure that those who "publish" on the Internet are subject to some of the same constraints under which print publishers operate, such as that all subscribers receive the same information and that information is posted or "published" at regular intervals? The SEC also may wish to consider whether online services raise any potential interpretive questions regarding the scope of the broker-dealer exclusion.

The SEC also should examine whether the statute continues to strike the right balance for investors. For example, should the definition of "investment adviser" be expanded to subject a broader category of services to the Act's antifraud provisions? Should the SEC have greater flexibility to require advisers who might be brought within the Act's antifraud provisions, but remain exempt from SEC registration, to disclose certain information to investors? A minimal level of disclosure, for example, might ensure that unregistered advisers must disclose key facts, such as conflicts of interests, identity, qualifications, background, and physical location, to investors and regulators.

Does Technology Suggest a Need to Re-Assess Rule 3a-4 Under the Investment Company Act?

Technology also is affecting the manner in which discretionary investment advisory programs, operated in reliance on the safe harbor from Investment Company Act regulation set forth in Rule 3a-4, are marketed and managed. We respectfully suggest that these developments present investor protection concerns that justify a re-examination of the parameters of Rule 3a-4 and industry compliance with the conditions of the rule.

Discretionary investment advisory programs typically are designed to provide professional portfolio management services on a discretionary basis to a large number of clients. They were developed as a means for investment managers to provide professional portfolio management to clients who wished to invest less than the minimum dollar amount required by the manager for an individual account, but significantly more than the minimum required by most mutual funds. [24]

Under a discretionary investment advisory program, a client account is managed on a discretionary basis in accordance with pre-selected investment objectives. Clients with similar investment objectives often receive the same investment advice and may hold the same or substantially the same securities in their accounts. In light of this, the SEC and its staff take the position that such programs may meet the definition of investment company under the Investment Company Act, and may be deemed to be issuing securities for purposes of the Securities Act of 1933. [25]

The SEC adopted Rule 3a-4 in 1997. The rule establishes a safe harbor that permits discretionary investment advisory programs to be operated without registration under the federal securities laws, provided various conditions are met. The conditions are designed to ensure "that clients in a program relying on the rule receive individualized treatment." For example, Rule 3a-4 requires a sponsor to obtain information about each client’s financial situation and objectives, and to offer each client the opportunity to place reasonable restrictions on the management of the account. Each client account must be managed in accordance with this information. The sponsor also must contact the client at least annually to determine whether there have been any changes in the client’s financial situation or objectives, or in the restrictions that the client wishes to impose, and must remind the client in writing at least quarterly to contact the sponsor if there have been any changes in these matters. In addition, individuals who are knowledgeable about the client’s account must be reasonably available to the client for consultation.[26]

Since 1980, when the SEC first issued no-action letters concerning what constitutes individualized investment advice, the Institute has expressed reservations about whether any set of mandated procedures can serve as a legitimate proxy for bona fide individualized advice. [27] Although the Institute supported the adoption of Rule 3a-4, we continue to believe that these concerns are valid, particularly in light of recent technological advances. In our view, a mechanistic or ritualistic approach to compliance with the conditions set forth in Rule 3a-4 raises the possibility that numerous small individual accounts may be managed in a manner that is nearly indistinguishable from a mutual fund, but with none of the critical investor protections set forth in the Investment Company Act.

Is Technology Changing the Way Discretionary Investment Advisory Programs Are Operated?

In recent years, the number of discretionary investment advisory programs that are operated outside the Investment Company Act, in reliance on the safe harbor set forth in Rule 3a-4, has increased dramatically.[28] At least one report indicates that the growth rate of these programs may be nearly double that of registered mutual funds. [29] Technology may enable financial professionals to offer new ways to create portfolios for individual investors and to operate a "virtual" mutual fund online, often with lower minimum account size requirements than typically were imposed in the past. Technology, including expanded Internet access, also is making it feasible for these programs to be mass marketed to individual investors.

Are Clients Participating in Discretionary Investment Advisory Programs Adequately Protected by Rule 3a-4?

Technological advances may call into question the extent to which investors in some programs are, in fact, receiving the individualized treatment deemed critical by the SEC in adopting Rule 3a-4. As Paul F. Roye, Director of the SEC's Division of Investment Management, recently observed, technology is "[m]aking mass customization more feasible … The customized separate account portfolios being marketed on a retail basis raise issues under the Investment Company Act. Are these advisory programs providing individualized investment advice, or are these programs the equivalent of unregistered investment companies?"[30] This is an important question. Investment advisory programs that simply place investors within broad categories of investment objectives and manage their portfolios consistent with such objectives are essentially nothing more than mutual funds. The fact that some of these programs may offer investors the ability to vary their investments from those recommended does not appear to necessarily lead to a different conclusion, especially if relatively few investors in fact choose to do so. Moreover, when such programs are offered over the Internet, it is even more doubtful that they can provide the sort of individualized advice contemplated under Rule 3a-4. Finally, the proliferation of these programs itself may call into question the SEC's ability to monitor compliance with Rule 3a-4. The Institute therefore recommends that the SEC undertake a review of the various types of programs that are offered in reliance on Rule 3a-4.

In our view, a review would assist the SEC in a number of ways. A review would enable the SEC to determine whether programs are being operated without compliance with the conditions of the rule, and whether the SEC should devote more resources to monitoring this growing segment of the financial services industry, especially those programs marketed and operated on the Internet. A review also would assist the SEC in determining whether the rule is serving the objective of ensuring individualized treatment and regulatory oversight.

In this regard, the SEC should study average and minimum account sizes for these programs. The SEC did not require a minimum account size as a condition to the safe harbor under Rule 3a-4,[31] but the Adopting Release specifically noted that the minimum account sizes for these programs were "significantly" more than those for most mutual funds.[32] To the extent technological advances have led to a reduction in these account sizes, the SEC may wish to consider the greater number of investors (and their relative level of sophistication) in these programs, and the implications of such a change.

The Institute also believes that a review would help the SEC determine whether some or all aspects of mutual fund regulation would be appropriate in the case of discretionary investment advisory programs that are widely marketed to retail investors. For example, the SEC may wish to consider whether there should be some independent oversight of these programs, similar to that provided by mutual fund directors (including oversight of fees assessed by these programs), and whether the programs should be subject to the comprehensive prohibitions on affiliated transactions set forth in the Investment Company Act. The SEC also may wish to consider whether the disclosure received by clients participating in these programs is adequate. For example, clients might benefit by receiving information that is similar to that provided to mutual fund investors, including the information provided in a prospectus risk/return summary and standardized performance information (including, if adopted for mutual funds, after-tax returns). Finally, the SEC could consider whether the same technological advances that have permitted the growth of discretionary investment advisory programs would make compliance with the investor protection provisions of the Investment Company Act (or substantially similar provisions) more feasible, which would obviate the need to provide these programs an exemption from them.

Conclusion

The Institute commends the SEC for its attention to the continued effectiveness of its administration of the Advisers Act. Issues raised by technological advances in the industry pose a number of important questions, and the Institute is committed to working with the SEC in any way possible to ensure a continued high level of investor protection.

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 381 associate members that render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

2 See *The Cerulli Report - Internet and Financial Product Distribution*, Cerulli Associates Inc., 2000, at p. 16. Hereinafter cited as "The Cerulli Report."

3 Id.

4 Online trading volume accounted for 37% of all retail trades for the first half of 1999, up from 30% the year before. The number of online accounts rose from 3.7 million in 1997 to 7.3 million in 1998 to 9.7 million in 1999. See Technology Bytes the Securities Industry: The New Millennium Brings New Investors and New Markets, Remarks of SEC Commissioner Laura S. Unger before the Securities Industry Association, March 14, 2000.

5 See *Equity Ownership in America*, Investment Company Institute and Securities Industry Association, Fall 1999. In 1983, an estimated 42.4 million Americans owned stock directly or through mutual funds. By 1999, this number had increased to nearly 78.7 million, more than an 85% increase.

6 Id. at p. 7.

7 See *The Cerulli Report* at p. 206. See also *The New Internet Economy—A Compliance Imperative*, Remarks of Lori Richards, Director, SEC Office of Compliance Inspections and Examinations, 2000 National Regulatory Services Spring Compliance Conference, April 17, 2000.

8 See Statement of SEC Chairman Arthur Levitt, Jr. Before the House Subcommittee on Commerce, Justice, State and the Judiciary, Committee on Appropriations, March 30, 2000.

9 The Advisers Act has been amended a number of times since 1940, most notably in 1960, 1975, 1980, 1986 and 1996.

10 See *Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission*, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong., 2d Sess. (1939) ("SEC Study" or "Study") at p. 25.

11 Id. at p. 23. When queried as to what investment medium existed to service investors with a "few hundred or a few thousand dollars to invest," the same representative indicated savings banks, building and loan associations and investment trusts as likely alternatives.

12 See *Report of Special Study of Securities Markets of the Securities and Exchange Commission*, H.R. Doc. No. 95, Part 1, 88th Cong., 1st Sess. (1963) at p. 146.

13 See *The Cerulli Report* at p. 206.

14 The SEC has established an Office of Internet Enforcement, which administers the Division of Enforcement’s efforts to combat Internet fraud. The SEC has brought a number of cases alleging fraud on the Internet. See, e.g., SEC v. Robert Garganese, Securities Exchange Act Rel. No. 34-42737 (May 1, 2000); SEC v. Yun Soo Oh Park, a/k/a "Tokyo Joe," Lit. Rel. No. 16399 (January 5, 2000); SEC v. Dynamic Daytrader, Lit. Rel. No. 16475 (March 20, 2000).

15 See, e.g., Investors’ Biggest Mistakes, Money, September 1999.

16 See SEC Study at p. 27-28.

17 Id.

18 Id.

19 H.R. Rep. No. 2639, 76th Cong., 3d Sess. (1940) at p. 28.

20 "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities, but does not include (A) a bank, or any bank holding company as defined in the Bank Holding Company of 1956 which is not an investment company; (B) any lawyer, accountant, engineer or teacher whose performance of such services is solely incidental to the practice of his profession; (C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor; (D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (E) any person whose advice, analyses or reports relate to no securities other than securities which are obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the Untied States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to Section 3(a)(12) of the Securities Exchange Act of 1934, as exempted securities for purposes of that Act; or (F) such other person not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.

21 The SEC detailed its views on the scope of the definition in Investment Advisers Act Rel. No. 1092 (October 8, 1987).

22 See *Lowe v. SEC*, 472 U.S. 181 (1985).

23 A rule proposal is pending that would provide guidance as to the circumstances under which a broker-dealer would not be subject to regulation under the Advisers Act. Investment Advisers Act Rel. No. 1845 (November 4, 1999).

24 Investment Company Act Release No. 22579 (March 24, 1997) ("Rule 3a-4 Adopting Release") at p. 4.

25 See *SEC v. First National City Bank*, Lit. Rel. No. 4534 (February 6, 1970); In the Matter of Clarke Lanzen Skalla Investment Firm, Inc., Investment Company Act Release No. 21140 (June 16, 1995) (SEC administrative proceedings involving discretionary investment advisory programs that failed to register under the Investment Company Act).

26 Rule 3a-4 imposes a number of other conditions, including requirements that each client retain all indicia of ownership with respect to the securities held in his or her account, and receive statements, at least quarterly, detailing all activity in his or her account.

27 See, e.g., Letter from Craig S. Tyle, Vice President & Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated September 29, 1995 (comment letter on reproposed Rule 3a-4).

28 Included among the types of programs have become popular in recent years are wrap fee programs, in which a client typically is provided with portfolio management, execution of transactions, asset allocation, and administrative services for a single fee based on the size of the account, and customized portfolios of securities, in which a sponsor typically assists the client in selecting and assembling a specific portfolio of securities customized to meet the client's financial circumstances and objectives.

29 See *FRC Fund Monitor*, March 2000.

30 See *Challenges for the Mutual Fund Industry in the Competitive Frontier*, Remarks of Paul F. Roye, Director, Division of Investment Management, at the 2000 Mutual Funds and Investment Management Conference, March 27, 2000.

31 While the Commission concluded that a minimum account size requirement is not a necessary condition to ensure that clients are provided individualized management services, it did recognize that the smaller the minimum account size, the more likely it would be that clients would not have the ability to demand and receive individualized treatment in a program. See Rule 3a-4 Adopting Release at p. 33.

32 Id. at p. 4.
