

October 2, 1970

TO: PETER FLANIGAN

FROM: JIM LOKEN

Mr. Groesbeck's "Financial Advisors Act" is, in essence, a proposal to expand the Investment Advisers Act of 1940 by broadening the definition of investments, narrowing the exemptions, increasing record-keeping burdens, and forcing the creation of a gigantic trade association with statutory enforcement powers. However, rather than amending the IAA, he would add another statute covering those situations not regulated by the IAA.

I consider this proposal ill advised in a number of respects, principally because I think it would weaken competition and produce massive over-regulation. In addition, a financial advisors act and the IAA would present conflicting regulatory schemes for similar conduct. On the other hand, if Mr. Groesbeck had suggested, based on his own experience, that the IAA is being seriously evaded and needs strengthening amendments, his ideas might be worthy of SEC analysis.

Turning to specifics:

- (1) This proposal would require federal registration by everyone issuing advice, for direct or indirect compensations, as to any form of investment, including loans for investment, other than investments covered by the IAA. This would cover persons now regulated comprehensively under other federal and state regulatory schemes, such as bankers, insurance agents, and many brokers. It would also cover persons who frequently give financial advice, and arguably for indirect compensation, but who do not hold themselves out as financial advisors as such, e.g., lawyers, accountants, engineers, and the relative with a "hot tip." Obviously, many if not most of such persons are not going to register with the SEC as financial advisors; the result would be wholesale violation of a basically unenforceable law, an unhealthy situation as bar associations have frequently discovered.
- (2) Mr. Groesbeck's exemption for intrastate advisors requires that all clients, all transactions, and all assets be confined in one State, whereas the IAA exempts an advisor whose clients reside in the same State if he does not give advice regarding securities listed on national exchanges, 15 U.S.C. Sec. 80b-3(b)(1). In addition, Mr. Groesbeck would eliminate entirely the exemption for advisor having less than 15 clients per year who does not hold himself out to the public as an

investment advisor, 15 U.S.C. Sec. 80b-3(b)(3). As explained above, I prefer the existing exemptions.

- (3) Mr. Groesbeck's concept of fraudulent practices adds nothing to the IAA concept of fraud. Thus his only justification for creating an additional regulatory scheme is his proposal for a National Association of Financial Advisors which would have regulatory jurisdiction over all financial advisors, whether or not they chose to become members. Integrated bar associations seem the closest precedent for giving a private association this kind of powers -- national securities exchange have great rule-making powers over members, but they are federally regulated primarily because, I should suppose they create markets for the transfer of securities and thereby greatly affect the public interest. Primarily because bar associations preside over a far more homoge_____ profession than "financial advisors" (but partly because I am no great fan of bar associations), I would strongly oppose creating or compelling the creation of a financial advisors association to serve as a powerful private attorney general; the result would surely be severely anti-competitive.
- (4) Of less importance, I disagree with the manner in which Mr. Groesbeck would onerously expand the record-keeping burdens on investment or financial advisors beyond books and records necessary to audit their dealings with customers. He also would require that customers' assets be held segregated by the financial advisor, a rule that parallels SEC regulations under the IAA but which the S_____ has been easing because it frustrates attempts to eliminate unnecessary paperwork in connection with securities transactions. Finally, Mr. Groesbeck would greatly restrict advertising by financial advisors in a manner similar to restrictions on lawyers. The bar is coming to realize that, while such restrictions seem well suited to ethical conduct, they in many cases fru_____ the public's legitimate efforts to seek out the most qualified specialist for a particular problem.
- (5) It seems to me that Mr. Groesbeck's main point is that he feels there are categories of investment which do not come within the definition of "security" in the IAA, 15 U.S.C. Sec. 80b-2(a)(17), but which should be similarly regulated. If he is right, a single amendment to that Act should do the trick. If he has other specific objections to existing regulation, such as the intrastate advisor exemption, they may also be sound. But I strongly object to any expansion of this regulatory scheme in the wholesale manner he proposes.