UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

January 26, 1993

The Honorable Edward J. Markey
Chairman
Subcommittee on Telecommunications and Finance
U.S. House of Representatives
2133 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Today's financial markets and instruments are more complex than at any previous time, and this has led, in part, to an enormous growth in the reliance of ordinary investors on the services of investment advisers. At present, more than 18,000 investment advisers are registered with the SEC under the Investment Advisers Act of 1940, with a total of over $5 trillion of public savings under management. That amount is larger than the combined assets of all federally insured banks and thrift institutions in the United States.

Both the number of investment advisers and the total assets under management have skyrocketed over the past ten years. However, the resources available to the SEC to inspect and examine these advisers have remained extraordinarily limited and utterly inadequate to provide even a minimally adequate level of deterrence against wrongdoing. At present, the SEC has a total of 46 examiners nationwide to perform field examinations or other direct oversight of all investment advisers.

To stretch these extremely limited resources, we target examinations on advisers where we have cause to believe that a problem exists, and on the very largest advisory firms. While the SEC is still able to examine the largest advisers on average every three years, smaller advisers (representing by far the largest percentage of the advisory industry in terms of numbers) are only examined, on average, every 25-30 years. In my personal view, this level of oversight is utterly insufficient. The result is that the public is led to believe that advisers are under SEC oversight, when in fact in most cases we will not provide any effective inspection or oversight unless we obtain special knowledge that a problem may exist.

As I testified last year when your Subcommittee was considering H.R. 5726, there are several ways that this problem could be addressed. One would be to repeal the Investment Advisers Act, so that the public could at least be put on notice that federal oversight does not exist. The better alternative, in my view, is to change the "once per lifetime" $150 fee under current law into a modest annual fee assessed on a sliding scale based on the amount of assets under management. The provisions of H.R. 5726 included such an annual fee, and would have allowed the SEC to hire enough examiners to review all large firms every three years, and smaller advisers every five years. While some might suggest even greater frequency of examinations, this level of oversight will provide vastly greater deterrence against misappropriation of funds or other violations of the Advisers Act.

Your Subcommittee and its staff worked hard last year to draft legislation designed to remedy the readily apparent problems that have become worse with the growth of the advisory industry. Though this legislation was ultimately passed by the full House of Representatives, and similar legislation was passed by the Senate, there was not enough time for a conference to work out final legislation before Congress adjourned. Thus, as Congress returns to this question, all the problems that have been documented in the oversight of investment advisers remain in existence. Indeed, last year a single adviser, Mr. Steven Wymer, defrauded his clients, who were largely states, counties and municipalities. Mr. Wymer's syphoning of customer funds, distribution of phony customer statements and other violations of the Advisers Act were discovered by the SEC when we conducted an inspection based on a tip of possible wrongdoing. Mr. Wymer subsequently pled guilty to a nine count felony information, and was ordered to pay over $200 million in restitution of funds to his advisory clients. Sadly, those clients will, in the aggregate, incur losses of well over $100 million.

No legislation can prevent all cases of fraud like that conducted by Mr. Wymer. However, by increasing the resources for detecting such problems, we can make it much more difficult for such schemes to be conducted and to grow to such tragic proportions. Through fidelity bonding, we can assure that where losses from fraud do occur, there will be some source of compensation for defrauded clients. Through suitability standards and other techniques, we can also significantly reduce the likelihood that customers will be deliberately misled or induced to take risks beyond levels the particular customer is capable of absorbing. In short, modest reforms to the current system can provide much better protection against overreaching or wrongful conduct to literally hundreds of thousands of Americans.

The Investment Adviser Regulatory Enhancement and Disclosure Act of 1993 that you plan to introduce is an attempt to close the gaps in current law that weaken the SEC's ability to provide an adequate level of oversight for investment advisers. In several respects, the bill has been improved compared with the legislation passed last year by the House, based on continuing work by you and your staff on this problem. While there may still be a few provisions in the legislation that the Commission has not supported in the past, such as requirements for specific transaction reports, I would hope and expect that all such issues could be successfully resolved in the course of consideration by the Congress of this very important legislation.

My colleagues on the Commission have not yet had an opportunity to study the language of this legislation carefully. Therefore, it would not be appropriate for me to suggest what position the full Commission might ultimately take on this legislation. In addition, I do not wish in any way to diminish the importance of working out carefully all remaining issues due to the large number of investment professionals and customers that would be affected by final legislation. Of course the SEC will be pleased to work with you and other members of Congress and interested persons toward that end.

Despite these caveats, I wish to emphasize my personal view that this legislation can make a very important contribution to millions of investors, many of whom are persons of very modest means. By providing a more effective level of real oversight, we have the opportunity to help prevent many cases of outright abuse from occurring. At a time when the importance of saving and investing for America's future has never been greater, it is entirely appropriate for us to take reasonable steps to help protect against deliberate abuse of investors. Indeed, America's investors should be able to expect that all interested parties will work constructively and actively to achieve the highly desirable objectives of this legislation. Toward that end I appreciate very much the high priority that you and your Subcommittee have accorded to this extremely important effort.

Sincerely,

Richard C. Breeden

Richard C. Breeden
Chairman

cc: The Honorable John D. Dingell
The Honorable Carlos J. Moorhead
The Honorable Jack Fields