
NEWS

SECURITIES AND EXCHANGE COMMISSION

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THE GOAL OF PROFESSIONALISM IN
INVESTMENT ADVISER REGULATION

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1.

MOST OF US LIKE TO THINK WE DO OUR WORK PROFESSIONALLY. FURTHER, IF OUR WORK INVOLVES THE RENDERING OF EXPERT ADVICE TO OTHERS, WE LIKE TO THINK WE BELONG TO SOME PROFESSION. AND WE HOPE OUR CLIENTS WILL BELIEVE OUR PROFESSION IS A LEARNED ONE. YET, THE CONCEPT OF A PROFESSIONAL IS RATHER VAGUE. SOMETIMES THE TERM IS USED TO INDICATE THAT A PERSON IS GETTING PAID FOR DOING SOMETHING, AS OPPOSED TO DOING IT FOR PLEASURE -- AS IN SPORTS OR MUSIC. SOMETIMES PROFESSIONAL IS USED AS AN ADJECTIVE TO MEAN HAVING MUCH EXPERIENCE AND GREAT SKILL. THE EXAMPLE OF THIS USE GIVEN IN THE DICTIONARY IN MY OFFICE, EVIDENTLY APPROPRIATE FOR A PUBLIC OFFICIAL, IS "PROFESSIONAL RABBLERUSER." 1/

GENERALLY, AN OCCUPATION IS CONSIDERED A PROFESSION WHEN ITS PRACTITIONERS ATTAIN ADVANCED EDUCATION AND TRAINING AND OBSERVE HIGH ETHICAL STANDARDS. I BELIEVE THAT INVESTMENT ADVISERS SHOULD BE REGARDED AS A PROFESSION, IN THE SENSE OF THE TRADITIONAL LEARNED PROFESSIONS. FURTHER, I BELIEVE THAT YOUR PROFESSIONALISM WOULD BE ENHANCED BY MORE VIGOROUS REGULATION ON THE PART OF THE SEC AND GREATER SELF-REGULATION ON THE PART OF THE INVESTMENT ADVISER COMMUNITY.

1/ WEBSTER'S NEW TWENTIETH CENTURY DICTIONARY UNABRIDGED (2D ED. 1975).

I REALIZE THAT THE PREVAILING WINDS TODAY FAVOR DEREGULATION. ALSO, I FREQUENTLY HAVE ADVOCATED REGULATORY REFORM MYSELF. INDEED, THE PRESIDENT AND THE CONGRESS, AS WELL AS MANY REGULATORS ARE VYING TO DEVELOP NEW REGULATORY PROGRAMS FOR DECREASING REGULATION. THE ATTORNEY GENERAL OF THE UNITED STATES RECENTLY COMPARED THE FEDERAL BUREAUCRACY TO AN ARMY OF OCCUPATION AND CONCLUDED THAT "THE UNCHECKED GROWTH OF THE FEDERAL BUREAUCRACY MAY BE A MORTAL THREAT TO OUR HISTORIC FORMS OF GOVERNMENT." 2/ PRESIDENT CARTER HAS CALLED THE REGULATORY REFORM MOVEMENT "A CALL FOR COMMON SENSE," AND CRITICIZED THE AMERICAN IMPULSE TO "THROW ANOTHER LAW OR ANOTHER RULE AT EVERY PROBLEM IN OUR SOCIETY WITHOUT THINKING SERIOUSLY ABOUT THE CONSEQUENCES." 3/

ALTHOUGH THE PRESIDENT HAS MADE REGULATORY REFORM A PRINCIPAL TENET OF HIS ADMINISTRATION, HE ALSO HAS REAFFIRMED THE TRADITIONAL LIBERAL NOTION THAT:

MUCH OF FEDERAL REGULATION IS VITALLY IMPORTANT TO MODERN SOCIETY. GOALS SUCH AS A HEALTHY ENVIRONMENT, A SAFE WORKPLACE, AND A COMPETITIVE AND TRUTHFUL MARKETPLACE CANNOT BE ACHIEVED THROUGH MARKET FORCES ALONE. 4/

2/ BELL, "NOTES ON THE SITUATION: A CRITIQUE," REPRINTED AT CONG. REC. H324 (FEB. 22, 1979).

3/ RATTNER, "CARTER ANNOUNCES LEGISLATIVE PLAN TO REVISE U.S. REGULATORY PROCESS," NEW YORK TIMES, MARCH 26, 1979, P. A1, COL. 1.

4/ IBID.

ALTHOUGH MOST AMERICANS BELIEVE IN ECONOMIC FREEDOM, MOST AMERICANS ALSO BELIEVE THAT A CERTAIN AMOUNT OF GOVERNMENT REGULATION IS REQUIRED FOR THE GENERAL WELFARE. A RECENT NEWSPAPER ARTICLE CALLED ME A "RELUCTANT REGULATOR"^{5/} AND I WOULD HAVE TO AGREE WITH THAT DESCRIPTION. BUT I BELIEVE THAT OUR GOVERNMENT TRADITIONALLY HAS BEEN A RELUCTANT REGULATOR. AMERICANS WOULD PREFER TO HAVE THE MARKETPLACE PERFORM WELL ON ITS OWN. NEVERTHELESS, GOVERNMENT INTERVENTION IN THE ECONOMY OFTEN IS NECESSARY TO ACHIEVE WORTHWHILE OBJECTIVES.

MY PERSONAL PERSPECTIVE IS THAT AN UNTHINKING DISMANTLING OF THE APPARATUS OF GOVERNMENT WOULD NOT BE REGULATORY REFORM. RATHER, REGULATORY REFORM SHOULD ENDEAVOR TO REASSESS THE OBJECTIVES AND CONTINUING RELEVANCE OF SPECIFIC AREAS OF GOVERNMENT REGULATION, IN ORDER TO DETERMINE WHETHER PARTICULAR REGULATIONS DO MORE HARM THAN GOOD. IN THIS PROCESS, WE SHOULD APPRECIATE THAT THERE WAS, AND PROBABLY STILL IS, A VALID REASON FOR THE LAW IN QUESTION, AND ITS REGULATORY IMPLEMENTATION. NEVERTHELESS, WE SHOULD REVIEW WHETHER THAT REASON STILL SUPPORTS THE EXPENSE AND EFFORT NECESSARY TO COMPLY WITH THE LAW. AT THE SAME TIME WE SHOULD NOT BE AFRAID TO

^{5/} HAGER, "SEC TAKES STRIDE IN ACCOUNTING ENFORCEMENT," THE LEGAL TIMES APRIL 23, 1979, P. 5 COL. 1.

DEVELOP NEW REGULATORY SCHEMES, EITHER TO REPLACE OUTMODED ONES, OR TO COMPENSATE FOR UNDERREGULATION OF A PARTICULAR SEGMENT OF THE ECONOMY. BUT WHEN WE ENTER THE ARENA WE SHOULD MAKE SURE WE HAVE THE FACTS AND WE ARE REASONABLY ABLE TO PREDICT THE CONSEQUENCES OF OUR ACTS.

IN THIS CONTEXT, THEN, I WILL BE SO BOLD AS TO SUGGEST THAT THIS MAY WELL BE A VERY AUSPICIOUS TIME FOR THE INVESTMENT ADVISORY COMMUNITY TO SEEK MORE VIGOROUS REGULATION BY THE SEC TO STRENGTHEN THE BASIC PROTECTIONS AFFORDED THE PUBLIC BY THE INVESTMENT ADVISERS ACT OF 1940 ("ADVISERS ACT"). IN ADDITION, YOU MIGHT AVOID INAPPROPRIATE OR UNDUE GOVERNMENT REGULATION IN THE FUTURE BY EXERCISING GREATER PROFESSIONAL RESPONSIBILITY IN REGULATING YOURSELVES.

THE ADVISERS ACT WAS THE FINAL PIECE OF NEW DEAL SECURITIES LEGISLATION. IT MAY WELL BE CHARACTERIZED AS AN APPENDAGE TO THE INVESTMENT COMPANY ACT, AND IT WAS, IN PART, INTENDED TO BE A CENSUS TO DETERMINE HOW MANY PERSONS WERE HOLDING THEMSELVES OUT AS INVESTMENT ADVISERS. OF THE VARIOUS REGULATORY STATUTES ADMINISTERED BY THE COMMISSION, IT REPRESENTS THE LEAST COMPLETE REGULATORY SYSTEM. POSSIBLY THAT IS BECAUSE THE CONCEPT OF AN INVESTMENT ADVISER WAS STILL RELATIVELY NOVEL IN 1940. IN FACT, IN THE FIRST FISCAL YEAR OF THE ADVISERS ACT'S EXISTENCE, ONLY 753 INVESTMENT ADVISERS WERE REGISTERED. IN SHORT, INVESTMENT ADVISERS RECEIVED LITTLE LEGISLATIVE OR SEC ATTENTION BECAUSE THEY DID NOT APPEAR TO BE A MAJOR SEGMENT OF THE SECURITIES INDUSTRY SUFFICIENT TO WARRANT MUCH CONSIDERATION.

5.

BUT TIMES HAVE CHANGED MARKEDLY. AT THE END OF LAST YEAR THERE WERE ALMOST 5,400 REGISTERED INVESTMENT ADVISERS. AND THOSE NUMBERS ARE INCREASING BY ALMOST 10% ANNUALLY. THIS INCREASE IS DUE IN PART TO THE SEPARATION OF MONEY MANAGEMENT FROM BROKERAGE ACTIVITIES IN THE SECURITIES INDUSTRY. HOWEVER, IT ALSO SEEMS TO REPRESENT AN INFLUX OF NEW ENTRANTS INTO YOUR FOLD. THE COMMISSION RECENTLY ESTIMATED THAT THE ASSETS UNDER MANAGEMENT BY REGISTERED ADVISERS TOTAL \$200 BILLION. CONSEQUENTLY, IT IS NOT SURPRISING THAT WE ARE BEGINNING TO TAKE A CLOSER LOOK AT HOW INVESTMENT ADVISERS AFFECT THE SECURITIES MARKETPLACES, REPRESENT THEMSELVES TO PUBLIC INVESTORS, AND DO BUSINESS.

FROM THE PERSPECTIVE OF AN SEC COMMISSIONER, ONE INDEX OF THE INDUSTRY'S GROWTH HAS BEEN THE INCREASING NUMBER OF ENFORCEMENT CASES INVOLVING INVESTMENT ADVISERS. I AM PARTICULARLY CONCERNED ABOUT UNETHICAL PRACTICES BY REGISTERED INVESTMENT ADVISERS IN AREAS OF THE COUNTRY WHERE THERE ARE MANY RETIREMENT COMMUNITIES. UNFORTUNATELY FOR YOUR PROFESSION, THE ACTIVITIES OF THE UNSCRUPULOUS REFLECT POORLY ON THE LEGITIMATE PRACTITIONER AS WELL.

IN THE PAST, THE FEDERAL GOVERNMENT HAS TAKEN A PROTECTIONIST STANCE TO ALLOW THAT INDUSTRY TO ESTABLISH A CREDIBLE REPUTATION. INDEED, THE LEGISLATIVE HISTORY OF THE ADVISERS ACT INCLUDES THE FOLLOWING SENTENCE:

NOT ONLY MUST THE PUBLIC BE PROTECTED FROM THE FRAUDS AND MISREPRESENTATIONS OF UNSCRUPULOUS TIPSTERS AND TOUTS, BUT THE BONA FIDE INVESTMENT COUNSEL MUST BE SAFEGUARDED AGAINST THE STIGMA OF THESE INDIVIDUALS. 6/

HOWEVER, I DO NOT BELIEVE THAT PROTECTING THE PROFESSION'S INTEGRITY SHOULD NECESSARILY BE A CONTINUING GOVERNMENTAL RESPONSIBILITY. IF PROFESSIONALISM MEANS ANYTHING MORE THAN A REFERENCE TO A SKILLED TRADE, IT MEANS AN ALLEGIANCE TO STANDARDS WHICH GO BEYOND INDIVIDUAL ACCOUNTABILITY. THE TRADITIONAL LEARNED PROFESSIONS GENERALLY COLLECTIVELY MAINTAIN STANDARDS OF COMPETENCY WITH WHICH EACH PRACTITIONER MUST COMPLY, AND THEY ALSO HAVE PROFESSIONAL ASSOCIATIONS TO PROTECT CLIENTS FROM UNETHICAL OR ILLEGAL PRACTICES. INVESTMENT ADVISERS ALSO SHOULD CONSIDER THEIR MUTUAL RESPONSIBILITY FOR ESTABLISHING AND THEN ENFORCING STANDARDS OF PROFESSIONALISM FOR THOSE WHO HOLD THEMSELVES OUT AS INVESTMENT ADVISERS.

6/ S. REP. No. 1775, 76TH CONG., 3D SESS. 21 (1940),

BECAUSE OF THE INCREASING NUMBERS OF INVESTMENT ADVISERS AND THE ASSETS UNDER THEIR MANAGEMENT, THE COMMISSION HAS ESTABLISHED A NEW OFFICE OF INVESTMENT ADVISER REGULATION IN THE DIVISION OF INVESTMENT MANAGEMENT. THE SOLE FUNCTION OF THIS OFFICE WILL BE TO OVERSEE INVESTMENT ADVISORS. AMONG ITS MANDATES IS TO DETERMINE WHETHER THE PRESENT REGULATORY STRUCTURE PROVIDES SUFFICIENT PROTECTIONS TO PUBLIC CLIENTS OF INVESTMENT ADVISERS.

ONE SUGGESTION THAT THE ADVISERS ACT DOES NOT PROVIDE A COMPLETE SYSTEM OF INVESTOR PROTECTION MAY BE FOUND IN AN ARGUMENT RECENTLY PRESENTED TO THE UNITED STATES SUPREME COURT IN THE CASE TRANSAMERICA MORTGAGE ADVISERS, INC. V. LEWIS. 7/ THIS CASE, IN MY OPINION IS SO IMPORTANT THAT I PERSONALLY WENT TO HEAR THE ARGUMENTS. AS YOU MAY HAVE HEARD, LAST MONDAY THE COURT REQUESTED REARGUMENT. THE PRIMARY ISSUE IN THE CASE IS WHETHER THERE IS AN IMPLIED PRIVATE RIGHT OF ACTION UNDER THE ADVISERS ACT. THE DEFENDANT INVESTMENT ADVISER -- IN ASSERTING THAT THERE IS NO IMPLIED PRIVATE RIGHT OF ACTION -- HAS ARGUED THAT THE ACT IS NOT A PERVASIVE REGULATORY SYSTEM, BUT PRIMARILY IS JUST A CENSUS OF INVESTMENT ADVISERS.

7/ 77-1645 (SUP. CT. 1979).

YOU SHOULD APPRECIATE THAT IF THE SUPREME COURT DOES NOT AGREE WITH THE COMMISSION'S POSITION THAT THERE IS SUCH AN IMPLIED RIGHT OF ACTION, THE COMMISSION'S REGULATION OF INVESTMENT ADVISERS MAY BE SIGNIFICANTLY IMPACTED. FOR IF PRIVATE LITIGANTS ARE DENIED STANDING UNDER THE ADVISERS ACT AND THE INVESTMENT ADVISORY COMMUNITY DOES NOT ENHANCE ITS OWN ROLE IN POLICING ITS PROFESSION, THE COMMISSION WOULD HAVE TO FILL THE VOID IN INVESTOR PROTECTION WHICH WOULD RESULT. THAT COULD MEAN A MORE PRONOUNCED SEC PRESENCE IN THE DAY-TO-DAY AFFAIRS OF THE PROFESSION. FOR EXAMPLE, AN ADVERSE RULING IN THE LEWIS CASE COULD RESULT IN A MORE VIGOROUS EXAMINATION PROGRAM.

BUT THE COMMISSION IS NOT SATISFIED WITH EVEN THE PRESENT LEVEL OF OUR ADVISERS ACT COMPLIANCE EXAMINATION PROGRAM. BECAUSE OF BUDGETARY CONSTRAINTS, WE HAVE BEEN EXAMINING REGISTRANTS AT A RATE OF ABOUT ONCE EACH DECADE. THAT REALLY IS NOT ADEQUATELY FREQUENT. GIVEN OUR FISCAL REALITIES, IT IS NOT SURPRISING THAT I AM ASKING THE PROFESSION TO TAKE A GREATER ROLE IN POLICING ITSELF.

NOW LET ME TURN TO SOME PROPOSALS TO ENHANCE THE REGULATION OF INVESTMENT ADVISERS. THE FIRST REPRESENTS THE SEC'S LEGISLATIVE PROPOSALS IN 1975 -- A BILL THAT DID NOT REACH THE FLOOR OF CONGRESS. THE SECOND IS INCORPORATED IN THE AMERICAN LAW INSTITUTE'S

PROPOSED FEDERAL SECURITIES CODE, WHICH HAS NOW BEEN ENDORSED BY THE AMERICAN BAR ASSOCIATION. FINALLY, I WILL DISCUSS AN ALTERNATIVE THAT I PERSONALLY FAVOR, BECAUSE IT WOULD RESULT IN THE LEAST FEDERAL INTRUSION INTO YOUR AFFAIRS. THIS ALTERNATIVE INVOLVES A COMBINATION OF SELF-REGULATION AND DISCLOSURE STANDARDS.

THE SEC'S PROPOSED 1975 AMENDMENTS TO THE ADVISERS ACT 8/ WOULD HAVE AUTHORIZED THE COMMISSION TO PRESCRIBE QUALIFICATIONS STANDARDS AND FINANCIAL RESPONSIBILITY REQUIREMENTS FOR THE PROFESSION. MOREOVER, THE PROPOSAL WOULD HAVE AUTHORIZED THE COMMISSION TO STUDY WHETHER SELF-REGULATORY ORGANIZATIONS WOULD FACILITATE THE ADVISERS ACT'S PURPOSES. INCIDENTALLY, IT ALSO PROPOSED TO CLARIFY THE EXISTENCE OF A PRIVATE RIGHT OF ACTION BASED ON A VIOLATION OF THAT ACT, THEREBY RESOLVING THE ISSUE PRESENTLY BEING CONSIDERED BY THE SUPREME COURT.

SUBSEQUENTLY, THE AMERICAN LAW INSTITUTE'S PROPOSED FEDERAL SECURITIES CODE SET FORTH A PROGRAM FOR COMPREHENSIVE INVESTMENT ADVISER REGULATION. IN EFFECT, AT LEAST TO SOME OBSERVERS, THE FEDERAL SECURITIES CODE SUBSTANTIALLY RESEMBLES THE SEC'S PROPOSED 1975 AMENDMENTS. 9/

8/ S. 2049, H.R. 13737 (94TH CONG.)

9/ SEE, E.G., M. BROWN, PRINCIPAL CHANGES WHICH WOULD BE EFFECTED UNDER THE PROPOSED FEDERAL SECURITIES CODE IN THE FEDERAL REGULATION OF INVESTMENT ADVISERS, 34 BUS. LAW. 395 (1978)

A THIRD ALTERNATIVE -- WHICH I PERSONALLY ENDORSE -- WOULD INVOLVE A LESSER FEDERAL ROLE BECAUSE IT EMPHASIZES THE CONCEPTS OF SELF-REGULATION AND DISCLOSURE. BUT, IT WOULD REQUIRE A COMMITMENT TO PROFESSIONALISM BY THE INVESTMENT ADVISORY COMMUNITY. ALSO, IT PROBABLY WOULD REQUIRE LEGISLATION TO BE FULLY EFFECTIVE.

I BELIEVE THAT SELF-REGULATORY ORGANIZATIONS, WITH SEC OVERSIGHT, WOULD PRESENT THE MOST EFFICIENT MODEL FOR REGULATORY REFORM. PERSONS WHOSE LIVELIHOOD IS BASED ON KNOWLEDGE OF A PARTICULAR INDUSTRY ARE MOST LIKELY TO DEVELOP STANDARDS BASED ON THE ACTUAL REQUIREMENTS OF THAT INDUSTRY. MOREOVER, THEY BRING AN OBVIOUS COST-SENSITIVITY THAT GENERALLY RESULTS IN LESS BURDENSOME REGULATION. ALSO, THIS APPROACH WOULD NOT INCUR A BURGEONING FEDERAL BUREAUCRACY. IN SHORT, IT WOULD MINIMIZE THE ACTUAL FEDERAL PARTICIPATION IN THE INDUSTRY WHILE POTENTIALLY SATISFYING THE FEDERAL INTEREST IN PROTECTING INVESTORS AND THE SECURITIES MARKETPLACE.

AN APPROPRIATE MODE FOR THAT FEDERAL PARTICIPATION IS DISCLOSURE. MY OWN THINKING ON THIS MATTER HAS BEEN HEAVILY INFLUENCED BY RECENT STUDIES UNDER THE SPONSORSHIP OF A SENATE COMMITTEE 10/ AND THE AMERICAN BAR ASSOCIATION. 11/

10/ COMMITTEE ON GOVERNMENTAL AFFAIRS, UNITED STATES SENATE "STUDY ON FEDERAL REGULATION," VOL. V, CHAPTER 3 (1977).

11/ AMERICAN BAR ASSOCIATION COMMISSION ON LAW AND THE ECONOMY, "FEDERAL REGULATION: ROADS TO REFORM," PP. 10-11 (EXPOSURE DRAFT 1978).

AS BOTH STUDIES SHOW, THERE IS NO MODE OF FEDERAL REGULATION MORE QUESTIONABLE THAN STANDARD SETTING. WHAT I HAVE COME TO BELIEVE IS THAT GOVERNMENTAL STANDARDS FREQUENTLY ARE NOT MATERIALLY RELATED TO THE REQUISITE SKILLS OF A LICENSEE. IN PARTICULAR, I BELIEVE THAT THE GOVERNMENT WOULD HAVE DIFFICULTY ESTABLISHING VALID EXAMINATION STANDARDS FOR INVESTMENT ADVISERS, WHOSE PROFESSIONAL SUCCESS IS BASED ON AN ABILITY TO PREDICT THE VAGARIES OF THE SECURITIES MARKETPLACE.

IN VIEW OF THE LACK OF A PROBABLE RELATIONSHIP BETWEEN AN INVESTMENT ADVISER'S SKILLS AND ANY GOVERNMENT ESTABLISHED ENTRY STANDARDS FOR THE PROFESSION, I BELIEVE THE BEST REGULATORY COURSE FOR THE COMMISSION TO FOLLOW IS TO PERMIT CLIENTS TO DETERMINE COMPETENCY. THE COMMISSION'S RECENTLY ADOPTED BROCHURE RULE 12/ IS DESIGNED TO ACHIEVE THIS OBJECTIVE THROUGH DISCLOSURE. THE RULE MANDATES CERTAIN DISCLOSURES ABOUT AN INVESTMENT ADVISER'S METHODOLOGY AND BACKGROUND, BUT ALLOWS EACH ADVISER TO SELECT A DISCLOSURE FORMAT AND TO SUPPLEMENT FREELY THE REQUIRED INFORMATION. HISTORICALLY, GOVERNMENT STANDARD SETTING APPEARS TO MORE READILY RESULT IN ANTI-COMPETITIVE BARRIERS TO ENTRY INTO A PROFESSION THAN IN CONSUMER PROTECTION. ACCORDINGLY, I BELIEVE THE APPROACH TO UPGRADING PROFESSIONAL STANDARDS TAKEN BY THE SEC IN THE BROCHURE RULE WAS WISE POLICY.

12/ INVESTMENT ADVISERS ACT RELEASE No. 664 (JAN. 30, 1979),
16 SEC DOCKET 901.

ONE DISCLOSURE MEDIUM -- ALTHOUGH IT IS RARELY THOUGHT OF IN SUCH TERMS -- IS ADVERTISING. AS YOU KNOW, THE COMMISSION HAS TRADITIONALLY APPLIED MAJOR RESTRICTIONS TO ADVERTISING BY INVESTMENT ADVISERS. THESE RESTRICTIONS ARE STRICTER THAN THE LIMITATIONS ON ADVERTISING BY BROKER-DEALERS IN THAT INVESTMENT ADVISERS ARE PRECLUDED FROM USING TESTIMONIALS.

REGULATORS TODAY ARE GENERALLY RECONSIDERING RESTRICTIONS ON ADVERTISING BECAUSE OF QUESTIONS WHICH HAVE BEEN RAISED UNDER THE FIRST AMENDMENT AND THE ANTI-TRUST LAWS CONCERNING SUCH PROHIBITIONS. AN EXPRESSION OF CONCERN AND RE-EXAMINATION BY THE COMMISSION WAS DEMONSTRATED BY OUR RECENT RESCISSION OF THE STATEMENT OF POLICY REGARDING INVESTMENT COMPANY ADVERTISING. THAT ACTION WAS AN EFFORT TO GET THE SEC OUT OF THE BUSINESS OF PREDETERMINING WHETHER ADVERTISING MAY HAVE IMPROPER EFFECTS. RATHER, THE COMMISSION WILL PLACE GREATER RELIANCE ON PROFESSIONAL RESPONSIBILITY AND SELF-RESTRAINT BY FUNDS, AND IF NECESSARY ON AFTER-THE-FACT ENFORCEMENT OF THE ANTI-FRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS. PERSONALLY, I BELIEVE THAT CONSTITUTIONAL QUESTIONS ARE RAISED BY THE GOVERNMENT'S PRIOR RESTRAINT OF COMMERCIAL SPEECH, AND THEREFORE WHERE THE GOVERNMENT CAN ACHIEVE ITS OBJECTIVES THROUGH LESS INTRUSIVE ALTERNATIVE REMEDIES, SUCH ALTERNATIVES SHOULD BE USED. AS A COMMISSIONER,

I WOULD BE PLEASED TO CONSIDER RECOMMENDATIONS BY THE INVESTMENT ADVISER COMMUNITY OR THE STAFF TO MODIFY THE SEC'S ADVERTISING RULES UNDER THE ADVISERS ACT TO THIS EFFECT.

ONE AREA OF INVESTMENT ADVISER REGULATION THAT MIGHT BE APPROPRIATE FOR SUBSTANTIVE -- AND NOT JUST DISCLOSURE RULES -- IS FINANCIAL RESPONSIBILITY. AS I NOTED BEFORE, SEC AUTHORITY TO ESTABLISH FINANCIAL RESPONSIBILITY STANDARDS WAS INCLUDED IN THE COMMISSION'S PROPOSED 1975 AMENDMENTS AND IS CONTAINED IN THE PROPOSED FEDERAL SECURITIES CODE. IN LARGE PART, I FAVOR SUCH AUTHORITY BECAUSE I BELIEVE THAT FINANCIAL RESPONSIBILITY STANDARDS -- UNLIKE ENTRY QUALIFICATIONS -- CAN BE DETERMINED BY THE GOVERNMENT IN A PRECISE MANNER AND AT A JUSTIFIABLY REASONABLE COST. OF COURSE, THAT MEANS THAT SUCH STANDARDS SHOULD BE APPLIED ONLY WHERE THE FINANCIAL INTEGRITY OF THE INVESTMENT ADVISER IS AN ELEMENT IN THE SERVICES PERFORMED. WHERE AN INVESTMENT ADVISER MAINTAINS CUSTODY OF CLIENTS' FUNDS OR SECURITIES OR IS PREPAID FOR FUTURE SERVICES, I THINK THAT IT WOULD BE APPROPRIATE FOR THAT INVESTMENT ADVISER TO ADHERE TO FINANCIAL RESPONSIBILITY REQUIREMENTS.

I UNDERSTAND THAT A LARGE NUMBER OF STATES HAVE APPLIED FINANCIAL RESPONSIBILITY STANDARDS -- AS WELL AS ENTRY QUALIFICATIONS -- TO INVESTMENT ADVISERS WHO PRACTICE WITHIN THEIR BOUNDARIES. I ALSO UNDERSTAND THAT INVESTMENT

ADVISERS ARE JUSTIFIABLY CONCERNED ABOUT THE COSTS AND INEFFICIENCIES OF ANSWERING TO A PATCHWORK OF BUREAUCRACIES ACROSS THE COUNTRY.

BUT THE PROLIFERATION OF INVESTMENT ADVISER REGULATION IN RECENT YEARS IS A VERY TELLING TREND. STATE LEGISLATURES AND STATE SECURITIES COMMISSIONS TYPICALLY ARE OVERWORKED AND UNDERSTAFFED INSTITUTIONS. COMMON SENSE SUGGESTS THAT THEY ORDINARILY WOULD NOT ENTER NEW AND SOPHISTICATED ASPECTS OF REGULATION, SUCH AS THEY HAVE BEEN DOING REGARDING INVESTMENT ADVISERS, UNLESS THEY FIND A PRESSING NEED TO PROTECT THE PUBLIC. IN SHORT, I INTERPRET THE INCREASE IN STATE REGULATION AS AN INDICATION OF UNDERREGULATION OF INVESTMENT ADVISERS BY THE COMMISSION OR THE PROFESSION ITSELF. IN THAT CONNECTION, ONE OF THE COMMISSION'S OBJECTIVES IN ENACTING THE BROCHURE RULE WAS TO HARMONIZE REPORTING AND DISCLOSURE REQUIREMENTS FOR ADVISERS UNDER THE VARIOUS REGULATORY SCHEMES TO WHICH THEY ARE SUBJECT.

LET ME SUMMARIZE THE SUBSTANCE OF MY MESSAGE TO YOU TODAY. I BELIEVE THAT INVESTMENT ADVISERS COLLECTIVELY SHOULD TAKE A MORE ACTIVE ROLE IN THE REGULATION OF THEIR OWN PROFESSION. SUCH HEIGHTENED RESPONSIBILITY IS ONE WAY TO ACHIEVE GREATER PROFESSIONALISM AS WELL AS A RATIONAL AND APPROPRIATE REGULATORY SCHEME. FURTHER, SELF-REGULATION IS A GOOD AND ACCEPTABLE ALTERNATIVE TO INCREASED FEDERAL AND STATE REGULATION.

IN THIS REGARD, I WOULD ENDORSE A MEANINGFUL EFFORT BY INVESTMENT ADVISERS TO CREATE ONE OR MORE SELF-REGULATORY ORGANIZATIONS. ONE OF THE UNIQUE AND EFFICACIOUS ASPECTS OF THE SEC'S OVERSIGHT OF THE SECURITIES INDUSTRY HAS BEEN THE ROLE OF SELF-REGULATORY ORGANIZATIONS IN OUR STATUTORY SCHEME. INVESTMENT ADVISERS HAVE NOT BENEFITED FROM SUCH SELF-REGULATION, SINCE SELF-REGULATION IS PARTICULARLY EFFECTIVE IN PROMOTING ETHICAL STANDARDS, I COMMEND IT TO YOU.

THE VALUE OF THESE EFFORTS SHOULD BE RECOGNIZED BY YOUR PROFESSION. IN THIS REGARD, LET ME READ TO YOU THE WORDS OF DWIGHT C. ROSE, WHO IN 1940 WAS THE PRESIDENT OF THE ICAA:

MAINTENANCE OF HIGH STANDARDS OF INTEGRITY, COMPLIANCE, AND PRACTICE IS DICTATED BY OUR SELF-INTEREST; FOR IN THE LONG RUN WE CAN PROSPER ONLY IF THE INVESTMENT COUNSEL PROFESSION MAINTAINS A REPUTATION FOR HONESTY, FOR ABILITY AND FOR SOUND METHODS OF PRACTICE. THEREFORE, WE STRONGLY FAVOR WHATEVER METHOD MAY BE RELIED UPON TO ASSURE THIS DESIRABLE RESULT. 13/

I BELIEVE THAT MR. ROSE'S WORDS ARE APT TODAY. SELF-REGULATION BY INVESTMENT ADVISERS CAN HAVE AS AN APPROPRIATE GOAL PROTECTION OF THE STATURE OF A PROFESSION. DIRECT

13/ HEARINGS BEFORE A SUBCOM. OF THE COMMITTEE ON BANKING AND CURRENCY, 76TH CONG., 3D SESS. AT 723 (1940).

GOVERNMENT REGULATION TAKEN IN REACTION TO ACTUAL OR PERCEIVED ABUSES, USUALLY LOOKS EXCLUSIVELY TO THE PROTECTION OF PUBLIC INVESTORS. WHILE THIS DIFFERENCE MAY BE SUBTLE, IT TENDS TO RESULT IN A DIFFERENT TYPE OF REGULATORY CLIMATE. I BELIEVE THAT THE PUBLIC INTEREST TODAY GENERALLY REQUIRES COOPERATIVE SELF-REGULATION RATHER THAN A RELATIONSHIP BETWEEN THE GOVERNMENT AND BUSINESS MARKED BY ADVERSARIAL HOSTILITY.