

of securities, which are traded on national securities exchanges and in interstate over-the-counter markets, securities issued by companies engaged in business in interstate commerce, and securities issued by national banks and member banks of the Federal Reserve System;

(3) they advise and through such advice influence the policies of large financial and other institutions engaged in banking and in interstate business; and

(4) all of the foregoing transactions are carried on in such great volume as substantially to affect interstate commerce, national securities exchanges, and other securities markets, the national banking and monetary system and the entire national economy.

#### DECLARATION OF POLICY

SEC. 202. Upon the basis of facts disclosed by the record and report of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—

(1) when investors are unable to obtain adequate information as to the activities, practices, ability, training, and integrity of investment advisers, their affiliated persons, and employees;

(2) when persons of proven lack of integrity in financial matters are permitted to engage in business as investment advisers;

(3) when the compensation of investment advisers is based upon profit-sharing contracts and other contingent arrangements conducive to excessive speculation and trading; or

(4) when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients.

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is presently practicable to eliminate the abuses enumerated in this section.

#### APPLICATION OF TITLE I

SEC. 203. The provisions of the following sections of title I are hereby incorporated in this title as though fully set forth herein: Sections 3, 34 (b), 35 (b) and (c), 36, 37 (e) and (f), 38, 39, 40, 41, 42, 43, 45, 46, and 47.

#### REGISTRATION OF INVESTMENT ADVISERS

SEC. 204. (a) Except as provided in subsection (b), it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser.

(b) The provisions of subsection (a) shall not apply to an investment adviser—

(1) all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business;

(2) who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on a national securities exchange; and

(3) who does not furnish advice or issue analyses or reports with respect to securities for which an over-the-counter market exists in any State other than that within which such investment adviser maintains his or its principal office or place of business.

(c) Any investment adviser, or any person who presently contemplates becoming an investment adviser, may register under this section by filing with the Commission an application for registration. Such application shall contain such of the following information and documents, in such form and detail as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:

(1) information in respect of—

(A) the organization and personnel of such investment adviser, including the number of his or its employees and their duties;

(B) the education, experience, and other background, and the past and present business affiliations of such investment adviser;

(C) the nature and scope of the business of, and of the advice, analyses, and reports furnished by, such investment adviser;

(D) the nature and scope of the authority and practices of such investment adviser with respect to clients' funds and accounts; and

(E) the basis or bases upon which such investment adviser, his or its partners, officers, directors, and employees are compensated;

(2) copies of every form of contract or agreement between such investment adviser and its clients which is regularly used by such investment adviser; and

(3) such further information and copies of such further documents relating to such investment adviser, his or its affiliated persons and employees as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors.

Except as hereinafter provided, such registration shall become effective thirty days after receipt of such application by the Commission, or within such shorter period of time as the Commission may determine. Any amendment of an application filed not more than fifteen days after the filing of such application shall be deemed to have been filed with and as a part of such application. Any amendment of an application filed more than fifteen days after the filing of such application shall be deemed a new application incorporating by reference the unamended items of the earlier application.

(d) The Commission shall by order deny registration to or revoke or suspend the registration of an applicant under this section, if the Commission finds that such denial, revocation, or suspension is in the public interest and that such investment adviser or any partner, officer, director, or controlling person thereof—

(1) within ten years of the issuance of such order, has been convicted of any felony or misdemeanor involving the purchase or sale of any security or arising out of any conduct or practice of such investment adviser or affiliated person as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company;

(2) at the time of the issuance of such order, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security;

(3) has omitted to state in such application or in an amendment thereto any fact which such person is required to state therein; or

(4) has willfully violated section 34 (b) of title I of this Act, or that portion of section 203 of this title which incorporates the provisions of said section 34 (b).

(e) The commencement of a proceeding to deny registration under this section shall operate to postpone the effective date of registration pending final determination of such proceeding.

(f) Any person registered under this section may, upon such terms and conditions as the Commission finds necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any person registered under this section, or who has pending an application for registration filed under this section, is no longer in business or is not engaged in business as an investment adviser, the Commission shall by order cancel the registration of such person.

#### INVESTMENT ADVISORY CONTRACTS

SEC. 205. No investment adviser registered under section 204 shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to enter into, extend, or renew any investment advisory contract, or in any way to perform any investment advisory contract entered into, extended, or renewed on or after the effective date of this title, if such contract—

(1) provides for compensation to the investment adviser on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client; or

(2) fails to provide, in substance, that no assignment of such contract shall be made by the investment adviser.

As used in this section, "investment advisory contract" means any contract or agreement whereby a person agrees to act as investment adviser or to manage any investment or trading account for another person. Paragraph (1) of this section shall not be construed to prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period or taken as of a definite date.

PROHIBITED TRANSACTIONS BY REGISTERED INVESTMENT ADVISERS

Sec. 206. It shall be unlawful for any investment adviser registered under section 204, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any client or prospective client;

(3) acting as principal, knowingly to sell any security to or purchase any security from any client, unless such investment adviser is a member of an association of brokers or dealers registered with the Commission pursuant to section 15A of the Securities Exchange Act of 1934; or

(4) if such investment adviser is a member of such an association, knowingly to sell any security to or purchase any security from any client without disclosing to such client in writing at or before the completion of such sale or purchase whether he is acting as a dealer for his own account, as a broker for such customer, or as a broker for some other person.

PENALTIES

Sec. 207. Any person who willfully violates any provision of this title shall upon conviction be fined not more than \$10,000 or imprisoned not more than two years, or both.

SHORT TITLE

Sec. 208. This title may be cited as the "Investment Advisers Act of 1940".

EFFECTIVE DATE

Sec. 209. This title shall become effective on October 1, 1940.

Senator WAGNER (chairman of the subcommittee). The first witness before the subcommittee will be Judge Robert E. Healy, Commissioner of the Securities and Exchange Commission. Judge Healy, are you prepared to proceed?

Mr. HEALY. Yes; Mr. Chairman.

**STATEMENT OF ROBERT E. HEALY, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION, WASHINGTON, D. C.**

Senator WAGNER. Judge Healy, would you rather proceed with your prepared statement and then have the members of the subcommittee propound such questions as they may desire? Or what is your preference in that regard?

Mr. HEALY. If it is left to my preference I think it would be better if I might go ahead and make my statement, and thereafter submit to such questions as the members of the subcommittee may wish to ask me.

Senator WAGNER. That will be all right. You may proceed.

Senator TOWNSEND. Judge Healy, may I state at this time that when I have to leave, about 5 minutes to 11 o'clock, I am not running out on you, but have to go to attend a meeting of a subcommittee of the Committee on Appropriations, of which I am a member.