

103D CONGRESS
1ST SESSION

H. R. 578

AN ACT

To provide for recovery of costs of supervision and regulation of investment advisers and their activities, and for other purposes.

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To provide for recovery of costs of supervision and regulation of investment advisers and their activities, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Investment Adviser
5 Regulatory Enhancement and Disclosure Act of 1993”.

6 **SEC. 2. ADDITIONAL RESOURCES FOR INVESTMENT AD-**
7 **VISER SUPERVISION.**

8 (a) AMENDMENT.—The Investment Advisers Act of
9 1940 (15 U.S.C. 80b–1 et seq.) is amended by inserting
10 after section 203 the following new section:

1 “FEES FOR REGISTRANTS AND APPLICANTS

2 “SEC. 203A. (a) IN GENERAL.—The Commission is
3 authorized, in accordance with this section, to collect fees
4 to recover the costs of registration, supervision, and regu-
5 lation of investment advisers and their activities. Such fees
6 shall be collected, and shall be available, only to the extent
7 provided in advance in appropriations Acts. No appropria-
8 tion Act may authorize fees to be collected under this sec-
9 tion during any fiscal year unless the amount appropriated
10 by such Act for such costs for such fiscal year equals or
11 exceeds the aggregate amount that may reasonably be ex-
12 pected to be collected by such fees. Such fees shall be de-
13 posited as an offsetting collection to the Commission’s ap-
14 propriation and may remain available for such purposes
15 for the succeeding fiscal year. The costs covered by such
16 fees shall be limited to the costs of Commission expenses
17 for registration, examinations, and surveys of persons reg-
18 istered or required to register under this Act.

19 “(b) TIME FOR PAYMENT.—

20 “(1) NEW REGISTRANTS.—At the time of filing
21 an application for registration under this title, the
22 applicant shall pay to the Commission the fee speci-
23 fied in subsection (c). No part of such fee shall be
24 refunded to the applicant. The filing of an applica-
25 tion for registration under this title shall not be

1 deemed to have occurred unless the application is ac-
 2 companied by the fee required under this section.

3 “(2) ONGOING REGISTRANTS.—Each invest-
 4 ment adviser whose registration is effective on the
 5 last day of its fiscal year shall pay to the Commis-
 6 sion the fee specified in subsection (c). Such pay-
 7 ment shall be made not later than 90 days after the
 8 end of its fiscal year, or at such other time as the
 9 Commission, by rule, shall determine, unless its reg-
 10 istration has been withdrawn, canceled, or revoked
 11 prior to that date. No part of such fee shall be re-
 12 funded to the investment adviser.

13 “(c) COST-BASED SCHEDULE OF FEES.—For any
 14 fiscal year for which fees are authorized to be collected
 15 by an appropriation Act, the amount of fees due from in-
 16 vestment advisers in accordance with paragraphs (1) and
 17 (2) of subsection (b) shall be determined according to the
 18 following schedule:

“Assets under management	Fee due:
Less than \$10,000,000	\$300
\$10,000,000 or more, but less than \$25,000,000	\$500
\$25,000,000 or more, but less than \$50,000,000	\$1,000
\$50,000,000 or more, but less than \$100,000,000	\$2,500
\$100,000,000 or more, but less than \$250,000,000	\$4,000
\$250,000,000 or more, but less than \$500,000,000	\$5,000
\$500,000,000 or more	\$7,000.

19 “(d) SUSPENSION FOR FAILURE TO PAY.—The Com-
 20 mission, by order, may suspend the registration of any in-
 21 vestment adviser if it finds, after notice, that such invest-

1 ment adviser has failed to pay when due any fee required
 2 by this section. The Commission shall reinstate such reg-
 3 istration upon payment of the fee (and any penalty due),
 4 if such suspension was based solely on the failure to pay
 5 the fee.

6 “(e) RULEMAKING.—The Commission may adopt
 7 such rules as are necessary to carry out this section.

8 “(f) DEFINITION OF ASSETS UNDER MANAGE-
 9 MENT.—As used in this section, the term ‘assets under
 10 management’ means the client assets with respect to which
 11 an investment adviser provides continuous and regular su-
 12 pervisory or management services.”.

13 (b) EFFECTIVE DATE.—This section shall become ef-
 14 fective upon the adoption by the Commission of imple-
 15 menting rules, under section 203A(f) of the Investment
 16 Advisers Act of 1940, as added by subsection (a).

17 **SEC. 3. EXAMINATIONS AND SURVEYS.**

18 The Investment Advisers Act of 1940 is amended by
 19 inserting after section 222 (15 U.S.C. 80b–22) the follow-
 20 ing new section:

21 “EXAMINATIONS AND SURVEYS

22 “SEC. 223. (a) PERIODIC EXAMINATIONS.—The
 23 Commission shall establish and periodically revise a sched-
 24 ule for the regular examination of investment advisers.
 25 Such schedule shall provide for more frequent examina-
 26 tions of certain investment advisers based on factors that

1 the Commission determines increase the need for examina-
2 tion of those investment advisers, which shall include (at
3 a minimum) each of the following:

4 “(1) the frequency of customer complaints;

5 “(2) the risks associated with newly registered
6 investment advisers;

7 “(3) custody of funds and the authority to exer-
8 cise investment discretion;

9 “(4) the existence of deficiencies detected dur-
10 ing an examination under this title that may con-
11 tinue to present high risks to clients; and

12 “(5) the receipt of commissions for the sale of
13 investments recommended to clients.

14 “(b) SURVEYS OF UNREGISTERED PERSONS.—The
15 Commission shall, within 3 years after the date of enact-
16 ment of this section and periodically thereafter, provide
17 for the conduct of a survey to determine the extent of,
18 and reasons for, the failure of persons to register as re-
19 quired by this Act. The Commission shall, on the basis
20 of such survey results, establish objectives for the reduc-
21 tion or elimination of such failures and shall include in
22 annual reports to Congress (under section 23(b) of the
23 Securities Exchange Act of 1934) submitted after comple-
24 tion of the first survey, a statement of such objectives,
25 an evaluation of the success in attaining those objectives

1 during the preceding year, and such recommendations as
 2 the Commission considers appropriate to assist in the at-
 3 tainment of those objectives. If the survey identifies any
 4 pattern of noncompliance with the registration require-
 5 ments of the title and the rules thereunder, the Commis-
 6 sion's objectives shall include such rulemaking proceedings
 7 as may be required to correct such noncompliance.

8 “(c) PROVISIONS NOT LIMITATION.—The provisions
 9 of this section shall not be construed to limit the authority
 10 of the Commission to prescribe rules under this Act or
 11 to conduct an examination or investigation at any time
 12 or to institute proceedings under this title or any other
 13 title.”.

14 **SEC. 4. DESIGNATION OF SELF-REGULATORY ORGANIZA-**
 15 **TIONS.**

16 The Investment Advisers Act of 1940 (15 U.S.C.
 17 80b–1 et seq.) is amended by inserting after section 223
 18 (as added by section 3 of this Act) the following new sec-
 19 tion:

20 “DESIGNATION OF SELF-REGULATORY ORGANIZATIONS

21 “SEC. 224. (a) DESIGNATION TO CONDUCT EXAMI-
 22 NATIONS.—The Commission, by rule, consistent with the
 23 public interest, the protection of investors, and the pur-
 24 poses of this title, may designate one or more self-regu-
 25 latory organizations registered with the Commission under
 26 section 6 or 15A of the Securities Exchange Act of 1934,

1 to conduct periodic examinations of its members, and af-
2 filiates of members, that are registered or required to reg-
3 ister under this title, to determine compliance with appli-
4 cable provisions of this title and the rules and regulations
5 thereunder. Such rule shall specify the minimum scope
6 and frequency for such examinations and shall, to the ex-
7 tent consistent with the protection of investors, be de-
8 signed to avoid unnecessary regulatory duplication or
9 undue regulatory burdens. Such self-regulatory organiza-
10 tion may discipline such members and affiliates of mem-
11 bers for violations of the applicable provisions of this title
12 and the rules and regulations thereunder pursuant to the
13 standards and procedures set forth in sections 6, 15A, and
14 19 of the Securities Exchange Act of 1934. The money
15 penalties imposed by a self-regulatory organization for vio-
16 lations of this title shall not exceed those contained in sec-
17 tion 203(i).

18 “(b) LIMITATIONS.—

19 “(1) PRIMARY BUSINESS LIMITATION.—The
20 Commission shall not exercise the designation au-
21 thority contained in subsection (a) for members or
22 affiliates of members if the primary business of the
23 member and its affiliates is investment advisory ac-
24 tivities.

1 “(2) LIMITATION WITH RESPECT TO AFFILI-
2 ATES OF MEMBERS.—The Commission shall not ex-
3 ercise the authority contained in subsection (a) for
4 an affiliate of a member if—

5 “(A) the primary business of the affiliate
6 is investment advisory activities;

7 “(B) the affiliate is an affiliate of the
8 member solely as a result of the adviser’s (or an
9 associated person of the adviser’s) registration
10 with the member as a registered representative;
11 and

12 “(C) the affiliate is a registered represent-
13 ative of the member solely to enable the adviser
14 to execute transactions that are incidental to
15 the investment adviser’s primary business;

16 unless the Commission determines, in accordance
17 with such other criteria as the Commission estab-
18 lishes by rule, that such exercise of designation au-
19 thority is consistent with the public interest, the pro-
20 tection of investors, the purposes of this title, and
21 the objectives of the Commission’s investment ad-
22 viser examination program.

23 “(3) LIMITATION WITH RESPECT TO SAVINGS
24 ASSOCIATION AFFILIATES OF MEMBERS.—The Com-
25 mission shall not exercise the authority contained in

1 subsection (a) for an affiliate of a member if the af-
2 filiate is a savings association, as such term is de-
3 fined in section 3(b)(1) of the Federal Deposit In-
4 surance Act (12 U.S.C. 1813(b)(1)).

5 “(4) DEFINITIONAL RULES.—For purposes of
6 this subsection, the Commission may, by rule, estab-
7 lish criteria for defining the terms ‘primary business’
8 and ‘incidental to the investment adviser’s primary
9 business’.

10 “(c) AUTHORITY TO IMPOSE FEES.—

11 “(1) IN GENERAL.—Any self-regulatory organi-
12 zation designated by the Commission to perform the
13 examinations specified in subsection (a) shall have
14 the authority to collect fees in accordance with this
15 subsection.

16 “(2) LIMITATION.—The total fee paid by a reg-
17 istered investment adviser under this subsection
18 shall not exceed an amount determined in accord-
19 ance with rules prescribed by the Commission. Such
20 rules shall require that the fees collected by a self-
21 regulatory organization under this subsection—

22 “(A) cover only the costs of the self-regu-
23 latory organization’s expenses for examinations
24 conducted pursuant to subsection (a);

1 “(B) as to any investment adviser, bear a
2 reasonable relationship to the costs of conduct-
3 ing an examination of that adviser pursuant to
4 subsection (a); and

5 “(C) not exceed such portion of the fee au-
6 thorized under section 203A as the Commission
7 determines is allocable to the Commission’s ex-
8 penses for conducting such an examination.

9 “(3) REDUCTION OF SECTION 203A FEES.—The
10 amount of any fee that a registered investment ad-
11 viser is required to pay under section 203A with re-
12 spect to any fiscal year shall be reduced by the
13 amount paid to a self-regulatory organization in ac-
14 cordance with this subsection with respect to such
15 fiscal year.

16 “(d) EFFECTIVE DATE OF RULE.—A rule prescribed
17 by the Commission under this section shall not be effective
18 until 90 days after the date on which the Commission sub-
19 mits to each House of Congress a report—

20 “(1) containing the text of the proposed rule
21 and the reasons therefor;

22 “(2) describing the procedures to be used to co-
23 ordinate the collection of fees by the Commission
24 under section 203A and by a self-regulatory organi-
25 zation under the rule; and

1 “(3) containing such other information as may
2 be necessary to describe the implementation and en-
3 forcement of the rule.

4 “(e) DEFINITION.—For purposes of this section, the
5 term ‘affiliate’ shall mean any person directly or indirectly
6 controlling, controlled by, or under common control with
7 a member.”.

8 **SEC. 5. SUITABILITY AND OTHER ADVISER OBLIGATIONS.**

9 (a) AMENDMENT.—Section 206 of the Investment
10 Advisers Act of 1940 (15 U.S.C. 80b–6) is amended to
11 read as follows:

12 “PROHIBITED TRANSACTIONS BY INVESTMENT ADVISERS

13 “SEC. 206. (a) PROHIBITED CONDUCT.—It shall be
14 unlawful for any investment adviser or any person associ-
15 ated with an investment adviser, by use of the mails or
16 any means or instrumentality of interstate commerce, di-
17 rectly or indirectly—

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

20 “(2) to engage in any transaction, practice, or
21 course of business which operates as a fraud or de-
22 ceit upon any client or prospective client;

23 “(3) acting as principal for his own account,
24 knowingly to sell any security to or purchase any se-
25 curity from a client, or acting as broker for a person
26 other than such client, knowingly to effect any sale

1 or purchase of any security for the account of such
2 client, without disclosing to such client in writing be-
3 fore the completion of such transaction the capacity
4 in which he is acting and obtaining the consent of
5 the client to such transaction;

6 “(4) to engage in any act, practice, or course of
7 business which is fraudulent, deceptive, or manipula-
8 tive;

9 “(5) to provide investment advice to any client,
10 other than in connection with impersonal advisory
11 services, unless the adviser—

12 “(A) prior to providing any investment ad-
13 vice, and as appropriate thereafter, makes a
14 reasonable inquiry into the client’s financial sit-
15 uation, investment experience, and investment
16 objectives;

17 “(B) reasonably determines that the in-
18 vestment advice is suitable for the client; and

19 “(C) maintains reasonable records, in ac-
20 cordance with such rules as the Commission
21 shall prescribe, of the information obtained
22 from the inquiries the adviser made in comply-
23 ing with this paragraph; or

1 “(6) to guarantee a client that a specific result
2 will be achieved as a result of the advisory services
3 provided by the investment adviser.

4 “(b) EXEMPTIONS AND SPECIAL RULES.—

5 “(1) EXEMPTION.—The prohibitions of sub-
6 section (a)(3) shall not apply to any transaction with
7 a customer of a broker or dealer if such broker or
8 dealer is not acting as an investment adviser in rela-
9 tion to such transaction.

10 “(2) AUTHORITY TO DEFINE AND PRE-
11 SCRIBE.—The Commission shall, for the purposes of
12 subsection (a)(4), by rules define, and prescribe
13 means reasonably designed to prevent, such acts,
14 practices, and courses of business as are fraudulent,
15 deceptive, or manipulative.

16 “(3) DEFINITION OF IMPERSONAL ADVISORY
17 SERVICES.—As used in subsection (a)(5), the term
18 ‘impersonal advisory services’ means any investment
19 advisory services provided—

20 “(A) by means of written material or oral
21 statements which do not purport to meet the
22 objectives or needs of specific individuals or ac-
23 counts;

24 “(B) through the issuance of statistical in-
25 formation containing no expression of opinion

1 as to the investment merits of a particular secu-
2 rity; or

3 “(C) by any combination of the foregoing
4 services.”.

5 (b) RULEMAKING REQUIRED.—The Commission shall
6 prescribe rules for purposes of paragraph (5)(C) of section
7 206(a) of the Investment Advisers Act of 1940 (as added
8 by subsection (a) of this section) within one year after the
9 date of enactment of this Act.

10 **SEC. 6. ADDITIONAL DISCLOSURE OBLIGATIONS OF IN-**
11 **VESTMENT ADVISERS.**

12 (a) ADDITIONAL OBLIGATIONS.—Section 204 of the
13 Investment Advisers Act of 1940 (15 U.S.C. 80b–4) is
14 amended—

15 (1) by striking the heading of such section and
16 inserting the following:

17 “PERIODIC REPORTS AND OTHER DISCLOSURE
18 REQUIREMENTS”;

19 (2) by inserting “(a) PERIODIC AND OTHER
20 REPORTS.—” after “SEC. 204.”; and

21 (3) by adding at the end the following new sub-
22 sections:

23 “(b) BROCHURE REQUIRED.—

24 “(1) IN GENERAL.—Each person registered
25 under section 203 of this title shall disseminate to
26 each client or prospective client a document disclos-

1 ing material facts concerning matters listed in para-
2 graphs (2) and (3) and such other matters as the
3 Commission shall prescribe. In order to provide for
4 timely and effective disclosure of such facts and
5 matters to clients, the Commission shall by rule pre-
6 scribe the format of the document and the timing of
7 its dissemination.

8 “(2) CONTENTS OF BROCHURE.—The document
9 required by paragraph (1) shall include information
10 concerning—

11 “(A) the education and business back-
12 ground of such person and of any associated
13 person providing significant investment advisory
14 services to the client,

15 “(B) compensation arrangements between
16 the client and the investment adviser,

17 “(C) the nature of services offered,

18 “(D) business practices,

19 “(E) methods for obtaining information on
20 the disciplinary history and registration of the
21 investment adviser and persons associated with
22 the investment adviser, and

23 “(F) conflicts of interest which could rea-
24 sonably be expected to impair the rendering of
25 disinterested advice.

1 “(3) PROMINENT DISCLOSURES.—Such docu-
2 ment shall also prominently disclose—

3 “(A) that—

4 “(i) the registered person receives or
5 may receive, directly or indirectly, sales
6 commissions or other fees in connection
7 with a purchase or sale effected on behalf
8 of a client; or

9 “(ii) the registered person will not re-
10 ceive, directly or indirectly, any sales com-
11 mission or other fees in connection with
12 such purchase or sale, but the client may
13 be charged a sales commission or other fee
14 by another person in connection with such
15 purchase or sale; and

16 “(B) that remedies may be available to the
17 client with respect to disputes arising out of the
18 advisory relationship.

19 “(4) DEFINITION.—The Commission shall de-
20 fine ‘associated person providing significant invest-
21 ment advisory services to the client’ by rule for pur-
22 poses of this subsection.

23 “(c) TRANSACTION REPORTS.—

24 “(1) INITIAL DISCLOSURE.—Before a purchase
25 or sale is effected on behalf of any client, each reg-

1 istered investment adviser shall, in accordance with
2 rules prescribed by the Commission, disclose to the
3 client the total amount of commissions, fees, or
4 other charges that may reasonably be expected to be
5 charged in connection with the transaction (or, in
6 the case of payments from third parties, that a pay-
7 ment will be received) and that the adviser or a re-
8 lated person will receive a portion of the commission,
9 fee, charge, or payment. Such initial disclosure shall
10 be in writing if the purchase or sale was rec-
11 ommended in writing.

12 “(2) CONFIRMATION.—After a purchase or sale
13 is effected, each registered investment adviser shall
14 transmit to each client a written statement that dis-
15 closes the amount of commissions, fees, or other
16 charges charged in connection with the transaction
17 (or, in the case of payments from third parties, that
18 a payment has been or will be received). Such writ-
19 ten statement shall be in such form and contain
20 such information, and be provided in accordance
21 with such rules, as the Commission shall prescribe.
22 Such rules shall, to the extent consistent with the
23 protection of investors, permit delivery of a con-
24 firmation statement of a broker or a dealer that in-
25 cludes information that meets the requirements of

1 this subsection (and the rules adopted thereunder)
2 in order to satisfy such requirements.

3 “(3) WAIVER.—The Commission may, by rule,
4 permit an investment adviser to omit disclosure re-
5 quired by this subsection with the knowing written
6 consent of the client.

7 “(4) EXCEPTIONS.—This subsection shall not
8 apply—

9 “(A) with respect to any purchase or sale
10 for which the investment adviser, and any per-
11 son associated or under common control with
12 the investment adviser, will not receive any por-
13 tion of the amount charged or deducted in con-
14 nection with the purchase or sale, and will not
15 receive any payment from a third party re-
16 quired to be disclosed under paragraph (1);

17 “(B) with respect to accounts for which
18 the person is authorized to exercise investment
19 discretion; or

20 “(C) with respect to any account for which
21 the person is not acting as an investment ad-
22 viser.

23 “(5) SPECIAL RULE.—The provisions of this
24 subsection shall also apply to any person associated
25 with an investment adviser effecting transactions for

1 advisory clients through a broker or dealer with
2 which the person is associated.

3 “(d) PERIODIC REPORTS.—

4 “(1) IN GENERAL.—Each registered investment
5 adviser shall provide to each client a periodic written
6 statement in such form and containing such infor-
7 mation as the Commission shall prescribe by rule
8 consistent with the public interest, the protection of
9 investors, and the purposes of this title. Such rule
10 shall require the disclosure of—

11 “(A) commissions, fees, or other charges
12 paid by the client during the period for services
13 provided by the investment adviser and any per-
14 son associated or under common control with
15 the investment adviser;

16 “(B) compensation directly or indirectly re-
17 ceived during the period by the investment ad-
18 viser, or any person associated or under com-
19 mon control with the investment adviser, from
20 any third party with respect to any rec-
21 ommended transaction;

22 “(C) in the case of a client account for
23 which the investment adviser provides invest-
24 ment supervisory services, securities positions

1 held in the account at the beginning and at the
2 end of the period; and

3 “(D) such other matters as the Commis-
4 sion shall prescribe.

5 “(2) COMMISSION RULES.—The rule prescribed
6 by the Commission pursuant to paragraph (1) shall
7 require that the format and timing of delivery be de-
8 signed to present the required information in a man-
9 ner that readily permits clients to compare the costs
10 charged by the investment adviser with the costs
11 charged by other advisers. In adopting such rule, the
12 Commission shall require an investment adviser
13 whose clients purchase or sell investment products
14 through persons other than such adviser, or persons
15 associated or under common control with such ad-
16 viser, to disclose to its clients that such information
17 concerning costs charged does not include commis-
18 sions or other fees paid in connection with such pur-
19 chases or sales. Such rule shall, to the extent con-
20 sistent with the protection of investors, permit deliv-
21 ery of a report of a broker or dealer that includes
22 information that meets the requirements of this sub-
23 section (and the rules adopted thereunder) in order
24 to satisfy such requirements.

1 “(3) WAIVER.—The Commission may, by rule,
2 permit an investment adviser to provide the state-
3 ment required by paragraph (1) no more frequently
4 than annually if the client knowingly waives, in writ-
5 ing, the right to obtain such statement more fre-
6 quently than annually.

7 “(4) EXCEPTION.—This subsection shall not
8 apply with respect to any account for which the per-
9 son is not acting as an investment adviser.

10 “(e) FACILITIES FOR FILING RECORDS AND RE-
11 PORTS; ACCESS TO DISCIPLINARY AND OTHER INFORMA-
12 TION.—

13 “(1) FILING DEPOSITORIES.—The Commission,
14 by rule, may require any investment adviser—

15 “(A) to file with the Commission any fee,
16 application, report, or notice required by this
17 title or by the rules issued under this title
18 through any entity designated by the Commis-
19 sion for that purpose; and

20 “(B) to pay the reasonable costs associated
21 with (i) such filing, and (ii) the maintenance of
22 the toll-free telephone listing required by para-
23 graph (2).

24 “(2) LISTING FOR TOLL-FREE INQUIRIES.—The
25 Commission shall require the entity designated by

1 the Commission to receive fees, applications, reports,
2 or notices pursuant to paragraph (1) to—

3 “(A) establish and maintain a toll-free tele-
4 phone listing to receive inquiries regarding the
5 disciplinary and other information involving in-
6 vestment advisers and persons associated with
7 investment advisers; and

8 “(B) respond promptly to such inquiries in
9 writing.

10 Such designated entity may charge persons, other
11 than individual investors, reasonable fees for the
12 cost of providing written responses to inquiries. Such
13 designated entity shall not have any liability to any
14 person for any actions taken or omitted in good
15 faith under this paragraph.”.

16 (b) RULEMAKING REQUIRED.—The Commission shall
17 prescribe rules for purposes of subsections (b), (c), and
18 (d) of section 204 of the Investment Advisers Act of 1940
19 (as added by subsection (a) of this section) within one year
20 after the date of enactment of this Act.

21 **SEC. 7. BOND REQUIREMENT.**

22 Section 208 of the Investment Advisers Act of 1940
23 (15 U.S.C. 80b–8) is amended by adding at the end the
24 following:

25 “(e) BOND REQUIREMENT.—

1 “(1) IN GENERAL.—The Commission, by rules
2 for the protection of investors, shall require any in-
3 vestment adviser registered under section 203 who—

4 “(A) is authorized to exercise investment
5 discretion, as defined in section 3(a)(35) of the
6 Securities Exchange Act of 1934, with respect
7 to an account,

8 “(B) has access to the securities or funds
9 of a client, or

10 “(C) is an investment adviser of an invest-
11 ment company, as defined in section 2(a)(20) of
12 the Investment Company Act of 1940,

13 to obtain a bond from a reputable fidelity insurance
14 company against larceny and embezzlement in such
15 reasonable amounts and covering such officers, part-
16 ners, directors, and employees of the investment ad-
17 viser as the Commission may prescribe.

18 “(2) CONSIDERATIONS IN RULEMAKING.—In
19 implementing paragraph (1), the Commission shall
20 consider—

21 “(A) the degree of risk to client assets that
22 is involved;

23 “(B) the cost and availability of fidelity
24 bonds;

1 “(C) existing fidelity bonding require-
2 ments; and

3 “(D) any alternative means to protect cli-
4 ent assets.

5 “(3) EXEMPTION AUTHORITY.—The Commis-
6 sion by rule may exempt any person or class of per-
7 sons, under such terms and conditions and for such
8 periods as the Commission shall provide in such
9 rule, from the requirements of this subsection and
10 the rules thereunder.”.

11 **SEC. 8. DISQUALIFYING CONDUCT.**

12 (a) AMENDMENT.—Section 203(e) of the Investment
13 Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended—

14 (1) by redesignating paragraphs (3) through
15 (7) as paragraphs (4) through (8), respectively; and

16 (2) by inserting after paragraph (2) the follow-
17 ing new paragraph:

18 “(3) has been convicted within ten years pre-
19 ceding the filing of any application for registration
20 or at any time thereafter of any crime that is pun-
21 ishable by imprisonment for one or more years and
22 that is not described in paragraph (2) of this sub-
23 section or of a substantially equivalent crime by a
24 foreign court of competent jurisdiction.”.

1 (b) CONFORMING AMENDMENTS.—Section 203 of
2 such Act is further amended—

3 (1) in subsection (e)(6) (as redesignated by
4 subsection (a) of this section), by striking “this
5 paragraph (5)” and inserting “this paragraph (6)”;

6 (2) in subsection (f)—

7 (A) by striking “paragraph (1), (4), (5), or
8 (7)” and inserting “paragraph (1), (5), (6), or
9 (8)”;

10 (B) by striking “paragraph (3)” and in-
11 serting “paragraph (4)”;

12 (3) in subsection (i)(1)(D), by striking “section
13 203(e)(5) of this title” and inserting “subsection
14 (e)(6) of this section”.

15 **SEC. 9. CONFIDENTIALITY.**

16 Section 208 of the Investment Advisers Act of 1940
17 (15 U.S.C. 80b–8), as amended by section 7, is further
18 amended by adding at the end the following new sub-
19 section:

20 “(f) DISCLOSURE OF CLIENT INFORMATION PROHIB-
21 ITED.—

22 “(1) ADVISER DISCLOSURE.—It shall be unlaw-
23 ful for any investment adviser to disclose any per-
24 sonally identifiable financial information with respect

1 to any client unless required by law to do so, or un-
2 less—

3 “(A) the client has been adequately in-
4 formed of the proposed information disclosure,
5 in accordance with rules prescribed by the Com-
6 mission, and (i) has been afforded the oppor-
7 tunity, in accordance with such rules, to object
8 to the disclosure, and (ii) has not objected or
9 has affirmatively consented;

10 “(B) the information disclosed is necessary
11 and appropriate in order to establish an advi-
12 sory or brokerage account or to effect or at-
13 tempt to effect a transaction for the client;

14 “(C) the information (i) is requested by
15 representatives of the Commission, a State
16 agency whose primary assignment is the regula-
17 tion of the securities business, or a self-regu-
18 latory organization, or (ii) is requested by sub-
19 poena; or

20 “(D) the information is requested by the
21 client’s auditors or accountants.

22 “(2) SECONDARY DISCLOSURE.—It is unlawful
23 for any person to whom information is disclosed for
24 the purpose described in paragraph (1)(B) to use

1 such information for any purpose other than the ef-
2 fectuation of the client's transaction.''.

3 **SEC. 10. CUSTODIANSHIP.**

4 (a) FINDINGS.—The Congress finds that—

5 (1) most clients of investment advisers who give
6 their advisers discretionary authority over their secu-
7 rities and funds provide for the safekeeping of their
8 securities and funds with a custodian;

9 (2) it is a customary business practice for
10 custodians to provide reports of the transactions in
11 client accounts directly to clients;

12 (3) such direct reporting provides an important
13 safeguard against improper use of client assets; and

14 (4) permitting advisers to serve as the sole re-
15 cipient of custodial account communications has al-
16 lowed, and may continue to allow, unscrupulous per-
17 sons to misuse client assets, causing substantial
18 losses for those clients.

19 (b) REPORT.—The Commission, within 18 months of
20 enactment of this Act, after consultation with the appro-
21 priate Federal banking agencies (as such term is defined
22 in section 3(q) of the Federal Deposit Insurance Act),
23 shall submit a report to Congress—

24 (1) analyzing the risks to investors when an in-
25 vestment adviser is made the sole recipient of com-

1 munications from the custodian or when an invest-
2 ment adviser or affiliate thereof serves as the custo-
3 dian; and

4 (2) making any recommendations the Commis-
5 sion believes are necessary to eliminate or reduce
6 these risks.

Passed the House of Representatives May 4, 1993.

Attest:

Clerk.

HR 578 EH—2