

[CHAPTER 686]

An Act

To provide for the registration and regulation of investment companies and investment advisers, and for other purposes.

August 22, 1940  
[H.R. 100651]  
[Public, No. 768]

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

TITLE I—INVESTMENT COMPANIES

Investment Company  
Act of 1940

FINDINGS AND DECLARATION OF POLICY

SEC. 1. (a) Upon the basis of facts disclosed by the record and reports 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 found that investment companies are affected with a national public interest in that, among other things—

Findings and  
declaration of policy.

49 Stat. 837.  
15 U.S.C., Supp. V.  
§ 79z-4.

(1) the securities issued by such companies, which constitute a substantial part of all securities publicly offered, are distributed, purchased, paid for, exchanged, transferred, redeemed, and repurchased by use of the mails and means and instrumentalities of interstate commerce, and in the case of the numerous companies which issue redeemable securities this process of distribution and redemption is continuous;

(2) the principal activities of such companies—investing, reinvesting, and trading in securities—are conducted by the use of the mails and means and instrumentalities of interstate commerce, including the facilities of national securities exchanges, and constitute a substantial part of all transactions effected in the securities markets of the Nation;

(3) such companies customarily invest and trade in securities issued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce;

(4) such companies are media for the investment in the national economy of a substantial part of the national savings and may have a vital effect upon the flow of such savings into the capital markets; and

any person or circumstances, shall be held invalid, the remainder of this title and the application of any such provision to person or circumstances other than those as to which it is held invalid shall not be affected thereby.

#### SHORT TITLE

SEC. 52. This title may be cited as the “Investment Company Act of 1940”.

Short title.

#### EFFECTIVE DATE

SEC. 53. The effective date of the provisions of this title, so far as the same relate to face-amount certificates or to face-amount certificate companies, is January 1, 1941: *Provided, however,* That any such face amount certificate company may register prior to said date, as provided by section 8 of this title, and such registration shall not operate to change or affect said effective date as to any such company or any face-amount certificates issued by it. The effective date of provisions hereof, insofar as the same do not apply to face-amount certificates or face-amount certificate companies is November 1, 1940. Except as herein otherwise provided, every provision of this title shall take effect on November 1, 1940.

Effective dates.

*Proviso.*  
Registration provisions, etc.

#### TITLE II—INVESTMENT ADVISERS

Investment Advisers Act of 1940.

#### FINDINGS

Findings.

SEC. 201. Upon the basis of the facts disclosed by the record and reports 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 found that investment advisers are of national concern, in that, among other things—

49 Stat. 837.  
15 U.S.C., Supp. V,  
§ 79z-4.

(1) their advice, counsel, publications, writings, analyses, and reports are furnished and distributed, and their contracts, subscription agreements, and other arrangements with clients are negotiated and performed, by the use of the mails and means and instrumentalities of interstate commerce;

(2) their advice, counsel, publications, writings, analyses, and reports customarily relate to the purchase and sale of securities 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; and

(3) the foregoing transactions occur in such volume as substantially to affect interstate commerce, national securities exchanges, and other securities markets, the national banking system and the national economy.

#### DEFINITIONS

SEC. 202. (a) When used in this title, unless the context otherwise requires—

Definitions.

(1) “Assignment” includes any direct or indirect transfer or hypothecation of an investment advisory contract by the assignor or of a controlling block of the assignor’s outstanding voting securities by a security holder of the assignor; but if the investment adviser is a partnership, no assignment of an investment advisory contract shall be deemed to result from the death or withdrawal of a minority of the members of the investment adviser having only a minority interest in the business of the investment adviser, or from the admission to the investment adviser of one or more mem-

“Assignment.”

bers who, after such admission, shall be only a minority of the members and shall have only a minority interest in the business

“Bank.”

(2) “Bank” means (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

36 Stat. 262.  
12 U.S.C. § 248(k);  
Supp. V, § 268 (k).

“Broker.”

(3) “Broker” means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

“Commission.”

(4) “Commission” means the Securities and Exchange Commission.

“Company.”

(5) “Company” means a corporation, a partnership, an association, a joint-stock company, a trust, or any organized group of persons, whether incorporated or not; or any receiver, trustee in bankruptcy, or similar official, or any liquidating agent for any of the foregoing, in his capacity as such.

“Convicted.”

(6) “Convicted” includes a verdict, judgment, or plea of guilty, or a finding of guilt on a plea of nolo contendere, if such verdict, judgment, plea, or finding has not been reversed, set aside, or withdrawn, whether or not sentence has been imposed.

“Dealer.”

(7) “Dealer” means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

“Director.”

(8) “Director” means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated.

“Exchange.”

(9) “Exchange” means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.

“Interstate commerce.”

(10) “Interstate commerce” means trade, commerce, transportation, or communication among the several States, or between any foreign country and State, or between any State and any place or ship outside thereof.

“Investment adviser.”

(11) “Investment adviser” means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include (A) a bank, or any holding company affiliate, as defined in the Banking Act of 1933, which is not an investment company; (B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession;

48 Stat. 162, 163.  
12 U.S.C. § 221a (a),  
(c); Supp. V, § 221a (a),  
(c).

(C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore; (D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation; (E) any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 3 (a) (12) of the Securities Exchange Act of 1934, as exempted securities for the purposes of that Act; or (F) such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.

(12) "Investment company", "affiliated person", "control", and "insurance company" have the same meanings as in the Investment Company Act of 1940.

(13) "Investment supervisory services" means the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client.

(14) "Means or instrumentality of interstate commerce" includes any facility of a national securities exchange.

(15) "National securities exchange" means an exchange registered under section 6 of the Securities Exchange Act of 1934.

(16) "Person" means a natural person or a company.

(17) "Security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guaranty of, or warrant or right to subscribe to or purchase any of the foregoing.

(18) "State" means any State of the United States, the District of Columbia, Alaska, Hawaii, Puerto Rico, the Philippine Islands, the Canal Zone, the Virgin Islands, or any other possession of the United States.

(19) "Underwriter" means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributor's or seller's commission. As used in this paragraph the term "issuer" shall include in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

(20) "Securities Act of 1933", "Securities Exchange Act of 1934", "Public Utility Holding Company Act of 1935", and "Trust Indenture Act of 1939", mean those Acts, respectively, as heretofore or hereafter amended.

(b) No provision in this title shall apply to, or be deemed to include, the United States, a State, or any political subdivision of a State, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned

48 Stat. 884.  
15 U.S.C. § 78c (a)  
(12).

"Investment  
company," etc.

"Investment  
supervisory services."

"Means or  
instrumentality of  
interstate commerce."

"National securities  
exchange."

48 Stat. 885.  
15 U.S.C. § 78f.  
"Person".

"Security."

"State."

"Underwriter."

"Issuer."

48 Stat. 74 881; 49  
Stat. 803; 53 Stat.  
1149.

Nonapplicability of  
provisions to U. S.,  
etc.; exceptions.

directly or indirectly by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

REGISTRATION OF INVESTMENT ADVISERS

Use of mails, etc.,  
registration requirement.

SEC. 203. (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.

Exemptions.

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

(1) any investment adviser all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;

(2) any investment adviser whose only clients are investment companies and insurance companies; or

(3) any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who does not hold himself out generally to the public as an investment adviser.

Application for  
registration.

(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, 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:

Information required.

(1) information in respect of—

(A) the name and form of organization under which the investment adviser engages or intends to engage in business; the name of the State or other sovereign power under which such investment adviser is organized; the location of his or its principal business office and branch offices, if any; the names and addresses of his or its partners, officers, directors, and persons performing similar functions or, if such an investment adviser be an individual, of such individual; and the number of his or its employees;

(B) the education, the business affiliations for the past ten years, and the present business affiliations of such investment adviser and of his or its partners, officers, directors, and persons performing similar functions and of any controlling person thereof;

(C) the nature of the business of such investment adviser, including the manner of giving advice and rendering analyses or reports;

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

(E) the basis or bases upon which such investment adviser is compensated; and

(F) whether such an investment adviser or any partner, officer, director, person performing similar function or controlling person thereof (i) within ten years of the filing of such application has been convicted of any felony or misdemeanor of the character described in paragraph (1) of subsection (d), or (ii) is permanently or temporarily

enjoined by an order, judgment or decree of the character described in paragraph (2) of subsection (d) and in each case the facts relating to such conviction or injunction; and

(2) a statement as to whether such investment adviser is engaged or is to engage primarily in the business of rendering investment supervisory services.

Statement as to primary business.

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 and before such application becomes effective shall be deemed a new application incorporating by reference the unamended items of the earlier application. Any amendment filed after the application has become effective shall become effective thirty days after the filing thereof, or at such earlier date as the Commission may order.

Effective date of registration.  
Amendments.

(d) The Commission after hearing may 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, person performing similar function, or controlling person thereof—

Denial, revocation, etc., for cause.

(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; or

(3) has violated the provisions of section 207 of this title.

(e) The commencement of a proceeding to deny registration under this section shall not operate to postpone the effective date of registration unless the Commission shall find that such postponement is necessary in the public interest and shall so order, but no such order shall operate to postpone such effective date for more than three months.

Postponement of effective date of registration.

(f) Any successor to the business of an investment adviser registered under this section shall be deemed likewise registered hereunder, if within thirty days from its succession to such business it shall file an application for registration under this section, unless and until the Commission, pursuant to subsection (d) of this section, shall deny registration to or revoke or suspend the registration of such successor.

Successor to business.

(g) 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 sec-

Withdrawal from registration.

Cancellation.

tion, 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.

#### ANNUAL AND OTHER REPORTS

Filing of reports.

Sec. 204. Every investment adviser registered under section 203 of this title shall file with the Commission such annual and special reports, in such form as the Commission by rules and regulations may prescribe for the purpose of keeping reasonably current the information contained in the registration application.

#### INVESTMENT ADVISORY CONTRACTS

Restriction on use of mails, etc., by investment advisers.

Sec. 205. No investment adviser registered under section 203 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;

(2) fails to provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract; or

(3) fails to provide, in substance, that the investment adviser, if a partnership, will notify the other party to the contract of any change in the membership of such partnership within a reasonable time after such change.

“Investment advisory contract” defined.

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 a person other than an investment company. 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 as of definite dates, or taken as of a definite date.

#### PROHIBITED TRANSACTIONS BY REGISTERED INVESTMENT ADVISERS

Prohibited transactions.

SEC. 206. It shall be unlawful for any investment adviser registered under section 203, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

Fraud, etc.

(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 as a fraud or deceit upon any client or prospective client;

Acting as principal or broker for client without consent

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction.

## MATERIAL MISSTATEMENTS

Material  
misstatements.

Sec. 207. It shall be unlawful for any person willfully to make any untrue statement of material fact in any registration application or report filed with the Commission under section 203 or 204, or willfully to omit to state in any such application or report any material fact which is required to be stated therein.

## UNLAWFUL REPRESENTATIONS

Sec. 208. (a) It shall be unlawful for any person registered under section 203 of this title to represent or imply in any manner whatsoever that such person has been sponsored, recommended, or approved, or that his abilities or qualifications have in any respect been passed upon by the United States or any agency or any officer thereof.

Unlawful  
representations.

(b) No provision of subsection (a) shall be construed to prohibit a statement that a person is registered under this title or under the Securities Exchange Act of 1934, if such statement is true in fact and if the effect of such registration is not misrepresented.

Statement of fact.

45 Stat. 881.  
15 U.S.C. §§ 78a-  
78jj; Supp. V, §§ 78c-  
78jj.

Misrepresentations.

(c) It shall be unlawful for any person registered under section 203 of this title to represent that he is an investment counsel or to use the name investment counsel as descriptive of his business unless such person is primarily engaged in the business of rendering investment supervisory services or unless his registration application as amended or as supplemented by the most recent report on file with the Commission states that such person is engaged or is about to engage primarily in the business of rendering investment supervisory services.

## ENFORCEMENT OF TITLE

Sec. 209. (a) Whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this title or of any rule or regulation prescribed under the authority thereof, have been or are about to be violated by any person, it may in its discretion require, and in any event shall permit, such person to file with it a statement in writing, under oath or otherwise, as to all the facts and circumstances relevant to such violation, and may otherwise investigate all such facts and circumstances.

Investigations.

(b) For the purposes of any investigation or any proceeding under this title, any member of the Commission or any officer thereof designated by it is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, contracts, agreements or other records which are relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in any State or in any Territory or other place subject to the jurisdiction of the United States at any designated place of hearing.

Powers of members  
of Commission.Attendance of  
witnesses, etc.

(c) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, contracts, agreements, and other records. And such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the

Contumacy.

Court order to  
compel appearance.

Service of process.

Penalty.	judicial district whereof such person is an inhabitant or wherever he may be found. Any person who without just cause shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in his or its power so to do, in obedience to the subpoena of the Commission, shall be guilty of a misdemeanor, and upon conviction shall be subject to a fine of not more than \$1,000 or to imprisonment for a term of not more than one year or both.
Self-incriminating testimony.	(d) No person shall be excused from attending and testifying or from producing books, papers, correspondence, memoranda, contracts, agreements, or other records and documents before the Commission, or in obedience to the subpoena of the Commission or any member thereof or any officer designated by it, or in any cause or proceeding instituted by the Commission, on the ground that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forfeiture; but no individual shall be prosecuted or subject to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he is compelled to testify or produce evidence, documentary or otherwise, after having claimed his privilege against self-incrimination, except that such individual so testifying shall not be exempt from prosecution and punishment for perjury committed in so testifying.
Exemption from prosecution.	
Perjury.	
Injunctions, restraining orders, etc.	(e) Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this title, or of any rule, regulation, or order hereunder, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has engaged or is about to engage in any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning any violation of the provisions of this title, or of any rule, regulation, or order thereunder, to the Attorney General, who, in his discretion, may institute the appropriate criminal proceedings under this title.
Transmittal of evidence to Attorney General.	

## PUBLICITY

Availability of information in applications, etc.	Sec. 210. (a) The information contained in any registration application or report or amendment thereto filed with the Commission pursuant to any provision of this title shall be made available to the public, unless and except insofar as the Commission, by rules and regulations upon its own motion, or by order upon application, finds that public disclosure is neither necessary nor appropriate in the public interest or for the protection of investors. Photostatic or other copies of information contained in documents filed with the Commission under this title and made available to the public shall be furnished to any person at such reasonable charge and under such reasonable limitations as the Commission shall prescribe.
Sale of photostatic copies, etc.	
Investigations.	(b) Subject to the provisions of subsections (c) and (e) of section 209, the Commission shall not make public the fact that any investigation under this title is being conducted, nor shall it make public the results of any such investigation, or any facts ascertained during any such investigation, except that the provisions of this subsection shall not apply— (1) in the case of any hearing which is public under the provisions of section 212; or

(2) in the case of a resolution or request from either House of Congress.

(c) No provision of this title shall be construed to require, or to authorize the Commission to require any investment adviser engaged in rendering investment supervisory services to disclose the identity, investments, or affairs of any client of such investment adviser, except insofar as such disclosure may be necessary or appropriate in a particular proceeding or investigation having as its object the enforcement of a provision or provisions of this title.

Disclosure of identity or affairs of clients.

#### RULES, REGULATIONS, AND ORDERS

Sec. 211. (a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this title. For the purposes of its rules or regulations the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters.

Rules, regulations, and orders

(b) Subject to the provisions of the Federal Register Act and regulations prescribed under the authority thereof, the rules and regulations of the Commission under this title, and amendments thereof, shall be effective upon publication in the manner which the Commission shall prescribe, or upon such later date as may be provided in such rules and regulations.

Publication.  
49 Stat. 800.  
44 U.S.C., Supp. V,  
§§ 301-314.

(c) Orders of the Commission under this title shall be issued only after appropriate notice and opportunity for hearing. Notice to the parties to a proceeding before the Commission shall be given by personal service upon each party or by registered mail or confirmed telegraphic notice to the party's last known business address. Notice to interested persons, if any, other than parties may be given in the same manner or by publication in the Federal Register.

Issuance of orders, notice.

(d) No provision of this title imposing any liability shall be apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

Act or omission in good faith.

#### HEARINGS

Sec. 212. Hearings may be public and may be held before the Commission, any member or members thereof, or any officer or officers of the Commission designated by it, and appropriate records thereof shall be kept.

Hearings.

#### COURT REVIEW OF ORDERS

Sec. 213. (a) Any person or party aggrieved by an order issued by the Commission under this title may obtain a review of such order in the circuit court of appeals of the United States within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, or upon any officer thereof designated by the Commission for that purpose, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside

Petition for review.

Service of copy upon Commission.

Jurisdiction of court.

Findings.  
Additional evidence.  
  
Modification of findings.  
  
Finality of court's decision.  
Review by Supreme Court.  
36 Stat. 1157.  
28 U.S.C. §§ 346, 647;  
Supp. V. § 347.  
Stay of Commission's order.

such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court affirming, modifying, or setting aside, in whole or in part, any such order of the Commission shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended.

(b) The commencement of proceedings under subsection (a) shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

#### JURISDICTION OF OFFENSES AND SUITS

Jurisdiction of courts.  
  
Venue.  
  
Judgments, etc., subject to review.  
36 Stat. 1133, 1157.  
28 U.S.C. §§ 225, 347;  
Supp. V, §§ 225, 347.  
27 Stat. 435.  
28 D. C. Code § 26.

Sec. 214. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

#### VALIDITY OF CONTRACTS

Void conditions, etc.  
  
Contracts in violation of designated provisions.

Sec. 215. (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this title and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this title, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance

of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision.

#### ANNUAL REPORTS OF COMMISSION

Sec. 216. The Commission shall submit annually a report to the Congress covering the work of the Commission for the preceding year and including such information, data, and recommendations for further legislation in connection with the matters covered by this title as it may find advisable.

Annual reports.

#### PENALTIES

Sec. 217. Any person who willfully violates any provision of this title shall, upon conviction, be fined not more than \$10,000, imprisoned for not more than two years, or both.

Penalties.

#### EMPLOYEES OF THE COMMISSION

Sec. 218. For the purposes of this title, the Commission may select, employ, and fix the compensation of such attorneys, examiners, and other experts as shall be necessary for the transaction of the business of the Commission in respect of this title without regard to the provisions of other laws applicable to the employment and compensation of officers or employees of the United States; and the Commission may, subject to the civil-service laws, appoint such other officers and employees as are necessary in the execution of the functions of the Commission and fix their salaries in accordance with the Classification Act of 1923, as amended.

Employment of experts.

42 Stat. 3488.  
5 U.S.C. §§ 661-674;  
Supp. V. §§ 673, 673c.

#### SEPARABILITY OF PROVISIONS

Sec. 219. If any provision of this title or the application of such provision to any person or circumstances shall be held invalid, the remainder of the title and the application of such provision to persons or circumstances other than those as to which it is held invalid shall not be affected thereby.

Separability of provisions.

#### SHORT TITLE

Sec. 220. This title may be cited as the "Investment Advisers Act of 1940".

Short title.

#### EFFECTIVE DATE

Sec. 221. This title shall become effective on November 1, 1940.

Effective date.

#### TITLE III—AMENDMENT OF SECURITIES ACT OF 1933

Sec. 301. Section 8 (a) of the Securities Act of 1933, as amended, is amended to read as follows:

48 Stat. 79.  
15 U.S.C. § 77b (a).

"Sec. 8. (a) Except as hereinafter provided, the effective date of a registration statement shall be the twentieth day after the filing thereof or such earlier date as the Commission may determine, having due regard to the adequacy of the information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof can be understood, and to the public interest and the protection of investors. If any amendment to any such statement is filed prior to the effective date of such statement, the registration statement shall be deemed to

Amendments.

INVESTMENT COMPANY ACT OF 1940 AND INVESTMENT  
ADVISERS ACT OF 1940

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JUNE 6 (legislative day, MAY 28), 1940.— Ordered to be printed

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Mr. WAGNER, from the Committee on Banking and Currency,  
submitted the following

**R E P O R T**

[To accompany S. 4108]

The Committee on Banking and Currency, to which was referred a bill (S. 4108) to provide for the registration and regulation of investment companies and investment advisers and for other purposes, having considered the same, reports favorably thereon, and recommends that the bill do pass.

This bill is a substitute for S. 3580, introduced March 14, 1940. The original bill was the outgrowth of an extensive study and investigation of investment trusts and investment companies conducted by the Securities and Exchange Commission pursuant to the direction of the Congress. A subcommittee held hearings on the original bill extending over a period of approximately four weeks. At these hearings, while the immediate need for national legislation regulating investment companies was conceded by virtually every witness who testified, representatives of the companies affected expressed considerable opposition to some features of the bill. Many of these joined in submitting to the subcommittee, at the close of the hearings, concrete proposals to regulate investment trusts and investment companies.

Almost immediately after the conclusion of the hearings, representatives of the investment companies and of the Securities and Exchange Commission advised the chairman of the subcommittee that they believed it might be possible for them to reach a common ground and to submit a joint recommendation as to the scope and provisions of the bill. The chairman encouraged them in this endeavor, and as a result of their cooperative efforts, the substitute bill (S. 4108) was drafted.

The substitute bill represents the result of intensive effort for a period of some five weeks by representatives of the industry and of the Commission. Not merely the principles of this bill, but also its

provisions as drafted, are strongly endorsed both by the Securities and Exchange Commission and by almost every company which appeared in opposition to the bill as originally drafted. In addition, the substitute bill is endorsed by a number of companies which did not appear either in opposition to or in support of the original bill. Thus the substitute bill, as introduced and reported, has the distinction of having the virtually unanimous support of the persons for whose regulation it provides, as well as of the regulatory agency by which it is to be administered. Representatives of the industry urged upon the committee that the present international situation should not only not be a deterrent to the enactment of this legislation but should rather serve as a vital reason for its immediate passage. As was stated by the representative of a substantial portion of the investment company industry at the close of the hearing:

\*\*\* we feel that this bill is not only a workable bill, but is a bill which is a good thing for the industry. We would like very much to see it passed, and we hope very much that it can be passed at this session. The industry would like to feel that it has regulation behind it; that is, that we may know what the regulation is to be and that we will no longer live in uncertainty as to what the future holds for us. This is the type of regulation under which the industry feels it can work and which it feels will be very beneficial to the industry. We are hopeful that if this legislation passes it will constitute a stimulus to the investment company industry's contributing to venture capital.

\*\*\* the critical period that we are going through now, rather than being a reason for postponing legislation, is, in our opinion, an added reason for passing this legislation. We feel that it would be helpful not only to the industry to have this legislation passed now, \*\*\* but also \*\*\* we feel that it is a very healthy sign that Government and industry can come together and do a constructive job of this kind.

## TITLE I. INVESTMENT TRUSTS AND INVESTMENT COMPANIES

### GENERAL STATEMENT

*Natures and types of investment trusts and investment companies.*— Investment trusts and investment companies are essentially institutions which provide a medium for public investment in common stocks and other securities. They may be divided into four broad classifications: (1) Management investment companies; (2) unit investment trusts, including the so-called “fixed trusts”; (3) periodic or installment payment plans; and (4) companies issuing face-amount certificates.

The distinctive feature of the management investment companies is that no restrictions, or only limited restrictions, are imposed with respect to the nature, type and amounts of investment which their managements may make. These companies fall into two broad classes—the open-end and the closed-end type. The peculiarity of open-end companies is that they issue so-called redeemable securities—that is, a security which provides that the holder may tender it to the company at any time and receive a sum of money approximating the current market value of his proportionate interest in the company's assets. Because of the exercise of this redemption feature, the assets of most open-end companies would constantly be shrinking if they did not continuously sell new securities to investors. It is because of this constant redemption and sales activity that these companies are called open-end companies. Closed-end companies are management investment companies which do not have

reserve on all its outstanding face-amount certificates issued prior to the effective date of the bill then the company cannot make any distribution or pay any dividend on any senior capital security which exceeds a prescribed percentage of its earnings or which the Commission determines might impair the financial integrity of the company or its ability to meet its liabilities on the outstanding certificates. In the future, face-amount certificate companies cannot issue senior capital securities in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate for the protection of investors, or if such company has such senior capital securities outstanding to make any distribution or pay any dividend in contravention of such rules and regulations as the Commission may prescribe to insure the financial integrity of the company and to prevent the impairment of the company's abilities to meet its obligations on its face-amount certificates (sec. 18). A face-amount company can acquire the securities of another face-amount company only upon certain prescribed conditions (sec. 12). The bill makes provision to obtain equality of treatment of certificate holders who are residents of various States in the event of bankruptcy of a face-amount company. The bill preserves the rights of residents in those States which require specific deposits with their State officials but makes provision for equalization of treatment of all certificate holders, by providing that residents of other States must receive an amount equal to that received by the residents of States with deposits, before the latter can share in the general assets of the bankrupt company (sec. 29).

*Unlawful representations.*—The bill contains the usual provisions prohibiting misrepresentations and half-truths in registration statements, reports and other documents filed with the Commission, and prohibiting the misrepresentation of the effect of registration with the Commission. In addition, the use of misleading names by registered investment companies is specifically prohibited. The latter provisions may be enforced by order of the Commission when the name is adopted after the effective date of the bill, and by a court at the suit of the Commission as to names theretofore adopted (secs. 34 (b), 35).

*Administrative and enforcement machinery.*—The bill contains ample provisions, but appropriately circumscribed, for the enforcement of its provisions: for the carrying out of the powers and duties vested in the Commission, and for court review of the Commission's action (secs. 38 to 46, 49).

*Formal provisions.*—The bill contains the usual provisions regarding validity of contracts, liability of controlling persons, the effect of the bill on existing law, and separability of provisions. The effective date of title I is November 1, 1940, as to all companies except face-amount certificate companies, as to which the bill does not become effective until January 1, 1941. The short title of the bill is the "Investment Company Act of 1940" (secs. 47, 48, 50 to 53).

## TITLE II. INVESTMENT ADVISERS

Title II, which deals with investment advisory services, is an outgrowth of the Commission's survey of these organizations in connection with its study of investment trusts and investment companies.

The subcommittee held hearings on the original provisions of title II as they were included in S. 3580. At these hearings representatives of the larger investment adviser firms and representatives of a voluntary association of investment advisers opposed that title. However, at the conclusion of the hearings, much as in the case of the investment trusts and investment companies, representatives of the investment adviser organizations and the Securities and Exchange Commission, at the suggestion of the chairman of the subcommittee, conferred with a view to drafting proposals which would have the support of the investment advisers and the Commission. As a result, title II of S. 4108 was prepared. This title has the affirmative support of virtually all investment advisers, both the members of the association and those who are not members, who appeared before the committee.

#### GENERAL STATEMENT

Investment advisers are persons who for compensation engage in the business of advising others, either directly or through publication or writings as to the value of securities, or as to the advisability of investing in, purchasing, or selling securities or who for compensation and as part of a regular business issue or promulgate analyses or reports concerning securities.

The emergence of the investment adviser as an important occupation or profession did not occur until the World War. However, it was not until after 1929 that the investment adviser firms organized and increased rapidly. The number of investment advisers presently functioning has been difficult to ascertain. The Commission reported to the Congress that in connection with its study of these firms, it obtained replies to questionnaires from only 394 persons or firms which administer funds or give investment advice.

Similarly, it is difficult definitely to estimate the amount of funds under the influence or control of investment advisers. However, some idea of the size of the funds administered by investment advisers may be deduced from the fact that 51 firms for which information was obtainable by the Commission managed, supervised, and gave investment advice with respect to funds aggregating approximately \$4,000,000,000.

The nature of the functions of investment advisers, their increasing widespread activities, their potential influence on security markets and the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces this committee that protection of investors requires the regulation of investment advisers on a national scale.

The report of the Commission to the Congress and the record before the committee is clear that the solution of the problems and abuses of investment advisory services—individuals and companies which either handle pools of liquid funds of the public or give advice with respect to security transactions—cannot be effected without Federal legislation.

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 the activities of these individuals. Virtually no limitations or restrictions exist with respect to the honesty and integrity of individuals who may solicit funds to be controlled, managed, and supervised.

Persons

who may have been convicted or enjoined by courts because of perpetration of securities fraud are able to assume the role of investment advisers. Individuals assuming to act as investment advisers at present can enter profit-sharing contracts which are nothing more than “heads I win, tails you lose” arrangements. Contracts with investment advisers which are of a personal nature may be assigned and the control of funds of investors may be transferred to others without the knowledge or consent of the client.

Title II recognizes that with respect to a certain class of investment advisers, a type of personalized relationship may exist with their clients. As a consequence, this relationship is a factor which should be considered in connection with the enforcement by the Commission of the provisions of this bill.

#### ANALYSIS OF PROVISIONS OF TITLE 11

*Findings and definitions.*—Sections 201 and 202 contain, respectively, the findings of the Congress with respect to investment advisers and the definitions of various terms used in title II. The term “investment adviser” is so defined as specifically to exclude banks, bank holding company affiliates, lawyers, accountants, engineers, teachers, brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive only brokerage commissions), publishers of bona fide newspapers, news magazines, or financial publications of general and regular circulation, and persons whose advice is limited to securities issued by the United States and certain instrumentalities of the United States. In addition, the Commission is authorized by rules and regulations or order, to make certain further exceptions according to prescribed statutory standards.

*Registration of investment advisers.*—Investment advisers who make use of the mails or instrumentalities of interstate commerce in connection with their investment advisory business, unless they fall within one of the specific exemptions provided in section 203 (b), are required to register by filing with the Commission an application for registration containing certain information, the character of which is specified in the bill. The administrative machinery for registration is similar to that provided in the Securities Exchange Act of 1934 for the registration of over-the-counter brokers and dealers. Registration may be denied or revoked if the registrant has within 10 years been convicted of a crime or is enjoined by a court in connection with a security or financial fraud, or if his application for registration is materially misleading. The data contained in the application for registration must be kept reasonably current by such annual and special reports as the Commission may require for that purpose (secs. 203, 204).

*Investment advisory contracts.*—Contracts or agreements between an investment adviser and a client may not provide for compensation to the investment adviser based upon capital gains or capital appreciation. Each such contract must be non-assignable, and must provide, if the investment adviser is a partnership, that the client will be notified of any change in the membership of the firm, so that he will be in a position, if he so desires, to disaffirm the contract (sec. 205).

*Certain prohibited transactions.*—Transactions and practices which defraud or operate as a fraud or deceit upon clients or prospective clients are prohibited. Registered investment advisers are also for-

bidden to purchase securities from or sell securities to any client, either as principal or in connection with a brokerage business, without first advising the client of the transaction and obtaining his consent thereto (sec. 206).

*Unlawful representations, administrative and enforcement machinery, and formal provisions.*—In these respects title II contains provisions generally comparable to those of title I (sec. 207 to 221, inclusive). Section 210, which relates to publicity, recognizes that in many instances the adviser-client relationship has a confidential basis, and provides for confidential treatment of information obtained in the administration and enforcement of the title, to the extent that such treatment is consistent with efficient enforcement.

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INVESTMENT COMPANY ACT OF 1940 AND INVESTMENT  
ADVISERS ACT OF 1940

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JUNE 18, 1940.—Committed to the Committee of the Whole House on the state  
of the Union and ordered to be printed

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Mr. COLE of Maryland, from the Committee on Interstate and  
Foreign Commerce, submitted the following

R E P O R T

[To accompany H.R. 10065]

The Committee on Interstate and Foreign Commerce to whom was referred the bill (H. R. 10065) to provide for the registration and regulation of investment companies and investment advisers, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

The amendments are as follows:

Page 12, line 9, strike out “prescribed” and insert in lieu thereof “described”.

Page 19, line 2, after the word “securities”, insert “or the issuer thereof”.

Page 20, line 3, strike out all the line and insert in lieu thereof:

so determined is not in excess of market value or asset value of such securities in the case of majority-owned subsidiaries, and is not in excess of market value in the case of other controlled companies.

Page 31, after line 23, insert a new paragraph as follows:

(3) Any company which since the effective date of this title or within five years prior to such date has been reorganized under the supervision of a court of competent jurisdiction, if (A) such company was not an investment company at the commencement of such reorganization proceedings, (B) at the conclusion of such proceedings all outstanding securities of such company were owned by creditors of such company or by persons to whom such securities were issued on account of creditors' claims, and (C) more than 50 per centum of the voting securities of such company, and securities representing more than 50 per centum of the net asset value of such company, are currently owned beneficially by not more than 25 persons; but such exemption shall terminate if any security of which such company is the issuer is offered for sale or sold to the public after the conclusion of such proceedings by the issuer or by or through any underwriter. For the purposes of this paragraph, any new company organized as part of the reorganization shall be deemed the same company as its predecessor; and beneficial ownership shall be determined in the manner provided in section 3 (c) (1).

interest either at the meeting, if any, at which such termination and removal occurs, or by instruments in writing filed with the custodian, or if not so filed within a reasonable time then at a subsequent meeting which shall be called by the trustees for the purpose. The provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at any meeting of the shareholders of such a trust held pursuant to this subsection.

Page 149, line 4, after “misleading”, strike out the comma and insert “in the light of the circumstances under which they were made”.

Page 55, line 8, after “broker”, insert “or dealer”.

Page 155, line 10, strike out “brokerage” and after the word “business” insert “as a broker or dealer”.

Page 155, line 25, at the end of the line strike out “and” and insert “control and”.

Page 156, strike out all of lines 3, 4, and 5.

Page 156, line 6, strike out “(14)” and insert “(13)”.

Page 156, lines 8 to 12, inclusive, strike out the following:

For the purposes of this paragraph the term “continuous advice” shall mean at least a quarterly review by the investment adviser of the investments of the client entrusted to his supervision.

Pages 156 and 157, renumber paragraphs (15), (16), (17), (18), (19), (20), and (21), respectively, to paragraphs (14), (15), (16), (17), (18), (19), and (20).

Page 161, strike out all of lines 5 and 6 and in lieu thereof insert the following:

(2) A statement as to whether such investment adviser is engaged or is to engage primarily in the business of rendering investment supervisory services.

Page 165, strike out all after line 17 and in lieu thereof insert the following:

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer or a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction.

Page 166, strike out all after line 19 and in lieu thereof insert the following:

(c) It shall be unlawful for any person registered under section 203 of this title to represent that he is an investment counsel or to use the name investment counsel as descriptive of his business unless such person is primarily engaged in the business of rendering investment supervisory services or unless his registration application as amended or as supplemented by the most recent report on file with the Commission states that such person is engaged or is about to engage primarily in the business of rendering investment supervisory services.

This bill is a substitute for H. R. 8935, introduced March 14, 1940, and as originally introduced was identical with S. 4108, reported favorably to the Senate on June 6, 1940, by its Committee on Banking and Currency. The Senate bill itself was a substitute for S. 3580, introduced March 14, 1940, as a companion bill to H. R. 8935.

These bills are the outgrowth of a comprehensive study and investigation of investment trusts and investment companies made by the Securities and Exchange Commission pursuant to the direction of the Congress. A subcommittee of the Senate Banking and Currency Committee held hearings on S. 3580 for a period of approximately 4 weeks

and carefully and exhaustively scrutinized and explored all of its provisions. In its consideration of this bill, your committee had before it the complete testimony on the original Senate bill and the reports of the Securities and Exchange Commission.

At the hearings before the Senate Committee on Banking and Currency the immediate need for national legislation regulating investment companies was admitted by virtually every witness who testified, but objection was made to several features of the bill. At the conclusion of these hearings the investment companies who had appeared submitted to the Senate committee specific principles for the regulation of investment trusts and investment companies. Following the submission of these counterproposals for regulation by the investment companies themselves, representatives of the Securities and Exchange Commission and of the investment companies informed the Senate Committee on Banking and Currency that it might be possible for them to reconcile their differences and to recommend a bill which would be acceptable both to the Securities and Exchange Commission and to the investment-company industry.

As a result of this cooperative effort upon the part of the Securities and Exchange Commission and the representatives of the investment-company industry, this bill, H. R. 10065, and its companion bill in the Senate, S. 4108, were recommended. They represent the result of intensive effort for a period of 5 weeks by representatives of the industry and of the Commission.

The bill as drafted has the unqualified support and endorsement of practically the entire investment-company industry and of the Securities and Exchange Commission, the body by whom the provisions of the bill are to be administered. No opposition to the bill was expressed by any witness who appeared before the subcommittee of this committee which held hearings on the bill. Every witness representing the industry who appeared, unqualifiedly endorsed the bill.

Thus this bill is a highly salutary indication that Government and business can come together in a cooperative spirit to do a constructive job. Representatives of investment companies urge that the present international situation should not only not constitute an impediment to the passage of this bill but rather should serve as a vital reason for its immediate enactment.

These representatives of the investment-company industry stressed the fact that proper and reasonable regulation of investment companies may substantially stimulate investment companies to supply new capital for the expansion of industry, particularly industries vital to the national defense, to a far greater extent than has been done in the past. To accelerate this activity upon the part of investment companies the bill expressly authorizes investment companies to contribute a portion of their capital to companies organized by themselves to underwrite the securities of, and to furnish capital to, industry.

#### TITLE I. INVESTMENT TRUSTS AND INVESTMENT COMPANIES

A detailed discussion of the background of this bill and the evils it is intended to remedy appears in the report of the Senate Banking and Currency Committee to the Senate, Report No. 1775, and the reports of the Securities and Exchange Commission to the Congress made pursuant to section 30 of the Public Utility Holding Company Act

certain types of criminal proceedings in the District of Columbia, the third sentence of the section contains a special provision making it clear that such proceedings may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business.

Section 45: Provides for confidential treatment of information filed with the Commission, and for the sale by the Commission of copies of information which is available to the public.

Sections 46, 47, and 48: Contain the usual provisions relating to annual reports, validity of contracts, liability of controlling persons, and preventing compliance.

Section 49: Contains the penalties for willful violations of the bill.

Section 50: Saving clause for existing laws.

Section 51: Separability clause.

Section 52: Short title.

Section .53: Effective date.

## TITLE II. INVESTMENT ADVISERS

Title II of the bill which deals with investment advisers is based on a survey of these organizations by the Securities and Exchange Commission made in connection with its study of investment trusts and investment companies. As in the case of title I, many of the original provisions of title II were opposed by many investment advisers who appeared at the hearings before the Senate Committee on Banking and Currency. However, at the conclusion of these hearings, the representatives of the Securities and Exchange Commission and of those investment advisers who opposed the provisions of the original title II met and as a result of their cooperative endeavors the present title II was drafted. As now drafted, the title has the approval and endorsement of the investment advisers who appeared at the hearings before the committee. In addition, the title is unqualifiedly endorsed by the Investment Counsel Association of America and by a large number of investment advisory organizations which did not testify before the congressional committee.

## GENERAL STATEMENT

Investment advisers are persons who for compensation engage in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities or who for compensation and as part of a regular business, promulgate analyses or reports concerning securities. The provision or occupation of investment adviser came into being after the World War and since 1929 the number of individuals and firms engaged in this vocation has increased rapidly. Although it is difficult to determine with precision the amount of public funds administered by investment advisers, some idea of the size of such funds may be deduced from the fact that only 51 firms for which information was available to the Securities and Exchange Commission, managed, supervised, and gave investment advice with respect to funds aggregating approximately \$4,000,000,000, a sum roughly equivalent to the entire assets of all investment trusts and investment companies now operating.

The essential purpose of title II of the bill is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful. The title also recognizes the personalized character of the services of investment advisers and especial care has been taken in the drafting of the bill to respect this relationship between investment advisers and their clients.

The title requires investment advisers doing business by the use of the mails and facilities of interstate commerce to register with the Commission, which is empowered to deny or revoke the registration only of individuals convicted or enjoined by the courts for securities fraud or who have made misleading statements in their registration statements.

#### ANALYSIS BY SECTIONS

Section 201. Findings.	Section 212. Hearings.
Section 202. Definitions.	Section 213. Court review or orders.
Section 203. Registration of investment advisers.	Section 214. Jurisdiction of offenses and suits
Section 204. Annual and other reports.	Section 215. Validity of contracts.
Section 205. Investment advisory contracts.	Section 216. Annual reports of commission.
Section 206. Prohibited transactions by registered investment advisers.	Section 217. Penalties.
Section 207. Material misstatements.	Section 218. Employees of the Commission.
Section 208. Unlawful representations.	Section 219. Separability of provisions.
Section 209. Enforcement of title.	Section 220. Short title.
Section 210. Publicity.	
Section 211. Rules, regulations, and orders.	

#### *Section 201. Findings*

This section recites the findings of the Congress with respect to investment advisers based on the report of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935 and facts otherwise ascertained.

#### *Section 202. Definitions*

This section defines the general terms used in the title. The term “investment adviser” is so defined as specifically to exclude banks, bank holding company affiliates, lawyer, accountants, engineers, teachers, brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive brokerage commissions), publishers of bona fide newspapers, news magazines, or financial publications of general and regular circulation and persons whose advice is limited to securities issued by the United States and certain instrumentalities of the United States. In addition, the Commission is authorized by rules and regulations or order to make certain further exceptions according to prescribed standards.

#### *Section 203. Registration of investment advisers*

Subsection (a) makes it unlawful for any investment adviser, unless he falls within one of the specific exemptions provided for in subsection (b), to make use of the mails or any means or instrumentality of interstate commerce in connection with his business unless regis-

tered with the Securities and Exchange Commission as provided in subsection (c).

Subsection (b) exempts from the registration requirement (1) an investment adviser, all of the clients of whom reside in the State in which such adviser maintains his place of business and who does not furnish advice as to securities traded on national securities exchanges; (2) an investment adviser whose only clients are investment companies or insurance companies; and (3) any investment adviser who during any year had less than 15 clients and who does not hold himself out to the public as an investment adviser.

Subsection (c) provides that investment advisers may register by filing an application for registration containing certain information the character of which is specified in the bill. The administrative machinery for registration is similar to that provided in the Securities Exchange Act of 1934 for the registration of over-the-counter brokers and dealers.

Subsection (d) provides that registration of an investment adviser may be denied or revoked by the Commission if the registrant has within 10 years been convicted of a crime or is enjoined by a court in connection with a security or financial fraud, or if his application for registration is materially misleading.

Subsection (e) provides that the commencement of a proceeding to deny registration shall not operate to postpone the effective date of registration unless the Commission shall find such postponement necessary in the public interest and shall so order.

Subsection (f) provides that a successor of a registered investment adviser shall be deemed to be registered if within 30 days from its succession to the business it files an application for registration with the Commission.

Subsection (g) permits investment advisers to withdraw their registration on such terms and conditions as the Commission finds necessary in the public interest and for the protection of investors.

#### *Section 204. Annual and other reports*

This section provides that the data contained in the application for registration must be kept reasonably current by such annual and special reports as the Commission may require for that purpose.

#### *Section 205. Investment advisory contracts*

In order to prohibit arrangements for contingent compensation to investment advisers based on profit-sharing arrangements with clients which encourage advisers to take undue risks with the funds of clients, this section provides that contracts between advisers and clients may not provide for compensation to the investment adviser based upon capital gains or capital appreciation. However, compensation based on the total value of a fund to be administered is not prohibited. Contracts between an investment adviser and his client must be nonassignable by the investment advisers without the consent of the client, and if the investment adviser is a partnership, the client must be notified of any change in the membership of the firm.

*Section 206. Prohibited transactions by registered investment advisers*

This section makes unlawful transactions and practices by investment advisers which defraud or operate as a fraud or deceit upon clients or prospective clients. Registered investment advisers are also forbidden to purchase securities from or sell securities to any client, either as principal or as broker for another person, without first advising the client of the transaction and obtaining his consent thereto.

*Section 207. Material misstatements*

This section makes it unlawful for any person willfully to make any untrue statement of material fact or to omit to state any material fact in any registration statement or report filed with the Commission pursuant to sections 203 and 204.

*Section 280--221, inclusive. Unlawful representations, administrative and enforcement machinery*

These sections contain provisions comparable to those in title I. Section 210, which relates to publicity, recognizes that in many instances the adviser-client relationship is a personalized one and provides for confidential treatment of information obtained in the administration and enforcement of the title, to the extent that such treatment is consistent with efficient enforcement.

## CHANGES IN EXISTING LAW

In compliance with paragraph 2a of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill are shown as follows (new matter is printed in italic and existing law in which no change is proposed is shown in roman):

Section 44 of the act entitled "An act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, as amended:

Sec. 44. TRUSTEES: CREDITORS' COMMITTEES: AND ATTORNEYS.—a. The creditors of a bankrupt, exclusive of the bankrupt's relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors or trustees or of other similar controlling bodies, shall, at the first meeting of creditors after the adjudication, or after a vacancy has occurred in the office of trustee, or after an estate has been reopened, appoint a trustee or three trustees of such estate. If the creditors do not appoint a trustee or if the trustee so appointed fails to qualify as herein provided, the court shall make the appointment.

*If the bankrupt is a face-amount-certificate company, as defined in section 4 of the Investment Company Act of 1940, the court alone shall make the appointment: but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard.*

b. Such creditors may, at their first meeting, also appoint a committee of not less than three creditors, which committee may consult and advise with the trustee in connection with the administration of the estate, make recommendations to the trustee in the performance of his duties and submit to the court any question affecting the administration of the estate.

c. An attorney shall not be disqualified to act as attorney for a receiver or trustee merely by reason of his representation of a general creditor.

Section 67 of the said act of July 1, 1898, as amended:

Sec. 67. LIENS AND FRAUDULENT TRANSFERS.—a. (1) Every lien against the property of a person obtained by attachment, judgment, levy, or other legal