SECURITIES AND EXCHANGE COMMISSION

AGENCY: Securities and Exchange Commission.

17 CFR Part 275

PROPOSED RESCISSION OF A RULE EXCLUDING FROM REGISTRATION AS INVESTMENT ADVISERS CERTAIN PERSONS WHO OFFER INVESTMENT ADVICE TO EMPLOYEE BENEFIT PLANS SPONSORED BY THEIR EMPLOYERS

[Release No. IA-870; File No. S7-984]

July 21, 1983

ACTION: Proposed rescission of a rule.

SUMMARY: The Commission is requesting public comments on the proposed rescission of a rule under the Investment Advisers Act of 1940 which rule excludes from the definition of investment adviser a person who offers investment advice to an employee benefit plan (as defined in the Employee Retirement Income Security Act of 1974) sponsored by an employer of such person, if such person is not engaged in the business of providing investment advice or management to others, and does not hold himself out generally to the public as an investment adviser. Rescission of the rule would permit a person providing investment advice to an employee benefit plan sponsored by his employer to register voluntarily with the Commission even though registration of such person under the Advisers Act may not be required.

DATE: Comments should be received on or before August 22, 1983.

ADDRESSES: Comments should be submitted in triplicate to: George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549. Comment letters should refer to File No. S7-984. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, Room 1026, 450 Fifth Street NW., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT:

Forrest R. Foss, Office of Regulatory Policy, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Washington, D.C. 20549, (202) 272-2079.

TEXT:
SUPPLEMENTARY INFORMATION:

I. Introduction

Rule 202-1 [17 CFR 275.202-1] under the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. 80b-1 et seq.] generally prohibits persons who serve as in-house investment managers of employee benefit plans from registering as investment advisers under the Advisers Act. n1 The Commission has concluded that Rule 202-1 no longer is necessary or appropriate in the public interest and, accordingly, the Commission proposes to rescind it.

> n1 Rule 202-1 provides: "The term 'investment adviser,' in Section 202(a)(11) of the [Advisers] Act, shall not include any person who offers investment advice to an employee benefit plan, as defined in the Employee Retirement Income Security Act of 1974, sponsored by an employer of such person, if such person is not engaged in the business of providing investment advice or management to others and does not hold himself out generally to the public as an investment adviser. For purposes of this rule 'person' shall include a natural person, or a company which is

controlled by or under common control with the employer, and 'employer' shall include any company controlling, controlled by or under common control with a person."

II. Discussion

The Employee Retirement Income Security Act of 1974 [29 U.S.C. Section 1001 et seq.] ("ERISA"), which took effect in January 1975, provides a comprehensive system of regulation for private sector employee benefit plans. As a result of certain provisions of ERISA, the Commission, after enactment of ERISA, received a number of applications for investment adviser registration from in-house asset managers of employee benefit plans. Generally, the investment advisory activities of such persons consisted solely of giving advice to an ERISA-covered employee benefit plan sponsored by their employers.

It is not uncommon for an employee benefit plan to manage all or a portion of the plan's assets internally rather than engage an outside manager for such assets. Employee benefit plans managing pension plan assets "in-house" typically utilize the services of employees of the employer-sponsor or of its affiliates (companies controlling, controlled by or under common control with the employer sponsor) to manage plan assets. Although an employee providing investment advisory services to the plan sponsored by his employer might fall within the Advisers Act definition of investment adviser, the advisory activities of such person would typically be limited to services performed for the employer and its employee benefit plans, and the employee therefore would generally be exempt from registration pursuant to Section 203(b)(3) of the Advisers Act [15 U.S.C. 80-3(b)(3)] because he would have had fewer than 15 clients in the preceding year and would not be holding himself out to the public as an investment adviser. An affiliate whose business is limited to providing investment advisory services to fewer than 15 companies and employee benefit plans within the control group generally also would be excepted from registration under Section 203(b)(3). n2 Nevertheless, following the passage of ERISA, a number of in-house asset managers of employee benefit plans whose registration under the Advisers Act was not required sought to register voluntarily with the Commission.

n2 Other bases for excluding such employees and affiliates from Commission regulation under the Advisers Act also may exist, depending on the facts and circumstances. For example, in some cases such persons might not be deemed to be engaged in the business of providing investment advice to others and, therefore, would not be investment advisers under the Section 202(a)(11) definition.

It appeared that the motive for such voluntary registration was to enable an in-house investment adviser to an employee benefit plan covered under Title I of ERISA to qualify as an "investment manager" under Section 3(38) of ERISA [29 U.S.C. 1002(38)]. That section defines investment manager to include investment advisers registered with the Commission under the Advisers Act, banks as defined in the Advisers Act, and certain insurance companies. Under Section 405(d)(1) n3 of ERISA [29 U.S.C. 1105(d)(1)], if an investment manager as defined in Section 3(38) is appointed for the plan, plan trustees are not liable for the acts or omissions of such manager nor are they obliged to invest or manage plan assets subject to the management of the investment manager. In some cases it appeared that employers were encouraging or even requiring employees who gave investment advice to employee benefit plans covered under ERISA to register voluntarily as investment advisers with the Commission, notwithstanding the fact that such registration was not required under the Advisers Act.

n 3 ERISA Section 405(d)(1) provides that: "If an investment manager or managers have been appointed under Section 402(c)(3) of this title [29 U.S.C. 1102(c)(3)], then, notwithstanding subsections (a) (2) and (3) and subsection (b) of this section, no trustee shall be liable for the acts of omissions of such investment manager or managers, or be under an obligation to invest or otherwise manage any asset of the plan which is subject to the management of such investment manager."

The Commission was concerned that its registration process under the Advisers Act not be used in a manner which would be detrimental to the protections afforded to plans and their participants under ERISA and, in March of 1976, adopted Rule 202-1, which generally excludes from the definition of

investment adviser persons whose only investment advisory activities consisted of giving advice to an employee benefit plan sponsored by their employer. n4 After adoption of Rule 202-1, most in-house plan managers who appeared to have voluntarily registered with the Commission as investment advisers withdrew their registrations at the request of the Commission staff. A number of such persons, however, continued to be registered with the Commission because they had or intended to seek clients other than employee benefit plans. n5

n 4 Advisers Act Release No. 503 [41 FR 12878, March 29, 1976]. Rule 202-1 was proposed in Advisers Act Release No. 478 [40 FR 46118, October 6, 1975].

n 5 By its terms, the exclusion from the definition of investment adviser provided by Rule 202-1 is not available to persons engaged in the business of providing investment advice to others or holding themselves out to the public as investment advisers. Because Section 203(c)(1) of the Advisers Act provides that an investment adviser "or any person who presently contemplates becoming an investment adviser" may register with the Commission, a person who represents that he intends to engage in activities not covered by Rule 202-1 would be permitted to register. Since the adoption of Rule 202-1, several in-house managers have been permitted to register where it appeared that the existing or proposed activities of such persons might cause them not to fall within the terms of Rule 202-1.

The Commission has considered the continued need for Rule 202-1 and determined to propose that the rule be rescinded. The Commission believes that doing so would not undermine the concept of "investment manager" as defined in Section 3(38) of ERISA. In concluding that investment advisers registered under the Advisers Act could qualify as "investment managers", Congress presumably determined that the protections for employee benefit plans and their participants n6 provided by the Advisers Act justified permitting plan trustees who appoint an "investment manager" to manage plan assets to limit their responsibility for the investment adviser and to limit their liability for the acts or omissions of such managers, pursuant to Section 405(d)(1) of ERISA. In this regard, the Commission is not aware of anything in ERISA or its legislative history which suggests that an in-house asset manager of an employee benefit plan should be treated differently under ERISA from an outside asset manager with respect to qualification as an "investment manager". Moreover, it is important to note that, even in those situations in which the plan trustees appoint an "investment manager", thereby benefiting from the limitations on their responsibility and liability provided in Section 405(d)(1), they remain subject to their fiduciary duties under ERISA, which include acting prudently and solely in the interest of plan participants and beneficiaries in selecting and monitoring the performance of such asset manager. n7 Accordingly, it would not appear to be necessary for the protection of the employee benefit plan clients of in-house plan managers for the Commission to exclude such persons from registration under the Advisers Act.

n 6 Persons who voluntarily register under the Advisers Act, in circumstances where their registration may not be required, are, of course, subject to all the provisions and rules under the Advisers Act applicable to persons required to register. See letter re Weiss, Barton Asset Management, available March 12, 1981.

n 7 See ERISA Conference Report, H.R. Rep. No. 93-1280, 93d Cong. 2d Sess. (1974) at 302.

Finally, in certain circumstances, the effect of Rule 202-1 may be to diminish the effectiveness of the Commission's efforts to administer the Advisers Act in the public interest and for the protection of investors. The Commission staff conducts periodic examinations of the records and operations of registered investment advisers. These inspections often uncover deficiencies in an adviser's operations relating to its compliance with the Advisers Act or its adherence to its fiduciary duties to its clients. Some of these deficiencies, if not corrected, could result in significant harm to clients including loss of client assets. In most cases when deficiencies are uncovered, the Commission staff and the registrant agree informally to appropriate remedial action. However, a difficult situation arises if it appears that the registrant should be excluded from registration by virtue of Rule 202-1. Deregistration in such circumstances, while consistent with Rule 202-1, would deny the Commission the opportunity to monitor the adviser's activities to determine whether the deficiencies recurred, a result which would not appear

to be in the public interest or consistent with the protection of investors. For the foregoing reasons the Commission seeks public comment on the proposed rescission of Rule 202-1 under the Investment Advisers Act.

Regulatory Flexibility Act

The Chairman of the Commission has certified that the proposed amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.

List of Subjects in 17 CFR Part 275

Investment advisers, Reporting requirements, Securities.

Commission Action

It is proposed to amend Part 275 of Chapter II of the Code of Federal Regulations under the Investment Advisers Act of 1940 by removing § 275.202-1.

PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

§ 275.202-1 Exclusion of certain persons who offer investment advice to their employer-sponsored employee benefit plans.

§ 275.202-1 [Removed].

Statutory Authority

The Commission hereby proposes to rescind Rule 202-1 pursuant to the authority contained in Section 211(a) of the Advisers Act (15 U.S.C. 80b-11(a)).

By the Commission.
Dated: July 15, 1983.
Shirley E. Hollis,
Assistant Secretary.

Regulatory Flexibility Act Certification

I, John S. R. Shad, Chairman of the Securities and Exchange Commission, hereby certify, pursuant to 5 U.S.C. 605(b), that the rescission of Rule 202-1 under the Investment Advisers Act of 1940 ("Advisers Act") will not have a significant economic impact on any entity, and therefore will not have a significant impact on a substantial number of small entities. The reason for this certification is that rescission of Rule 202-1 will permit, but not require, the voluntary registration of certain persons as investment advisers. In this regard, the costs of registration are not such that persons choosing to voluntarily register would be deterred in doing so, and those advisers who chose not to register would of course not incur any cost. Accordingly, rescission would not be expected to have any significant economic effect on these persons.

Dated: July 14, 1983.

John S. R. Shad,
Chairman.

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