

SECURITIES AND EXCHANGE COMMISSION

AGENCY: Securities and Exchange Commission.

17 CFR Part 275

RECORDKEEPING BY INVESTMENT ADVISERS

[Rel. No. IA-1135; File No. S7-34-87]

53 FR 32033

August 23, 1988

ACTION: Adoption of rule amendments.

SUMMARY: The Commission is adopting amendments to the recordkeeping rule under the Investment Advisers Act of 1940. The amendments require registered investment advisers to keep for Commission inspection all of their advertisements and to make and keep all records necessary to form the basis for performance information in their advertisements. The rule amendments permit Commission staff to examine advisers' advertisements and the basis for performance information in their advertisements for compliance with the antifraud provisions of the Investment Advisers Act of 1940.

EFFECTIVE DATE: October 20, 1988.

FOR FURTHER INFORMATION CONTACT: Dorothy M. Donohue, Attorney, or Robert E. Plaze, Special Counsel, (202) 272-2107, Office of Disclosure and Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Mail Stop 5-2, Washington, DC 20549.

TEXT:

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") today is amending Rule 204-2 (17 CFR 275.204-2) under the Investment Advisers Act of 1940 ("Advisers Act") (15 U.S.C. 80b-1 et seq.). The amendments, among other things, require an adviser that advertises performance to maintain records substantiating any performance figure.

Discussion

On November 5, 1987, the Commission proposed amendments to the investment adviser recordkeeping rule that would require registered investment advisers ("advisers") to keep all of their advertisements and all documents necessary to form the basis for performance information in advertisements ("supporting records"). The proposed amendments would require advertisements and supporting records to be kept for five years from the end of the fiscal year in which the advertisement was last published or otherwise disseminated. n1 The Commission received letters from four commenters, all of whom supported the purpose of the proposed rule amendments -- to deter the use of false or misleading performance information by advisers. n2 The commenters also suggested specific modifications to the proposed recordkeeping requirements. The Commission has decided to adopt the proposed amendments to the recordkeeping rule substantially as proposed, but modified to reflect several of the comments received.

In the release proposing the amendments, the Commission explained that they were designed to permit examination of adviser advertisements for compliance with Rule 206(4)-1 (17 CFR 275.206(4)-1) under the Advisers Act which, among other things, prohibits false or misleading advertisements by advisers. None of the commenters objected to the requirement that advisers substantiate advertised performance information; three, however, were concerned that the proposed amendments might require advisers advertising the performance of managed accounts to keep all documents of original entry from which

information is inputted into an adviser's client accounting system. They asserted that this would require an adviser to retain a considerable amount of paper, the storage of which would be very expensive. To alleviate these concerns, the Commission has clarified the recordkeeping requirement for advisers advertising the performance of managed accounts. Rule 204-2(a)(16), as adopted, permits an adviser to substantiate advertised performance by retaining all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts ("worksheets") and by retaining all account statements, if the statements reflect all debits, credits, and other transactions in a client's account ("account statements").ⁿ³ The Commission believes that account statements prepared for clients contemporaneously with the period reported will ordinarily be sufficient to substantiate advertised performance of managed accounts when accompanied by worksheets that transform the account information into performance figures.

If advertised adviser performance consists of performance other than that of managed accounts,ⁿ⁴ the adviser is required to prepare and retain whatever documents are necessary to substantiate performance data.ⁿ⁵ For example, under the rule as adopted, an adviser advertising the performance of written recommendations is required to document the nature of the recommendations, when they were made, and any assumptions made to compute performance, e.g., that the customer acted on the recommendations at a given time.ⁿ⁶

Three commenters argued that adoption of the amendments requiring advisers to substantiate their advertised performance would, in effect, preclude advisers who have not retained the required documentation from advertising performance data for periods prior to adoption of the amendments. One pointed out that advisers are only required to keep the type of records necessary to substantiate the performance of managed accounts for the most recent five years.ⁿ⁷ Three commenters pointed out, however, that most advisers keep account statements. The Commission believes, therefore, that advisers should be able to meet the revised rule requirements for managed accounts.

Finally, one commenter pointed out that the proposed amendments would require advisers to retain and substantiate performance information in documents not distributed to the public. The Commission has modified the rule amendments to require an adviser to keep all of its advertisements but to except from the recordkeeping and substantiation requirements communications distributed solely to persons connected with the adviser.ⁿ⁸

Regulatory Flexibility Act Analysis

A summary of the Initial Regulatory Flexibility Analysis, which was prepared in accordance with 5 U.S.C. 603, was published in Investment Advisers Act Release No. 1093. No comments were received on this analysis. The Commission has prepared a Final Regulatory Flexibility Analysis, a copy of which may be obtained by contacting Dorothy M. Donohue, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street NW., Mail Stop 5-2, Washington, DC 20549.

List of Subjects in 17 CFR Part 275

Investment Advisers, Reporting and recordkeeping requirements.

Test of Rule

Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

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

1. The authority citation for Part 275 is amended by adding the following citation:

Authority: Sec. 203, 15 U.S.C. 80b-3; Sec. 204, 15 U.S.C. 806b-4; Sec. 206A, 15 U.S.C. 80b-6A; Sec. 211, 15 U.S.C. 80b-11 * * * Sec. 275.204-2 is also issued under Sec. 206, 15 U.S.C. 80b-6.

2. Section 275.204-2 is amended by revising paragraphs (a)(11) and (e)(1), and adding paragraphs (a)(16) and (e)(3) as follows:

§ 275.204-2 Books and records to be maintained by investment advisers.

(a) * * *

(11) A copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser), and if such notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication recommends the purchase or sale of a specific security and does not state the reasons for such recommendation, a memorandum of the investment adviser indicating the reasons therefor.

* * * * *

(16) All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser); provided, however, that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph.

* * * * *

(e)(1) All books and records required to be made under the provisions of paragraphs (a) to (c)(1), inclusive, of this rule (except for books and records required to be made under the provisions of paragraphs (a)(11) and (a)(16) of this rule), shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the investment adviser.

* * * * *

(3) Books and records required to be made under the provisions of paragraphs (a)(11) and (a)(16) of this rule shall be maintained and preserved in an easily accessible place for a period of not less than five years, the first two years in an appropriate office of the investment adviser, from the end of the fiscal year during which the investment adviser last published or otherwise disseminated, directly or indirectly, the notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication.

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By the Commission.

August 17, 1988.

Shirley E. Hollis,
Assistant Secretary.
[FR Doc. 88-19067 Filed 8-22-88; 8:45 am]

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ENDNOTES

n 1 Investment Advisers Act Rel. No. 1093 (Nov. 5, 1987) (52 FR 43343 (Nov. 12, 1987)).

n 2 The comment letters and a summary of comments prepared by the Commission staff are contained in File No. S7-34-87.

n 3 An adviser complying with paragraph (a)(16) by retaining account statements must retain all account statements, whether or not a particular account is included in the computation of a performance figure.

n 4 Under the rule, of course, an adviser must be able to substantiate each performance figure advertised.

n 5 Investment companies have been able to comply with rule 31a-1(a) (17 CFR 240.31a-1(a)), a similar provision requiring investment companies to retain all "documents * * * which constitute the record forming the basis for financial statements." Rule 31a-1(a) is almost identical to Section 31(a) (15 U.S.C. 80a-31(a)) of the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.). Paragraph (a)(16) of rule 204-2, as proposed and adopted, is patterned after rule 31a-1(a).

n 6 Supporting records for advertised performance must be made contemporaneously with the recommendations or assumptions made. However, data published or generated subsequently but accumulated contemporaneously with the events could be used to compute and substantiate advertised adviser performance (e.g., Standard and Poor Corporation's Daily Stock Price Record could be used to document stock prices at which the adviser's recommendations were made or the closing positions of market indices).

n 7 See Rule 204-2: paragraph (a)(3) (memoranda of orders and instructions relating to purchases and sales of securities by adviser); paragraph (a)(7) (written communications relating to securities recommendations and purchase and sale orders by adviser); paragraph (a)(10) (written agreements between adviser and clients); paragraph (a)(11) (certain advertisements distributed by adviser that recommend the purchase or sale of specific securities); paragraphs (b) (1), (2), and (3) (journals, ledger accounts, and copies of confirmations relating to purchase or sale of certain securities by adviser); and paragraph (c)(1) (records relating to purchase and sale of certain clients' securities by adviser).

n 8 See Rule 204-2(a)(11) (17 CFR 275.204-2(a)(11)).