Company Act. Revised proposed rule 3a–4 would require Form N–3a4 to be filed by sponsors of programs intending to rely on the rule.

Finally, the Commission is requesting comment with respect to the application of certain provisions of the Advisers Act to investment advisers participating in investment advisory programs. These comments will be considered in the preparation of an interpretive release dealing with certain issues raised under the Advisers Act by investment advisory programs.

I. Background

In recent years, there has been a proliferation of investment advisory programs that typically are designed to provide professional portfolio management services to a large number of individual clients. These programs have historically been marketed to clients who are investing an amount of money less than the amount otherwise required by portfolio managers but more than the minimum account size of most mutual funds.

Investment advisory programs typically are organized and administered by a sponsor, which provides, or arranges for the provision of, asset allocation advice and administrative services.[2] In some programs, the sponsor or its employees also provide portfolio management services, including the selection of particular securities, to the program's clients. In other programs, the sponsor selects, or provides advice to clients regarding the selection of, a portfolio manager (which may or may not be affiliated with the sponsor).[3] In these programs, the sponsor generally is responsible for continuously monitoring the portfolio manager selected and its management of client accounts. The sponsor, rather than the portfolio manager, often serves as the primary contact for the client in connection with the program.[4] The sponsor and the portfolio managers usually meet the definition of ''investment adviser'' under the Advisers Act[5] and are required to register under that Act,[6] unless they are excepted from the definition of investment adviser[7] or exempted from registration.[8]

Included among these investment advisory programs are those commonly referred to as ''wrap fee programs.'' In a wrap fee program, the client is typically provided with portfolio management, execution of transactions, asset allocation, and administrative services for a single fee based on assets under management.[9] As of year-end 1994, assets in wrap fee programs totaled approximately $116.8 billion, an increase of 42 percent over a two-year period.[10]

Under wrap fee and other investment advisory programs, a client's account typically is managed on a discretionary basis in accordance with pre-selected investment objectives. Clients with similar investment objectives often receive the same investment advice and may hold the same or substantially the same securities in their accounts. In light of this similarity of management, some of these investment advisory programs meet the definition of investment company under the Investment Company Act, and can be deemed to be issuing securities for purposes of the Securities Act of 1933 (''Securities Act'').[11]

Section 3(a)(1) of the Investment Company Act defines the term investment company generally to include any ''issuer'' which is engaged primarily in the business of investing, reinvesting, or trading in securities.[12] The definition of issuer includes any organized group of persons, whether or not incorporated, that issues or proposes to issue any security.[13] An investment advisory program could be considered to be an issuer because the client accounts in the program, taken together, could be considered to be an organized group of persons.[14] Investors in the program could be viewed as purchasing securities in the form of investment contracts.[15] If an investment advisory

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[2] The sponsor is often a broker-dealer or mutual fund adviser or, in some instances, a bank or money management firm. See, *e.g.*, Wall Street Preferred Money Managers, Inc. (pub. avail. Apr. 10, 1992) (broker-dealer); Strategic Advisers Inc. (pub. avail. Dec. 13, 1988) (mutual fund adviser); Atlantic Bank of New York (pub. avail. June 7, 1991) (bank). The sponsor also may execute some or all of the transactions in client accounts.

[3] More than one portfolio manager may manage the client's assets, depending on the program, the client's investment objectives, and the size of the client's account. *See, e.g.*, Westfield Consultants Group (pub. avail. Dec. 13, 1991); Rauscher Pierce Refsnes, Inc. (pub. avail. Apr. 10, 1992); Wall Street Preferred Money Managers, Inc., *supra* note .

[4] Some investment advisory programs, however, are marketed by the sponsor through unaffiliated investment advisers, such as small financial planners. In some of these programs, the unaffiliated investment adviser rather than the sponsor may serve as the primary contact for its clients that participate in the program. *See, e.g.*, Westfield Consultants Group, *supra* note .

[5] 15 U.S.C. 80b-1 *et seq.*

[6] Section 203(a) of the Advisers Act (15 U.S.C. 80b–3(a)) requires any person who meets the definition of investment adviser and is not otherwise exempt from registration to register with the Commission. Section 202(a)(11) of the Advisers Act (15 U.S.C. 80b–2(a)(11)) defines ''investment adviser'' as ''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 . . . .''

[7] See section 202(a)(11)(A)–(F) of the Advisers Act (15 U.S.C. 80b–2(a)(11)(A)–(F)) (persons excepted from the definition of investment adviser). A sponsor of an investment advisory program that is a broker-dealer or a registered representative of a broker-dealer generally cannot rely on the exception from the definition of investment adviser for broker-dealers in section 202(a)(11)(C) of the Advisers Act. *See, e.g.*, National Regulatory Services, Inc. (pub. avail. Dec. 2, 1992). That exception is available only to a broker-dealer that provides investment advice that is ''solely incidental'' to its brokerage business and that does not receive special compensation for the investment advice. Id. The staff is of the view that an investment advisory program generally is not incidental to a sponsor's broker-dealer business and, at least in a wrap fee program, the sponsor's portion of the wrap fee is special compensation. *Id.*

[8] *See* section 203(b) of the Advisers Act (15 U.S.C. 80b-3(b)) (persons exempted from registration). Unlike a person excepted from the definition of investment adviser, a person that meets the definition but is exempted from registration remains subject to the Advisers Act's antifraud provision, section 206 (15 U.S.C. 80b–6). The exemption from registration provided in section 203(b)(3) of the Advisers Act would not be available as a general matter to the sponsor or portfolio manager of an investment advisory program because participation in the program would cause the sponsor or portfolio manager to be holding itself out to the public as an investment adviser. *See, e.g.*, Resource Bank & Trust (pub. avail. Mar. 29, 1991).

[9] *See* paragraph (g)(4) of rule 204–3 under the Advisers Act (17 CFR 275.204–3(g)(4)) (defining wrap fee program for purposes of wrap fee brochure requirement).

[10] The Cerulli Report, The State of the Wrap Account Industry 3 (1995). According to this report, assets in mutual fund wrap programs, also called mutual fund asset allocation programs, represented 11% of total assets in wrap fee programs as of year-end 1994. These programs differ from traditional wrap fee programs, in part, in that a client's assets are allocated only among specified mutual funds.

[11] 15 U.S.C. 77a *et seq.* See In the Matter of Clarke Lanzen Skalla Investment Firm, Inc., Investment Company Act Release No. 21140 (June 16, 1995); *SEC* v. *First National City Bank*, Litigation Release No. 4534 [1969–1970 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92592 (Feb. 6, 1970).

[12] 15 U.S.C. 80a–3(a)(1).

[13] Section 2(a)(22) of the Investment Company Act defines issuer generally to include any person who issues any security (15 U.S.C. 80a–2(a)(22)). Under section 2(a)(28), a person includes a company, and under section 2(a)(8), a company includes any organized group of persons, whether incorporated or not (15 U.S.C. 80a–2(a)(28), 2(a)(8)).

[14] The accounts managed by a particular portfolio manager also can be considered an organized group of persons under certain circumstances. The legislative history of the Investment Company Act explained that one type of investment company involves ''an agency relationship between the individual contributors to the fund and the management upon whom they confer substantially a power of attorney to act as agent in the investment of the moneys contributed. The group of individual investors is not a legal entity but rather constitutes in essence a combination of distinct individual interests.'' H.R. Doc. No. 707, 75th Cong., 3rd Sess. 24 (1939). In *Prudential Insurance Co. of America* v. *SEC*, the court, citing this legislative history, found that an organized group of persons does not refer only to identifiable business entities. 326 F.2d 383 (3rd Cir.), *cert. denied*, 377 U.S. 953 (1964).

[15] The definition of security in both section 2(a)(36) of the Investment Company Act (15 U.S.C.

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