program is deemed to be an ''issuer,'' it also would be deemed to be an investment company because it is engaged in the business of investing, reinvesting, or trading in securities.

The status of investment advisory programs under the Investment Company Act and the Securities Act has been a subject of debate for twenty-five years. In 1972, the Commission established the Advisory Committee on Investment Management Services for Individual Investors (''Advisory Committee'') to assist the Commission in developing policies regarding these programs.[16] The Advisory Committee published a report generally concluding that an investment advisory program should not be required to register under the Investment Company Act as long as the program's clients maintain all indicia of ownership of the securities in their accounts, thereby avoiding the ''pooling'' of client assets.[17]

In 1980, the Commission proposed rule 3a–4 under the Investment Company Act, which would have provided a safe harbor from the definition of investment company for investment advisory programs meeting the conditions of the rule.[18] The proposed rule would have required that: (i) The client receive continuous advice based on its individual needs; (ii) the persons authorized to make investment decisions have significant contact with the client, as described in the rule; (iii) each client maintain all indicia of ownership of the securities in its account; and (iv) each client have the opportunity and authority to instruct the person managing its account to refrain from purchasing particular securities that otherwise might be purchased. The Commission expressed the view that when an investment manager provides each client with individualized treatment, the likelihood of a common enterprise existing among a group of advisory clients is substantially reduced and no investment company is created.[19]

Commenters generally opposed the proposed rule, arguing, among other things, that the rule's conditions were burdensome, would cause unnecessary changes in industry practice, and were too detailed for purposes of a safe harbor rule.[20] In contrast, one commenter argued that the proposed rule would have permitted programs that are *de facto* investment companies to be excluded from regulation under the Investment Company Act merely by meeting ''mechanistic and ritualistic conditions,'' the performance of which is not indicative of individualized investment advice being provided.[21] The proposed rule was never adopted.

Since the proposal of rule 3a–4, the Division of Investment Management (''Division'') has responded to numerous inquiries with respect to the status of wrap fee and other types of investment advisory programs under the Investment Company Act. The Division has issued over 20 letters to persons requesting assurance that the Division would not recommend that the Commission bring enforcement action with respect to investment advisory programs that are not registered under the Investment Company Act (the ''no-action letters'').[22] Each of these letters was conditioned on representations that were based primarily on the terms of proposed rule 3a–4.[23]

II. Discussion

The investment advisory program industry has developed and matured since the original proposal of rule 3a–4 in 1980. During this time period, the Commission has acquired substantial experience with the organization and operation of investment advisory programs. This experience has come from the review of numerous requests for no-action relief, as well as from examinations of sponsors and other registered investment advisers that are involved with operating these programs. For many of these programs, registration and regulation under the Investment Company Act would not appear to be necessary.[24] Nevertheless, that the law in this area has been defined and redefined principally through a series of no-action letters has created some uncertainty regarding the status of these programs under the federal securities laws. While counsel can (and frequently does) offer advice and issue opinions based on the no-action letters, those letters do not provide the same degree of certainty that would be provided by a Commission rule and may not be as readily accessible. The Commission is therefore publishing for comment revised proposed rule 3a–4 to provide a regulatory safe harbor from investment company regulation for programs that satisfy certain conditions. The Commission also is proposing new Form N–3a4, which would be filed with the Commission by sponsors of

80a–2(a)(36)) and section 2(1) of the Securities Act (15 U.S.C. 77b(1)) includes an ''investment contract.'' The Supreme Court, in *SEC* v. *W.J. Howey Co.*, defined an investment contract for purposes of the Securities Act as a scheme that ''involves an investment of money in a common enterprise with profits to come solely from the efforts of others.'' 328 U.S. 293, 301 (1946). The Commission has taken the view that an investment advisory program could satisfy the common enterprise element of the *Howey* test if the accounts are discretionary, the investors receive the same or substantially overlapping investment advice, and the investment advice is not ''individualized.'' *See* Individualized Investment Management Services, Investment Company Act Release No. 11391 (Oct. 10, 1980), 45 FR 69479 (Oct. 21, 1980) (''Release 11391''). *See also* In the Matter of Clarke Lanzen Skalla Investment Firm Inc., *supra* note ; SEC v. First National City Bank, *supra* note.

[16] The Advisory Committee was established after the Commission instituted an enforcement action against an investment adviser and broker-dealer for operating an unregistered investment company in the form of an investment advisory program. While the program was advertised as offering individualized advice, the adviser invested client funds in a virtually identical manner and made investment decisions in a generally uniform manner to all clients. SEC v. First National City Bank, *supra* note . The Division subsequently denied no-action relief to similar investment advisory programs. *See, e.g.*, Wheat & Co., Inc. (pub. avail. July 9, 1971); Finanswer America/Investments, Inc. (pub. avail. Apr. 26, 1971); Jacobs Persinger & Parker (pub. avail. Mar. 8, 1971).

[17] Advisory Committee on Investment Management Services for Individual Investors, Small Account Investment Management Services (Jan. 1973). The Advisory Committee also concluded that the interests in the program (*i.e.*, the client accounts) should not be required to be registered as securities under the Securities Act if the program provides each client with individualized treatment.

[18] See Release 11391, *supra* note . Release 11391 also stated that the Commission's Division of Corporation Finance had indicated that if rule 3a–4 was adopted, that Division would not recommend that the Commission take enforcement action under the Securities Act with respect to the interests in an investment advisory program operated in accordance with the proposed rule's requirements. *Id.* at n.15.

[19] *Id.* at note and accompanying text. Although the statements in the Release 11391 focused on the necessity for each client to be provided with individualized treatment, the proposed rule also would have included conditions designed to avoid the ''pooling'' of client assets.

[20] E.g., Letter from the American Bar Association to George A. Fitzsimmons, Secretary, SEC 1–2, 4 (Jan. 9, 1981), File No. S7–854; Letter from the Investment Counsel Association of America, Inc. to George A. Fitzsimmons, Secretary, SEC 3–4 (Jan. 9, 1981), File No. S7–854; Letter from Neuberger and Berman to George A. Fitzsimmons, Secretary, SEC 2 (Jan. 12, 1981), File No. S7–854.

[21] Letter from the Investment Company Institute to George A. Fitzsimmons, Secretary, SEC 2, 4 (Jan. 9, 1981), File No. S7–854. This commenter also pointed out that the proposed rule would have permitted commercial banks, which are excepted from regulation under the Advisers Act, to sponsor investment advisory programs without being subject to the Advisers Act's prohibitions against conflicts of interest, the Act's brochure requirements, and inspection by Commission staff. Id. at 2.

[22] In each case, the Division of Corporation Finance also has granted no-action relief with respect to registration of interests in the programs under the Securities Act.

[23] *See, e.g.*, Wall Street Preferred Money Managers, Inc., *supra* note ; Rauscher Pierce Refsnes, Inc., supra note .

[24] The Commission, however, recently brought an enforcement action against a sponsor of an investment advisory program that was operating as an unregistered investment company. In the Matter of Clarke Lanzen Skalla Investment Firm, Inc., supra note .