

MEMO# 5697

March 18, 1994

SEC PROPOSED RULES UNDER THE ADVISERS ACT RELATING TO SUITABILITY AND CUSTODIAN ACCOUNT STATEMENTS

March 18, 1994 TO: INVESTMENT ADVISERS COMMITTEE NO. 23-94 RE: SEC PROPOSED RULES UNDER THE ADVISERS ACT RELATING TO SUITABILITY AND CUSTODIAN ACCOUNT STATEMENTS _____ The Securities and Exchange Commission has proposed two new rules under the Investment Advisers Act of 1940. The rules concern an adviser's duty to make suitable recommendations and the delivery of custodian account statements to clients on a periodic basis. A copy of the SEC's release is attached. The proposed rules are summarized below.

Suitability The SEC has proposed new Rule 206(4)-5 under the Advisers Act, which would prohibit an investment adviser from making unsuitable recommendations to clients. Specifically, an adviser would be required, before providing any investment advice and, as appropriate thereafter, to make a reasonable inquiry into the client's financial situation, investment experience, and investment objectives and to reasonably determine that the investment advice is suitable for the client. The extent of the inquiry would turn on what is reasonable under the circumstances. In connection with this proposal, the SEC has proposed to amend Rule 204-2 (the recordkeeping rule) to require advisers to maintain records of the information obtained under the proposed suitability rule.

Custodian Account Statements The SEC has proposed new Rule 206(4)-6 under the Advisers Act, which would prohibit an investment adviser (except for an adviser to an investment company or a business development company) from exercising investment discretion with respect to a client account unless it reasonably believes that the custodian of the account is providing account statements to the client (or its designee) no less frequently than quarterly. An adviser would be deemed to have a reasonable belief that the custodian is providing account statements if the adviser has received copies of client account statements indicating that they were sent to clients. A receipt of a copy of the account statement would not be the exclusive means by which an adviser could form a reasonable belief that the custodian is providing account statements to the client. Comment is specifically requested on whether a 60 day transition period would be sufficient to permit advisers to confirm that their clients' custodians are providing account statements and, if they are not, to permit clients to direct custodians to provide them with account statements. * * *

Comments are due to the SEC on the proposed rules by May 23, 1994. [Please provide me with any comments you have on the proposals by April 29, 1994. My direct number is 202/326-5824 and the fax number is 202/326-5828. We will discuss these proposals at the April 12th Committee meeting.] Amy B.R. Lancellotta
Associate Counsel Attachment

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