

## COMMENT LETTER

April 28, 1998

# Letter to NASAA Re Proposed Examination for Investment Adviser Representatives, April 1998

April 28, 1998

Donald J. Reis, Chair  
NASAA Investment Adviser Competency Examination Committee  
c/o Nevada Securities Division  
555 East Washington Avenue  
5th Floor, Suite 5200  
Las Vegas, Nevada 89101

Re: Proposed Competency Examination

Dear Don:

The Investment Company Institute<sup>1</sup> appreciates having been provided the opportunity to attend the recent open meeting of the NASAA Investment Adviser Competency Examination Committee (the "Committee") held on March 16, 1998. We value the opportunity to work with the Committee and the members of NASAA on this and other projects impacting our members. As you know, the Institute has a long-standing history of supporting reasonable regulation that is designed to protect investors. We do not, however, believe that, as currently contemplated, the Committee's initiative will constitute such regulation. In particular, we have serious doubts about the ability to assess, through an objective, one-size-fits-all examination, a person's competency as an investment adviser representative, as currently being contemplated by the Committee. These concerns are discussed in detail below.<sup>2</sup>

Instead of concentrating its efforts on an examination that cannot be said to enhance investor protection, the Institute recommends that the Committee and NASAA explore other avenues relating to investment adviser regulation that are more likely to result in enhanced investor protection. The provisions in the National Securities Markets Improvement Act of 1996 ("NSMIA") that reallocated regulatory responsibility between the states and the U.S. Securities and Exchange Commission for investment advisers and their representatives were intended, in part, to enable the states to more effectively oversee state-registered investment advisers and their representatives through more frequent and thorough inspections as well as through enhanced abilities to investigate investor complaints and impose corrective action when warranted. By concentrating their regulatory efforts in this

manner, we believe the states can best strike an appropriate balance between promoting investor protection and avoiding ineffective, yet burdensome, regulation on investment advisers and investment adviser representatives.

## **I. The Proposed Examination Is Inappropriate For Assessing Competency**

### **A. Competency to Render Investment Advice Cannot Be Adequately Assessed Through an Objective Examination**

The Institute strongly disputes the notion that an investment adviser representative's competency can be assessed by an examination. Indeed in 1984, NASAA itself rejected the idea of developing a competency examination for investment adviser representatives based upon the same concerns being raised today. Many of those concerns were set forth in a position paper submitted by the Industry Advisory Group to the NASAA Committee on Investment Advisers when NASAA was considering this issue [3](#):

. . . [T]he industry strongly opposes the imposition of burdensome regulatory requirements which do not truly improve investor protection. Requiring examinations of individual agents of investment advisory firms offers a perfect example of misguided regulation. . . Possible problems stemming from specific segments of the extremely heterogeneous investment advisory industry should be dealt with through regulations aimed at the particular problem areas, not by imposing inappropriate regulation on all segments of the industry, and by excepting the vast majority of firms and individuals which do not give rise to the problem.

. . . The most essential qualities of any individual rendering investment advice—integrity and soundness of judgment—cannot be discerned through a standardized, objective examination.

In recognition of the validity of these and other concerns, NASAA abandoned its efforts to develop a competency examination for investment adviser representatives. We submit that nothing in the intervening years would warrant a reversal of NASAA's previous determination.

### **B. Utilizing A "One Size Fits All" Examination Is Inappropriate**

At the first public meeting held by the NASAA Committee to discuss its current plans to develop a competency examination,[4](#) the Committee expressed its intent to develop a "one-size-fits-all" examination. In response, participants at that meeting discussed the inappropriateness of this approach based upon the diversity of functions performed under the rubric of "investment adviser representative." For example, as defined in the NASAA Model Amendments to the Uniform Securities Act and in the securities acts of many states, the term "investment adviser representative" includes some persons that arguably render no investment advice—such as solicitors and persons that help a customer select an investment adviser in connection with a wrap fee program—as well as persons that provide advice in very limited areas—such as in the allocation of assets among various mutual funds or the timing of investment choices as provided by a timing service. At the other end of the spectrum are those investment adviser representatives who provide comprehensive financial planning services, including, but not limited to, rendering advice relating to investments, retirement, tax planning, debt management, etc.[5](#)

Obviously, the knowledge necessary to be a competent investment adviser representative is going to differ depending upon the services provided to the public. It would serve no

public purpose to require a representative who limits her or his activities to soliciting to be as knowledgeable as and to meet the same competency standards as a financial planner who offers a full range of investment and other advisory services. As expressed in the 1984 position paper:

Competency cannot be tested adequately because there are no basic skills which every agent must have to function well. In fact, the specific knowledge necessary to perform specific investment advisory functions varies greatly depending on the function. . . A uniform examination could not possibly test the knowledge necessary to perform all of the tasks performed by members of the heterogeneous investment advisory industry. . .

And yet, as currently contemplated, NASAA plans to propose one examination to demonstrate the competency of every person who falls within the broad definition of investment adviser representative.

Not only does this approach seem inappropriate, as noted in the 1984 position paper, it would also be unfair:

Even if NASAA developed a comprehensive examination, the requirement that any given person pass the examination would be unfair because it would condition employment in the advisory industry on demonstrated competence in many areas totally unrelated to that person's specific job.<sup>6</sup>

The Committee should take account of the experience of the National Association of Securities Dealers Regulation, Inc. ("NASDR") in developing a competency examination. NASDR currently utilizes approximately seventeen different tests for representatives and thirteen different tests for supervisors or principals. The number of tests utilized by the NASDR reflects the variety of products offered and sold by broker-dealer representatives and the number of areas of specialization in which a representative may concentrate its business. By contrast, the Committee is proposing one examination for all investment adviser representatives, irrespective of the services they provide.

## **II. A Need For The Examination Has Not Been Demonstrated**

Perhaps it would be appropriate for NASAA to reverse its 1984 determination regarding the inappropriateness of a competency examination if, in the intervening years, NASAA had been able to document that the concerns that led to it abandoning the examination in 1984 either are no longer present or have been outweighed by an identifiable need for such examination. This, however, is not the case: the same concerns remain and, since 1984, there have been no reports or studies or other documented findings by NASAA either evidencing or supporting the need for a competency examination nor discounting the concerns with the examination that were raised in 1984. Even the Memorandum of Understanding Concerning Investment Advisers and Investment Adviser Representatives (the "NASAA MOU"), which was adopted by the NASAA membership on April 27, 1997 and which calls for the development of the competency examination, is silent on the issue of why such an examination is necessary.<sup>7</sup> In the absence of any evidence demonstrating the need for a competency examination, it is just as inappropriate to proceed today with the development of such examination as it was when NASAA rejected the idea almost fourteen years ago.<sup>8</sup>

Representatives of NASAA have sought to justify the development of this examination on the grounds that NSMIA and noting that NSMIA has increased state regulatory responsibility over investment advisers and their representatives. But this is not the case; NSMIA did not grant the states increased regulatory responsibilities with respect to investment adviser representatives—if anything, it diminished such regulatory responsibility. Thus, it is far from clear how the enactment of NSMIA could have lead to the need for such a competency examination.

### **III. Concerns About The Survey To Determine The Contents Of The Examination**

The Institute is concerned about the manner in which the contents of the examination are being determined. Participants at the recent open meeting of the NASAA Committee were provided a copy of "A Survey of Tasks and Knowledge Areas for the Investment Adviser Representative" (the "survey"), which was recently sent to 4,000 persons currently registered as investment adviser representatives. It is the information obtained from this survey that will be used to determine the contents of the proposed competency examination. The instructions to this survey include the following:

Please do not relate each statement to your own job or work situation, but rather to what you believe all entry-level Investment Adviser Representatives should know and be able to do regardless of their current work situation. For example, a particular task or knowledge area may have little importance in your current job, but you might believe it very important to competent practice as an entry-level Investment Adviser Representative. (Emphasis in original.)

Rather than providing useful information that will facilitate the development of a meaningful examination, it appears that this survey may, instead, compound the problem. This is because, without defining the term "entry-level investment adviser representative," the survey solicits views on what such a person should know in order to demonstrate competence. Moreover, the survey expressly instructs responders not to respond based upon their own experience. As a result, it appears that there will be no relationship between the information received and the relevance of it to assessing any representative's competence.

### **IV. Concerns About The Administration Of The Examination**

To date, very little has been said about the proposed administration of the examination. The one thing that has been said, however, and that has given us pause for concern, is that there is a possibility that this examination will not be added to the list of examinations, including the other three state examinations (Series 63, 65 and 66), that are administered by NASDR. This is of concern to the Institute because (1) there are no assurances that the price of the examination will be in line with the price of the other examinations offered through NASDR and/or with the costs reasonably incurred in administering the examination and (2) it may result in great inconvenience if persons subject to the examination have to visit multiple examination sites in order to qualify for state registration. Should the Committee elect to proceed with its current initiative, the Institute encourages it and the NASAA Board to keep these concerns in mind.

## V. Conclusions And Recommendations

Though the Institute supports reasonable initiatives to enhance investor protection, we are unable to support the Committee's plans to develop a one-size-fits all competency examination. As discussed above, in lieu of NASAA's current initiative, which cannot be truly said to enhance investor protection, the Institute recommends that NASAA explore regulatory alternatives—such as conducting more rigorous and regular inspections of those advisers that remain subject to the states' registration and regulatory authority and bringing more enforcement actions—that are more focused in their scope and that will have greater likelihood of increasing investor protection without unduly burdening the entire advisory industry. The Institute would welcome the opportunity to work with NASAA in exploring such alternatives.

At the very least, if NASAA is determined to proceed with the development of a competency examination, it should do so in a more deliberate fashion.<sup>9</sup> In particular, NASAA should first obtain more information about the classes of persons that fall under the rubric of "investment adviser representative," determine those classes that are of concern to the members of NASAA, and design one or more examinations specifically tailored to those classes. This approach would be consistent with the testing approach utilized by the NASDR. In addition, it would enable NASAA to design examinations that properly assess the knowledge needed to perform specific functions performed by the various types of investment adviser representatives.

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The Institute appreciates your consideration of our views. If you have any questions concerning these comments or would like any additional information, please contact me at 202/326-5825.

Sincerely,

Tamara Cain Reed  
Associate Counsel

cc: Members, NASAA Investment Adviser Competency Examination Committee  
Members, NASAA Board of Directors  
Members, NASAA

### ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. The Investment Company Institute also represents the interests of investment advisers. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 488 associate members which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

2 This letter is intended to memorialize those issues that have been discussed at each of the two public meetings the Committee has held on this issue to date.

3 The Industry Advisory Group was composed of representatives of the ICI, the Financial Analysts Federation, the Institute of Certified Financial Planners, the Institute of Chartered Financial Analysts, the International Association for Financial Planning, Inc., the Investment Counsel Association of America, Inc., and the Subcommittee on Investment Companies and Investment Advisers of the State Regulation of Securities Committee, Section on Corporation, Banking and Business Law of the American Bar Association.

4 This meeting was held in San Diego, California in January 1997 during the NASAA Winter Enforcement Conference.

5 Based upon the comments made by the Committee at the open meetings, its concern with assessing competency appears to be directed at those persons that provide comprehensive financial advice. This concern is not new. As noted in the industry's 1984 position paper,

If the concern [resulting in NASAA's consideration of a competency examination] stems from the increase in financial planners, NASAA should devise an examination specifically for financial planners, rather than for all individual agents of all types of investment advisory firms. While it is impossible to draft a meaningful industry-wide examination, it might be possible to draft an appropriate examination solely for financial planners.

6 Thus, many representatives are likely to fail the test as it will not be tailored to the functions actually performed by them. One possible solution to this problem would be to design the text so that almost everyone can pass it. Of course, this would render the entire program meaningless, and provide no investor protection.

7 The NASAA MOU includes the following provision:

NASAA shall develop and make available to its members an exam to test the subject matter knowledge and competency of state-registered investment adviser representatives. NASAA shall also urge its members to implement the exam and require passage as a requirement of being licensed as an investment adviser representative.

8 Since plans for a competency examination were last abandoned by NASAA, it should be noted that the Series 63, 65, and 66 examinations have gained widespread adoption by the states. The Institute believes these examinations, which test a representative's knowledge of state and federal law, coupled with vigilant state oversight of investment adviser representatives obviate the need for an additional examination.

9 The Institute is also concerned that a rush to completion may result in problems similar to those that occurred in connection with NASAA's introduction of the Series 65 examination. While the Institute initially supported the Series 65 examination, we withdrew that support when it was found that the problems with the examination—including the structure of the questions and answers, its scope, the time constraints placed on persons taking the examination, and the inadequacy of the training materials—resulted in a passage rate that, according to the NASD, ranged over a twelve month period from a low one month of 7% to a high in another month of 52.4%—percentages that were far below those for other tests administered by the NASD. As noted by the Institute at the time, " . . . the Series 65 poses a substantial impediment to investment adviser registration and qualification in the states requiring passage of the examination as a requisite for doing business." (See letter from W. Richard Mason, Assistant General Counsel of the Institute, to the NASAA Board of Directors, dated February 14, 1991.) These problems resulted in a moratorium being declared on the

examination and NASAA having to go back to the drawing board to make the test more appropriate for the persons taking it.

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