

The Age of Independent Advice

The Remarkable History of the Independent Registered Investment Adviser Industry



Chapter Two: Birth of a Profession

This is the second of six chapters excerpted from Schwab Institutional’s book on the history of the RIA industry. The existence of the independent advisor profession was due to a convergence of events and influences: the authorization of a national income tax by the Sixteenth Amendment, the issuance of bonds to finance World War I, and the striking U.S. economic recovery during the 1920s.

Chapter Two covers the early years and the pioneers of the industry, the formation of the first industry association, and the events leading up to the Investment Adviser Act of 1940.

The independent adviser profession—or “investment counseling,” as it was originally called—owes its existence to a convergence of events and influences in the first quarter of the twentieth century. It was shaped by a few tireless, visionary individuals who saw beyond traditional investment services to a new model that valued the client relationship more than the financial product. And it was tested and strengthened by a series of investigations and reforms that grew out of President Franklin D. Roosevelt’s New Deal.

Some background is useful here. In the early years of the twentieth century, corporate America was barely emerging from the era of the robber barons—bankers and industrialists whose great achievements were often matched by equally great abuses of power. As late as the 1920s, investing in most American companies was viewed as a highly risky activity. Pioneering investment adviser Theodore T. Scudder wrote that “prior to 1900 corporate morals were so low that common stocks of practically all publicly held companies could be considered nothing more than outright speculations.”¹

Investment bankers, insurance companies, and professional trustees dominated the investment profession; none allowed individual investors much control over their investments other than to say yes or no to a recommendation. The firms that offered investment advice were the same firms that sold investment products.

In 1912, Arsène Pujo, a Democratic congressman from Louisiana, received authorization to form a House committee to investigate the “money trust”—a group of financial leaders who were abusing the public trust to consolidate their control over many industries. The committee’s findings lent support to a number of reforms, including the Sixteenth Amendment to the Constitution, which authorized a national income tax and was ratified in 1913; the Federal Reserve Act, also in 1913; and the Clayton Antitrust Act in 1914. The imposition of the federal income tax in particular stimulated interest in investment counsel.

Then came World War I and a second major influence on investment patterns: the issuance of huge numbers of bonds to finance the war effort. The liberty loans, as they were known, were the largest bond issues of their time; by 1919 more than \$21 billion in bonds were sold, in denominations of \$100 each. Ordinary Americans who had never been “speculators” responded to the U.S. Treasury’s exhortations to buy them—some out of patriotism and others because the bond issues were a tax-exempt hedge against the rampant inflation of the war years. In 1917, when the first war bonds were issued, Wall Street investment bankers had estimated that no more than three hundred fifty thousand people would buy them. By 1919 more than eleven million Americans had invested in liberty loans. “Inadvertently,” writes Wall Street historian Charles R. Geisst, “the war effort had given the vast majority of small investors a taste for securities that would only grow

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stronger in the 1920s.”² Charles Mitchell, president and chairman of the National City Bank (later Citicorp) referred to “a large, new army of investors...who may in the future be developed into savers and bond buyers.”³

A brief, severe recession followed the 1919 Armistice. But by 1922 the United States had made a striking recovery. The country experienced a surge in business activity that raised living standards, generated entrepreneurial wealth, and opened the door to a deluge of securities issuance on Wall Street. Between 1919 and 1929, the annual rate of corporate securities issuance nearly quadrupled. The flood of securities coming to market in those boom years overwhelmed amateur investors. They needed expert help to identify investments with good prospects amid the mass of new issues. As one investment adviser later described the situation, “The average private security buyer, whether he was retired or in active business, or even if he were to some extent connected to finance, had not the time or the money to cover the entire investment field and choose from the securities that were soundest and best suited to his particular objective. And in most cases he did not have the experience.”⁴ Moreover, the boom was playing out against a backdrop of economic uneasiness. The Federal Reserve was relatively new, and price stability was not yet on the horizon. Between 1913 and 1920, inflation had eroded fully half the dollar’s value. Caution, even fear, was the watchword of many investors in the 1920s. Preserving capital and its purchasing power was a major objective.

It was in this environment that a small number of independent advisers—then self-styled as “counselors”—got their start. In general, their clients weren’t speculators trying to cash in on a stock tip overheard at a speakeasy. Instead, they tended to be business owners, corporate executives, and members of the professions—knowledgeable individuals of means looking for ongoing advice in a challenging investment environment. Rising prosperity had given them the assets to meet the minimum account size required by independent advisers, typically \$1 million or more in today’s dollars. And waves of innovation, which had brought forth the radio, the refrigerator, and air mail, among other novelties, increased their tolerance for new ideas and made them willing—even eager—to take a chance on independent financial advisory firms. The two new breeds—the independent adviser and

the affluent client willing to delegate investment management to a trusted professional—emerged together. Both prospered as a burgeoning economy and a bull market created unprecedented new wealth. Though small in overall numbers—the SEC in 1942 reported just 753 registered advisers⁵—independent advisers represented a significant change in the status quo and an influence much greater than their size would suggest.

THE PIONEERS

Who were the early investment advisers? What inspired them to pioneer a new profession?

Arthur M. Clifford was motivated by chance and imagination. He had opened his brokerage firm in Los Angeles in 1911, when that city’s population numbered less than four hundred thousand. In 1915, one of his wealthy clients asked him to review her \$30 million in assets, and from then on Clifford called himself an “investment counselor and financial analyst.” By 1921, Clifford was focusing exclusively on investment counsel and charging fixed fees for his services. His firm, Clifford Associates, is still active in Pasadena, California.⁶

Across the country in Boston, frustration and restlessness spurred Theodore T. Scudder to invent his own brand of investment counsel. In 1919, the young bond salesman had founded an investment bank with two partners, Sidney Stevens and F. Haven Clark, but he became dissatisfied with the conflicts of interest he faced serving customers of securities firms. Those firms held stocks and bonds from corporate underwritings or their trading inventories and—not coincidentally—often recommended those very securities to their retail customers. The savvier customers protested. Scudder later told the story about one hard-nosed customer to whom he’d tried to sell some bonds. “How do you know I should buy this bond?” the man shot back. “Perhaps I already own too many bonds. Perhaps I should buy more. How can a doctor or lawyer advise you what to do if they don’t know all about you?” Finally, before shooing Scudder out of his office, the man declared, “I’d be willing to pay for unbiased advice if I could find it.” He became Scudder, Stevens & Clark’s first client when the firm left the investment banking business in 1921 to focus solely on investment advice.⁷

Slowly but persistently, other firms followed the lead of the pioneers on both coasts. By 1929 there were as many as

seventy “investment counsel” firms throughout the country,⁸ including Laurence Booth & Company in Los Angeles; Farwell & Company (later Sheridan, Farwell and Morrison) in Chicago; Cambridge Associates and Eaton & Howard in Boston; Haydock, Cressler & Lamson in Cincinnati; and Investors Economic Services in Milwaukee. In addition to supervising wealthy clients’ personal funds, the firms managed their clients’ trusts, endowments, and charitable funds. Thus they were not only the country’s first independent financial advisers but also the first independent money managers.

The new independent financial advisers differed in striking ways from their predecessors and competitors. First, they focused on their clients’ unique needs rather than on selling a particular product. Second, they styled themselves as professional practitioners, emulating lawyers and accountants in the way they dealt with clients. To reduce conflicts of interest, many offered no services other than investment advice. Typically, they helped clients identify investment goals, set priorities, and prepare a formal investment plan. Investments were continuously monitored and supervised. Their fees, usually based on assets under management, were fully disclosed and paid directly by the clients. This method of charging fees required advisers to value client portfolios regularly and helped direct the attention of investment professionals to the performance of the client’s total holdings. The experience of Scudder, Stevens & Clark illustrates the evolution of fee arrangements. When it entered the business, the firm charged 1 percent of all transaction amounts, either sales or purchases, with brokerage charges coming out of Scudder’s fee. Not only did that approach generate inadequate revenue, it also—contrary to the firm’s philosophy—encouraged transactions. Scudder replaced that structure with a one-half percent fee on assets, with the brokerage fee being paid by the clients, and soon imposed a 1 percent fee on assets with breakpoints for larger account balances.⁹

A third innovation was financial planning. As a discipline and a profession, financial planning would not be recognized until the early 1970s (the College for Financial Planning, founded in Denver in 1972, was the nation’s first financial planning educational institution). But these early independent advisers pioneered some of the essential tools of the financial planning process. In his 1940

testimony to the Senate Banking Committee, Charles M. O’Hearn of Clarke, Sinsabaugh & Co. in New York described his firm’s approach in a way most modern financial planners would recognize and endorse:

Our first task is to prepare and maintain for each client a broad plan for his general financial objectives and for the methods appropriate to their accomplishment...In making the plan, we must determine the soundness of the relation of his income to his standard of living. We must also consider his capacity to assume financial risks, his probable future expenses for educating his family, the number of his dependents, and so forth. We must establish with each client a relationship of trust and confidence designed to last over a long period of time because economic forces work themselves out slowly. Business and investment cycles last for years and our investment plans have to be similarly long-range...It is not our objective to make money for him in a series of spectacular moves.¹⁰

Above all, independent advisers believed that ethical standards, professional objectivity, and trust were the keys to their success. When the Investment Counsel Association of America (predecessor to the Investment Adviser Association), the industry’s first trade group, adopted its code of professional practice in 1937, an important provision was that “neither the firm nor any partner, executive or employee thereof should directly or indirectly engage in any activity which may jeopardize the firm’s ability to render unbiased investment advice.”¹¹

BRIGHT SPOTS IN THE DEPRESSION

The 1929 stock market crash and the decade-long Great Depression that followed brought misery to millions of Americans. In contrast, independent advisers fared relatively well as a group and even managed to expand their business. Because they charged fees based on assets under management and tended to follow conservative investing strategies—with a focus on investment-grade fixed-income securities—-independent advisers could keep their clients, and themselves, afloat. Treasury bonds, for example, were a mainstay of conservative investors. One dollar invested in U.S. Treasury bonds at the start of 1930 was worth \$1.27 five years later. By contrast, a dollar invested in the stock market shrank to 59 cents over the same period. Then, as now, asset allocation made all the difference in investing, and asset allocation—not yet called by that name, but

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known rather as “don’t put all your eggs in one basket”—was what independent advisers specialized in. Whatever pain they suffered from the stock market crash, independent advisers’ clients benefited because their money was being professionally managed.

However, that did not minimize the overall bleakness of the economic landscape. The shrinking economy left one in four workers jobless in 1933.¹² Between 1930 and 1932, industrial stocks lost 80 percent of their value, and even blue-chip stock investors suffered painful losses. President Herbert Hoover struggled unsuccessfully to turn the economy around. In derisive recognition of his failure, camps of homeless people springing up throughout the country became known as Hoovervilles. On Wall Street, business was in shambles and the stock markets thoroughly discredited. The term then used for brokers—“customers’ men”—carried a bitter irony, because customers were in scarce supply. Securities firms declared “apple days,” when brokers were encouraged to take unpaid leave and supplement their income by selling apples on the streets.

The nation’s economic woes were not the consequence of unseen global forces, as some apologists tried to argue. Real people and their misdeeds were at fault. In angry response, reformers wanted new laws to regulate the securities markets and prevent fraud. After Franklin D. Roosevelt’s landslide presidential victory in 1932, they got their wish: public investigations and hearings continued throughout the decade and exposed a scandalous record of abuse.

First in the dock were the bankers. In hearings before the Senate Banking Committee, which commanded the whole country’s attention, chief counsel Ferdinand Pecora, a former New York City prosecutor, avoided economic complexities. Instead, he dragged in top financiers and grilled them relentlessly about Wall Street’s misdeeds during the 1920s. Among those eventually exposed was Albert Wiggin, chairman of the Chase National Bank and the bank’s largest shareholder; he made several million dollars selling short the shares of his own bank as the stock market tumbled, then laundered the profits through Canada to avoid paying income tax.¹³

For weeks, Pecora put on a mesmerizing show while building a copious record to support fundamental reforms

being prepared by the new administration. “The Pecora findings created a tidal wave of anger against Wall Street,” financial historian Ron Chernow wrote in 1990. “As people followed the hearings on their farms and in their offices, on soup lines and in Hoovervilles, they became convinced that they’d been conned in the 1920s. Yesterday’s gods were no more than greedy little devils. Even most of Wall Street was shocked.”¹⁴

Congress responded with waves of reform legislation. The Glass-Steagall Act of 1933 prohibited most securities activities by commercial banks and addressed abuses uncovered by Pecora; it was part of a comprehensive banking bill that also established federal deposit insurance and ultimately separated banking from brokerage. The Securities Act of 1933 and the Securities Exchange Act of 1934 became the basis of fundamental regulation of the securities industry. A Federal Trade Commission investigation and a new round of congressional hearings focused on the interstate holding companies that had gobbled up utilities in the 1920s; the result was the Public Utility Holding Company Act of 1935, which outlawed interstate utilities holding companies and strengthened utility regulation.

The public may have been shocked by the revelations, but none of the targets of the investigations should have been truly caught off guard. The bankers, for example, knew full well that regulation was on its way before Ferdinand Pecora first appeared in the headlines; after all, Roosevelt had made Wall Street reform a campaign pledge. Abuses had endangered the financial health and shareholder profits of the utilities and investment companies as well. They would not be allowed to recur. And buried in the Public Utility Holding Company Act of 1935, which addressed those abuses, was a passage that would have surprising and lasting effects on a formerly overlooked profession: independent investment advisers.¹⁵

INDEPENDENT ADVISERS: THE NEXT TARGET

For a while, independent advisers seemed immune from legislative scrutiny. But a young SEC lawyer named David Schenker, who had served on Pecora’s staff and conducted his own eight-year investigation into investment trusts, soon stepped into his mentor’s shoes. While not as ferocious or high-profile as Pecora, Schenker was equally determined and savvy. An easy-to-overlook passage in the Public Utility Holding Company Act of 1935 included a

congressional command to the SEC to investigate investment companies, known then as investment trusts and today called mutual funds, which had lent a hand in financing the utility manipulations. The SEC found that some \$7 billion worth of investment trusts had been floated at the end of the 1920s; by 1935 their assets were worth just \$2 billion. As *Time* magazine put it in August 1936, “It became SEC’s job to find out where, how and why the rest disappeared.”¹⁶

Soon after the probe got under way, Schenker decided to take a look at the investment advisers who managed the trusts’ portfolios. “It became quite obvious to us that there were a great many of them and we felt duty bound to make that study,” Schenker testified. When the agency couldn’t come up with the names of advisory firms, it decided it needed legislation to get them to report in on their own. Said Schenker:

Now, we canvassed every source we could and we learned of the existence of 394 investment counselors. That, in my opinion, does not even approximate the number of people who are engaged in this profession, or business, or type of activity. After all, the only way we could get that list is through the telephone directories. But there are many who do not even have telephones, or have their offices in their hats. We could not obtain any information about them. Therefore our fundamental approach to this problem, before we could intelligently make an appraisal of the economic function or the abuses which might exist in that type of organization, [was] to see if we could get something approximating a compulsory census. Fundamentally, that is the basic approach of [the Investment Advisers Act legislation].¹⁷

While acknowledging that most advisers wanted to do good work for their clients, Schenker testified, “they are impeded in doing that job by the fact that there is a fringe of people who do not perform this function, but who, if I may use the expression, cash in on the goodwill of the reputable organizations...by giving themselves a designation of investment counselors. These individuals are nothing more than tipsters, who have outrageous arrangements with respect to profit sharing, and so on.”

It was true that at the time the field was essentially unregulated and inevitably attracted some unscrupulous operators. In the 1930s, only six states specifically

regulated investment advisers: California, Connecticut, Michigan, New Hampshire, Oklahoma, and Rhode Island. Tip sheets published by stock touts, who promoted stocks in an effort to boost prices, offered hot picks to subscribers, often in league with profit-seeking speculators. Hustlers posing as advisers used other scams as well to bilk the unsuspecting. Many of these activities could be prosecuted under state and local fraud statutes, but some fell through the legal cracks.

The dilemma faced by Schenker, as well as the profession itself, was how to weed out the bad elements without impairing the business of reputable firms.

Realizing that they were in the spotlight and would likely be subject to new federal regulation, independent advisers began meeting among themselves. Some pushed to organize a trade association to represent their profession; after lengthy arguments the Investment Counsel Association of America was formed in 1937. (The association changed its name to the Investment Adviser Association in April 2005.) Some of the bigger firms, like Scudder, Stevens & Clark, declined to join, even though several of their alumni took leading roles in the new organization. According to an internal Scudder history, “By joining, Scudder would bring prestige to the new organization, which could benefit these [smaller, newer] competitors.”¹⁸ ICAA joiners and holdouts were united only by their opposition to Schenker’s regulatory scheme. The advisers “as a group were ill-prepared for the legislative and bureaucratic assaults. They knew their hearts were pure, they sold nothing but advice, each was single-mindedly struggling to make it the best advice available anywhere...and each new development in the long series came as a shock, much like an insult; how could anyone have the effrontery to raise serious demanding questions about the good-hearted victims of this new inquisition?”¹⁹

In its report to Congress in 1939, the SEC discussed four problem areas with investment advisers: “tipster” services masquerading as bona fide investment advisory firms; the use of performance fees to compensate advisers; the lack of solvency standards for advisers with custody of client assets; and the practice of assigning adviser agreements to other advisers without client consent. Although the agency never cited any specific instances of abuse in the testimony presented to Congress, it did include a general

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declaration implying problems among investment advisers in its draft legislation.

Many advisers questioned whether the SEC had even come close to demonstrating the need for legislation covering them. In a letter to the Senate, Augustus P. Loring Jr., an investment adviser and private trustee in Boston, quoted the SEC's own report in which the agency acknowledged its study was not detailed and failed to examine any particular firms. "It would seem that the comprehensive type of regulation of investment counsel contemplated by the bill...should not be attempted without detailed study," Loring wrote. "Prior to the enactment of such legislation there should be a presentation of very convincing testimony to the effect that such regulation would prevent repetition of existing abuses, and would be for the public good."²⁰ Douglas T. Johnston, an adviser with Johnston & Lagerquist of New York, echoed Loring's comments: "Here the cart would seem to be before the horse—a bill is being proposed to include all investment advisers with certain important exceptions, not to correct predetermined abuses, but to discover whether they exist."²¹

The legislation aroused little interest outside the small coterie of investment advisory firms. Exemptions for banks, broker-dealers, lawyers, and accountants assured that those groups were not going to object. Although the number of individuals offering investment advice—including investment newsletters and tip sheets—was widely (and erroneously) estimated to be in the thousands, no one from those groups came forward. As a result, witnesses were limited to SEC officials and representatives of a small number of advisers. Most of the advisers opposed the SEC's regulatory plan. The only surprise came during an appearance by E. Merrick Dodd, a professor at Harvard Law School. He had been invited to discuss the investment company scandals, but while waiting to testify he heard witnesses testifying on issues related to advisers, and he volunteered to weigh in on that subject as well.

I have been somewhat astonished as I have been listening to the testimony today and read the testimony of yesterday, at the suggestion that because investment advisers, investment counsel, properly enough regard themselves as members of a profession, that is the reason why they should not be regulated. It seems to me quite obvious that just the

opposite is the case, that it is the normal practice under our laws, both state and federal, to regulate professions; when people hold themselves out as competent to render professional services to the public we do regulate them. We regulate the profession to keep undesirable people out. We regulate the legal profession, we regulate the medical profession, we regulate the accounting profession, and we regulate all of the major professions.²²

Dodd's brief comments helped convince any committee members who still might have had reservations that investment advisers should be included in the reform legislation.

A compromise came when industry representatives opposing the bill began to realize that some legislation was politically inevitable. At the same time, the SEC felt the strain of more than three years of investment company hearings and was now facing congressionally mandated deadlines for reform proposals. Both sides were thus open to compromise, and the SEC made the first move. Hardwick Stires, a Scudder Stevens executive attending some of the Senate hearings, shared a cab after one of the sessions with Schenker, who got directly to the point, as Stires later recalled. "Wicks, don't you fellows think it's time to throw in the sponge and realize there is going to be a bill and that we are going to have, as a minimum, a registration of investment counsel?" Stires later recalled Schenker asking him. "So why don't you tell your group to stop thrashing and get together and write a simple bill that I feel sure we can all agree on?"²³

Stires and his colleagues jumped at the offer. The next evening, several industry representatives and Robert G. Page, a lawyer from New York, began an all-night drafting session to prepare the bill Schenker had requested. The new bill had the registration and antifraud provisions sought by the SEC, as well as restrictions on adviser contract assignments and principal trading by advisers with clients. It also featured a measure sought by the industry making it unlawful for registered advisers to use the term *investment counsel* unless they were primarily engaged in the business of rendering "continuous advice as to the investment of funds on the basis of the individual needs of the client." The bill was accepted with only slight change by the SEC and passed both the Senate and the House without significant modification. What became the Investment Advisers Act of 1940 took up just three pages

when reprinted in the *Congressional Record*. By contrast, the Investment Company Act of 1940 required thirty pages.

A COURSE FOR THE FUTURE

For a law that seemed in many respects an afterthought at the time of its passage, the Investment Advisers Act of 1940 has proven remarkably practical and enduring, both for the investing public and for the advisory industry.²⁴ Several factors have contributed to its success. One is the emphasis on full disclosure. The Advisers Act is at its heart a disclosure statute. Registered investment advisers are required to disclose real and potential conflicts of interest to their clients. Over the years, the SEC has expanded the scope of its disclosure requirements, and even put a key disclosure document, part 1 of Form ADV, online so it can be viewed conveniently over the Internet by the public.

A second factor has been the SEC's broad and flexible authority to regulate fraud in the industry. Though the final draft of the legislation was written by the Investment Counsel Association of America, the industry's only trade group at the time, its role turned out not to be a drawback. The ICAA's standards of practice were exemplary, and the legislation confirmed and codified them. By ceding regulatory power to the SEC, the ICAA demonstrated its commitment to ethical practices and its intolerance for unscrupulous conduct.

Most important in the long run has been the way the law was later interpreted by the U.S. Supreme Court. In *SEC. v. Capital Gains Research Bureau, Inc.*, the high court ruled that the 1940 Advisers Act "reflects a congressional

recognition of the delicate fiduciary nature of an investment advisory relationship." The court also noted that the 1940 Advisers Act reflects "a congressional intent to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested" (emphasis added). Further, the court said that every investment adviser owes his or her clients a duty of "utmost good faith, and full and fair disclosure of all material facts" as well as an affirmative obligation "to employ reasonable care to avoid misleading clients."²⁵

The notion that the interest of the client must always come first has been strengthened over the years by subsequent court decisions and by SEC rule making. As the SEC noted in a 1988 analysis of the law:

The act's imposition on the adviser of a fiduciary duty to clients is intended to eliminate conflicts of interest and to prevent the adviser from overreaching or taking unfair advantage of a client's trust. An adviser, as a fiduciary, owes clients more than honesty and good faith alone. An adviser must also be sensitive to the possibility of rendering less than disinterested advice whether consciously or unconsciously, and an adviser may be faulted even where it did not intend to injure the client and even if the client does not suffer a monetary loss.²⁶

Enacted to cover a relative handful of practitioners, the act today applies to many thousands of investment advisers. It was the first set of regulations to shape the fledgling profession, and a harbinger of the three decades to come, during which investment advisers would begin to assume their modern role.

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Theodore Scudder, Founder, Scudder, Stevens & Clark

As a young bond salesman in Boston, Theodore Townsend Scudder longed to expand his horizons. Born in 1889, Scudder had graduated from Harvard and gone to work as an office boy at an investment banking firm, then quit because he wasn't being trained for advancement. He returned to the firm in 1912 to take a sales position, at which he excelled. Yet he still wasn't satisfied. "It did not take me more than three months," he later wrote, "to come to the conclusion that although I was selling securities in exactly the same way as other salesmen, I was not doing a good business."

What was missing? A clue came during a conversation Scudder had with Frederic H. Curtiss, chairman of the Federal Reserve Bank of Boston, during a sales call. "Have you looked all over these bonds, and do you think they are perfectly good?" Curtiss later recounted. Yes, he had, Scudder replied. "And then I said, 'Well, how do you know that is what I need?'...Well, [Scudder] hesitated and said of course he didn't...Then [Scudder] said, 'What is needed here is a separate agency that will give advice and that would have no interest in the things they have to sell.'"

As a result of insights like this one, Scudder left the investment banking firm in 1914 and went into business in Boston under the wing of a local brokerage house. In 1919, he established his own firm, Scudder, Stevens & Clark, with two fellow Harvard alumni, Sidney Stevens and F. Haven Clark.

At first, the three men remained in investment banking, offering investment counsel without charge. But it soon became clear that their advice was at least as valuable as their banking services. So Scudder approached about twenty clients and offered them counsel "on an impartial and increasingly expert basis. We agreed that they would tell us their complete portfolio and other pertinent facts, such as how much life insurance they carried, how much real estate mortgages they owned, what they needed per annum to live on, etc. We would then diagnose their situation and suggest to them what we believed to be a sound investment program to follow." In return, clients would pay the firm a fee of 1 percent of the value of any securities bought or sold on the firm's advice.

It was a "whole new revolutionary concept where instead of selling products, you're selling advice," observes David G. Tittsworth, executive director of the Investment Adviser Association (IAA) in Washington, D.C. "To me, that's the beginning of the investment adviser business."

Stevens found the concept too radical: After just one year, he retired from an active role in the firm. A few months later, Scudder and Clark wrote a five-page business prospectus in which they established the profession's first principles: offer "unbiased expert advice," create a diversified portfolio, and provide constant supervision of the account.

Scudder died in 1953, before the true flowering of the independent investment adviser profession. But his vision continues to guide every practitioner.

Ferdinand Pecora: Crusading Investigator

Facing him in the dock were some of America's most influential men, whose names were synonymous with power, privilege, and great wealth. But Ferdinand J. Pecora—a shoemaker's son born in Sicily in 1882—proved more than equal to the task of interrogating them. He had earned his stripes as an assistant New York district attorney in the 1920s, when he had successfully prosecuted corrupt politicians and questionable stock salesmen. By the time he was appointed chief counsel to the U.S. Senate Banking Committee, in early 1933, Pecora was ready to come out swinging against the most prominent bankers and brokers in the country.

A brilliant, sarcastic cross-examiner, Pecora personally questioned many of the most prominent witnesses, including Charles Mitchell, president and chairman of the National City Bank (later Citicorp); Samuel Insull, head of a huge utilities empire in Illinois; and J. P. ("Jack") Morgan II, of J. P. Morgan and Company. Pecora elicited that Morgan had paid no personal income tax in 1930, 1931, and 1932, and that his bank, like many others, had used "preferred lists" to extend financial privileges to its best clients. It was painful evidence of the insulation of financial elites at a time when most Americans were scraping to get by. Pecora became a hero of reformers and working people and was featured, cigar clenched between his teeth, on the cover of *Time* magazine. By the end of 1933, Congress had passed two landmark pieces of reform legislation, the Glass-Steagall Act and the Securities Act. More reforms would follow in succeeding years.

When the Pecora hearings concluded in July 1934, President Roosevelt appointed Pecora a commissioner of the new Securities and Exchange Commission; Pecora resigned in 1935 and was appointed a New York State Supreme Court judge. His 1939 book, *Wall Street under Oath: The Story of Our Modern Money Changers*, gave an insider's account of the Pecora Commission hearings. After running unsuccessfully for New York City mayor in 1950, Pecora joined a private law practice.

Uncharacteristically, he took on some large companies as clients; in 1954, he successfully represented Warner Bros. Pictures Distributing Corporation—accused of antitrust violations—before the U.S. Supreme Court. Pecora died in 1971.

“Adviser” or “Counselor”?

In the early part of the last century, when the first independent advisers—Theodore T. Scudder, Arthur M. Clifford, and their contemporaries—were setting up shop, no term existed to describe their profession. They settled on *investment counsel*, which comprised education and “unbiased expert advice.” *Counselor* remained the preferred term for several decades. The Investment Counsel Association of America, the first nonprofit organization to represent the new profession, was founded in 1937 in response to the Securities and Exchange Commission’s moves to investigate investment trusts; the ICAA later played a role in the creation of the Investment Advisers Act of 1940.

The act further defined *counselor* and restricted its use: only advisers who rendered “investment supervisory service” and gave “continuous advice as to the investment of funds on the basis of the individual needs of each client” could call themselves “investment counselors.” The definition intentionally excluded others who were required to register under the 1940 act, such as newsletter publishers who dispensed advice but didn’t manage money.

Gradually, however, practitioners began using *adviser* instead of *counselor* as an umbrella term, with *counselor* as a subset. In 1975, the ICAA established the Chartered Investment Counselor program “to recognize the special qualifications of persons employed by member firms whose primary duties are consistent with section 208(c) of the Investment Advisers Act of 1940 (pertaining to the use of the term ‘investment counsel’).” The ICAA changed its name in 2005 to the Investment Adviser Association. Most states require licensing for investment adviser representatives through an exam called the Series 65. In addition, to use certain industry trade group marks such as “Certified Financial Planner,” “Certified Financial Consultants,” “Certified Financial Analysts” and “Certified Investment Counselors,” such industry groups require practitioners to pass specific certification exams.

Depression-Era Financial Reforms

Glass-Steagall Act of 1933: Prohibited most securities activities by commercial banks. Separated commercial banking from investment banking. Part of the Banking Act of 1933, which also established the federal deposit insurance.

Securities Act of 1933: Regulated the issuance of securities by requiring the registration of new offerings and the full disclosure of financial information. Prohibited misrepresentation or other fraud in the sale of securities.

Securities and Exchange Act of 1934: Established the Securities and Exchange Commission with broad authority to regulate the securities industry, markets, and trading. Required broker-dealers to register with the SEC and comply with its rules.

Public Utility Holding Company Act of 1935: Enacted to address fraud, stock manipulation, and other abuses that had led to the collapse of major utility companies. In accordance with this act, Congress ordered the SEC to investigate investment companies for their role in financing the utility manipulations.

Maloney Act of 1938: Authorized self-regulatory organizations to police the securities industry under the direction of the SEC. Led to 1939 designation of the National Association of Securities Dealers as a self-regulatory organization for the securities industry.

Investment Company Act of 1940: Established regulatory framework for mutual funds, also known as investment companies or investment trusts. Required registration with the SEC and full disclosure of relevant information.

Investment Advisers Act of 1940: Required registration of investment advisers with the SEC and imposed antifraud provisions on their activities. Banks and broker-dealers were generally exempted from registration.

Birth of a Profession

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