

9-1-1988

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L. Bombich

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Recommended Citation

Bombich, L. (1988) "CORPORATIONS, PARTNERSHIPS, AND ASSOCIATIONS Investment Advisory Business: Regulate," *Georgia State University Law Review*: Vol. 5 : Iss. 1 , Article 48.
Available at: <http://readingroom.law.gsu.edu/gsulr/vol5/iss1/48>

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CORPORATIONS, PARTNERSHIPS, AND ASSOCIATIONS

Investment Advisory Business: Regulate

CODE SECTIONS:	O.C.G.A. §§ 10-5-2 to -4 (amended), 10-5-10 to -14 (amended), 10-5-16 (amended), 10-5-20 (amended), 10-5-23.1 (new)
BILL NUMBER:	HB 1566
ACT NUMBER:	1327
SUMMARY:	The Act amends the Georgia Securities Act of 1973 to provide for the regulation of the investment advisory industry by requiring the registration of investment advisers and investment adviser representatives. The Act further provides for examinations; registration and renewal fees; the refusal, denial, and revocation of registration; bonds; the keeping of records and accounts, and the examination of these materials by representatives of the commissioner; the powers of the commissioner; rules, regulations, investigations, and hearings (including notice and opportunity for such hearings); cooperation with other jurisdictions; administrative, civil, and criminal actions; civil liability; and penalties for violations.
EFFECTIVE DATE:	April 1, 1989

History

The Georgia Securities Act of 1973¹ regulates the securities industry in Georgia by regulating the activity of securities dealers and salesmen who sell securities for a commission.² A dealer includes an “agent, broker, or principal in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person but . . . not . . . a bank or trust company.”³ A salesman is one who works under the authority of a

1. O.C.G.A. §§ 10-5-1 to -24 (1982).

2. O.C.G.A. § 10-5-2(a)(6), (11), (12), (18) (1982); telephone interview with Representative Ken Workman, House District No. 51 (Mar. 29, 1988) [hereinafter Workman Interview].

3. O.C.G.A. § 10-5-2(a)(6) (Supp. 1988).

dealer or issuer.⁴ A commission includes any fee collected "which is directly related to the sale of securities."⁵

As the general public has become more interested in financial investment, the demand for investment advice has increased, providing opportunities for incompetent and unethical individuals to enter the financial advisement field.⁶ Many abuses of the fiduciary duty owed by investment advisers have been called to the attention of the Secretary of State, who serves as the commissioner of securities in Georgia.⁷ Abuses include incidents of nondisclosure of conflicts of interest and nonconformance with provisions of the federal Investment Advisers Act of 1940.⁸

To meet public demand,⁹ the Securities and Exchange Commission (SEC) has encouraged increased regulation of the securities industry in Georgia.¹⁰ The SEC's ability to regulate activities is limited to "large cases of national significance."¹¹ These SEC recommendations, as well as actions of other states, prompted the Secretary of State to recognize the need for "the state regulation of investment advisers and financial planners in Georgia."¹²

In 1985, Max Cleland, Secretary of State, created the Committee on the State Regulation of Investment Advisers (Committee) to address this need to regulate financial planners and investment advisers.¹³ Deputy Secretary of State Wayne Howell was appointed to oversee and direct the committee.¹⁴ Members of the committee were selected from the fields of accounting, commercial banking, financial planning, insurance, investment banking, and law.¹⁵ Three subcommittees were formed: jurisdiction;

4. O.C.G.A. § 10-5-2(a)(18) (Supp. 1988).

5. O.C.G.A. § 10-5-2(a)(5), (15) (1982).

6. REPORT OF THE SECRETARY OF STATE'S COMMITTEE ON THE STATE REGULATION OF INVESTMENT ADVISERS 1 (1988) (copy on file at Georgia State University Law Review office) [hereinafter COMMITTEE REPORT].

7. *Id.*; O.C.G.A. § 10-5-10 (1982) (denoting the Secretary of State as the commissioner of securities).

8. COMMITTEE REPORT, *supra* note 6, at 1; Investment Advisers Act of 1940, 15 U.S.C. § 80b (1982).

9. COMMITTEE REPORT, *supra* note 6, at 2.

10. Workman Interview, *supra* note 2.

11. COMMITTEE REPORT, *supra* note 6, at 2. The Securities and Exchange Commission is granted authority to regulate the investment adviser industry in section 209 of the federal Investment Advisers Act of 1940, 15 U.S.C. § 209 (1982).

12. COMMITTEE REPORT, *supra* note 6, at 2.

13. *Id.*

14. *Id.*

15. *Id.* The members of the committee were W. B. Shearer, Esq. (Chairman); O. M. Welch (Vice Chairman); K. Workman; H. W. Howell (Staff Coordinator); W. M. Armistead; J. Baker; L. Blount; R. Chadwick; H. L. Harris; J. M. Glazman; V. Goetz; J. Hardin, Esq.; J. Harmon; E. L. Jansson; T. D. Jones; R. W. Jones, Esq.; W. H. Koegler, Jr.; O. Lee, Esq.; K. Logue, Esq.; D. Lundell; M. Mantler; W. F. Miller; L. M. Nease, III; L. Walker; A. B. Smith; F. L. Somers, Jr., Esq.; L. B. Williams; and J. Young. Special Advisers included J. K. Jackson and G. Johnson, Business Services and Regu-

registration, compliance, and examinations; and enforcement and antifraud.¹⁶ These subcommittees operated independently and formulated recommendations to be presented to the committee as a whole.¹⁷

The Secretary of State's office investigated Georgia's present investment field, current national and local standards, and resources available to facilitate possible changes.¹⁸ Staff reports indicated a substantial increase in substandard investment advice given by persons who frequently called themselves financial planners. Many of these self-styled financial planners are engaging in fraud; they are not qualified and do not disclose this lack of qualification to customers.¹⁹

Numerous organizations in the investment industry are concerned about the failure of some investment advisers to conform to recognized standards in the industry. These organizations, such as the Institute of Certified Financial Planners, the International Association for Financial Planning, and the Society of Certified Public Accountants, are taking an active role in creating a positive investment environment for the public across the nation.²⁰ The North American Securities Administrators Association (NASAA) recommends that states which do not currently regulate investment advisers enact such legislation.²¹ NASAA currently is working with the National Association of Securities Dealers (NASD) to create and operate the Central Registration Depository (CRD) "to become a registering agent on a national basis" for investment advisers, dealers, and others involved in the industry.²²

Georgia's regulation committee recommended the adoption of the CRD when it is able to handle such registration efficiently.²³ In August of 1987, the committee met and began work on proposed legislation.²⁴ The major purpose of the legislation is to enhance Georgia's business environment by subjecting investment advisers to the same regulations governing securities dealers and salesmen.²⁵ This legislation, together with Georgia's new Limited Partnership and Corporate Codes,²⁶ is intended to create a "great business environment" and attract more businesses to the state.²⁷

lation and R. M. Moler, Department of Banking and Finance. *Id.* at 3—5.

16. *Id.* at 5—7.

17. *Id.* at 7.

18. *Id.* at 8.

19. *Id.* at 8—9.

20. *Id.* at 9; Workman Interview, *supra* note 2.

21. COMMITTEE REPORT, *supra* note 6, at 9.

22. *Id.* at 10. The CRD will be a nationwide computerized registration system. All states will have access to the system for registration of those in the investment business.

23. *Id.* at 10—11.

24. *Id.* at 7.

25. Workman Interview, *supra* note 2.

26. O.C.G.A. §§ 14-9-1 (Supp. 1988) (limited partnerships) and 14-2-1 (Supp. 1988) (business corporations).

27. Workman Interview, *supra* note 2.

Georgia is among the first states to enact legislation regulating investment advisers.²⁸

HB 1566

Section 1 of HB 1566 amends the definitional section of the Securities Code. The new definitions include assignment,²⁹ investment adviser,³⁰ and investment adviser representative.³¹ Other changes are technical.³²

Assignment is defined as "any direct or indirect transfer . . . of an investment advisory contract" except that a minor change in the membership of an investment adviser partnership will not be considered an assignment.³³ This definition is almost identical to the definition of assignment in section 202(a)(1) of the federal Investment Advisers Act of 1940.³⁴

The Act defines an investment adviser as an individual who, for a fee, counsels others regarding the value of securities and recommends the purchase or sale of such securities.³⁵ The first part of the definition is based on the duties of an investment adviser,³⁶ and is modeled after section 202(a)(11) of the federal Investment Advisers Act of 1940.³⁷ The next part of the definition includes those individuals who recommend sales or purchases under the titles "investment adviser" or "financial planner."³⁸ This is not modeled after the federal Act and is unique to Georgia.³⁹ However, it is "consistent with the Securities and Exchange Commission's staff interpretation of section 202(a)(11) of the federal act with respect to financial planners"⁴⁰

28. *Id.*

29. O.C.G.A. § 10-5-2(a)(2) (Supp. 1988).

30. O.C.G.A. § 10-5-2(a)(8) (Supp. 1988).

31. O.C.G.A. § 10-5-2(a)(9) (Supp. 1988).

32. *See, e.g.*, O.C.G.A. §§ 10-5-2(a)(2) to -(7), (10) to -(24) (Supp. 1988) (renumbering of subsequent paragraphs).

33. O.C.G.A. § 10-5-2(a)(2) (Supp. 1988).

34. COMMITTEE REPORT, *supra* note 6, at 15; *see* Investment Advisers Act of 1940, § 202(a)(1), 15 U.S.C. § 80a-2(4) (1982).

35. O.C.G.A. § 10-5-2(a)(8) (Supp. 1988).

36. COMMITTEE REPORT, *supra* note 6, at 15.

37. *Id.* at 15; Investment Advisers Act of 1940, § 202(a)(11), 15 U.S.C. § 80a-2(20) (1982).

38. O.C.G.A. § 10-5-2(a)(8) (Supp. 1988) ("Investment adviser shall also include any person who holds himself out as a 'financial planner' or 'investment adviser.'"); *see* COMMITTEE REPORT, *supra* note 6, at 15-16; *see also* Workman Interview, *supra* note 2.

39. COMMITTEE REPORT, *supra* note 6, at 15. It also has no counterpart in the Uniform Securities Act, 7B U.L.A. 509 (1985), crafted by the National Conference of Commissioners on Uniform State Laws (1985). *Id.*

40. COMMITTEE REPORT, *supra* note 6, at 15; *see* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. IA-1092 52 Fed. Reg. 38,400 (Oct. 8, 1987).

Certain individuals are specifically excluded.⁴¹ An investment adviser representative is excluded from the definition.⁴² Others excluded are those whose investment advice is based on the performance of their professions: lawyers and teachers; noncompensated securities dealers; individuals who publish information for the general public; others designated by the commissioner; and entities such as banks and bank holding companies which are not required to be registered by the federal Investment Advisers Act of 1940.⁴³ The Georgia statute includes individuals "giving advice concerning direct-obligation securities of the federal government;" the federal Investment Advisers Act of 1940 excludes such individuals.⁴⁴ The committee rejected the exclusion of "investment advisers outside of Georgia who have only a specified minimum number of clients in Georgia."⁴⁵ Individuals whose clients are insurance companies or who have had less than fifteen clients in the past year and do not hold themselves out as investment advisers or investment adviser representatives are excluded.⁴⁶

The definition of an investment adviser representative as one who gives investment advice on behalf of an investment adviser⁴⁷ is not found in the federal Act or the Uniform Securities Act⁴⁸ and is "unique to Georgia."⁴⁹ However, a similar definition is found in the federal Act's reference to a "person associated with an investment adviser."⁵⁰ The New Mexico Securities Act of 1986 has a definition similar to the one used by Georgia.⁵¹

The second section of the Act amends O.C.G.A. § 10-5-3 to include registration requirements for investment advisers and investment adviser representatives. It also establishes the requirements for record keeping, the provision for necessary disclosure documents, and the authority of the commissioner to establish the system for record keeping.⁵²

Every investment adviser and investment adviser representative must

41. O.C.G.A. § 10-5-2(a)(8) (Supp. 1988).

42. O.C.G.A. § 10-5-2(a)(8)(i) (Supp. 1988). The definition of investment adviser representative is found in O.C.G.A. § 10-5-2(a)(9) (Supp. 1988).

43. See O.C.G.A. § 10-5-2(a)(8) (Supp. 1988). The Act, as introduced, contained the same exceptions but arranged in a different order. See HB 1566, as introduced, 1988 Ga. Gen. Assem. The Senate Committee on Banking and Finance added to the exception for banking entities by specifically compelling the registration of those already required to register by the federal Act. HB 1566 (SCA), 1988 Ga. Gen. Assem.

44. COMMITTEE REPORT, *supra* note 6, at 16.

45. *Id.* The committee called this a "de minimus" [sic] exclusion. *Id.*

46. O.C.G.A. § 10-5-3(b) (Supp. 1988).

47. O.C.G.A. § 10-5-2(a)(9) (Supp. 1988).

48. UNIF. SECURITIES ACT, 7B U.L.A. 509 (1985).

49. COMMITTEE REPORT, *supra* note 6, at 16.

50. *Id.*; Investment Advisers Act of 1940, § 202(a)(17), 15 U.S.C. § 80b-2(a)(17) (1982).

51. COMMITTEE REPORT, *supra* note 6, at 17; N.M. STAT. ANN. § 58-13B-2.M (1986).

52. O.C.G.A. § 10-5-3 (Supp. 1988).

register in order to transact any business "within or from this state."⁵³ The phrase "transact business" is the same as that used by the Uniform Securities Act.⁵⁴ The "within or from" requirement is used for both investment advisers and securities dealers and salesmen.⁵⁵

The amendments to paragraphs (c) and (d) establishing the required manner of registration⁵⁶ are intended to give the commissioner the authority to "facilitate the use of centralized national computerized filings of registration applications"⁵⁷ with the CRD in Washington, D.C.⁵⁸ The registration requirements for investment advisers⁵⁹ and investment adviser representatives⁶⁰ are designed to parallel the requirements for securities dealers⁶¹ and securities salesmen.⁶² The requirements for investment advisers are similar to those required by the federal Act⁶³ and the Uniform Securities Act.⁶⁴

A National Competency Examination is being formulated by the National Association of Securities Administrators.⁶⁵ The applicant investment adviser⁶⁶ or investment adviser representative would be required to pass this examination to be considered fully registered.⁶⁷

An order may be issued by the commissioner refusing to register an applicant once the applicant has been given an "opportunity for a hearing."⁶⁸ Sufficient grounds are the same as those for securities dealers or salesmen, including a determination that the "applicant is not of 'good business reputation.'"⁶⁹

The requirements imposed on investment advisers for the keeping of balance sheets,⁷⁰ the payment of fees for registration,⁷¹ and the keeping of

53. O.C.G.A. § 10-5-3(a) (Supp. 1988).

54. UNIF. SECURITIES ACT § 201(a), 7B U.L.A. 509; *see* COMMITTEE REPORT, *supra* note 6, at 29.

55. COMMITTEE REPORT, *supra* note 6, at 29; *see* O.C.G.A. § 10-5-3(a) (1982).

56. O.C.G.A. § 10-5-3(c), (d) (Supp. 1988).

57. COMMITTEE REPORT, *supra* note 6, at 29.

58. *Id.* at 10; *see also supra* text accompanying notes 22—23.

59. O.C.G.A. § 10-5-3(e) (Supp. 1988).

60. O.C.G.A. § 10-5-3(f) (Supp. 1988).

61. O.C.G.A. § 10-5-3(c) (Supp. 1988).

62. *Id.*; COMMITTEE REPORT, *supra* note 6, at 30.

63. Investment Advisers Act of 1940, § 203(c), 15 U.S.C. § 80b-3(c)(1) (1982); COMMITTEE REPORT, *supra* note 6, at 30. The form used for registration is that issued by the Securities and Exchange Commission, form ADV (copy on file at *Georgia State University Law Review* office). Telephone interview with Wayne Howell, Deputy Secretary of State (Mar. 31, 1988) [hereinafter Howell Interview].

64. UNIF. SECURITIES ACT § 205, 7B U.L.A. 509.

65. Workman Interview, *supra* note 2.

66. O.C.G.A. § 10-5-3(e) (Supp. 1988).

67. O.C.G.A. § 10-5-3(f) (Supp. 1988).

68. O.C.G.A. § 10-5-3(g) (Supp. 1988).

69. *Id.*; O.C.G.A. § 10-5-3(d) (1982).

70. O.C.G.A. § 10-5-3(h) (Supp. 1988).

71. O.C.G.A. § 10-5-3(i) (Supp. 1988).

records regarding business activities⁷² are comparable to the requirements imposed on securities dealers.⁷³ The commissioner has the authority to establish the rules regarding record keeping.⁷⁴ The committee intended for these rules to be “compatible and generally uniform with the record keeping requirements imposed by federal rules promulgated under the federal Investment Advisers Act of 1940.”⁷⁵

Investment advisers may be required by the commissioner to provide clients with information which the commissioner determines to be “in the public interest or for the protection of investors and advisory clients.”⁷⁶ This disclosure may be satisfied by the rules promulgated under the federal Investment Advisers Act of 1940.⁷⁷

The technical amendments made in section 3 are intended to extend the “authority [of the commissioner] to deny, suspend, or revoke the registration” of securities dealers, salesmen, and issuers to include investment advisers and investment adviser representatives.⁷⁸ This was effected by the insertion of the terms “investment advisers” and “investment adviser representatives” in the applicable places.⁷⁹

Sections 4 and 5 incorporated the term “investment adviser” regarding cooperation with other jurisdictions in the enforcement of state, federal, and international laws.⁸⁰ This incorporation is to emphasize the “desirability of uniformity among federal and state laws regulating investment advisers and of cooperation among the governmental agencies charged with the administration of such laws.”⁸¹

It is now unlawful for an investment adviser to transact business in Georgia without being duly registered.⁸² The Act extends criminal sanctions to those individuals who act as financial planners and are not registered.⁸³ Further, the titles “investment adviser” and “financial planner” may not be used in a deceptive manner.⁸⁴ The commissioner has the au-

72. O.C.G.A. § 10-5-3(k) (Supp. 1988).

73. O.C.G.A. § 10-5-3(j) (Supp. 1988).

74. O.C.G.A. § 10-5-3(k) (Supp. 1988).

75. COMMITTEE REPORT, *supra* note 6, at 31.

76. O.C.G.A. § 10-5-3(n) (Supp. 1988).

77. *Id.*; Investment Advisers Act of 1940, § 211(a), 15 U.S.C. § 80b-11(a) (1982). For example, 15 U.S.C.A. § 80b-10(a) requires that registration information be available to the public. COMMITTEE REPORT, *supra* note 6, at 31. The Committee Report also refers to the “brochure rule” in Rule 204-3, promulgated under the federal Act of 1940 § 204. COMMITTEE REPORT, *supra* note 6, at 31.

78. COMMITTEE REPORT, *supra* note 6, at 34; O.C.G.A. § 10-5-4(a) (Supp. 1988).

79. O.C.G.A. § 10-5-4(a) (Supp. 1988).

80. O.C.G.A. §§ 10-5-10(b), 10-5-11(h) (Supp. 1988).

81. COMMITTEE REPORT, *supra* note 6, at 35.

82. O.C.G.A. § 10-5-12(f) (Supp. 1988). This requirement is similar to that required by the federal Investment Advisers Act of 1940, § 203(a), 15 U.S.C. § 80b-3(a) (1982). *See also* COMMITTEE REPORT, *supra* note 6, at 39.

83. O.C.G.A. § 10-5-12(g) (Supp. 1988).

84. O.C.G.A. § 10-5-12(g), (h)(1), (2) (Supp. 1988).

thority to define deceptive and dishonest practices.⁸⁵ This authority is not patterned after other laws and is designed to give the commissioner expansive authority to regulate behavior.⁸⁶

It is illegal for an individual to represent that the commissioner has approved of his abilities as an investment adviser.⁸⁷ This section is similar to section 505 of the Uniform Securities Act.⁸⁸ It is acceptable, however, to state truthfully that an investment adviser is registered with the state.⁸⁹ The federal Act and the Georgia Securities Act of 1973 contain a similar provision⁹⁰ regarding the registration of dealers and salesmen.⁹¹

The Act stipulates that no investment advisory contract will be renewed unless the written contract provides that: compensation generally will not be based on commission; assignment may not occur without consent; and notification of any change in the membership of an investment adviser partnership will be made within a reasonable time.⁹²

Section 7 of the Act inserts the terms "investment adviser" and "investment adviser representative" throughout the provision which designates the administrative, civil, and criminal actions which may be instituted against violators of the Act.⁹³ The purpose is to allow the current treatment of dealers, salesmen, and issuers who violate the Act to apply to investment advisers and representatives.⁹⁴

Section 8 declares void any contract made in violation of the Act.⁹⁵ This portion is similar to section 215(b) of the federal Act.⁹⁶ The section also "creates an express private civil remedy in the nature of contractual rescission."⁹⁷ This remedy is limited by a two-year statute of limitations.⁹⁸

85. O.C.G.A. § 10-5-12(h)(3) (Supp. 1988).

86. COMMITTEE REPORT, *supra* note 6, at 40—41. The Committee referenced rules established under the federal Act, including Rules 206(3)-2, 206(4)-1 to -4, and the regulatory position embodied in the SEC's staff interpretation of section 206 of the federal Act, SEC Release No. IA-40 (Jan. 5, 1945).

87. O.C.G.A. § 10-5-12(i) (Supp. 1988).

88. COMMITTEE REPORT, *supra* note 6, at 41; UNIF. SECURITIES ACT § 505, 7B U.L.A. 509.

89. O.C.G.A. § 10-5-12(i) (Supp. 1988).

90. COMMITTEE REPORT, *supra* note 6, at 41; Investment Advisers Act of 1940, § 208(b), 15 U.S.C. § 80b-8(b) (1982).

91. COMMITTEE REPORT, *supra* note 6, at 41.

92. O.C.G.A. § 10-5-12(j)(1)—(3) (Supp. 1988). These requirements are modeled after section 205 of the federal Act. Investment Advisers Act of 1940, § 205, 15 U.S.C. § 80b-5 (1982); COMMITTEE REPORT, *supra* note 6, at 41.

93. O.C.G.A. § 10-5-13 (Supp. 1988).

94. COMMITTEE REPORT, *supra* note 6, at 45—46.

95. O.C.G.A. § 10-5-14(b) (Supp. 1988).

96. COMMITTEE REPORT, *supra* note 6, at 48; Investment Advisers Act of 1940, § 215(b), 15 U.S.C. § 80b-15(b) (1982).

97. COMMITTEE REPORT, *supra* note 6, at 48; *see also* O.C.G.A. § 10-5-14 (Supp. 1988).

98. O.C.G.A. § 10-5-14(e) (Supp. 1988).

The changes made by section 9 extend the “procedural ‘due process’ protections afforded to securities issuers, dealers, and salesmen . . . to investment advisers and investment adviser representatives.”⁹⁹ This extension of procedural due process is accomplished by requiring that before denial or revocation of registration, notice must be sent which provides an opportunity for a hearing before the commissioner.¹⁰⁰

Section 10 extends the stipulation that waiver of the provisions of the Georgia Investment Advisers Act will be void.¹⁰¹ Previously, this stipulation applied only to securities dealers.¹⁰² The registration of investment adviser representatives is delayed until the CRD “is able to accept such registration filings on a national level.”¹⁰³ This provision is implemented in agreement with the committee’s recommendation to utilize the CRD, giving Georgia access to “a computerized, national registration system”¹⁰⁴ and is consistent with the goal of uniform application of securities laws as expressed in O.C.G.A. § 10-5-10.¹⁰⁵

This legislation does not become effective until April 1, 1989,¹⁰⁶ to permit the promulgation of rules to enforce the Act. It is anticipated that, in the course of establishment of the rules and their review by the House and Senate committees, any potential problems with the Act will be recognized and corrected in the next legislative session.¹⁰⁷ Also during this time the office of the Secretary of State will publish a policy release that will address the effect of the Act on that office.¹⁰⁸

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99. COMMITTEE REPORT, *supra* note 6, at 49; O.C.G.A. § 10-5-16(a) (Supp. 1988).

100. O.C.G.A. § 10-5-16(a) (Supp. 1988).

101. O.C.G.A. § 10-5-20 (Supp. 1988).

102. *See* O.C.G.A. § 10-5-20 (1982). This is similar to the provision in the federal Act. Investment Advisers Act of 1940, § 215(a), 15 U.S.C. § 80b-15a (1982). It is also similar to the UNIF. SECURITIES ACT § 802, 7B U.L.A. 509.

103. COMMITTEE REPORT, *supra* note 6, at 51; O.C.G.A. § 10-5-23.1 (Supp. 1988).

104. COMMITTEE REPORT, *supra* note 6, at 51; *see also supra* text accompanying note 22.

105. O.C.G.A. § 10-5-23.1 (Supp. 1988).

106. O.C.G.A. § 10-5-14 (Supp. 1988).

107. Workman Interview, *supra* note 2.

108. Howell Interview, *supra* note 63.