



Bank Insurance &
Securities Association

BANK INSURANCE & SECURITIES ASSOCIATION

**LEGISLATIVE, REGULATORY &
COMPLIANCE CONFERENCE**

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New Investment Adviser Rules

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New Investment Adviser Rules

- Background
- Rule 202(a)(11)-1 Overview
- Fee Based Accounts -- SEC Interpretive Guidance to SIA (Dec. 16, 2005)
- Practical Issues and Guidance

Background

- Definition of investment adviser
- Broker exclusion
 - Incidental advice
 - Special compensation
- Bank exclusion
- Wrap accounts
- Enter fee based brokerage accounts
 - And SEC's 1999 proposal

Rule 202(a)(11)-1 Overview

- “Special compensation”
 - Fee based brokerage exception
- “Solely Incidental” – Advice by broker-dealer is not “solely incidental” if the broker-dealer
 - Charges a separate fee or separately contracts for advisory services
 - Provides advice as part of a financial plan
 - Exercises investment discretion
- Registered broker-dealers are deemed advisers only for accounts for which they provide advisory services

“Special Compensation”

- A registered broker-dealer will not be deemed an adviser based on its receipt of “special compensation” if
 - Advice provided to accounts from which it receives special compensation is solely incidental to brokerage services provided
 - Ads, agreements, applications and other forms governing accounts for which the broker-dealer receives special compensation disclose
 - Your account is a brokerage (not advisory) account
 - Our interest may not always be the same as yours
 - Ask questions to ensure you understand your rights & our obligations to you, including to disclose conflicts and to act in your best interest
 - We are paid both by you and others who pay based on what you buy
 - Our profits and our reps’ compensation may vary by product & over time
 - The disclosure must identify an appropriate person at the firm with whom the customer can discuss the differences

“Solely Incidental” - Discretion

- Exercising investment discretion is not incidental to brokerage
- Not covered – Discretion granted “on a temporary or limited basis”
 - As to price or time to trade a definite quantity of a specified security
 - On an isolated or infrequent basis, to trade a security or type when customer is unavailable for a limited time (up to few months)
 - As to cash management, such as to exchange sweep vehicles
 - To purchase or sell securities to satisfy margin requirements
 - Tax loss harvesting trades
 - To purchase a bond with a specified credit rating and maturity
 - To trade a security or type of security limited by specific parameters
- Employee trading

“Solely Incidental” - Discretion

- Limited guidance to date
 - *UBS Financial Services, Inc.* (Sept. 29, 2005)
 - *Morgan Lewis* (Nov. 17, 2005)

“Solely Incidental” - Financial Plans

- Advice is not incidental to brokerage if the broker-dealer provides advice as part of a financial plan or in connection with providing financial planning services and
 - Holds itself out as a financial planner or as providing financial planning services
 - Delivers a financial plan to the customer
 - Represents to the customer that the advice is provided as part of a financial plan or in connection with financial planning services
- The concept of financial planning is not clearly defined
 - Focus on comprehensiveness
 - Input versus output

SIA Letter

- “The Four Questions”
- Guiding Principles

SIA Letter

- Dual registrant use of advertising that references a broad range of advisory and financial planning services
 - Making it known that such services are available, does not create an advisory relationship
 - It is nature of services actually provided which will determine whether the relationship is advisory or brokerage
 - “Holding out” matters

SIA Letter

- Distinguishing between financial plans/financial planning services vs. brokerage services
 - Comprehensiveness and scope are factors
 - Financial “tools” generally fit under brokerage umbrella
 - Clear disclosure that a “tool” not a “plan” is being provided, is helpful to establishing that a brokerage relationship exists

SIA Letter

- Dual relationships with clients
 - Most critical part of interpretation
 - Both an advisory and brokerage relationship can exist with the same customer as long as certain conditions are met
 - Contractual provisions and clear disclosure are critical elements

SIA Letter

- Use of “CFP” or similar professional credentials
 - Use on business cards or letterhead alone will not create advisory relationship
 - Dependent on nature of services actually offered

Practical Issues & Guidance

- Classify existing business activities as brokerage, financial planning or other investment advisory services
 - Identify services that could be considered financial planning under the rule using the “reasonable investor” standard
 - Trigger is “comprehensive”
 - Evaluate whether services could be adequately tracked and supervised as financial plans or, alternatively, revised to be used as non-comprehensive suitability tools
 - Adjust substance of tools and broker “holding out”

Disclosures

- Advertising – Focus on
 - Disclosures clarifying the firm’s role
 - RR use of credentials (e.g., CFP)
 - Limit use of comprehensive or “planning” language in materials created by RRs
 - Whether financial planning materials meet investment advisory rule requirements (no testimonials, past specific recommendations, etc.)

Disclosures

- Form ADV, Part II Brochure
- Financial Planning Agreement
 - Clarify the firm is acting as investment adviser for formation and delivery of the plan only
 - Once the plan is delivered, advisory relationship ends
 - Client may choose to implement the plan with the firm or another broker-dealer.
 - If client chooses to implement the plan using a brokerage account, client should acknowledge that the firm will not have fiduciary liability and may engage in principal trades

Website Disclosures

- Disclose of differences between brokerage accounts and advisory accounts, discussing obligations owed to clients in brokerage, financial planning and other advisory roles
- Eliminate broad or generic references to financial planning
- Reorganize content to ensure clear distinction between
 - Brokerage and advisory services
 - Financial planning and non-comprehensive services

Supervision Issues

- Suitability - Process for completing the plan and ensuring that recommendations contained in plan are suitable
- Methodology – Firm has fiduciary duty on content of plan
- Licensing - Process to ensure that RRs providing financial planning are properly licensed (Series 65/66)
- Tracking – Identifying clients/accounts that received financial plans to ensure that investment advisory requirements for disclosures, monitoring, etc. are met

Sales Practice Issues

- Branch inspection process may need to be revised to address
 - Non-approved third party planning software or tools
 - Ad-hoc or “homemade” financial plans
 - Inadvertent financial plans (*i.e.*, combining tools)
 - Communications that would look like a financial plan
- Other items that may be overlooked:
 - “On Hold” Recordings in the Branch Offices
 - Marketing videos
 - Practices of marketing support personnel (e.g., estate planning personnel)

Training

- Train the trainers and review existing training programs to eliminate generic references to “financial plans” or “financial planning” in brokerage context
- Communication to RRs
 - Differences between brokers and investment advisers
 - Basic requirements of the SEC rule
 - Changes made at the firm for compliance
 - Discussion of how RRs can distinguish between roles
- Supervisory activities of branch office managers
 - RR correspondence under the rule
 - Non-approved financial plans
 - RR presentations to clients to ensure the nature of the role is clearly presented

Bank Exclusion

- Banks may provide investment advice and financial plans under bank exclusion
- Parameters remain unclear
 - But investment advice should originate from and be supervised by the bank in its fiduciary role

Recap: Separating Advice from Brokerage

- Narrowly define advice
 - Primary job is as broker
 - Flags of advice relationship: ADV and contract
 - Advice limited to “four corners” of the Plan
 - Relation to brokerage accounts
 - Advice relationship terminates with Plan delivery

Recap: Separating Advice from Brokerage

- Limit overlapping guidance
 - Strip stock recommendations from plans (provide recommendations as brokerage)
 - Trim planning modules to be offered as brokerage (provide full, tailored guidance as advice)
 - Full fledged plan (advice) versus 3 (or less than half) modules (brokerage)
 - Disclose that overlapping modules are advice only when offered as an integrated component of a plan
 - Skip plan (advice) and go to action steps (brokerage)
 - Interpose separate adviser or bank

Recap: Challenges of Concurrent Advice

- Defining – and tagging – when the advice relationship begins . . . And ends
 - Draft plans that linger while the firm shifts into broker mode
 - Post plan analyses
- Fee based (advice) accounts and standalone brokerage accounts
 - What trades go where?
 - Does advice relationship seep into brokerage relationship?



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