

**KOYEN, CLARKE & ASSOCIATES, INC.**

**Investment Advisers Act of 1940 -- Section 202(a)(11)(C) -- Rule 206(4)-3**

**Nov 10, 1986**

**TOTAL NUMBER OF LETTERS: 2**

**SEC-REPLY-1:  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
OCT 09 1986  
RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT  
Our Ref. No. 86-433-CC  
Koyen, Clarke & Associates, Inc.  
File No. 801-16554**

We would not recommend any enforcement action to the Commission if solicitors for Koyen, Clarke & Associates, Inc. did not register as investment advisers under the Investment Advisers Act of 1940 ("Act") in the circumstances described in your letter of August 27, 1986, and in your telephone conversation with A. Thomas Smith of this Office on October 2, 1986. n1

The Commission stated in Investment Advisers Act Release No. 688 (July 12, 1979) that "a solicitor who engages in solicitation activities in accordance with paragraph (a)(2)(iii) of the rule . . . will be, at least with respect to those activities, an associated person of an investment adviser and therefore will not be required to register individually under the Advisers Act solely as a result of those activities. n2

We believe payment of a cash fee to a solicitor in compliance with Rule 206(4)-3, strictly for the performance of solicitation activities, would not represent compensation for investment advisory services and would not constitute "special compensation" for purposes of application of Section 202(a)(11)(C) of the Act to solicitors who are registered representatives of a broker/dealer. Therefore, insofar as the solicitors for Koyen, Clarke & Associates, Inc. are engaged in activities in accordance with paragraph (a)(2)(iii) of Rule 206(4)-3, the solicitors need not register as investment advisers under the Act.

A. Thomas Smith III  
Attorney

**Footnotes**

n1 In that telephone conversation, you confirmed that the solicitors will engage in solicitation activities in accordance with paragraph (a)(2)(iii) of Rule 206(4)-3. Any solicitor for an investment adviser who relies on paragraph (a)(2)(iii) must provide each client with a copy of the advisers's brochure and of the solicitation agreement.

n2 See Part III ("Status of Solicitors under the Advisers Act") of Release 688.

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**INQUIRY-1: HOTZ, KIZER & WINTZ  
A PROFESSIONAL CORPORATION  
ATTORNEYS AT LAW  
317 AMERICAN NATIONAL BUILDING  
6990 WEST DODGE ROAD  
OMAHA, NEBRASKA 68114  
August 27, 1986**

**Office of Chief Counsel  
Division of Investment Management  
Securities & Exchange Commission  
450 5th St., N.W.  
Washington, DC 20549**

**Re: Investment Advisors Act of 1940, §§ 202(a)(11)(C) and 203,  
15 U.S.C. § 806-1, et seq.**

Dear Sir or Madam:

On behalf of Koyen, Clarke & Associates, Inc. (KC&A) an investment adviser registered under the Investment Advisors Act of 1940 (the "Advisors Act"), we hereby request that the staff (the "Staff") of the Securities and Exchange Commission (the "Commission") issue a no-action letter with respect to the necessity of solicitors of KC&A to register as investment advisors under Section 203 of the Advisors Act, and the availability of the exemption from registration provided in Section 202(a)(11)(C) of the Advisors Act to registered representatives of a broker-dealer who also act as solicitors for KC&A.

#### **FACTS**

KC&A provides a mutual fund market timing service for clients with investments in mutual funds. The service provided by KC&A involves switching clients' funds between equity and money market funds within the same mutual fund on a discretionary basis. KC&A is not involved in the selection or purchase of mutual fund shares prior to market timing.

Clients are referred to KC&A through its appointed solicitors. Solicitors represent KC&A in presenting information to prospective clients about KC&A's market timing service and solicit clients for KC&A. Solicitors receive a commission based upon the total advisory fees paid to KC&A for this service. The solicitors are all registered representatives of a broker-dealer under the NASD and have passed the Series 7 NASD examination.

KC&A has structured its arrangements with its solicitors to meet the requirements of the "Cash Payment for Client Solicitations" rule in 17 C.F.R. § 275.206(4)-3. The solicitors must not be subject to any disqualification described in 17 C.F.R. § 275.206(4)-3(a)(1)(ii); there is a written agreement between KC&A and its solicitors; the solicitors are required to provide clients or potential clients with a copy of Part II of KC&A's Form ADV; and, the solicitors are required to obtain a signed acknowledgement from the client that they received the separate Disclosure Statement containing information about the solicitor. Furthermore, the "Solicitor Agreement" between KC&A and its solicitors confines the solicitors' activities in referring clients to KC&A to an explanation of KC&A's services and fee schedules and prohibits the solicitors from making any investment recommendations or giving any investment advice to clients or prospective clients while acting on behalf of KC&A. Solicitors for KC&A are free to recommend the market timing services of others.

Two forms of a "Solicitor Agreement" are used by KC&A; one form is a two-party agreement between KC&A and the solicitor, the other form is a three-party agreement among KC&A, the solicitor and the solicitor's broker-dealer. In the latter form, the solicitor's broker-dealer receives a share of the commissions generated by the solicitor, while in the two-party agreement the solicitor's broker-dealer

does not share in commissions. Where the solicitor's broker-dealer is not a party to the agreement, and does not share in the commissions, the broker-dealer is informed by the solicitor and KC&A of the solicitation activities. Regardless of whether the solicitor's broker-dealer shares in the commissions or not, the cost to the client for KC&A's services is the same because the fee charged to clients by KC&A is based upon a percentage of funds under management by KC&A. Furthermore, KC&A and the broker-dealers are not associated persons or entities, nor does either KC&A or the broker-dealer directly or indirectly control the other.

The solicitation activities on behalf of KC&A conducted by the solicitors involve presenting seminars to the general public or holding meetings with pre-existing clients to describe KC&A's services and fee schedules. Although a solicitor may not make any investment recommendations or give any investment advice while acting on behalf of KC&A, as registered representatives of a broker-dealer, these same persons are, or may be, involved in the sale of mutual fund shares to their clients. Furthermore, such sales of mutual fund shares may involve making investment recommendations or giving investment advice to clients. Any compensation for the sale of mutual fund shares or investment advice given as a result of such sales is a share as a registered representative of any broker commission paid by the client on mutual fund shares.

## **ANALYSIS**

Section 203(a) of the Advisors Act makes it unlawful for any investment adviser to make use of any instrumentality of interstate commerce unless registered under the Advisors Act. Section 202(a)(11) of the Advisors Act defines "investment advisor" and Section 202(a)(11)(C) excludes from the definition of investment advisor, "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."

The activities conducted by KC&A's solicitors thus raise two questions under the Advisory Act. First, are solicitors of KC&A required to be registered individually with the SEC as a result of their solicitation activities on behalf of KC&A? Second, if the solicitors are not required to register as a result of their solicitation activities on behalf of KC&A, are they also exempt from registration as registered representatives of a broker-dealer pursuant to Section 202(a)(11)(C) of the Advisors Act?

SEC Release No. 688, issued July 12, 1979, provides that a solicitor who engages in solicitation activities in accordance with the "Cash Payments for Client Solicitations" rule, 17 C.F.R. § 275.206(4)-3 is an "associated person" of the investment adviser and, therefore, will not be required to register individually with the SEC solely as a result of his or her solicitation activities. Under the first question raised above, therefore, we do not believe solicitors would be required to register individually with the SEC as a result of their solicitation activities.

The second question is whether the exemption from registration provided in Section 202(a)(11)(C) of the Advisors Act is available to a person who acts in the dual capacity as a registered representative of a broker-dealer and solicitor for KC&A. Specifically, the issue is if a registered representative of a broker-dealer gives investment advice to a client who is subsequently solicited for KC&A's market timing service, does the registered representative still qualify for the exemption from registration in Section 202(a)(11)(C) of the Advisor's Act. As noted above, any investment advice would be given in the capacity of a registered representative of a broker-dealer because the agreement between KC&A and its solicitors prohibits the solicitors from giving investment advice on behalf of KC&A. Any sales of mutual fund shares would be through the broker-dealer, and any compensation for investment advice would be a share, as a registered representative, of broker commissions paid by the client.

Under no-action letters previously issued by the SEC, whether a registered representative of a broker-dealer who gives investment advice is required to register turns upon whether the person was acting under the supervision of his or her broker-dealer at the time the investment advice is given. See, e.g., *Southmark Financial Services* (pub. avail. August 23, 1981) (stating that "a financial planner not supervised by the broker-dealer for whom you act as a registered representative, . . . would be required to register even if compensation for such service is only a share, as a registered representative of any broker commissions paid by the client or mutual fund share") (emphasis added); *Baker, Watts & Co.*

(pub. avail. June 11, 1984) (registered representatives, while acting on their own behalf, are not exempted from registration requirements pursuant to Section 202(a)(11)(C)); David Willmore (pub. avail. August 20, 1984) (financial planner not supervised by the broker-dealer who gives investment advice would be required to register); Institute of Certified Financial Planners, (pub. avail. January 21, 1986), Fed. Sec. L. Rep. (CCH), P78,190 (stating that, "For example, if a registered representative provides investment advice independent of the broker-dealer employer, such as, for example, by establishing an independent financial planning practice, then he could not rely on the exception [in Section 202(a)(11)(C)] because his investment advisory activities would not be subject to control by this broker-dealer employer") (emphasis added). Because any investment advice given by registered representatives of a broker-dealer who are also solicitors for KC&A would be given on behalf of the broker-dealer, we believe the registered representative would still qualify for the exemption from registration provided in Section 202(a)(11)(C) of the Advisors Act, notwithstanding the fact that the registered representative also solicits clients for KC&A.

Another SEC no-action letter which supports this conclusion is Robert S. Stevell (pub. avail. April 29, 1985). The Stevell letter which discusses financial planners who are also represented representatives of a broker-dealer (FPRR), states that the "threshold question is whether an FPRR is providing investment advice in its capacity as a registered representative of the broker-dealer by whom it is employed." It goes further to state that an FPRR who is compensated only from commissions is not required to register because it is not receiving special compensation. Based upon the facts set forth above, we do not believe the commissions received by the solicitors of KC&A for their solicitation activities on behalf of KC&A should be considered a form of "special compensation" which would disqualify these same persons from the exception from registration in Section 202(a)(11)(C) when they are acting in their capacity as registered representatives of their broker-dealers because the commissions received from KC&A are solely for the solicitation activities and have no relationship to any investment advice the registered representative may provide on behalf of its broker-dealer. Furthermore, any investment advice given by the registered representatives would be solely incidental to their activities as a registered representative of a broker-dealer, and that the investment advice would be given on behalf of their broker-dealer. Thus, our analysis is that registered representatives of a broker-dealer who also solicits clients for KC&A are not required to individually register as investment advisers with the SEC because they qualify for the exemption from registration in Section 202(a)(11)(C) of the Advisors Act.

## **REQUEST**

Based upon the foregoing, we respectfully request that the Staff agree not to recommend any enforcement action to the Commission under Section 203(a) of the Advisor Act against KC&A or its solicitors because the solicitors are not properly registered under Section 203(c) of the Advisors Act. We also request that th Staff agree not to recommend any enforcement action under Section 203(a) of the Advisors Act against persons who act both as solicitors for KC&A and registered representatives of a broker-dealer because they give investment advice but do not qualify for the exemption from registration in Section 202(a)(11)(C).

Sincerely,

D. Vaughn Gangwish