

Investment Advisers Act of 1940 -- Section 202(a)(11)

Oct 1, 1987

Price Waterhouse

TOTAL NUMBER OF LETTERS: 6

**SEC-REPLY-1:
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT
Our Ref. No. 87-270-CC
Price Waterhouse
File No. 132-2**

In your letter of May 8, 1987, you request our assurance that we would not recommend any enforcement action to the Commission under the Investment Advisers Act of 1940 ("Advisers Act") if Price Waterhouse ("PW"), an accounting firm, establishes a registered investment adviser ("PWIA") to oversee the rendering of personal financial planning services, without PW registering under the Advisers Act.

Your letter states that PWIA will be formed to supervise the delivery of investment advice by partners and professional employees of PW in connection with personal financial planning services offered by PW. The investment advisory component of such services will not involve recommendations regarding specific securities, but will encompass matters such as asset allocation, portfolio diversification, etc. PWIA will determine the scope and content of the advice rendered. In addition, PWIA will prescribe quality control standards and monitor the delivery of advice. You argue that registering PWIA, instead of PW, is not only more practical, but also will provide clients with more relevant information regarding the actual source of the investment advice and avoid potential confusion.

PWIA will be formed as a partnership with PW as a general partner. PWIA will be governed by an advisory board of eight or more members, comprised of PW partners, principals and senior managers. At no time will more than two members of the PWIA advisory board also be members of the PW Policy Board.

Traditionally, the staff has been concerned that a parent company may engage in the advisory business and use a controlled entity to avoid registration. n1 Several abuses could occur in such a situation. First, the controlled entity could be an under-capitalized shell, formed to limit the parent's liability. n2 Second, to the extent that personnel of a parent actually provide investment advice, the registration of an affiliated entity may not provide sufficient disclosure regarding the parent or its personnel or might be used to attempt to shield their activities from regulatory scrutiny under the Advisers Act. In this regard, the potential for "scalping" exists if the parent or its personnel have access to the recommendations to be made by the controlled entity. These concerns have been addressed in several no-action letters, which set forth conditions under which a subsidiary would be regarded as having a separate existence from its parent. n3

The facts here differ to some extent from the facts presented in these earlier no-action letters and your proposed arrangement would not meet the conditions set forth in those letters. However, because your arrangement would address the concerns present in these earlier letters, we do not believe that the conditions established in these letters are necessarily appropriate here. n4 For this reason, we would not recommend any enforcement action to the Commission under the Advisers Act if PW establishes and registers PWIA as an investment adviser to conduct operations as described in your letter, without PW registering under the Advisers Act. This position is based on

the facts and circumstances of your letter and oral representations made on July 7 and 8, 1987, particularly that: (i) PW will own a general partnership interest in PWIA; (ii) the investment advisory and personal financial planning services provided will be substantially similar in nature to traditional accounting services; (iii) neither PW nor PWIA will recommend investments in specific securities or specific industry sectors; (iv) neither PW nor PWIA will have custody or possession of clients' funds or securities; (v) copies of all written financial plans, personal financial planning time records and billing statements, and other engagement letters or communications relating to personal financial planning clients will be maintained at PWIA headquarters and will be available for inspection by the Commission staff; (vi) amounts billed for financial planning services will be separately stated; and (vii) for purposes of Form ADV and the Advisers Act, PW personnel providing personal financial planning services or overseeing these services will be deemed to be "advisory affiliates" and "persons associated with an investment adviser." Because these positions are based upon the written and oral facts and representations you provided, you should note that any different facts or conditions might require a different conclusion. Further, this response only expresses our position on enforcement action and does not express any legal conclusions on the questions presented.

Mary S. Podesta
Chief Counsel

Footnotes

n1 In Investment Advisers Act Rel. No. 353 (Dec. 18, 1972), the Commission stated that "in some situations the controlling person . . . of the registered adviser may be the entity which in fact is providing the services essential to the rendering of investment advice. . . ." In that release the Commission proposed Rule 202-1 which, operating as a safe harbor, would have prescribed conditions under which registration of the controlling entity would not be required. Among these conditions were the requirements that the registered adviser be adequately capitalized, that a majority of the registered adviser's directors not be personnel of the controlling entity and that these directors be compensated by the registered adviser, and that the officers of the registered adviser not be personnel of the controlling entity. Although the rule was never adopted, the concerns articulated in the release remain relevant.

n2 See *id.* ("[T]he registered investment adviser may have only nominal capitalization to carry on its investment advisory business.")

n3 See, e.g., *Kenneth Leventhal & Co.* (pub. avail. Feb. 7, 1983); *United Asset Management Corporation* (pub. avail. Nov. 2, 1981); *Richard Ellis/R. E. Holdings Limited* (pub. avail. Sept. 17, 1981) ("*Ellis*"). *Ellis*, which still represents the staff's general position on determining whether the controlling entity of a registered adviser must also register, states that a subsidiary entity may be regarded as having a separate, independent existence if it: (1) is adequately capitalized; (2) has a buffer between the subsidiary's personnel and the parent's; (3) has employees, officers, and directors who are not otherwise engaged in an investment advisory business of the parent; (4) determines the investment advice given to clients and does not limit sources of investment information to its parent; and (5) keeps its investment advice confidential until communicated to its clients.

n4 For example, because no specific securities will be recommended and only generic advice will be given, the potential for "scalping" is removed. Similarly, because PW will own a general partnership interest, PWIA would not operate to shield PW from liability.

**INQUIRY-1:
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May 8, 1987

Kathryn B. McGrath, Esq.
Director
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Ms. McGrath:

Our client, Price Waterhouse ("PW"), intends to register an affiliate under the Investment Advisors Act of 1940 (the "Advisers Act"). This letter describes the proposed arrangement between PW and the registered affiliate ("PWIA") and seeks to confirm that the staff of the Securities and Exchange Commission (the "Commission"), based upon the facts and representations set forth herein, will not recommend the initiation of any enforcement action against PW under Section 203 of the Advisers Act if PW itself does not register as an investment adviser.

As we describe below, PWIA will register under the Advisers Act and will supervise the delivery of investment advice by partners and professional employees of PW in connection with personal financial planning services offered by PW to its clients. PW will not register under the Advisers Act, but as to any investment advice its partners or professional employees provide in connection with the provision of personal financial planning services, PWIA will control the scope and content of the advice, and the delivery of such advice will be subject to quality control standards prescribed and monitored by PWIA. In providing investment advice in connection with personal financial planning engagements, PW will not rely upon the accountant's exclusion from registration contained in Advisers Act Section 202(a)(11)(D).

Registration of PWIA, and not PW, under the circumstances described herein satisfies both the technical requirements of the Advisers Act and the policies that underlie the Act. Because the level of supervision to be exercised by PWIA over PW will strengthen internal controls over the furnishing of investment advisory services, and hence will redound to the benefit of advisory clients and further the public interest, we respectfully request that the staff grant PW's no-action request.

I. Facts

A. The Registered Entity

1. PWIA Structure and Operations

PWIA will be formed as a New York general partnership and will have a separate legal identity. The general partners of PWIA will be PW and Price Waterhouse & Co., Inc., a corporation organized under the laws of the state of New York which is wholly-owned by PW. n1 PW's purpose in creating PWIA is decidedly not to insulate, or to attempt to insulate, PW from any potential liability arising from the actions of PWIA or from claims that may be asserted against PWIA. PW will be responsible to its clients for all aspects of personal financial planning services, including those portions involving investment advice. Indeed, by adopting the partnership form for PWIA, PW will assume the full liability of a general partner for the acts of its affiliate, PWIA. n2

PWIA will be governed by an advisory board composed of PW partners, principals and senior managers. The advisory board at all times throughout the life of PWIA will have at least eight members. At no time will more than two members of the PWIA advisory board also be members of the PW Policy Board (PW's governing body). One member of the PWIA advisory board will serve as the national director of PWIA. PWIA will have a limited administrative and clerical support staff at its Los Angeles, California headquarters. In consideration for PWIA's services, PW will pay PWIA an annual consulting fee. PWIA will keep separate books and records to reflect its own operational and

administrative expenses.

The PWIA advisory board will control the scope and content of all investment advice rendered by PW in the course of providing financial planning services to PW clients and will supervise the delivery of investment advice by PW in connection with such services. n3 To this end, the PWIA advisory board will formulate policies and promulgate guidelines to control the investment advice that PW will render in the course of financial planning activities. To implement PWIA policies and guidelines, the PWIA advisory board presently intends to devise a number of typical client profiles, each with a recommended asset allocation model. These client profiles and related asset allocation models will conform to the policies and guidelines respecting investment advice that are discussed herein. n4 PW personal financial planning professionals will be required to conform to these models in counseling clients. From time to time other forms of guidance may be developed to supplement or substitute for the forms of guidance described above.

All PW personal financial planning engagements will be reported to PWIA headquarters. A client engagement letter will describe the financial planning services that PW will provide and will indicate that any investment advice included in the PW financial plan is delivered under the supervision of PWIA. Copies of engagement letters and all other communications of substance with personal financial planning clients, including all written financial plans, will be maintained at PWIA's headquarters. A computerized index to all personal financial planning engagements will be developed.

Copies of all PW billing statements that include personal financial planning services will be maintained at PWIA headquarters. PW statements that include personal financial planning services will bear a legend indicating that the statement includes charges for PW financial planning services and that any investment advice included in such services was delivered under the supervision of PWIA. In addition to engagement letters, client communications, and statements, copies of time records for all PW personal financial planning professionals will be maintained at PWIA headquarters. These procedures will ensure that current records for all PW personal financial planning activities will be accessible through the PWIA central records center. The materials maintained in or accessible through the PWIA records center will be available for inspection by the Commission staff pursuant to the Advisers Act.

2. PWIA Supervisory and Compliance Controls

The responsibilities and authority of the PWIA advisory board will be comparable in scope to that of a corporate board of directors. In particular, the PWIA advisory board will be responsible for devising and administering internal policies and procedures to ensure that the investment advice component of personal financial planning services offered by PW meets professional standards, comports with the strictures of the federal securities laws and applicable state law, and conforms to the guidelines developed by PWIA. In carrying out its responsibilities, the advisory board will develop and administer:

- guidelines as to the scope of investment advisory services to be offered by PW, including limitations on the furnishing of investment advice in connection with financial planning activities;
- guidelines as to the design and administration of educational and training programs and qualifications for PW personnel whose activities include providing investment advice in connection with financial planning services;
- guidelines as to appropriate levels of consultation among PW financial planning professionals and adherence to uniform standards in the furnishing of investment advice in connection with providing financial planning services to clients in different locations throughout the United States;
- procedures for a quality control review program under which PW offices where personal financial planning services are performed will be subjected to periodic review for compliance with PWIA guidelines; and

- procedures for billing providing that PW statements will include personal financial planning services will bear a legend indicating the supervisory responsibilities of PWIA.

Through implementation of these guidelines and procedures, formation and registration of PWIA will markedly increase the centralization, control and degree of oversight exercised over the provision of investment advice by partners and professional employees of PW.

B. Relationship of Investment Advisory Services to Other Financial Planning Services of PW

1. Financial Planning Services

PW is seeking to expand the range of its financial planning services and, as an incident thereto, will provide generic investment advice to its financial planning clients. The PW personnel who will deliver financial planning services will consist of PW professionals, almost all of whom are licensed as certified public accountants and have college or post-graduate degrees in business, finance or law. Many of these individuals are accredited as Chartered Financial Consultants, Certified Financial Planners, or Chartered Financial Analysts. In the rendering of personal financial services (including investment advice), each individual will act solely in his or her capacity as a PW partner, principal, manager or employee. Any investment advice rendered, however, will be a part of other non-investment advisory financial planning services.

The limited forms of investment advice provided to clients reflect the broader focus of PW's financial planning activities. Although the services performed for any client or group of clients may vary, the focus will encompass such matters as personal budget preparation and analysis, estate planning, retirement planning, educational funding, insurance, personal tax planning, employee benefits consultation and the preparation of financial plans and personal financial statements presenting items such as net worth, cash flow and income tax projections.

Consultations with individual financial planning clients will be provided by PW professionals through PW's Executive Financial Services ("EFS") division. EFS also will offer financial planning seminars and conferences for employees of corporate clients or other groups. EFS will charge clients hourly rates for all individual financial planning consultations, will receive no commissions for such services, and will not charge performance-based fees. For both personal consultations and financial planning seminars and conferences, all investment advice rendered by EFS professionals will conform to the PWIA guidelines described herein.

In addition to the services described above, PW will provide computer-prepared personal financial plans produced by the Consumer Financial Institute ("CFI") division of PW. These computer-prepared plans will be based on information provided in a questionnaire completed by the recipient of the financial plan. CFI, located in Waltham, Massachusetts, will offer both personal financial plans prepared directly for individual clients and "private label" financial plans prepared by CFI for various financial institutions.

With respect to preparation of private label plans, CFI will act only as a programmer and processor of data in accordance with the specifications provided by CFI's institutional clients. Private label financial plans will be distributed by those institutional clients directly to their customers. In accordance with contractual arrangements between CFI and the client firm, customers of the client firm will be unaware of the identity of CFI and of the fact that the plans were processed by CFI.

Any investment advice included in CFI personal financial plans prepared directly for individual clients will be under the supervisory control of PWIA and will conform to the guidelines described herein. In general, CFI will bill clients for computer-prepared reports on a fixed fee basis.

2. The Investment Advisory Component of PW's Financial Planning Services

PW will not recommend investments in any particular security or industry sector. The extent of

PW's investment advice instead will be confined to matters such as the allocation of assets among different investment categories, portfolio diversification, hedging of portfolio risk, and more general economic topics such as interest rates, rate of economic growth, and inflation. n5

PW will not maintain custody of clients' funds or securities and will not manage or exercise discretionary authority over clients' accounts. In instances where clients seek or would benefit from specific advice on securities investment, PW may recommend an investment adviser or a securities brokerage firm that specializes in providing such advice. PW will not accept any fees in connection with such referrals.

III. Discussion

PW is proposing to register an affiliate under the Advisers Act rather than to register the entire accounting firm. For three essential reasons, we submit that under the circumstances present here the Commission is warranted in affording no-action relief to the provider of advisory services:

- (1) the registration of an affiliate in which PW is a general partner means that, for all practical purposes, the reach of the Advisers Act and the protections afforded thereunder to advisory clients are as broad and effective as if PW were itself to register;
- (2) the collateral consequences of requiring a large, national public accountancy firm itself to register as an investment adviser -- notably, subjecting the firm to state blue sky requirements for audited financial statements -- would serve no purpose under the federal statute and would create the potential of entangling federal and state securities regulators in matters beyond their proper regulatory concerns; and,
- (3) registration of the entire accounting firm as an investment adviser would misrepresent the extent of PW's investment advisory activities and would create confusion among PW's clients as to the role and activities of the firm.

The very fact that Congress saw fit to include an exemption for accountants from the registration requirements of the Advisers Act underscores the sui generis nature of PW's application. As the Commission staff is aware, there is little legislative, judicial, or administrative guidance as to the scope of this exemption from registration. Accounting firms, availing themselves of the exemption, have not had occasion to register under the Advisers Act. Accordingly, there is a relative dearth of precedential guidance under the Advisers Act on registration of accounting firms. Among accounting firms there may thus be differing views on the exact breadth of the exemption in light of the changes which the accountancy profession has undergone. The American Institute of Certified Public Accountants and state societies of certified public accountants sponsor affinity groups, conferences, seminars and publications on personal financial planning. These activities demonstrate the significance to the accounting profession of personal financial planning services and indicate that personal financial planning may be viewed as incidental to the practice of accountancy. PW, however, is not proposing to test the bounds of the accountant's exclusion, and instead would much prefer to find a practical way to register an affiliate under the Advisers Act and thus to avoid entangling the Commission in the non-investment advisory activities of a large, full-service public accounting firm.

No-action requests that provide guidance on registration of investment adviser affiliates generally address circumstances that are markedly different from those presented by PW's proposal n6 -- most important, the extent of liability of a parent for the acts of its registered adviser affiliate. The parent/affiliate arrangements addressed in such letters envision a situation where the parent, often a foreign entity, wishes to register an investment advisory affiliate and avoid financial liability for that entity. n7 In contrast, PW is not in any manner attempting to avoid responsibility for the actions of PWIA, but instead, as its general partner, is effectively subject to claims of advisory clients and to the reach of the Commission's regulatory powers.

As to the second point noted above, registration of the entire accounting firm would present serious operational problems to PW, particularly as the result of collateral implications under state

blue sky laws. It is difficult to justify subjecting the entirety of PW's operations to regulation by up to 50 state securities commissioners administering their states' blue sky laws governing investment advisers. More particularly, and in contrast to the federal approach, some states (such as Connecticut and Pennsylvania) require investment advisers -- whether or not they hold customers' funds or securities -- annually to file audited financial statements. PW, organized as a general partnership, does not presently provide the public or any competitor access to confidential financial information, which the preparation and public filing of audited financial statements would entail.

Other blue sky laws, such as those imposing recordkeeping obligations and requiring preclearance of all advertising by registered advisers, could expose the operations of PW to a degree of regulation by state blue sky authorities that it considers far disproportionate to the level of investment advisory activities in which it will engage. To provide a rough perspective: PW's tax services account for approximately 22% of the firm's total revenues; financial planning services (the majority of which do not involve investment advisory activities), in turn, account for less than 10% of tax services revenues.

PW is convinced that the costs and uncertainty of regulation of the entire firm under state blue sky laws -- taken together with the unpredictability of future changes to state blue sky laws and regulations -- outweigh the projected benefits of parent firm registration. PW recognizes that, from the vantage point of the Commission staff, these concerns respecting registration of an entire accounting firm may seem insubstantial, but from PW's viewpoint they are quite real.

Another collateral result of registering PW, itself, as an investment adviser is the potential for confusion among members of the public and the firm's audit clients who are likely to misperceive the import of such registration. As we have explained, PW does not intend to recommend specific securities or to provide analyses of particular companies or industry groups, but rather will provide generic advice relating to portfolio diversification, interest rates, economic trends, and the like. This generic advice itself is subordinate to the furnishing of essentially non-investment advisory financial planning services -- relating to such matters as personal budgets, retirement planning, estate planning, and educational funding.

PW thus is concerned that registration of the entire firm as an investment adviser will be mistaken as signifying full-scale entry into the investment advisory field. Establishing a separate affiliate to serve as the registered adviser, in PW's view, will be extremely helpful in differentiating PW's core auditing, tax and consulting practices from its ancillary financial planning activities. Again, we appreciate that concerns over image and reputation may seem somewhat attenuated to the Commission staff, but for PW such concerns have a real, and immediate, impact on its competitive standing with other nationally-recognized accounting firms.

Formation of PWIA also will provide an important managerial service for PW with regard to the firm's provision of financial planning services. PW believes that formation and registration of a registered investment adviser affiliate is essential to underscore the separation of investment advisory services from the auditing and other traditional services of the firm and to provide centralization of supervisory responsibility for investment advisory activities. In accordance with the AICPA's Statement on Quality Control Standards No. 1, PW believes that the affiliate approach will help assure effective planning and supervision of investment advisory services by centralizing responsibility for the setting and implementation of training and other qualifications for the designation of individuals competent to provide investment advisory services, the assignment of personnel to particular engagements, and the establishment of quality control procedures and monitoring of compliance with those procedures. PW recognizes that the centralization of these functions does not necessarily dictate the formation of an affiliate as a legally distinct entity, but, by the same token, there does not appear to us any compelling reason why an affiliate approach should not be permitted where, as here, the accounting firm, as a general partner of PWIA, will have full liability for the obligations and acts of the adviser.

Advisers Act registration of a special-purpose affiliate, rather than the entire firm, not only

comports with the reality of how PW's financial planning activities will be coordinated, but also will effectively satisfy the policy and purposes of the Advisers Act. The entity registered under the Advisers Act, PWIA, will control the scope and content of all investment advice provided by PW in connection with financial planning services and supervise its delivery to PW's clients. Registration of PWIA thus will provide an efficient vehicle to facilitate the Commission's Advisers Act oversight of all delivery of investment advice by PW without subjecting the entirety of PW's operations to federal registration. In addition, registration of an affiliate will facilitate administration of the Advisers Act by the Commission staff. All records, statements, substantive client communications, and other materials related to PW's personal financial planning activities will be available through PWIA headquarters.

* * *

The investor protection and other purposes of the Advisers Act will be promoted by permitting PWIA to register as the entity responsible for provision of investment advice by PW. In granting this no-action request, the Commission staff in our view will advance the public interest in providing a model for other national accounting firms to register affiliates under the Advisers Act. For the reasons set forth above, we request that the Commission staff provide assurance that it will not recommend that the Commission initiate enforcement action under Section 203 of the Advisers Act if PWIA registers as an investment adviser and PW itself does not so register.

Respectfully submitted,
Ralph C. Ferrara

Footnotes

n1 Price Waterhouse & Co., Inc. is an inactive corporation formed to protect the name of the firm from unauthorized use.

n2 In contrast, past no-action requests respecting Advisers Act registration of affiliates have involved corporate affiliates, which presumably were intended to afford the parent companies the benefits of limited liability under state law. See, e.g., Peterson, Young, Self & Asselin, SEC No-Action Letter (February 21, 1985) (LEXIS, Fedsec library, Noact File).

n3 The investment advice that PW will provide in connection with its financial planning engagements is described in detail in Section I.B. below.

n4 The policies, procedures and guidelines that PWIA will develop to control the scope and content of investment advice rendered by PW in connection with personal financial planning engagements are outlined in Section I.A.2 below.

n5 PW may retain an investment banker or similar consultant to provide supporting economic analysis and research. If such economic analysis is obtained, it presently is intended that such data will be used by the advisory board of PWIA to prepare its investment guidelines, by EFS officials in providing personal financial planning services, and by CFI in producing computer-prepared financial plans for individual clients.

n6 See, e.g., Richard Ellis, Inc., SEC No-Action Letter, [1981-1982 Transfer Finder] Fed. Sec. L. Rep. (CCH) P 77,064 (Aug. 18, 1981); Peterson, Young, Self & Asselin, *supra*.

n7 See, e.g., Morgan Grenfell Investment Services, SEC No-Action Letter (May 13, 1977) (LEXIS, Fedsec library, Noact file) (wholly-owned subsidiary of a London merchant bank); Robert Fleming Investment Management Limited, SEC No-Action Letter (Jan. 20, 1978) (LEXIS, Fedsec library, Noact file) (activities of London branch of American based investment adviser do not require registration of separate London investment adviser under common control with the American entity); Mellon-Pictet International Management, Ltd., SEC No-Action Letter (May 8, 1980) (LEXIS, Fedsec library, Noact file) (joint venture between Swiss private bank and Mellon National Corporation); Richard Ellis, Inc., *supra* (indirect wholly-owned subsidiary of British partnership);

Robeco Group, SEC No-Action Letter (Oct. 28, 1981) (LEXIS, Fedsec library, Noact file) (company wholly-owned by group of Netherlands investment companies); County Bank Limited, SEC No-Action Letter (Oct. 29, 1981) (LEXIS, Fedsec library, Noact file) (wholly-owned subsidiary of British merchant bank); Gartmore Investment, Ltd., SEC No-Action Letter (Oct. 29, 1981) (LEXIS, Fedsec library, Noact file) (joint venture between British investment adviser and subsidiary of the Allegheny Corporation); Prudential Corp., SEC No-Action Letter (Nov. 6, 1981) (LEXIS, Fedsec library, Noact file) (wholly-owned subsidiary of a Prudential entity); Wardley Marine International Investment Management, SEC No-Action Letter (Nov. 1, 1982) (LEXIS, Fedsec library, Noact file) (joint venture of Marine Midland Bank and Hong Kong and Shanghai Banking Corp.); United States Trust Company of New York and F&C International Investment Management, SEC No-Action Letter (Jan. 26, 1983) (LEXIS, Fedsec library, Noact file) (joint venture of British investment adviser and United States Trust Company in the form of a general partnership); Hill Samuel Investment Management, Ltd., SEC No-Action Letter (Jan. 27, 1983) (LEXIS, Fedsec library, Noact file).