Investment Advisors Act of 1940 -- Section 206

Mar 28, 1983

ROCKY MOUNTAIN FINANCIAL PLANNING, INC.

TOTAL NUMBER OF LETTERS: 2

SEC-REPLY-1:
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
February 24, 1983
RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 82-370-CC
Rocky Mountain Financial Planning, Inc.
File No. 801-17363

We do not agree that "an investment adviser may have interests in a transaction and that his fiduciary obligation toward his client is discharged so long as the adviser makes complete disclosure of the nature and extent of his interest." While section 206(3) of the Investment Advisors Act of 1940 ("Act") requires disclosure of such interest and the client's consent to enter into the transaction with knowledge of such interest, the adviser's fiduciary duties are not discharged merely by such disclosure and consent. The adviser must have a reasonable belief that the entry of the client into the transaction is in the client's interest. The facts concerning the adviser's interest, including its level, may bear upon the reasonableness of any belief that he may have that a transaction is in a client's interest or his capacity to make such a judgment.

You also have asked us to comment upon the advisability of Rocky Mountain Financial Planning, Inc. ("RMFP"), a registered investment adviser, and Sentra Securities Corp. ("Sentra"), a registered broker-dealer, operating from the same office space and identifying the offices to be those of Sentra and RMFP. We understand that they would be operating through Steven H. Morton ("Morton"), the principal of RMFP and a registered representative of Sentra.

In any case a client may be confused as to whether Morton, in providing certain services, is doing so for RMFP or as a registered representative of Sentra and what the differences are between RMFP and Sentra. The sharing of offices may contribute to this confusion. However, where clients are aware of the capacity in which Morton would be acting with respect to any service and the difference, for example, with respect to supervision, between his acting for RMFP and his acting for Sentra, the mere sharing of offices would not violate Section 206 of the Act.

Stanley B. Judd
Deputy Chief Counsel

INQUIRY-1:
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ATTORNEYS AT LAW
717 SEVENTEENTH STREET SUITE 2150
DENVER, COLORADO 80202
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October 13, 1982

U.S. Securities and Exchange Commission
Division of Investment Management
Office of Chief Counsel
450 Fifth Street
Washington, D.C. 20001

Re: Investment Advisors Act of 1940, Section 206(1)-(4)
Rocky Mountain Financial Planning, Inc.; File No. 801-17363-3

Gentlemen:

We respectfully request your interpretation of Section 206 of the Investment Advisors Act of 1940 (the "1940 Act") as it relates to the anticipated activities of our client, Rocky Mountain Financial Planning, Inc. ("RMFP") and its principal, Steven H. Morton ("Morton").

RMFP is a Colorado corporation located in Glenwood Springs, Colorado and was recently registered as an investment advisor pursuant to the 1940 Act. Morton, a certified public accountant, is the sole shareholder and principal officer of RMFP. RMFP proposes to enter into contracts with individuals pursuant to which RMFP will provide investment advisory services. RMFP will charge for its services on an hourly basis. Depending upon the financial position and financial goals of each individual client, RMFP's advice could entail recommending an investment package comprised of any combination of equity securities, tax-free securities, government obligations, insurance and tax sheltered investments, in addition to other financial products.

In addition to being the principal of RMFP, Morton is now a registered representative who intends to place his license with Sentra Securities Corp., a registered broker-dealer located in San Diego, California ("Sentra"), for the purpose of operating a branch office of Sentra in Glenwood Springs, Colorado. Sentra is unaffiliated with RMFP or Morton, is a member of the NASD and is engaged in a general securities business.* As a branch office of Sentra, Morton would be subject to all applicable laws, rules and regulations of the Securities & Exchange Act of 1934 and the NASD.

> ** In accordance with the guidelines set forth by the staff in Financial Services Corp. of America, avail. Oct. 9, 1974, Morton will make all appropriate disclosures and obtain the permission of Broker to engage in the advisory business.*

RMFP contemplates that in connection with the giving of investment advice, it may from time to time recommend that a client purchase of tax sheltered investment in the nature of limited partnership interests offered through Sentra. In these instances, Morton may have a financial interest in the transaction which will allow Morton to earn compensation in addition to RMFP's advisory fees. The compensation which could be received by Morton is illustrated by the following situations:

1. Limited partnership interests for which Sentra acts as selling agent. With respect to such limited partnership interests, Morton would receive a commission as a registered representative of Sentra for any interests placed with advisory clients of RMFP.

2. Limited partnership interests for which Sentra acts as selling agent and Morton receives a sales commission as in paragraph (1) above. In addition, as added incentive for the placing of the interest, Morton would receive a percentage of the general partner's participation in proportion to

the sales for which Moton is responsible.

3. The same as paragraph (1) above except that in addition to receiving a commission based on a percentage of sales, Morton would also be compensated on an hourly basis for rendering financial consulting advice to the promoters of the limited partnership in connection with the structuring of the transaction. The payment of such hourly fees may or may not be contingent upon the closing of the deal.

Before considering the issues raised by the above situation, it should be noted that pursuant to Section 206(3) of the Act, RMFP will make written disclosure of the capacity in which Morton is acting and will obtain the client's consent to the transaction. Additionally, this disclosure will set forth the amount of compensation to be received by Morton and that similar investments are available from other sources. *

** The exact nature of the disclosures will be in accordance with guidelines set forth by the Commission and the staff in 17 CFR 276.40, (Rel. No. I.A.-40, Jan. 5, 1945); Don P. Matheson Co., avail. Sept. 1, 1976; Madison & Burke Capital, avail. Oct. 21, 1973; David P. Atkinson, avail. Aug. 1, 1977; In the Matter of Investment Controlled Research, et al., I.A. Rel. No. 701, Sept. 17, 1979; Boston Advisory Group, avail. Dec. 5, 1976.*

The source of our concern, regardless of the level of disclosure RMFP makes concerning the nature and extent of an interest which Morton may have in a transaction, results from the Commission's suggestion that in certain circumstances, investment advisors may be prohibited from advising clients to purchase financial products in which the investment advisor has a personal interest. In the matter of Kidder, Peabody & Company, Inc., et al., 48 SEC 911 (1968), the Commission stated "... an investment advisor must not effect transactions in which he has a perrsonal interest in a manner that could result in preferring his own interest to that of his advisory client's" at 916. The Kidder case is somewhat inconsistent with relevant SEC no-action letters dealing with this issue. **

*** See footnote above.*

Our reading of these no-action letters indicates that an investment advisor may have interests in a transaction and that his fiduciary obligation toward his client is discharged so long as the advisor makes complete disclosure of the nature and extent of his interest. The Kidder case, however, suggests that there is some level of interest which once attained by the investment advisor absolutely prohibits him from recommending that investment vehicle to his advisory clients. We request your guidance in resolving this issue as it relates to the three situations above presented.

Finally, we request your interpretation as to the advisability of operating the Sentra branch office and RMFP from the same office space and of identifying the offices to be those of Sentra and RMFP. It is the position of RMFP and Morton that by operating both businesses from the same office space and identifying RMFP's office an also being an office of Sentra, additional protection will be provided to RMFP's advisory clients in that they will be immediately put on notice that Morton may act in a dual capacity. Additionally, it appears that Section 206(3) of the 1940 Act impliedly permits this situation in that the last sentence of that section states that it does not apply to an investment advisor who "... is not acting as an investment advisor in relation to such transaction." Of course, as previously discussed, RMFP will follow all SEC guidelines with respect to disclosure to RMFP advisory clients of any adverse financial interest RMFP or Morton may have in recommended Investments. Additionally, Morton will keep the operations of RMFP and Sentra separate and distinct through, among other things, the use of separate letterhead for correspondence and different books of account.

Your assistance in this matter is greatly appreciated.

Sincerely,
FISHMAN, GEMAN, GERSH & BURSIEK, P.C.
Peter E. Gadkowski