

**TOWNSEND AND ASSOCIATES, INC.**

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

**September 21, 1994**

**TOTAL NUMBER OF LETTERS: 2**

**SEC-REPLY-1:**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**September 21, 1994**

**Mr. Jeff Townsend  
Townsend and Associates, Inc.  
1120 Lincoln Street, Suite 708  
Denver, CO 80203**

Dear Mr. Townsend:

In your letter dated August 10, 1994, you state that you are a licensed broker and that you refer all of your clients to an asset manager, who in turn pays you a referral fee. You also state that you sell insurance products, and that, upon client request, you place IRA or SEP/IRA investments with, or forward money to, Oppenheimer. Finally, you state that you do not advise clients as to which funds are appropriate investments.

You ask whether, as a result of these activities, you must register as an investment adviser. We have provided general guidance regarding the circumstances in which a broker-dealer must register as an investment adviser and specifically addressed the consequences of a broker-dealer receiving referral fees from an investment adviser.

Section 202(a)(11) of the Investment Advisers Act of 1940 (the "Advisers Act") defines "investment adviser" as:

*any person, who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . .*

A person who meets the definition of investment adviser is required to register with the Commission as an investment adviser, unless he or she is otherwise excluded from the definition or exempt from registration. The Advisers Act contains an exclusion from the definition of investment adviser for any broker or dealer, including a registered representative of a broker-dealer, who performs investment advisory services that are "solely incidental" to the conduct of his or her broker-dealer business and who receives no "special compensation" for providing advisory services. n1

Because the determination of whether investment advice is solely incidental to your activities as a broker is fact-specific, we cannot definitively determine from your letter whether your advisory activities are solely incidental to your brokerage activities. While the term "solely incidental" is not defined in the Advisers Act or the rules thereunder, the staff has provided some guidance on its meaning. The staff has taken the position that the following activities may not be solely incidental to the conduct of a broker-dealer's business: (1) advisory services offered as part of an overall plan that assesses the financial situation of a customer and formulates a financial plan, n2 and (2) performance of investment supervisory services or other investment management services tailored to the specific long-term investment needs of individual clients. n3

We cannot determine from your letter all the sources of your compensation, but we can provide you with the following guidance. The staff has stated that, for purposes of the broker-dealer exclusion, special compensation generally refers to compensation other than commissions from brokerage transactions. For example, if a broker-dealer has two general commission schedules in effect, and the higher schedule includes investment advice, the broker is receiving special compensation. n4 In contrast, a broker-dealer charging all clients the same commission for brokerage transactions while only some clients receive investment advice is not receiving special compensation. n5

Although you do not fully describe your compensation arrangement, you do state that you receive referral fees from investment advisers for whom you solicit clients. The staff takes the position that broker-dealers that receive cash referral fees for referring clients to an investment adviser are not receiving "special compensation." n6 Separately, you should note that rule 206(4)-3 under the Advisers Act regulates cash referral fee payments by registered investment advisers, imposing certain obligations on both the adviser and the recipient of the fee. I have enclosed a copy of the rule for your information.

In conclusion, if you provide investment advisory services that are solely incidental to your broker-dealer business and receive no special compensation for such services, you may rely on the broker-dealer exception and do not have to register under the Advisers Act. Finally, we note that your stationery suggests that Townsend and Associates is a "Registered Investment Advisor." If, as you stated in your telephone conversation with Amy Doberman of this office, this representation applies to Consolidated Investment Services, the registered broker-dealer with which you are affiliated, you should alter your stationery to clarify this representation. n7

If you have further questions you may write or call this office at (202) 942-0660.

Sincerely,

Barbara Chretien-Dar  
Senior Counsel

## Footnotes

n1 Section 202(a)(11)(C).

n2 Investment Management & Research, Inc. (pub. avail. Jan. 27, 1977).

n3 Investment Advisers Act Release No. 471 (Aug. 20, 1975).

n4 Robert S. Strevell (pub. avail. Apr. 29, 1985).

n5 SEC v. National Executive Planners, Ltd., 503 F. Supp. 1066 (M.D.N.C. 1980).

n6 Koyen, Clarke & Associates, Inc. (pub. avail. Nov. 10, 1986).

n7 It may violate the antifraud provisions of the federal securities laws for a broker-dealer to employ the terms "financial adviser" or "financial consultant" merely as a device to induce the sale of securities. Security Sources Inc./Robert E. Frey (pub. avail. May 18, 1989).

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**INQUIRY-1: TOWNSEND AND ASSOCIATES, INC.**  
**A STRATEGIC FINANCIAL CONSULTING FIRM**  
**A Member of the BDC Consulting Group**  
**1120 Lincoln Street, Suite 708**  
**Denver, Colorado 80203**  
**(303) 832-7153**

**August 10, 1994**

**Office of the Chief Counsel**  
**Division of Investment Management**  
**Securities and Exchange Commission**  
**450 Fifth Street, NW**  
**Washington, DC 20549**

Dear Sirs,

Recently I read an article in the Financial Planning News regarding Investment Advisers. The article reviewed and answered questions whether one should become registered as an investment adviser. The one questions that I still have is this:

If I am a licensed broker and choose to refer all my clients over to an asset manager, who in turn pays me a referral fee, am I still obligated to register as an investment adviser? I still continue to sell insurance products, and on occasion, per client request, will place IRA or SEP/IRA investments, or forward funds to Oppenheimer, again, per my clients request. I do not advise the client as to which fund the moneys should go, I only provide current information to them and let them decide what to do.

I would appreciate any information you can supply me.

Sincerely,  
Jeff Townsend