

## **SECURITIES ACT INTERPRETIVE STATEMENT -22**

**RE:** Investment Adviser Fee Sharing - Credit Unions and other Financial Institutions

RCW 21.20.040 - Registration and notice filings required.

RCW 21.20.005(6) – Definition of investment adviser.

### **Questions Presented:**

- When may investment adviser fees be shared with unlicensed persons and entities including credit unions and other financial institutions?
- May a credit union or credit union service organization that is not licensed as an investment adviser receive advisory fees related to advisory services being provided by a licensed investment advisory operating on credit union premises?

### **Statutes and Regulations:**

RCW 21.20.040(3) states:

It is unlawful for any person to transact business in this state as an investment adviser or investment adviser representative unless: (a) The person is so registered or exempt from registration under this chapter; (b) the person has no place of business in this state and (i) the person's only clients in this state are investment advisers registered under this chapter, federal covered advisers, broker-dealers, banks, savings institutions, trust companies, insurance companies, investment companies as defined in the Investment Company Act of 1940, employee benefit plans with assets of not less than one million dollars, or governmental agencies or instrumentalities, whether acting for themselves or as trustees with investment control, or (ii) during the preceding twelve-month period the person has had fewer than six clients who are residents of this state other than those specified in (b)(i) of this subsection; (c) the person is an investment adviser to an investment company registered under the Investment Company Act of 1940; (d) the person is a federal covered adviser and the person has complied with requirements of RCW 21.20.050; or (e) the person is excepted from the definition of investment adviser under section 202(a)(11) of the Investment Advisers Act of 1940.

### **“Investment adviser” is defined in RCW 21.20.005(6) to mean:**

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 a part of a regular business, issues or promulgates analyses or reports concerning securities. "Investment adviser" also includes financial planners and other persons who, as an integral component of other financially related services, (a) provide the foregoing investment advisory services to others for compensation as part of a business or (b) hold themselves out as providing the

foregoing investment advisory services to others for compensation. Investment adviser shall also include any person who holds himself out as a financial planner.

"Investment adviser" does not include (a) a bank, savings institution, or trust company, (b) a lawyer, accountant, certified public accountant licensed under chapter 18.04 RCW, engineer, or teacher whose performance of these services is solely incidental to the practice of his or her profession, (c) a broker-dealer or its salesperson whose performance of these services is solely incidental to the conduct of its business as a broker-dealer and who receives no special compensation for them, (d) a publisher of any bona fide newspaper, news magazine, news column, newsletter, or business or financial publication or service, whether communicated in hard copy form, by electronic means, or otherwise, that does not consist of the rendering of advice on the basis of the specific investment situation of each client, (e) a radio or television station, (f) a person whose advice, analyses, or reports relate only to securities exempted by RCW 21.20.310(1), (g) an investment adviser representative, or (h) such other persons not within the intent of this paragraph as the director may by rule or order designate.

## **Discussion:**

### **A. Persons receiving advisory fees are “engaged in the business of advising others.”**

Investment advisers frequently enter into agreements whereby fees generated by providing investment advice are shared with other persons or entities. An “investment adviser” is defined as a person “who, for compensation, engages in the business of advising others.” Any person who receives advisory fees satisfies this definition. Therefore, any person who receives a portion of the advisory fee, including a wrap fee (which constitutes the receipt of both advisory and brokerage compensation), must be appropriately licensed or exempted or excluded from such licensure.

### **B. Statutory Exclusions for certain financial institutions.**

RCW 21.20.005(6)(a) excludes banks, savings institutions, or trust companies from the definition of investment adviser. Therefore, these entities may receive investment advisory fees even though they may not be licensed as investment advisers.

### **C. Credit Unions and Credit Union Service Organizations may receive advisory fees in certain circumstances.**

The Division has received inquiries in connection with an investment advisor offering advisor services on the premises of, and sharing advisory fees with, a credit union. RCW 21.20.005(6)(a) does not specifically exclude a credit union or a credit union service organization (CUSO) from the definition of “investment adviser.” Therefore, the credit union or CUSO may be subject to registration as an investment adviser.

The Division has previously addressed similar issues in connection with broker-dealer services being offered on credit union premises. Based in part on SEC interpretations of federal securities laws, the Division adopted WAC 460-21C-020, which provides that under certain “networking arrangements,” a credit union (or other financial institution) need not be licensed as a broker-dealer in order to receive a portion of the fees generated by the brokerage activities on credit union premises. The SEC’s “Chubb” no-action letter of November 24, 1993 (Chubb Letter), upon which WAC 460-21C-020 is based, discusses the factors that lead to a determination that a credit union in a networking arrangement need not be licensed as broker-dealer. The key factors include, but are not limited to:

1. The broker-dealer and its representatives operating on credit union premises are appropriately licensed.
2. The broker-dealer’s location is physically distinct from surrounding the credit union activity.
3. The broker-dealer informs all securities customers, and the customers acknowledge in writing, that the brokerage services are provided by the broker-dealer and not by the credit union or its CUSO, and that the securities acquired by the customer are not insured or guaranteed by the government.

The Division takes the position that credit unions and CUSOs may receive fees generated from advisory activities on credit union premises without being licensed as investment advisors, and without their employees being licensed as investment adviser representatives, if they enter into an agreement containing provisions similar to those discussed in the Chubb Letter. Among the provisions such agreements should contain are:

1. The firms and individuals providing the advisory services must be appropriately licensed with the Division, or in the case of a federal covered adviser, the SEC;
2. The investment adviser must be responsible for the training and supervision of all persons providing investment advisory services.
3. The adviser and its representatives will operate from a location on the credit union premises that is physically distinct from the surrounding credit union activity.
4. No credit union employee shall accept funds from customers to purchase advisory services.
5. As appropriate, the investment adviser will provide written disclosure to customers receiving advisory services that the products and services being offered or recommended are (a) not insured by deposit insurance; (b) are not deposits with, obligations of, or guaranteed by the credit union or CUSO; and (c) as applicable, subject to investment risk, including loss of principal.
6. The adviser must provide a separate written disclosure document where there is compensation for referrals and explain the terms of that compensation.
7. The investment adviser will require written acknowledgement, signed by the customer, of the customer’s receipt of the disclosures required by items 5 and 6, above.

#### **D. Liability for Unlawful Acts**

Nothing in this Interpretive Statement shall be deemed to limit in any way any liability that may be incurred by any person for violation of RCW 21.20.010 through RCW 21.20.030.

**Conclusion:**

Persons and entities receiving any portion of an advisory fee are “engaged in the business of advising others” and, therefore must be appropriately licensed as investment advisers or investment adviser representatives unless they are exempted from such registration or excluded from the statutory definition. Entities such as banks, savings institutions, and trust companies are excluded from the definition of “investment adviser” and may therefore receive advisor fees without being licensed as investment advisers. Credit unions and CUSOs, while not statutorily excluded, may nevertheless receive advisory fees without registration if they enter into agreements with appropriately licensed investment advisers that contain certain provisions and if the advisor agrees to provide the additional disclosures and acknowledgements.

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