



IDAHO
DEPARTMENT OF FINANCE

C.L. "BUTCH" OTTER
Governor

GAVIN M. GEE
Director

March 17, 2014



Re: [REDACTED] – Request for No-Action Letter

Dear [REDACTED]:

This is in response to your submission on February 19, 2014 requesting this Department take a “no-enforcement” position with respect to [REDACTED] referral arrangement with [REDACTED] and its licensed accountants. [REDACTED] is a state-registered investment advisory firm and [REDACTED] is a firm offering accountancy services.

Your letter and supplemental materials indicate that [REDACTED] wishes to enter into a referral arrangement with [REDACTED] and its licensed accountants. Under the referral agreement (“Agreement”) [REDACTED] through its licensed accountants would refer prospective investment advisory clients to [REDACTED] in exchange for a fee. Your letters and supplemental material reflect, but are not limited to, the following representations:

- The proposed Agreement shall meet the requirements of the Securities and Exchange Commission’s (“SEC”) rule on cash payments for client solicitations set forth in 17 C.F.R. § 275.206(4)-3 (“Advisers Act Rule 206(4)-3”).
- [REDACTED] will develop internal procedures and controls to centralize and document each referral of its accountancy clients to [REDACTED] for investment advisory services.
- [REDACTED] will ensure that the accountancy clients to whom [REDACTED]’s services are recommended are Idaho residents.
- Referrals will be made only by members, employees and other affiliates of [REDACTED] (“Licensed Accountants”), each of whom:
 - i. offers accountancy services to the public; and
 - ii. holds a valid, unrevoked and unsuspended license under the provisions of chapter 2, title 54, Idaho Code, designating such person as a certified public accountant or a licensed public accountant.

SECURITIES BUREAU

Bureau Chief - Marilyn T. Chastain
800 Park Blvd, Suite 200, Boise, ID 83712
Mail To: P.O. Box 83720, Boise ID 83720-0031
Phone: (208) 332-8004 Fax: (208) 332-8099
<http://finance.idaho.gov>

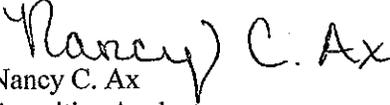
- A Licensed Accountant's referral to [REDACTED] will be made consistent with any fiduciary or other obligations owed to those accountancy clients, including but not limited to, the American Institute of CPA's ("AICPA") Rules of Professional Conduct.
- [REDACTED] and its Licensed Accountants will make referrals under the Agreement in accordance with the Agreement, [REDACTED]'s instructions (subject however to any fiduciary or other obligations owed to accountancy clients by [REDACTED] or its Licensed Accountants), the Investment Advisers Act of 1940, and SEC rules and regulations, the Idaho Uniform Securities Act 2004 ("IUSA") and rules and regulations thereunder, and other applicable federal, state or local law, rules and regulations.
- [REDACTED] will allocate and distribute referral fees received from [REDACTED] pursuant to the Agreement only among and to Licensed Accountants.
- Neither [REDACTED] nor any of its Licensed Accountants will render any investment advice on behalf of [REDACTED].
- Neither [REDACTED] nor any of its Licensed Accountants will make any representation regarding [REDACTED] that is false or misleading or in any way inconsistent with the written materials provided by [REDACTED], including Part 2 of [REDACTED]'s Form ADV (or a substitute brochure prepared by [REDACTED]).
- Neither [REDACTED] nor any of its Licensed Accountants will deliver to any accountancy client any written materials concerning [REDACTED] that have not been specifically approved in advance by [REDACTED] in writing.

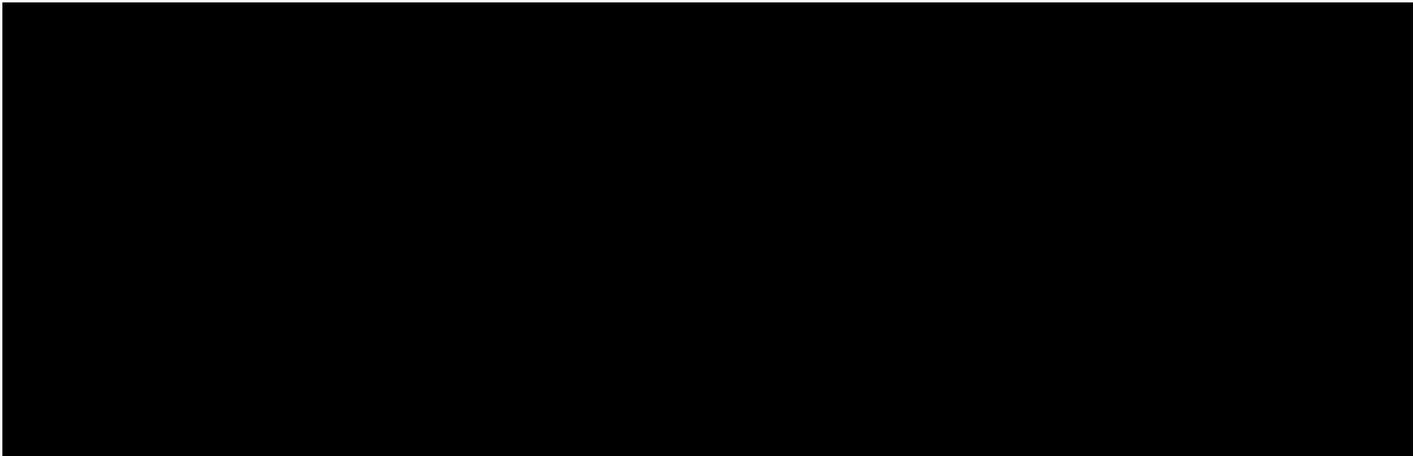
Based upon our review of [REDACTED]'s submissions, it appears that the Licensed Accountants' proposed solicitation activities on behalf of [REDACTED] would be considered investment adviser representative activities under the IUSA definition. Therefore, based on documents filed with the Department and [REDACTED]'s representations, the Department agrees to take a no enforcement action position with regard to the registration requirements for Licensed Accountants who refer accountancy clients to [REDACTED] in accordance with the Agreement.

Please be advised that this letter only expresses the Bureau's position on the enforcement action and does not purport to express any legal conclusion regarding the applicability of the statutory or regulation provisions of the IUSA. In addition, this position is based solely on the representations that you have made, and any different facts or circumstances might require a different conclusion.

If you have questions or comments regarding this matter, please contact Marilyn T. Chastain, Securities Bureau Chief, or me at 208-332-8004.

Sincerely,


 Nancy C. Ax
 Securities Analyst



March 13, 2014

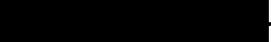
VIA HAND DELIVERY

Ms. Nancy C. Ax, Securities Analyst
Idaho Department of Finance
800 Park Blvd., Suite 200
Boise, Idaho 83712

Re: 

Request for No-Action Letter

Dear Ms. Ax:

This letter responds to the questions in your February 24, 2014 email concerning the February 19, 2014 letter submitted on behalf of registered investment adviser  requesting a no action position by the Department with respect to a referral arrangement with , Certified Public Accountants . You requested clarification of the following items (*in italics*):

- 1. Please specify the fiduciary or other obligations owed to 's accountancy clients in connection with a Qualified Accountant's recommendation of 's investment advisory services as referenced in Section 1 of the Referral Agreement ("Agreement").*

Accountants who perform attest services must preserve independence from their audit clients and, in that context, do not owe fiduciary duties. However, if an accountant "goes outside the normal role of independent auditor" and provides non-audit services,

fiduciary duties may arise.¹ In particular, courts have found that an accountant can be a fiduciary to his or her client when providing certain professional services including tax services, asset management and general business consulting.² Generally, if the following three elements are present in a client relationship, an accountant may be deemed to be a fiduciary to the client: (i) the accountant holds himself or herself out as an expert in an aspect of business, (ii) the client places a high degree of trust and confidence in the accountant and (iii) the client is heavily dependent upon the accountant's advice.³

The AICPA Code of Professional Conduct⁴ embodies standards of conduct which are closely analogous to a fiduciary relationship — objectivity, integrity, avoidance of conflicts of interest that impair objectivity, and truthfulness.⁵

Rule 102 -- Integrity and objectivity. In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

One of the AICPA Interpretations of this rule addresses conflicts of interest in more detail:

A conflict of interest may occur if a member performs a professional service for a client or employer and the member or

1 Goldwasser & Arnold, Accountants' Liability § 7:1:4 (Rel. #14, 10/11) (“[A] fiduciary relationship exists where a client justifiably reposes trust and confidence in an accountant to act in the client’s interest. Such a relationship may exist where the accountant renders personal financial, investment, or tax advice to a client or where the accountant manages the assets or business of a client.”)

2 <http://www.aicpa.org/interestareas/personalfinancialplanning/resources/practicecenter/professionalresponsibilities/pages/fiduciarystandardofcare.aspx> Note [REDACTED]’s assumed business name, [REDACTED] and the non-audit services listed on its website, including business advisory, business valuation and litigation, estate planning, transition planning and tax services.
[REDACTED]

3 <http://www.aicpa.org/interestareas/personalfinancialplanning/resources/practicecenter/professionalresponsibilities/pages/fiduciarystandardofcare.aspx>

4 The Idaho Accountancy Rules require Idaho-licensed accountants to comply with the AICPA Professional Standards as applicable under the circumstance. IDAPA 01.01.01.004.01.

5 www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_102.aspx CPAs also have a duty of confidentiality. Rule 301 of the AICPA Rules of Professional Conduct prohibit a CPA from disclosing any confidential information without the specific consent of the client.

his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service....

The AICPA Professional Conduct Rules thus impose on accountants the duty to maintain objectivity and avoid conflicts of interest that could impair that objectivity. These principles require that, in recommending ██████'s investment advisory services to an accountancy client, the referring ██████ accountant must believe that he or she is making an objective recommendation in the client's best interests and that the receipt of the referral fee is not impairing that objectivity. Further, AICPA Professional Conduct Rule 503 and Idaho Code § 54-218(1)(b) require disclosure of the conflict of interest resulting from the referral arrangement.^{6,7}

The Referral Agreement is drafted to acknowledge and comply with the foregoing professional duties and disclosure obligations owed to ██████'s accountancy clients in connection with a Qualified Accountant's recommendation of ██████'s investment advisory services.

2. *Please describe the purpose and ramifications of the caveat "(subject however to any fiduciary or other obligations owed to accountancy clients by ██████ and its Qualified Accountants)" in connection with ██████'s requirement to follow ██████'s instructions as referenced in Section 5 of the Agreement.*

⁶ AICPA Rules of Professional Conduct Rule 503 -- Commissions and Referral Fees: "Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity ... shall disclose such acceptance ... to the client." Idaho Code § 54-218(1)(b): "A licensee who is paid or expects to be paid a commission shall disclose in writing that fact to any person to whom the licensee recommends or refers a product or service to which the commission applies."

⁷ In compliance with Rule 206(4)-3 under the Investment Advisers Act of 1940 ("*Advisers Act*"), the Referral Agreement requires that each potential investment advisory client be notified of not only the conflict of interest created by the referral arrangement but also the terms of the referral fee and the amount, if any, that the potential client will be charged (through advisory fee differentials or otherwise) that may be attributable to the referral arrangement. 17 C.F.R. §275.206(4)-3 ("*Rule 206(4)-3*").

The "subject to" clause was added to the Referral Agreement to acknowledge the professional duties and obligations owed to [REDACTED]'s accountancy clients in connection with a Qualified Accountant's recommendation of SWM's investment advisory services.

As described in the February 19, 2014 letter, an SEC-registered investment adviser is permitted to pay a cash fee, directly or indirectly, to a third party who refers clients to the adviser (a "solicitor") if the parties comply with the requirements of Advisers Act Rule 206(4)-3. One of the requirements of Rule 206(4)-3 is that the written agreement between the investment adviser and the solicitor must include "an undertaking by the solicitor to perform his duties under the agreement in a manner consistent with the instructions of the investment adviser and the provisions of the Act and the rules thereunder." 17 C.F.R. §275.206(4)-3(a)(2)(iii)(A).

The "subject to" clause addresses any unanticipated conflict between instructions by [REDACTED] and the professional obligations owed by [REDACTED] accountants to their accountancy clients. For example, if [REDACTED] instructed [REDACTED] to provide personally identifiable financial information about a referral Prospect, [REDACTED] would decline on the grounds that AICPA Professional Conduct Rule 301 prohibits the disclosure of any confidential information without the specific consent of the client. The "subject to" clause acknowledges the priority of [REDACTED]'s duties to its clients in the event there is a conflict between those duties and [REDACTED]'s instructions under the Agreement.

- 3. Section 9 of the Agreement asserts [REDACTED]'s representation that its Qualified Accountants are not investment adviser representatives as defined in Idaho Code Section 30-14-102(16). Pursuant to the IUSA, the definition of an investment adviser representative appears to apply to ... "an individual... who receives compensation to solicit, offer, or negotiate for the sale of or for selling investment advice..." Please explain why [REDACTED] asserts that the definition of an investment adviser representative as set forth in Idaho Code Section 30-14-102(16) is not applicable.*

We read your question to imply that an individual who is paid for soliciting the sale of investment advice may thereby fall within the definition of "investment adviser representative" under Idaho's Uniform Securities Act ("IUSA"). However, it is necessary to consider the entire definition of "investment adviser representative" under the IUSA:

"Investment adviser representative" means an individual employed by or associated with an investment adviser or federal covered adviser who [1] makes any recommendations or otherwise gives investment advice regarding securities, [2]

manages accounts or portfolios of clients, [3] determines which recommendation or advice regarding securities should be given, [4] provides investment advice or holds herself or himself out as providing investment advice, [or 5] receives compensation to solicit, offer, or negotiate for the sale of or for selling investment advice... .

Idaho Code § 30-14-102(16) (*italics and clause numbers added for purposes of discussion below*). On its face, this definition has two necessary elements: First, the statute requires a specific type of agency relationship between the individual (as the representative) and an investment adviser or federal covered adviser (as the principal). Second, the statute requires that the individual perform at least one of the numbered activities.

The first element of Idaho Code § 30-14-102(16) requires that the individual must be “*employed by or associated with*” an investment adviser or federal covered adviser. For the reasons explained below, the Qualified Accountants do not satisfy this required relationship element of Idaho Code § 30-14-102(16) by virtue of their relationship with ██████ under the Referral Agreement and therefore should not be considered “investment adviser representatives”.

A. The Relationship between ██████ and ██████’s Qualified Accountants.

(1) *Uniformity of Interpretation.* Our analysis starts by acknowledging the fundamental precept that the IUSA is a Uniform Act and that maximizing uniformity of federal and state regulatory standards is one of its express objectives. Idaho Code § 30-14-608(b)(2). Based on this legislative direction, it is appropriate to look to the Advisers Act for the meaning of the term “investment adviser representative” as used in the IUSA.

(2) *Advisers Act Definition of “Investment Adviser Representative”.* Section 203A of the Advisers Act allocates between the SEC and state securities regulators regulatory oversight of investment advisers and persons associated with investment advisers.⁸ In particular, Section 203A(b)(1) provides, in pertinent part:

No law of any State ... requiring the registration, licensing, or qualification as an investment advisor or supervised person of an

⁸ Please note that the statement in the February 19th letter that ██████ currently has less than \$25 million of assets under management is incorrect. ██████ currently has more than \$89 million of assets under management and in the not-to-distant future expects to exceed the \$100 million trigger for switching back from state to federal regulation pursuant to Section 203A of the Advisers Act.

investment adviser shall apply to any person -- (A) that is registered under section 203 as an investment adviser or that is a supervised person of such person, except that a State may license, register, or otherwise qualify any *investment adviser representative* who has a place of business located within that State; (Emphasis added.)

The Advisers Act thereby pre-empts State regulation of supervised persons of federally registered investment advisers, except that the States retain authority to regulate "investment adviser representatives" as defined for purposes of Section 203A.⁹

The Commission's rules (17 CFR § 275.203A-3) define "investment adviser representative" as used in this statute, providing (in pertinent part):

For purposes of section 203A of the Act (15 U.S.C. 80b-3a) and the rules thereunder:

(a)(1) *Investment adviser representative.* "Investment adviser representative" of an investment adviser means a supervised person of the investment adviser

(2) Notwithstanding paragraph (a)(1) of this section, a supervised person is not an investment adviser representative if the supervised person:

(i) Does not on a regular basis solicit, meet with, or otherwise communicate with clients of the investment adviser

Under Advisers Section 203A and 17 CFR § 275.203A-3(a)(2)(i), the state is authorized to regulate a "supervised person" who (i) has a place of business located within the state and (ii) regularly solicits, meets with or otherwise communicates with clients of the supervising investment adviser. The Qualified Accountants do have a place of business located within the state of Idaho. But as explained below, the Qualified Accountants are not "supervised persons" as defined in the Advisers Act; and they do not regularly solicit, meet with or otherwise communicate with the clients of [REDACTED]. Accordingly, they are not "investment adviser representatives" within the meaning of Advisers Act Section 203A.

⁹ The following analysis of the effect of Advisers Act Section 203A and Rule 203A-3 on Idaho regulation of investment adviser representatives under the IUSA will apply directly once [REDACTED] reverts to federal registration and, we submit, should also apply, pursuant to the IUSA uniformity principle, to the relationship between [REDACTED] and the Qualified Accountants while [REDACTED] remains subject to Idaho investment adviser regulation.

(a) Supervised Person. ██████████'s Qualified Accountants are not "supervised persons". That term is defined in Section 202(25) of the Advisers Act to include any "person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser." ██████████ does not supervise the practice of accountancy by ██████████'s Qualified Accountants or their recommendation of ██████████ advisory services to their accountancy clients.

Nor does ██████████ control the management or policies of ██████████. In a related rule under Advisers Act Section 203A,¹⁰ the SEC considers "control" to mean power to direct or cause the direction of the management or policies, whether through ownership of securities, by contract, or otherwise. The Referral Agreement accords ██████████ no such power to affect the management or policies of ██████████ or the Qualified Accountants' practice of their profession. Because ██████████'s Qualified Accountants are not supervised or controlled by ██████████, they are not "supervised persons" and are not "investment adviser representatives" of ██████████ under Rule 203A-3(a)(1).

Even if ██████████'s Qualified Accountants could be characterized as "supervised persons", they are nonetheless excluded from the definition of "investment adviser representatives" by Rule 203A-3(a)(2)(i). ██████████'s Qualified Accountants will not on a regular basis solicit their own accountancy clients to engage ██████████ for investment advisory services; rather, a Qualified Accountant will refer a client to ██████████ only if the accountant deems the referral to be in a specific client's best interest and only if the referral is incidental to the accountancy services rendered to that client. Moreover, ██████████'s Qualified Accountants will not on a regular basis meet with or otherwise communicate with ██████████'s clients. Applying Rule 203A-3(a)(2)(i), ██████████'s Qualified Accountants are not investment adviser representatives for purposes of Advisers Act Section 203A; and, applying the IUSA's uniformity principle, ██████████'s Qualified Accountants are not investment adviser representatives under the IUSA.

(b) Person Associated With An Investment Advisor. To fall within the IUSA's definition of "investment adviser representative", the individual must be "employed by or associated with an investment adviser". Idaho Code § 31-14-102(16). ██████████'s Qualified Accountants are not employed by ██████████. Nor are they "associated with" ██████████. Turning again to the Advisers Act, Section 202(17) defines "person associated with an investment adviser" to include "any person directly or indirectly ... controlled by such investment adviser" Because ██████████ does not control the management or policies

¹⁰ 17 CFR § 275.203A-2(b).

of [REDACTED],¹¹ its Qualified Accountants who refer Prospects to [REDACTED] pursuant to the Referral Agreement are not “associated with” [REDACTED] within the meaning of Idaho Code § 30-14-102(16).

(3) *Exclusion from the IUSA definition of “investment adviser representative”.* The definition of investment adviser representative under the IUSA excludes an “agent whose performance of investment advice is solely incidental to the individual acting as an agent and who does not receive special compensation for investment advisory services.” Idaho Code § 30-14-102(16)(b). Our February 19th letter explains that the Referral Fee payable to Qualified Accountants pursuant to the Referral Agreement would not constitute “special compensation” as that term has been construed by the SEC in *Koyen, Clarke & Associates, Inc.* (publicly available Nov. 10, 1986). That no-action letter states the opinion of the Office of Chief Counsel of the SEC’s Division of Investment Management that payment of a cash fee by a registered investment adviser to a broker-dealer for performance of solicitation activities would not constitute “special compensation” for purposes of the comparable exclusion under Advisers Act section 202(a)(11).¹² Although the Qualified Accountants are not “agents” as that term is defined in Idaho Code § 30-14-102(2), if the same rule were applied in this case by analogy, Qualified Accountants would be excluded from the IUSA definition of investment adviser representative because the Referral Fee paid by [REDACTED] to [REDACTED] would not constitute “special compensation” for the referral.

B. Conceptual Consistency. Certified Public Accountants are expressly excluded from the definition of “investment adviser” under both the IUSA¹³ and the Advisers Act¹⁴ and therefor can receive compensation for giving investment advice without having to register as investment advisors under the IUSA or the Adviser’s Act. Clearly, the functions identified in clauses numbered [1] through [4] of Idaho Code § 30-14-201(16) (as quoted above on pages 4-5) are investment advisory functions that can be performed by CPAs in exchange for compensation without registration as investment advisers. As a matter of conceptual consistency, we believe that an individual CPA who recommends an investment adviser to an accountancy client should not be brought back under the regulatory umbrella

¹¹ See note 10 and accompanying text discussing “supervised person”.

¹² “Investment adviser’ ... does not include ... (C) 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”

¹³ Idaho Code § 30-14-102(15)

¹⁴ Advisers Act Section 202(11).

through clause [5] of the definition of "investment advisor representative". The reasons for excluding CPAs from the "investment adviser" registration requirements apply equally to CPAs who solicit for the sale of or selling investment advice, particularly given the authority cited in our February 19, 2014 letter that recommending an investment adviser is itself the giving of investment advice. Conceptually, it just makes logical and regulatory policy sense that CPAs excluded from the definition of "investment adviser" should also be deemed to be excluded from the IUSA definition of "investment advisor representative".

4. *Please identify any provisions within the Agreement that provide authority to [REDACTED] that will enable it to ascertain whether [REDACTED] or its Qualified Accounts is complying with the terms of the Agreement.*

Considerations of accountant-client confidentiality obligations and accountant-client privilege¹⁵ preclude [REDACTED] from direct access to information about [REDACTED] accountants' communications with their clients. Accordingly, much of the responsibility for ensuring compliance with the Agreement is borne by [REDACTED] pursuant to its contractual undertakings in the Referral Agreement (e.g., the obligations in paragraph 5 to comply with federal and state laws, in paragraph 6 to not render investment advice on behalf of [REDACTED] or act on behalf of [REDACTED] except as described in the Agreement, in paragraph 11 to allocate and distribute referral fees and act in compliance with specific Idaho Code sections). However, [REDACTED] can independently verify some information through public records (e.g., confirming that the referring accountant holds a valid, unrevoked and unsuspended license under Idaho Code and is not subject to any Statutory Disqualification as described in paragraph 11(G) of the Agreement).

In addition, as provided in paragraph 7 of the Agreement, [REDACTED] must obtain from each Prospect and forward to [REDACTED] a signed and dated Acknowledgement of Receipt of Part II of [REDACTED]'s Form ADV and [REDACTED]'s own Disclosure Statement. This acknowledgement process enables the referred Prospects to operate as a third party verification that [REDACTED] has complied with its disclosure obligations under the Agreement. As a practical matter, [REDACTED] can cross-check [REDACTED]'s compliance with the Agreement through its own contact with referred Prospects during the advisory client intake process.

Further, we've revised the Referral Agreement to require that each Qualified Accountant must sign an additional acknowledgment, to be delivered with each Prospect's

¹⁵ See note 5 and accompanying text re Rule 301 of the AICPA Rules of Professional Conduct; Idaho Code § 9-203A (confidentiality of accountant-client communications).

Acknowledgement of Receipt, certifying that the referring accountant has complied with the terms of the Agreement as of the time of the referral.

Lastly, [REDACTED] has contractual rights intended to ensure compliance with the Referral Agreement by [REDACTED] and its Qualified Accountants. First, [REDACTED] has disclosure obligations under paragraph 11(G) to notify [REDACTED] of any Statutory Disqualification in a timely manner. In addition, paragraph 3(D) of the Agreement provides that [REDACTED] will not be obligated to pay [REDACTED] any referral fee if, in the opinion of [REDACTED]'s legal counsel, such payment would violate any federal or state law, rule or regulation to which [REDACTED] is subject. Finally, paragraph 12 provides for automatic termination of the Agreement in the event that any representation or warranty by [REDACTED] in paragraph 11 ceases to be true and correct in all respects.

[REDACTED]'s verification of [REDACTED]'s compliance with the Referral Agreement will be accomplished through a combination of publicly verifiable information, third-party acknowledgement, an additional certification accompanying each referral, and contract rights under the Agreement. [REDACTED] is open to any other compliance verification mechanism the Department might suggest.

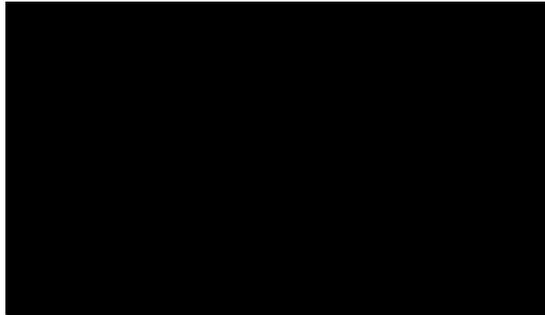
Request for No Action Letter

[REDACTED] requests that the Department take a no action position with respect to [REDACTED]'s referral arrangement with [REDACTED] and its Qualified Accountants. As set forth in the February 19th letter, the Department has discretion to take a no action position if it would be consistent with the IUSA and in the public interest. Our analysis in this supplemental letter demonstrates that, interpreted against the backdrop of the Advisers Act and the IUSA's uniformity principle, the definition of "investment adviser representative" is intended to capture only persons who are subject to the supervision and control of an investment adviser, which is not the case for [REDACTED] or its Qualified Accountants. Our analysis in this letter also demonstrates that it is consistent with the IUSA to exclude from the definition of "investment adviser representative" a certified public accountant who is excluded from the IUSA's definition of "investment adviser" and whose only relationship with an investment adviser is embodied in and governed by an Advisers Act Rule 206(4)-3 referral agreement. As explained in the February 19th letter, the antifraud provisions of the IUSA apply to [REDACTED] and its Qualified Accountants in referring Prospects to [REDACTED]. Moreover, the Agreement's provisions described in this supplemental letter further operate to protect the public interest. We respectfully request that the Director, pursuant to statutory authority, issue a no action letter stating that, if [REDACTED] and [REDACTED] enter into the proposed Rule 206(4)-3 compliant Referral Agreement and perform in accordance with the terms thereof, the Department will not

Ms. Nancy C. Ax
March 13, 2014
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take enforcement action against [REDACTED], [REDACTED] or its Qualified Accountants under the IUSA.

Very truly yours,

A large black rectangular redaction box covering the signature area.

RAR:
Enclosures

Nancy Ax

From: Nancy Ax
Sent: Monday, February 24, 2014 11:33 AM
To: [REDACTED]
Subject: Idaho Department of Finance- [REDACTED] Request for No-Action Letter

Dear [REDACTED]:

Your request for a no-action position on behalf of [REDACTED] has been forwarded to my attention for response. In connection with my review, please provide clarification regarding the following items.

1. Please specify the fiduciary or other obligations owed to [REDACTED]'s accountancy clients in connection with a Qualified Accountant's recommendation of [REDACTED]'s investment advisory services as referenced in Section 1 of the Referral Agreement ("Agreement").
2. Please describe the purpose and ramifications of the caveat "(subject however to any fiduciary or other obligations owed to accountancy clients by [REDACTED] and its Qualified Accountants)" in connection with [REDACTED]'s requirement to follow [REDACTED]'s instructions as referenced in Section 5 of the Agreement.
3. Section 9 of the Agreement asserts [REDACTED]'s representation that its Qualified Accountants are not investment adviser representatives as defined in Idaho Code Section 30-14-102(16). Pursuant to the IUSA, the definition of an investment adviser representative appears to apply to ... "an individual... who receives compensation to solicit, offer, or negotiate for the sale of or for selling investment advice..." Please explain why [REDACTED] asserts that the definition of an investment adviser representative as set forth in Idaho Code Section 30-14-102(16) is not applicable.
4. Please identify any provisions within the Agreement that provide authority to [REDACTED] that will enable it to ascertain whether [REDACTED] or its Qualified Accounts is complying with the terms of the Agreement.

Please send your response directly to my attention.

Sincerely,

Nancy C. Ax
Securities Analyst
Idaho Department of Finance

All of the pages comprising this email transmission and attachments contain confidential information from the Idaho Department of Finance. This information is intended solely for use by the individual or entity named as the recipient. If you are not the intended recipient, be aware that any disclosure, copying, distribution, or use of the contents of this transmission is prohibited. If you received this transmission in error, please notify us immediately by telephone at 332-8000.

February 19, 2014

VIA HAND DELIVERY

Mr. Kurt V. Merritt, Securities Analyst
Idaho Department of Finance
800 Park Blvd., Suite 200
Boise, Idaho 83712

RECEIVED
2014 FEB 19 AM 11:02
STATE OF IDAHO
DEPT OF FINANCE

Re: [REDACTED]
Request for No-Action Letter

Dear Mr. Merritt:

This law firm represents [REDACTED] an Idaho registered investment adviser. [REDACTED] requests that the Director of the Idaho Department of Finance (the "Director"), in his capacity as administrator under the Idaho Uniform Securities Act (Idaho Code § 30-14-101 *et seq.*, the "Idaho Securities Act") and pursuant to authority granted by § 30-14-605(d) of the Idaho Securities Act and IDAPA 12.01.08.003, issue a determination that the administrator will not institute a proceeding or an action under the Idaho Securities Act in connection with a proposed Referral Agreement between [REDACTED] and [REDACTED], Certified Public Accountants, a Professional Limited Liability Company ("[REDACTED]").

BACKGROUND

[REDACTED] is a limited liability company formed under the laws of the state of Idaho and registered with the Idaho Department of Finance as an investment adviser pursuant to Section 30-14-403 of the Idaho Securities Act. At the present time, [REDACTED] has less than \$25 million of assets under management and is therefore exempt from registration with the Securities and Exchange Commission (the "SEC") under the federal Investment Advisers Act of 1940 ("Advisers Act").

Mr. Kurt V. Merritt
February 19, 2014
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██████████ is an Idaho professional limited liability company doing business as ██████████. Its members are certified public accountants licensed by the state of Idaho to practice accountancy pursuant to the Idaho Accountancy Act, Idaho Code §§ 54-201 *et seq.*

██████████ and ██████████ desire to enter into a referral arrangement whereby certain Qualified Accountants (as defined below) may refer accountancy clients to ██████████ for investment advisory services and ██████████ will pay referral fees equal to a percentage of ██████████'s asset-based management fee charged to referred clients who contract for ██████████'s investment advisory services ("Referral Fees"). ██████████ and ██████████ propose to structure their referral arrangement to meet the requirements of the SEC's rule on cash payments for client solicitations set forth in 17 C.F.R. § 275.206(4)-3 ("Advisers Act Rule 206(4)-3"). Under federal law, a SEC-registered investment adviser is permitted to pay a cash fee, directly or indirectly, to a third party who refers clients to the adviser (a "solicitor") if the parties comply with the requirements of Advisers Act Rule 206(4)-3; and the solicitor will not be required to register separately as an investment adviser under federal law.

The proposed referral arrangement appears to be an issue of first impression under the Idaho Securities Act, as neither the Idaho Securities Act nor the rules implementing the Idaho Securities Act explicitly address referral arrangements between an investment adviser and a solicitor. However, the Director may take a no-action position if those determinations are consistent with the Idaho Securities Act and in the public interest. Idaho Code § 30-14-605(d) and IDAPA Section 12.01.08.003 (authorizing the Director to take a no-action position where consistent with the Idaho Securities Act and in the public interest).

THE REFERRAL ARRANGEMENT

The proposed referral arrangement between ██████████ and ██████████ will be governed by the attached Referral Agreement. Referrals will be made only by members, employees and other affiliates of ██████████, each of whom: (a) (i) offers accountancy services to the public and (ii) holds a valid, unrevoked and unsuspended license under the provisions of chapter 2, title 54, Idaho Code, designating such person as a certified public accountant or a licensed public accountant, and (b) whose recommendations are incidental to the professional practice of accountancy (each individually a "Qualified Accountant" and collectively "Qualified Accountants").

At the time of any solicitation activities, the Qualified Accountant must provide the prospective advisory client with a copy of ██████████'s brochure (Part II of Form ADV), and a separate written disclosure document that discloses, among other things, that ██████████ is being compensated for referring or recommending ██████████ and the terms of the compensation

(including any additional amounts the client will be charged by the adviser as a result of the referral arrangement). In addition, [REDACTED] must receive from the client, prior to or at the time of entering into any written or oral investment advisory agreement with the client, a signed and dated acknowledgment that the client received the investment adviser's brochure and the solicitor's written disclosure document. These features make the Referral Agreement compliant with Advisers Act Rule 206(4)-3.

We submit that it is appropriate and in the public interest in these circumstances for the Director to take a no-action position with respect to [REDACTED], [REDACTED] or any Qualified Accountant under the Idaho Securities Act in connection with the Referral. From a regulatory perspective, there is very little lost in investor protection by permitting the actions contemplated in the Referral Agreement. The terms of the Referral Agreement further the disclosure requirements of the Idaho Securities Act, and the anti-fraud provisions of the Idaho Securities Act continue to apply to the acts of both parties. The following legal analysis demonstrates that a no-action position is consistent with Idaho's laws and would not have an adverse effect on the public.

ANALYSIS

A. [REDACTED]'s Activities Do Not Violate the Idaho Securities Act or Rules.

The Idaho Securities Act allows [REDACTED]'s Qualified Accountants to refer accountancy clients to [REDACTED] for compensation, without registering as investment advisers under Part 4 of the Idaho Securities Act. The Referral Agreement is drafted so that "Qualified Accountants" performing the proposed referral activities fall within an exclusion from the definition of "Investment Adviser" under Idaho Code § 30-14-102(15).

Qualified Accountants are Excluded from the Definition of "Investment Adviser." Federal and state law definitions of "investment adviser" are broadly drafted to include essentially any person who is in the business of providing "investment advice" for compensation. Section 202(a)(11) of the Advisers Act and Idaho Code § 30-14-102(15) define "investment adviser" as "a person that, for compensation, engages in the business of advising others ... as to the value of securities or the advisability of investing in, purchasing or selling securities"

Both the Advisers Act and the Idaho Securities Act exclude from the definition of "investment adviser" an accountant whose investment advice is solely incidental to the practice of accountancy. Advisers Act Section 202(a)(11)(B); Idaho Code § 30-14-102(15)(b).¹ In

¹ It appears that state regulation of investment advisory services rendered by accountants is pre-empted and prohibited by Section 203A(b)(1)(B) of the Advisers Act, which provides: "No law of any

addition, Idaho Code § 30-14-102(15)(h) excludes from the definition of investment adviser “any person who offers accountancy services to the public and who holds a valid, unrevoked and unsuspended license under the provisions of chapter 2, title 54, Idaho Code, designating said person as a certified public accountant or a licensed public accountant.” This second broader exclusion of accountants, which is not part of the Uniform Securities Act and is unique in Idaho, allows accountants to give investment advice for compensation regardless of whether their advice is incidental to the practice of accountancy.

The Referral Agreement is drafted so that the definition of “Qualified Accountant” mirrors the accountant exclusion requirements under Idaho Code § 30-14-102(15). Therefore, [REDACTED]’s Qualified Accountants may give their accountancy clients investment advice, without triggering any registration requirement as investment advisers under Part 4 of the Idaho Securities Act.²

Referrals Qualify as “Investment Advice.” The combined effect of the exclusions in Idaho Code §§ 30-14-102(15)(b) and (h) means that it is not unlawful for a [REDACTED] Qualified Accountant to dispense “investment advice” for compensation without registering as an investment adviser under the Idaho Securities Act. The SEC has interpreted “investment advice” to include advice on the selection or retention of an investment manager. Securities and Exchange Commission Release No. IA-1092, October 8, 1987, page 7. The Department also acknowledges this concept. See IDAPA 12.01.08.090.06(a) (exempting an agent from registration as an investment adviser representative, to the extent that his “investment advisory activities are limited to recommending the investment advisory services of an investment adviser registered under Section 30-14-405”).

Qualified Accountants May Receive Compensation for Investment Advice. The Idaho Securities Act does not prohibit or limit the type of compensation that accountants exempted from registration may receive for “investment advice.” In contrast to the exclusions of accountants under Idaho Code §§ 30-14-102(15)(b) and (h), the exclusions of broker-dealers and their agents under Idaho Code §§ 30-14-102(15)(c) and (16)(b) require, in addition to their

State... requiring the registration... as an investment adviser or supervised person of an investment adviser shall apply to any person... (B) that is not registered under section 203 because that person is excepted from the definition of an investment adviser under section 202(a)(11).”

² While [REDACTED]’s Qualified Accountants commonly give their accountancy clients advice concerning investments, investment objectives and strategies, please note that neither [REDACTED] nor any of its Qualified Accountants charges any accountancy client a separate or additional fee or other special compensation for investment advice.

advice being incidental to the broker-dealer's business, that the broker-dealer not receive any "special compensation" for the investment advice. This prohibition mirrors Advisers Act Section 202(a)(11)(C).

While the prohibition of receipt of "special compensation" does not apply to accountants, it should be noted that the Referral Fee payable to Qualified Accountants pursuant to the Referral Agreement would not, in any event, constitute "special compensation", as that term has been construed by the SEC in *Koyen, Clarke & Associates, Inc.* (publicly available Nov. 10, 1986). That no-action letter states the opinion of the Office of Chief Counsel of the SEC's Division of Investment Management that payment of a cash fee by a registered investment adviser to a broker-dealer for performance of solicitation activities would not constitute "special compensation" for purposes of the exclusion under Advisers Act section 202(a)(11).

Qualified Accountants Remain Subject to Anti-Fraud Rules. The anti-fraud and liabilities provisions of Part 5 of the Idaho Securities Act continue to apply to the activities of any person providing investment advice, regardless of any exemption from the registration requirements in Part 4 of the Idaho Securities Act. As described above, the activities of the Qualified Accountants in the proposed referral arrangement would qualify as investment advice and therefore investors remain protected under Idaho Code § 30-14-502 and the anti-fraud rules issued thereunder.

B. ██████████'s Payment of the Referral Fee Is Not Prohibited by the Idaho Securities Act or Rules.

Section 30-14-404(f) Does Not Prohibit Referral Fees Paid to Solicitors. The Idaho Securities Act does not prohibit payments to solicitors (i.e., third-parties who refer clients to an investment adviser). The only provision of the statute that mentions referrals of investment advisory clients is Idaho Code § 30-14-404(f) ("Section 404(f)"). The relevant language of Section 404(f) provides that: "An investment adviser registered under [the Idaho Securities Act]... is not required to employ or associate with an individual as an investment adviser representative if the only compensation paid to the individual for a referral of investment advisory clients is paid to an investment adviser registered under [the Idaho Securities Act]... with which the individual is employed or associated as an investment adviser representative."³

³ In its entirety, Section 404(f) states:

An investment adviser registered under this chapter, a federal covered investment adviser that has filed a notice under section 30-14-405, Idaho Code, or a broker-dealer registered under this chapter, is not required to employ or associate with an individual

In other words, an investment adviser representative who refers investment advisory clients to more than one investment adviser does not have to be registered as a representative of multiple investment advisers.

On its face, Section 404(f) does not: (i) prohibit referrals of investment advisory clients by unregistered solicitors; (ii) prohibit compensation therefor; (iii) require a solicitor to be registered as an investment adviser representative; or (iv) require a solicitor to be employed or associated with a registered investment adviser to receive a compensation for such a referral. Rather, as discussed below, Section 404(f) is designed to avoid the necessity of dual registration of an individual as an investment adviser representative of more than one investment adviser.

The official comments to Section 404(f) and actions of other states confirm that Section 404(f) does not prohibit the payment of referral fees to unregistered solicitors, but rather it simply addresses a potential dual registration situation for investment adviser representatives. As discussed below, a majority of the states which have a statutory provision identical or equivalent to Section 404(f) have also adopted administrative rules allowing an investment adviser to pay third-parties for the referral of investment advisory clients.

The Official Comments to Section 404(f) Confirm This Interpretation. Official Comment 5 to Section 404(f) provides that administrators may adopt rules or orders interpreting this section, and specifically mentions Advisers Act Rule 206(4)-3 as an example of a rule that addresses referral fees. This comment indicates that a rule that permits the payment of compensation to unregistered third-party solicitors for referrals of investment advisory clients (i.e., a rule like Advisers Act Rule 206(4)-3) is not inconsistent with Section 404(f).

In addition, Official Comment 6 to Section 404(f) provides alternative language to be adopted for a state that intends to extend Section 404(f) to investment advisers who are not required to register (i.e., a registered investment adviser would not be required to employ or associate an individual as an investment adviser representative if payments for the referral are paid to *an investment adviser who is not required to register* under the Idaho Securities Act). It is unclear what was intended by including this Official Comment in the Idaho Securities Act since Idaho did not enact the alternative provision. Perhaps this comment indicates that, in the eyes of the drafters of the model act, the original language of Section 404(f) may carry a

as an investment adviser representative if the only compensation paid to the individual for a referral of investment advisory clients is paid to an investment adviser registered under this chapter, a federal covered investment adviser who has filed a notice under section 30-14-405, Idaho Code, or a broker-dealer registered under this chapter with which the individual is employed or associated as an investment adviser representative.

negative implication that only investment adviser representatives employed or associated with a registered investment adviser may refer investment advisory clients for compensation. However, as discussed below, a number of states have refuted this negative implication by adopting administrative rules explicitly permitting referrals by unregistered solicitors.

The Actions of Other States Confirm This Interpretation. At least fourteen other states have adopted language identical or similar to Section 404(f).⁴ Ten of these states have also adopted rules explicitly allowing an investment adviser to pay referral fees to solicitors, and only 3 of the 10 states have explicitly imposed a registration requirement for solicitors in all instances.⁵ The remaining 7 of the 10 states do not impose a registration requirement for solicitors.⁶ These actions reflect a broad consensus among other states that have adopted the Uniform Securities Act that Section 404(f) does not prohibit an investment adviser from receiving a referral from an individual who is not an investment adviser representative and paying compensation therefor.

In addition, most of the administrative rules that permit solicitations by unregistered third parties model the requirements of Advisers Act Rule 206(4)-3, which indicates broad consensus that compliance with those requirements adequately protects the investing public.

Payment of the Referral Fee Is Not Prohibited By Any Rule. IDAPA § 12.01.08.104 ("Rule 104") defines certain fraudulent, dishonest and unethical practices that violate the Idaho Securities Act. Rule 104 does not prohibit a referral arrangement for compensation between an investment adviser and a solicitor. Subsections 24 and 25 of Rule 104 prohibit the following practices:

24. Profit/Loss Sharing. Sharing directly or indirectly in profits and losses in the account of any customer without the written

⁴ The following states have statutes identical or equivalent to Section 404(f): Georgia, Indiana, Iowa, Kansas, Maine, Michigan, Mississippi, Missouri, New Mexico, Oklahoma, South Carolina, South Dakota, Vermont, and Wisconsin.

⁵ Only Mississippi, Oklahoma and South Dakota require the solicitor to be registered as an investment adviser representative or investment adviser. New Mexico generally requires registration, unless the payment is one-time only or the Director waives the registration requirement.

⁶ See Ga. Comp. R. & Regs. 590-4-4-.12 and 590-4-4.19(22); Iowa Admin. Code. R. 50.37(502); Kan. Admin. Regs. § 81-14-5(f); Mo. Code Regs. Tit. 15, § 30-51; S.C. Code Ann. Regs. 13-408(15); and Wis. Admin. Code § DFI-Sec 5.06(25).

authorization of the customer and the broker-dealer which the agent represents.

25. Splitting Commissions. Dividing or otherwise splitting the agent's commissions, profits, or other compensation from the purchase or sale of securities with any person not also registered in Idaho as an agent for the same broker-dealer, or for a broker-dealer under direct or indirect common control.

Both of these provisions, by their express terms, apply to agents of broker-dealers⁷ and not to investment advisers. Even if applied to investment advisers, these rules do not prohibit ██████'s payment of its asset-based referral fee, which is a specified percentage of the asset-based management fee charged by ██████ to its investment advisory client: ██████ does not share in the profits and losses in its investment advisory clients' accounts and does not itself purchase or sell securities for its clients and therefore does not itself charge its clients any commission or other compensation for the purchase or sale of securities.⁸ Further, each investment advisory client referred to ██████ by a ██████ Qualified Accountant acknowledges, prior to entering into an investment advisory agreement with ██████, that ██████ will be paying the referral fee to ██████. See Exhibit A to the Referral Agreement.

One of the rationales behind the prohibition on fee splitting in Rule 104 is to preserve the Department's oversight of parties who profit from regulated transactions under the Idaho Securities Act. Three features of the proposed referral arrangement demonstrate the inapplicability of that rationale to this situation. First, as discussed above, ██████'s Qualified Accountants are already exempted from the investment adviser registration requirements of the Idaho Securities Act. The very broad exclusion of accountants in Idaho Code § 30-14-102(h) reflects the policy decision of the Idaho Legislature that registration and regulatory oversight are unnecessary for accountants who provide investment advice for compensation, likely because accountants must abide by strict rules of professional conduct which require that they act in the best interests of their clients.

Second, Qualified Accountants who perform under the Referral Agreement must not be subject to any Statutory Disqualifications, as defined in Section 11(G) of the Referral Agreement. This additional layer of qualification further protects potential investment advisory

⁷ Idaho Code § 30-14-102(2) defines "agent" as an individual who represents a broker-dealer.

⁸ Investment advisory clients are liable to pay commissions or other compensation to the registered broker-dealers who purchase or sell securities for the clients' accounts.

Mr. Kurt V. Merritt
February 19, 2014
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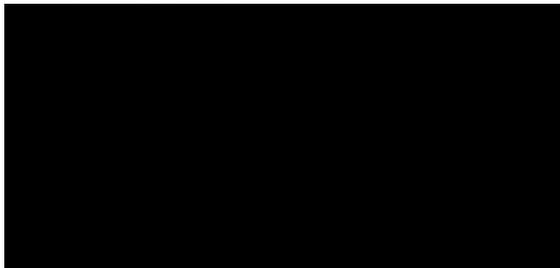
clients from persons who may meet the definition of Qualified Accountant, but are known violators of selected state and federal securities laws. Third, Section 5 of the Referral Agreement requires the Qualified Accountant to perform any duties in accordance with the Idaho Securities Act and the rules thereunder, as well as the Advisers Act. Under these circumstances, there is little to be gained by imposing on investment advisers an anti-fee splitting rule similar to Rule 104(25).

CONCLUSION

Based on the foregoing facts and legal analysis, [REDACTED] requests that the Director issue a determination, pursuant to authority granted by § 30-14-605(d) of the Idaho Securities Act and IDAPA 12.01.08.003, that the administrator will not institute a proceeding or an action against [REDACTED], [REDACTED] or any Qualified Accountant under the Idaho Securities Act in connection with the Referral Agreement.

Please find a check for \$50.00 enclosed, in satisfaction of the required fee under IDAPA 12.01.08.003.03.

Very truly yours,

A large black rectangular redaction box covering the signature area.

RAR:
Enclosures