SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release Nos. 34-52407; IA-2426; File No. S7-25-99]

RIN 3235-AH78

Certain Broker-Dealers Deemed Not To Be Investment Advisers, Extension of Compliance Date

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; extension of compliance date.

SUMMARY: The Securities and Exchange Commission is extending the compliance date for the rule that identifies circumstances under which a broker-dealer's advice is not "solely incidental to" its brokerage business or to brokerage services provided to certain accounts and thus subjects the broker-dealer to the Investment Advisers Act of 1940.

DATES: The effective date for §275.202(a)(11)-1, issued on April 12, 2005 (70 FR 20424, Apr. 19, 2005), remains April 15, 2005 (except for §275.202(a)(11)-1(a)(1)(ii), which was effective May 23, 2005). Effective on September 19, 2005, the compliance date for §275.202(a)(11)-1 (b)(2) and §275.202(a)(11)-1(b)(3) is extended from October 24, 2005 to January 31, 2006.

FOR FURTHER INFORMATION CONTACT: Catherine E. Marshall, Senior Counsel, or Nancy M. Morris, Attorney-Fellow, at (202-551-6787), or Iarules@sec.gov, Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-0506.

SUPPLEMENTARY INFORMATION: On April 12, 2005, the Securities and Exchange Commission ("Commission") issued its release adopting rule 202(a)(11)-1 under the Investment Advisers Act of 1940 ("Advisers Act") regarding the application of

the Advisers Act to certain broker-dealers. Paragraph (b)(2) of the rule provides that when a broker-dealer provides advice as part of a financial plan or in connection with providing financial planning services, a broker-dealer provides investment advice that is not "solely incidental to" (a) the business of a broker or dealer within the meaning of the Advisers Act or (b) brokerage services within the meaning of the rule if it: (i) holds itself out to the public as a financial planner or as providing financial planning services; or (ii) delivers to its customer a financial plan; or (iii) represents to the customer that the advice is provided as part of a financial plan or in connection with financial planning services. Paragraph (b)(3) provides that exercising investment discretion is not "solely incidental to" (a) the business of a broker or dealer within the meaning of the Advisers Act or (b) brokerage services within the meaning of the rule (except for investment discretion granted by a customer on a temporary or limited basis).

The American Council of Life Insurers ("ACLI"), the Securities Industry Association ("SIA") and the Financial Services Institute ("FSI") each filed a petition for rulemaking under rule 192 of our Rules of Practice seeking an extension of certain compliance dates in rule 202(a)(11)-1.[1] The ACLI expressed concerns about its

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[1] American Council of Life Insurers, Petition for Rulemaking Under Rule 192 of the SEC's Rules of Practice Concerning Extended Implementation Date in Rule 202(a)(11)-1(b)(2) Under the Investment Advisers Act of 1940, July 27, 2005, File No. 4-507 (available at: http://www.sec.gov/rules/petitions/4-507a.pdf) (The ACLI is seeking an extension of the compliance date for rule 202(a)(11)-1(b)(2) until April 24, 2006.); Securities Industry Association, Petition for Rulemaking; Request for Extension of Certain Compliance Dates for Rule 202(a)(11)-1 (S7-25-99), July 28, 2005, File No. 4-507 (available at: http://www.sec.gov/rules/petitions/petn4-507.pdf) (The SIA is seeking an extension of compliance dates for rule 202(a)(11)-1(b)(2) and (b)(3) until April 1, 2006.); Securities Industry Association, Request for Extension of Certain Compliance Dates for Rule 202(a)(11)-1 (S7-25-99), August 25, 2005, File No. 4-507 (supplementing the SIA's petition for rulemaking) (available at: http://www.sec.gov/rules/petitions/4-507b.pdf); Financial Services Institute Inc., Request for Extension of Compliance Dates for Certain Aspects of Rule 202(a)(11)-1 (S7-25-99), Aug. 25, 2005, File No. 4-507 (available at: http://www.sec.gov/rules/petitions/4-507c.pdf) (The FSI is seeking an extension of the

members' ability to fulfill the enterprise-wide transformation necessary to comply with the financial planning provision of rule 202(a)(11)-1(b)(2) by the October 24, 2005, compliance date. The SIA and the FSI expressed concerns about their members' ability to comply with the financial planning and investment discretion provisions of rule 202(a)(11)-1(b)(2) and (b)(3) by the October 24, 2005, compliance date. All three organizations state that, to comply with the rule, many of their members face requirements that will make it difficult to complete their compliance efforts by the October compliance date.

Specifically, with respect to subparagraph (b)(2), the ACLI and the SIA note that, among other things, the detailed personnel training and system enhancements (which need to be coded and tested) required by the rule will add to compliance complexities. The ACLI states, for example, that its members need time to ascertain the application of the rule to their activities, train their employees to fulfill their Advisers Act obligations, and license their employees as investment adviser representatives under state law. The SIA and the FSI state that their member firms need time to make judgments about their activities, products and services that are, and are not, subject to the Advisers Act and to develop and disseminate meaningful disclosures about brokerage and advisory relationships which, they state, will require substantial computer programming changes.

With respect to subparagraph (b)(3), the SIA and the FSI state that broker-dealers must evaluate each account currently classified as "discretionary" to determine whether it is discretionary within the meaning of the rule, to discuss with each affected client the investment options available for each account and to provide those clients with time to

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compliance dates for rule 202(a)(11)-1(b)(2) and (b)(3) until April 24, 2006.) Although the FSI did not expressly petition for rulemaking, we so construe its extension request.

choose whether they want to maintain their accounts as non-discretionary brokerage accounts or investment discretion advisory accounts. According to the SIA, the volume of accounts, coupled with associated recordkeeping requirements and time spent waiting for customer responses, will cause the process to take a longer time to complete than currently permitted by the rule. In this regard, the SIA notes that this process will be labor intensive and time-consuming and will involve functions other than merely categorizing accounts. For example, for those clients who elect to have their accounts be advisory accounts, the SIA states that the broker-dealers will need time to create and finalize advisory agreements, prepare ADV filings and related adviser disclosures, adopt internal policies and procedures, and implement internal system infrastructure and trade processing so that the accounts comply with the Advisers Act. For accounts that will become non-discretionary brokerage accounts, the SIA states that its members likewise will need to consult with clients about the clients' options, document the new brokerage services, and develop systems to document that the account is a non-discretionary brokerage account. Further complicating the compliance process, according to the SIA, due to year-end reporting requirements, many member firms "black-out" their systems to changes from late-November through the end of the year. Finally, the SIA states that some broker-dealers who provide services that will be deemed to be investment advice under the rule are not currently registered as investment advisers and will need time to register as advisers and comply with the Advisers Act. The FSI similarly states that its members need additional time to review accounts and to consult with their clients about the clients' options and choices.

The ACLI, the SIA, and the FSI thus seek an extension of the compliance date so that their members have more time to take the actions necessary to bring them into compliance with the rule.

We have received three letters in opposition to the rulemaking petitions filed by the ACLI and the SIA. We have not received any letters that directly oppose the FSI's rulemaking petition.

The Investment Adviser Association ("IAA") filed a letter in opposition to the SIA's petition to extend the compliance date for paragraph (b)(3) of rule 202(a)(11)-1 concerning investment discretion advisory accounts.[2] The Consumer Federation of America, Fund Democracy, Consumer Action, and Consumers Union (collectively, "CFA") and Joseph Capital Management, LLC ("JCM") each filed a letter in opposition to the ACLI's and the SIA's petitions to extend the compliance dates for the financial planning and investment discretion provisions of rule 202(a)(11)-1.[3]

The IAA and CFA assert that determining whether a broker-dealer exercises investment discretion over an account is neither difficult nor time-consuming and that the SIA never indicated in its comment letter to this rulemaking that this determination would be difficult or time consuming. In a similar vein, JCM asserts that the final rule was "liberal" in the time constraints originally imposed and that the petitioners have not

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[2] Letter of Investment Adviser Association to Jonathan G. Katz (Aug. 4, 2005), File No. 4-507 (available at: http://www.sec.gov/rules/petitions/4-507/dgtittsworth080405.pdf).

[3] Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America; Mercer Bullard, Founder and President, Fund Democracy; Kenneth McEldowney, Executive Director, Consumer Action; and Sally Greenberg, Senior Counsel, Consumers Union, to Jonathan G. Katz, Secretary, Commission (Aug. 11, 2005), File No. 4-507 (available at: http://www.sec.gov/rules/petitions/4-507/4507-2.pdf); Letter from Ron A. Rhoades, Chief Compliance Officer, Joseph Capital Management, LLC, to Jonathan G. Katz, Secretary, Commission (Aug. 18, 2005), File No. 4-507 (available at: http://www.sec.gov/rules/petitions/4-507/4507-3.pdf).

adequately justified their extension requests. The IAA and the CFA further assert that the SIA and its members have long been aware that the final rule would require broker-dealers to treat investment discretion accounts as advisory accounts. With respect to financial planning, while the CFA acknowledges that "brokers and insurance agents will be required to undertake a significant effort to come into compliance with the rule in the allotted time," the CFA further states that investor protection concerns "justify that effort." JCM challenges the SIA's assertion that its members will be required to develop and disseminate disclosure once they determine whether a given activity is financial planning within the meaning of the rule. JCM asserts that financial planning activities have always triggered application of the Advisers Act.[4] According to JCM, the SIA's and ACLI's requests thus are inconsistent with our emphasis on compliance with the federal securities laws.

The Commission is persuaded that extending the compliance date for rule 202(a)(11)-1(b)(2) and (b)(3) for a short period of time is appropriate. While we have concerns about the effect of the extension in delaying the anticipated benefits of the rule, in our judgment a limited extension of the compliance date is, on balance, appropriate. Our judgment is based on the representations made by the SIA, the ACLI, and the FSI (whose members are required to comply with the rule and thus are in a position to assess the level of difficulty and time involved in their complying with the rule) and our

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[4] JCM cites our staff's interpretive release on financial planning. Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)]. We note, however, that the release expressly contemplated that, under appropriate circumstances, broker-dealers who provide financial planning services may have been able to avail themselves of the statutory exception set out in section 202(a)(11)(C).

experience in overseeing the industry. We are not, however, persuaded that a delay of up to an additional six months is necessary given that we already afforded broker-dealers approximately a six-month compliance period, and that these provisions will provide investors with important protections.[5] Accordingly, the Commission believes it is appropriate to extend the compliance date for rule 202(a)(11)-1(b)(2) and (b)(3) until January 31, 2006. The rule's effective date of April 15, 2005 remains unchanged.

The Commission for good cause finds that, for the reasons cited above, including the brief length of the extension we are granting, notice and solicitation of comment regarding the extension of the compliance date for rule 202(a)(11)-1(b)(2) and (b)(3) are impracticable, unnecessary, or contrary to the public interest.[6] In this regard, the Commission notes that broker-dealers need to be informed as soon as possible of the extension and its length in order to plan and adjust their implementation processes accordingly.

By the Commission.

Jonathan G. Katz
Secretary

Date: September 12, 2005

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[5] JCM asserts that providing the requested relief will exacerbate and extend investor confusion with respect to fee-based accounts. We disagree. Broker-dealers already are required to comply with the specific disclosure provisions of rule 202(a)(11)-1(a)(1)(ii).

[6] See section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) ("APA") (an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are "impracticable, unnecessary, or contrary to the public interest). The change to the compliance date is effective upon publication in the Federal Register, which is less than 30 days after publication. The APA allows effective dates less than 30 days after publication in the Federal Register for "a substantive rule which grants or recognizes an exemption or relieves a restriction." See section 553(d)(1) of the APA.