Proposed Interpretive Rule Under the Advisers Act Affecting Broker-Dealers

On September 24, 2007, the Securities and Exchange Commission ("SEC") released for comment a proposed interpretive rule discussing the applicability of the Investment Advisers Act of 1940 ("Advisers Act") to certain broker-dealer activities. This proposed rule would respond to certain ambiguities in the so-called broker's exemption from the Advisers Act created by the decision in Financial Planning Association v. SEC ("FPA Decision") invalidating Rule 202(a)(11)-1 under the Advisers Act. That Rule had attempted to clarify and define the scope of the broker's exemption in light of current business practices.

The SEC received just three relatively brief comments before the comment period expired on November 2, 2007. The SEC could adopt the proposed interpretive rule as quickly as late November 2007, consistent with the requirements of the Administrative Procedures Act. This timing would be curious, however, since it would occur only a few weeks before the Rand Corporation is scheduled to publish its study of the very issues addressed in the proposed interpretive rule.

Proposed Rule 202(a)(11)-1 under the Advisers Act would clarify that: (1) the broker's exemption is unavailable when a broker-dealer exercises investment discretion over the client account, unless the exercise of such discretion is "temporary and limited," or the broker-dealer charges a separate fee, or separately contracts, for advisory services; (2) a broker-dealer does not receive "special compensation," thereby forfeiting availability of the broker's exemption, solely because it charges different rates for its full-service brokerage services and discount brokerage services; and (3) a broker-dealer is an investment adviser solely with respect to accounts for which it provides services that subject it to the Advisers Act. "Temporary and limited investment discretion" is interpreted to include cases in which the broker-dealer is given discretion as to: (1) the price and time to execute a trade for a set quantity of securities; (2) an isolated instance of discretion; (3) sweep accounts where idle cash is swept into an interest paying vehicle; (4) trades to satisfy margin calls; (5) certain tax motivated trades in bonds; (6) purchases of bonds that meet certain criteria; and (7) trades within parameters set by the client. The brokerage industry apparently identified these issues to the SEC as requiring clarification.

The SEC deferred proposed rule-making on the application of the broker's exemption to financial planning activities, a subject that had been treated in the invalidated Rule 202(a)(11)-1, until after the Rand Corporation completes its study of these issues later in 2007.

Two procedural aspects of the proposed interpretative rule are of interest. First, the SEC relied upon its rarely used authority to issue interpretative rules. Such rules are exempt from certain provisions of the Administrative Procedures Act and, more importantly, do not require a statutory grant of authority for their issuance. See Pierce, Administrative Law Treatise §6.4 (2002); Skidmore v. Swift & Co., 323 U.S. 134 (1944). Second, it is also interesting that, while the invalidated Rule 202(a)(11)-1 relied upon rule-making authority granted in Sections 202(a)(11)(F) and 211(a) of the Advisers Act, the proposed interpretative rule relies only upon rule-making authority granted in Section 211(a). The FPA Decision had treated the SEC's reliance upon Section 211(a) as nothing more than an unhelpful after-thought. That Decision had also interpreted the grant of rule-making authority in Section 202(a)(11)(F) of the Advisers Act very narrowly.

Contact Information

For further information, please contact your usual Ropes & Gray lawyer or:

Richard D. Marshall
212-596-9006
richard.marshall@ropesgray.com