



8 JUL 1994

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-11-CC  
Arthur Andersen & Co.  
File No. 132-3

In your letter dated June 20, 1994 you request our assurance that we would not recommend any enforcement action to the Commission under the Investment Advisers Act of 1940 ("Advisers Act") if Arthur Andersen & Co. ("Arthur Andersen") establishes Arthur Andersen Financial Advisers ("AAFA"), a registered investment advisory affiliate, to oversee the rendering of investment advice by Arthur Andersen, without registering Arthur Andersen under the Advisers Act, in the manner described below.

AAFA will supervise the rendering of investment advice by partners and professional employees in connection with Arthur Andersen's personal financial planning and employee benefit plan consulting services. AAFA will be organized as a general partnership. Its general partners will be Arthur Andersen, itself an Illinois general partnership, and Arthur Andersen & Co., a Delaware corporation, wholly owned by Arthur Andersen. AAFA will be governed by an advisory board of seven or more members, all of whom will be Arthur Andersen partners, principals, and managers. The Advisory Board will establish, and supervise compliance with, policies regarding the scope and content of any investment advice rendered by Arthur Andersen personnel in the course of providing personal financial planning or employee benefit plan consulting services to Arthur Andersen clients.

Arthur Andersen will provide, subject to AAFA's supervision, investment consulting services to clients, including employee benefit plans, relating to asset allocation, portfolio diversification, managing portfolio risk, and general economic and financial topics. Arthur Andersen will, if a client desires, identify categories of mutual funds that satisfy the client's investment objectives and other criteria, and provide the client with a list of two or more mutual funds in each category from which the client may choose. If a client desires more specific investment advice, Arthur Andersen will provide the client with a list of two or more investment advisers or broker-dealers that meet certain predetermined criteria from which the client may choose. Arthur Andersen will not receive any fees or other economic benefit from the mutual funds, investment advisers, or broker-dealers that it recommends, although it may provide audit or other accounting services to these entities. 1/ It will also

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1/ Arthur Andersen will disclose to clients in its written disclosure statement required under Rule 204-3 of the Advisers Act that: (1) Arthur Andersen may provide audit or other accounting services to the investment advisers, broker-dealers, or mutual funds it recommends; and (2) whether Arthur Andersen provides audit or other accounting

review a client's asset allocation plan on a periodic basis and compare the portfolio's performance against certain benchmarks. In addition, Arthur Andersen will publish a newsletter concerning financial planning. No recommendations would be made with respect to investing in specific industry sectors or securities, other than to provide a list of mutual funds. Arthur Andersen, however, may recommend the purchase or sale of a specific security in connection with providing tax or estate planning services. You state that these recommendations are driven by tax or estate planning considerations, and do not reflect a view as to the intrinsic merits of a specific security for investment purposes. You further represent that these recommendations are a part of the traditional accounting services generally rendered by certified public accountants and are consistent with the exception to the definition of investment adviser in Section 202(a)(11)(B) of the Advisers Act. 2/

Arthur Andersen also may assist a fiduciary subject to the Employee Retirement Income Security Act of 1974 ("ERISA") by acting as an independent fiduciary. It may confirm the appropriateness, reasonableness, and/or propriety of: (1) the sale or exchange of plan assets, which may be securities, between an ERISA fiduciary and one or more ERISA plans; and (2) the sale by the trustee of real estate assets, which may include securities, held by a collective trust fund, insurance company separate account or other collective vehicle (collectively, "Commingled Funds"), and the value of the Commingled Fund units proposed by the trustee. These services will consist principally of review, appraisal, valuation, and accounting services of the type traditionally provided by accountants. Arthur Andersen may also be retained to direct the trustee whether to elect to maintain or liquidate an ERISA plan's interest in a Commingled Fund, when a participating plan does not itself make an election within a prescribed time frame.

Arthur Andersen will make and keep all books and records required under the Advisers Act. AAFA partnership documents, operational and expense records, Advisory Board policies and procedures, and education and training materials will be maintained and available for inspection at AAFA's headquarters. Other books and records required by the Advisers Act with respect to Arthur Andersen's investment advisory business (i.e., its

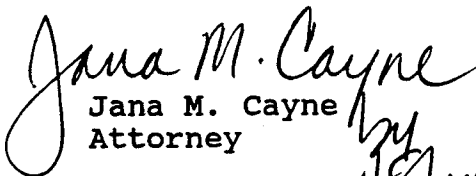
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services to these entities will not be a factor in determining whether to recommend an investment adviser, broker-dealer, or mutual fund.

2/ Telephone conversation between Rachel Arfa, Counsel to Arthur Andersen, and Heidi Stam, Assistant Chief Counsel, Division of Investment Management, July 5, 1994.

financial planning and employee benefit consulting services) will be maintained and made available to the staff at each Arthur Andersen office out of which these services are provided. Further, Arthur Andersen will make a copy of these records available to the staff at AAFA headquarters within a reasonable time after receipt of such a request from the staff.

On the basis of the facts and representations in your letter, we would not recommend enforcement action to the Commission if, without registration under the Advisers Act, Arthur Andersen establishes and registers AAFA. Our position is based particularly on your representations that: (1) Arthur Andersen will own a general partnership interest in AAFA; (2) except as previously noted with respect to tax and estate planning services that are consistent with Section 202(a)(11)(B) of the Advisers Act, neither Arthur Andersen nor AAFA will recommend investments in specific securities or specific industry sectors (other than to provide a list of mutual funds or investment advisers); (3) the investment advisory and personal financial planning services provided will be substantially similar in nature to traditional accounting services; (4) neither Arthur Andersen nor AAFA will have custody or possession of clients' funds or securities; (5) Arthur Andersen personnel who provide investment advice in connection with personal financial planning or employee benefit consulting services or hold themselves out as providing these services will be deemed to be "advisory affiliates" and "persons associated with an investment adviser" for purposes of Form ADV and the Advisers Act; <sup>3/</sup> (6) amounts billed for financial planning services will be separately stated; and (7) Arthur Andersen will make and keep all books and records required under the Advisers Act and will make the records readily available for inspection by the staff, as described above. This response only expresses the Division's position on enforcement action, and does not express any legal conclusions on the questions presented.

  
Jana M. Cayne  
Attorney



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<sup>3/</sup> Those persons who exclusively provide investment advice in reliance on Section 202(a)(11)(B) of the Advisers Act would not be considered associated persons of AAFA.

FRIED, FRANK, HARRIS, SHRIVER & JACOBSON

A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

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ACT IAA of 1940  
SECTION 203  
RULE \_\_\_\_\_  
PUBLIC AVAILABILITY 7-8-94

June 20, 1994

(212) 820-8109

Advisers Act/208(d)

Jana M. Cayne, Esquire  
Securities and Exchange Commission  
Division of Investment Management  
450 Fifth Street, N.W.  
Washington, D.C. 20549

ACT \_\_\_\_\_  
SECTION \_\_\_\_\_  
RULE \_\_\_\_\_  
PUBLIC AVAILABILITY \_\_\_\_\_

**Re: Arthur Andersen & Co.**

Dear Ms. Cayne:

On behalf of our client, Arthur Andersen & Co. ("Arthur Andersen"), we respectfully request that the staff of the Division of Investment Management (the "Staff") confirm that they will not recommend enforcement action to the Securities and Exchange Commission ("SEC" or "Commission") under the Investment Advisers Act of 1940 (the "Advisers Act") if Arthur Andersen establishes a registered investment adviser to oversee the rendering of investment advice by Arthur Andersen's personal financial planning and employee benefit plan consulting practices, without Arthur Andersen registering under the Advisers Act. As described below, Arthur Andersen proposes to organize and register an affiliate, Arthur Andersen Financial Advisers ("AAFA"), to supervise the rendering of investment advice by partners and professional employees of Arthur Andersen in connection with personal financial planning and employee benefit plan consulting services to be provided by Arthur Andersen to its clients as more fully described below. Arthur Andersen itself would not register as an investment adviser under the Advisers Act.

The proposed structure and operation of AAFA is based upon a no-action letter issued by the Staff of the Division of Investment Management to Price Waterhouse ("PW") in connection with the registration of Price Waterhouse Investment Advisers

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("PWIA"), a special purpose affiliate established by PW for the same purpose.<sup>1</sup> As discussed herein, AAFA's proposed structure and operation is nearly identical to the structure and operation of PWIA. Although some differences exist between the proposed operation of AAFA and PWIA, we do not believe that these differences are material or that they raise new regulatory concerns. Accordingly, we respectfully request, based upon the facts and representations set forth herein, that the Staff grant Arthur Andersen's no-action request.

## **1. STRUCTURE AND OPERATION OF AAFA**

### **1.1 Organization**

AAFA will be organized as an Illinois general partnership and will have a separate legal identity. The general partners of AAFA will be Arthur Andersen, itself an Illinois general partnership, and Arthur Andersen & Co., a Delaware corporation wholly owned by Arthur Andersen. Arthur Andersen will be responsible to its clients for all aspects of personal financial planning and employee benefit plan consulting services, including those portions involving investment advice, and, as a general partner of AAFA, will assume the full liability of a general partner for the acts of its affiliate (AAFA).

### **1.2 Management**

AAFA will be governed by an advisory board of seven or more members, comprised of Arthur Andersen partners, principals and managers (the "Advisory Board"). At no time during the life of AAFA will a majority of the members of the Advisory Board also be members of Arthur Andersen's Administrative Board (Arthur Andersen's governing body). The practice leaders with management responsibility for the overall operations of Arthur Andersen's personal financial planning and employee benefit plan consulting services described herein also will be members of the Advisory Board.

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<sup>1</sup> Price Waterhouse, SEC No-Action Letter (Oct. 1, 1987) (LEXIS, Fedsec Library, Noact File).

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AAFA will keep separate books and records to account for its own operational and administrative expenses. In consideration for AAFA's services, Arthur Andersen will pay AAFA an annual consulting fee and will provide clerical and other support personnel.

The authority and responsibility of the Advisory Board will be comparable in scope to that of a corporate board of directors. In particular, the Advisory Board will establish policies regarding the scope and content of any investment advice rendered by Arthur Andersen personnel in the course of providing personal financial planning or employee benefit plan consulting services to Arthur Andersen clients and will be responsible for supervising compliance with such policies by Arthur Andersen personnel in connection with such services. In carrying out its responsibilities, the Advisory Board will develop and administer:

- Qualification requirements for Arthur Andersen personnel who provide investment advice in connection with personal financial planning and employee benefit plan consulting services and education and training standards for such persons.
- Policies and procedures regarding the scope and content of investment advice rendered by Arthur Andersen's personal financial planning and employee benefit plan consulting practices.
- Policies and procedures designed to effect Arthur Andersen's compliance with the Advisers Act, and AAFA's own internal policies and procedures governing the rendering of investment advice, including appropriate audit or review procedures to be conducted on a periodic basis to ensure that Arthur Andersen personnel are complying with all relevant guidelines.
- Procedures for including on all personal financial planning and employee benefit plan consulting engagement letters and billing statements generated by Arthur Andersen in connection with personal financial planning and employee benefit plan consulting services that include an investment advisory component, a legend

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notifying clients that any investment advice component of such services is provided under the supervision of AAFA.

### **1.3 Personal Financial Planning Services, Employee Benefit Plan Consulting Services And Investment Advice**

#### **1.3.1 Personal Financial Planning Services**

Arthur Andersen provides personal financial planning services to its clients. Although the services performed will vary depending upon the client, these services may encompass matters such as personal tax and cash flow planning, estate planning, retirement planning, educational funding, insurance planning, compensation and benefits planning and the preparation of financial analyses and personal financial statements reflecting net worth, cash flow and income tax projections. Arthur Andersen also will provide, subject to AAFA's supervision, investment consulting services that relate to matters such as the allocation of assets among different investment categories, portfolio diversification, managing portfolio risk and general economic and financial topics. Arthur Andersen will not recommend investing in specific securities or specific industry sectors.

In connection with a client's asset allocation plan, Arthur Andersen, if the client desires, will identify categories of mutual funds (*e.g.*, short-term fixed-income, intermediate-term fixed-income, long-term fixed-income, etc.) that are compatible with the client's investment objectives, risk tolerances and other client criteria, and will put forward the names of two or more mutual funds in each such category from which the client may choose. The names of the possible mutual funds to be provided to clients by Arthur Andersen personnel will be taken from a mutual fund summary list (the "Mutual Fund Summary") prepared by Arthur Andersen.<sup>2</sup> The Mutual Fund Summary will be divided into categories of mutual funds and will contain the names of two or more mutual funds within each category. Arthur Andersen will determine which mutual funds to include in the Mutual Fund Summary based upon objective criteria.

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<sup>2</sup> Arthur Andersen, from time to time, may retain outside consultants to assist it in preparing the Mutual Fund Summary. In the event that Arthur Andersen retains an outside consultant, Arthur Andersen will make the final determination regarding which mutual funds to include in the Mutual Fund Summary.

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As a general matter, the mutual funds included in the Mutual Fund Summary will meet most or all of the following criteria. Such funds will: (i) have exhibited above-average performance over at least three-year and five-year periods, and/or be ranked above average or viewed as good performing funds by ranking or tracking organizations and/or business publications, when compared to the risks involved; (ii) be either no-load or low-load funds; and (iii) be maintained efficiently by the fund's manager from a cost standpoint. Other criteria that will be considered by Arthur Andersen will include, but will not necessarily be limited to: (i) whether the fund manager(s) who produced the above-average historical results is still with the fund, (ii) the size of the fund, and (iii) the fund's turnover ratio. Information with respect to the funds (*e.g.*, performance figures, expenses, etc.) will be obtained by Arthur Andersen from rating and tracking organizations, business publications, fund prospectuses and other sources. Arthur Andersen will review, and, if appropriate, update the Mutual Fund Summary on an annual or more frequent basis.<sup>3</sup>

If a client desires to create a portfolio consisting not of mutual funds but of specific securities, Arthur Andersen will provide the client with the names of investment advisers or broker-dealers (*i.e.*, money managers) from which the client may choose. Presently, to the extent that the names of possible investment advisers or broker-dealers are put forward by Arthur Andersen personnel, they are provided on an engagement-by-engagement basis, based upon the client's investment objectives and other client criteria, and the personal knowledge and experience of the particular Arthur Andersen partner, principal or manager involved in the engagement. With the registration of AAFA, Arthur Andersen expects to develop, either by itself or with the assistance of an outside consultant, a list of names of possible money managers to be put forward by Arthur Andersen personnel based upon objective criteria determined by Arthur Andersen (the "Money Manager Summary").<sup>4</sup>

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<sup>3</sup> In some instances, a client may request the names of mutual funds in a category that may not be included in the Mutual Fund Summary (*e.g.*, the names of mutual funds that invest in a specific country or specific geographical region). If this occurs, Arthur Andersen will seek to identify, if possible, the names of two or more such funds based upon the same objective criteria described above.

<sup>4</sup> In the event that Arthur Andersen retains an outside consultant to assist it in preparing the Money Manager Summary, Arthur Andersen will make the final determination regarding which money managers to include on the list.



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As a general matter, Arthur Andersen expects that the criteria that will be used to determine the names of money managers to be included on the Money Manager Summary will include, but will not necessarily be limited to: (i) the reputation of the money manager; (ii) the money manager's historical performance record; (iii) the money manager's investment style or philosophy and whether it consistently adheres to that style (*e.g.*, value investing, small cap investing, etc.); (iv) the continuity of management (*i.e.*, are the persons who produced the historical performance record still with the money manager); (v) the ability to service clients; (vi) the money manager's minimum dollar investment requirement; and (vii) the money manager's fees. Information with respect to money managers (*e.g.*, performance figures, investment style, etc.) will be obtained by Arthur Andersen from tracking organizations, business publications, money managers and other sources. Arthur Andersen will review, and, if appropriate, update the Money Manager Summary on an annual or more frequent basis. Upon the client's request, the names of two or more possible money managers will be put forward by Arthur Andersen personnel from the names included on the Money Manager Summary after considering the compatibility of the money managers' investment philosophy, minimum investment requirements and other possible factors with the client's investment objectives, risk tolerances, and other client criteria.

Arthur Andersen will not receive any fees or other economic benefit from the investment advisers or broker-dealers included in the Money Manager Summary or from the mutual funds included in the Mutual Fund Summary in connection with including the names of such persons or funds in such summaries. Arthur Andersen may provide audit or other accounting services to the investment advisers, broker-dealers or mutual funds included in the summaries. Whether Arthur Andersen provides audit or other accounting services to such money managers or funds will not be a factor in determining whether to include a money manager or a fund in the summaries.<sup>5</sup>

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<sup>5</sup> Arthur Andersen will disclose to clients in its written disclosure statement required pursuant to Advisers Act Rule 204-3 that: (i) Arthur Andersen may provide audit or other accounting services to the investment advisers, broker-dealers or mutual funds included in the summaries, and (ii) whether Arthur Andersen provides audit or other accounting services to such money managers or funds will not be a factor in determining whether to include a money manager or a fund in the summaries.

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Arthur Andersen, at the request of a client, also will (i) undertake to review a client's asset allocation plan on a quarterly, semi-annual or annual basis and analyze whether it continues to meet the client's investment objectives, risk tolerances and other client criteria and/or (ii) compare the performance of the client's portfolio to benchmarks agreed upon with the client. In the case of a client who implements his or her asset allocation plan by selecting mutual funds, such benchmarks will consist of the performance of other mutual funds in the same category and/or one or more appropriate market indices as agreed upon with the client. If a client chooses to implement the plan through a money manager, Arthur Andersen would compare the money manager's performance to the performance of other money managers and/or one or more appropriate market indices as agreed upon with the client.

In its newsletter, or a similar document, Arthur Andersen may, from time to time, discuss asset allocation, portfolio diversification, investment objectives and other topics concerning personal financial planning. No recommendations would be made with respect to investing in specific securities or specific industry sectors.

Although Arthur Andersen does not recommend specific securities or industry sectors to clients, it may make a recommendation with respect to the purchase or sale of a specific security in providing tax or estate planning services in connection with its personal financial planning practice. For example, Arthur Andersen may recommend that a client sell, or donate to charity, a specific stock for tax planning reasons. Such recommendations, however, are driven by tax, estate planning, or other considerations peculiar to a client's particular tax or financial circumstances and do not reflect a view as to the intrinsic merits of the specific security as an investment.

### **1.3.2 Employee Benefit Plan Consulting Services**

Arthur Andersen also will make available to employee benefit plan clients the same types of advisory services described above with respect to its personal financial planning practice. More specifically, Arthur Andersen personnel will perform an actuarial study of the plan and its related cash flows and will assist the client in its efforts to develop an appropriate asset allocation matrix. Based upon interviews with the client and information regarding the business and financial condition of the plan sponsor, demographic characteristics of the employee group, risk tolerances of the affected parties

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*e.g.*, plan sponsor, fiduciaries or participants) and the actions of similar plans, and other factors, Arthur Andersen will draft an investment policy statement for review by, and approval of, the client. Such statement would typically include a percentage asset allocation range by major asset class and limitations on the types of investments to be made by the plan (*e.g.*, limitations on equities as a percentage of plan assets, minimum required credit rating for bond purchases, etc.). In developing an asset allocation matrix or an investment policy statement for employee benefit plan consulting clients, Arthur Andersen will not recommend investing in specific securities or specific industry sectors.

If a client desires, Arthur Andersen also will assist plan fiduciaries in the selection of appropriate mutual funds by identifying categories of mutual funds that are compatible with the client's investment objectives, risk tolerances and other client criteria and will provide the client with the names of two or more mutual funds that meet the client-specified criteria from which the client may choose. The names of the mutual funds to be put forward by Arthur Andersen personnel to employee benefit plan clients will be determined on an engagement-by-engagement basis.<sup>6</sup> In determining the names of the mutual funds to be provided to an employee benefit plan client, Arthur Andersen, utilizing information obtained from rating and tracking organizations, business publications, fund prospectuses and other sources, will identify two or more funds within each relevant category that meet the same objective criteria described in the case of personal financial planning clients. Arthur Andersen also may consider other criteria, including, but not limited to, the administrative and recordkeeping and reporting services provided by a fund.

If a client desires, Arthur Andersen also will assist plan fiduciaries in the selection of appropriate investment advisers or broker-dealers by providing the client with the names of two or more money managers from which the client may choose. As in the case of mutual funds, the names of the money managers to be put forward by Arthur Andersen

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<sup>6</sup> Arthur Andersen expects that the number of employee benefit plan clients will be smaller than the number of personal financial planning clients. Arthur Andersen also expects that the client directed criteria to be considered in the case of employee benefit plan clients likely will be more numerous and, hence, the overall process of identifying funds compatible with such criteria more complex than in the case of personal financial planning clients. As a result, Arthur Andersen does not expect to make use of a list similar to the Mutual Fund Summary in the case of employee benefit plan clients. Arthur Andersen, however, may determine in the future to prepare and make use of such a summary.

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personnel will be determined on an engagement-by-engagement basis. In determining the names of the money managers to be provided to an employee benefit plan client, Arthur Andersen will apply the same objective criteria described in the case of personal financial planning clients. Arthur Andersen also may consider other criteria, including, but not limited to, the administrative and recordkeeping and reporting services provided by a money manager. Utilizing such criteria and information obtained from tracking organizations, business publications, money managers and other sources, Arthur Andersen will identify for the client two or more money managers whose investment philosophy, minimum investment requirements and other possible factors are compatible with the client's investment objectives, risk tolerances and other client criteria from which the client may choose.

Arthur Andersen will not receive any fees or other economic benefit from the investment advisers, broker-dealers, or mutual funds whose names are put forward to employee benefit plan clients in connection with providing the names of such persons or funds to clients. Arthur Andersen may provide audit or other accounting services to such investment advisers, broker-dealers or mutual funds. Whether Arthur Andersen provides audit or other accounting services to such money managers or funds will not be a factor in determining whether to provide the names of such money managers or funds to a client.<sup>7</sup>

Arthur Andersen, at the request of a client, also may interview and perform due diligence with respect to potential investment managers and mutual funds and provide information to support plan fiduciaries in their negotiations regarding appropriate management fees or commission rates. In addition, Arthur Andersen, at the request of a client, also will review the plan's portfolio for compliance with the plan's investment guidelines, will compare the money manager's or mutual fund's performance to appropriate market indices or other benchmarks as agreed upon with the client, such as the performance of other money managers or mutual funds, and will report on material changes relating to the money manager (*e.g.*, changes in key personnel, investment style, etc.).

In addition, Arthur Andersen occasionally may be engaged to assist a fiduciary subject to the Employee Retirement Income Security Act of 1974 ("ERISA") to resolve a

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<sup>7</sup> See *supra* note 5.

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conflict of interest and avoid engaging in a prohibited transaction under ERISA by acting as an independent fiduciary with respect to a transaction or transactions proposed by the ERISA fiduciary that involve one or more ERISA plans. The subject transactions may involve either a sale or exchange of ERISA plan assets<sup>8</sup> effected between an ERISA fiduciary (typically a bank, trust company, insurance company, or the plan sponsor) and one or more ERISA plans, or the sale of real estate assets held by a common or collective trust fund, insurance company pooled separate account or other collective investment vehicle (a "Commingled Fund") in which one or more ERISA plans have invested and in respect of which the plan fiduciary also acts as trustee. In these engagements, Arthur Andersen will assist the trustee to comply with its responsibilities under ERISA by confirming the appropriateness, reasonableness and/or propriety of: (i) the sale or exchange of plan assets between the ERISA fiduciary and one or more ERISA plans or (ii) the sale by the trustee of real estate assets held by a Commingled Fund and the value of the Commingled Fund units proposed by the trustee.<sup>9</sup> In this regard, Arthur Andersen will review the reasonableness of the methodology selected by the trustee for appraising the value of the assets, review the appraisals or valuations performed by third parties retained by the trustee for that purpose, and, where appropriate, make adjustments to the values so determined. In the event that the assets involved are real estate or other non-securities assets, Arthur Andersen may, from time to time, perform the appraisal or valuation.

As a plan fiduciary, the trustee of a Commingled Fund occasionally may be responsible for making certain elections regarding the possible retention or disposition of a participating plan's interest in the Commingled Fund in the rare event that one or more participating plans does not itself make the election. However, because of the plan fiduciary's role as trustee of the Commingled Fund, the trustee cannot make these

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<sup>8</sup> Plan assets involved may consist of guaranteed investment contracts, annuities, and/or real property or other non-securities assets. Arthur Andersen also may be engaged to act as an independent fiduciary in an engagement that does not involve securities at all such as confirming the appropriateness and reasonableness of a sale of real property held by a Commingled Fund or the appropriateness and reasonableness of compensation or administrative expenses paid to an ERISA fiduciary by an ERISA plan.

<sup>9</sup> Although the real estate assets in a Commingled Fund typically will be held in the form of a fee interest, Arthur Andersen anticipates that in some instances the real estate may be held in the form of securities (*e.g.*, limited partnership interests). In any event, the trustee's valuation of these assets (which will be confirmed by Arthur Andersen) will be based upon an appraisal of the value of the underlying real property assets.

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elections pursuant to applicable ERISA regulations. Accordingly, pursuant to express authorization granted by the U.S. Department of Labor, Arthur Andersen's obligations as an independent fiduciary under this type of engagement, on such rare occasions, also may include directing the trustee as to whether to elect to maintain or liquidate an ERISA plan's interest in the Commingled Fund when a participating plan does not itself make an election within a prescribed time frame.<sup>10</sup> Arthur Andersen will not recommend investing in specific securities or specific industry sectors and will not have overall investment management or discretionary control over plan assets.

#### **1.4 Persons Providing Personal Financial Planning And Employee Benefit Plan Consulting Services**

Arthur Andersen personnel who will hold themselves out as personal financial planners or who enter into engagements to provide personal financial planning services and Arthur Andersen personnel who will hold themselves out as providing investment consulting services of the kind described above to employee benefit plans or who enter into engagements to provide such employee benefit plan consulting services, will consist of Arthur Andersen trained professionals, many of whom will be licensed as certified public accountants or as attorneys, or will have college or post-graduate degrees in business or finance. Such persons, their supervisors responsible for the personal financial planning and employee benefit consulting engagements, and

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<sup>10</sup> To date Arthur Andersen has been engaged to provide this type of independent fiduciary service in connection with two ERISA exemption application requests filed by trustees of two different Commingled Funds. Both of these engagements were performed with the review and approval of the U.S. Department of Labor and Arthur Andersen's services were designed to resolve a conflict of interest. In one of these engagements, Arthur Andersen was engaged by the plan fiduciary to review the reasonableness and appropriateness regarding the sale of specified real estate assets held by the Commingled Fund. This engagement did not involve any securities related advice. In the second engagement, in addition to confirming the appropriateness, reasonableness and/or propriety of individual real property sales during the liquidation of the Commingled Fund, Arthur Andersen has been retained to (i) review and confirm the trustee's calculations of interest payable to participating plans and unit values proposed by the trustee and (ii) to direct the Trustee as to whether to make certain elections to maintain or dispose of the interests of certain participating ERISA plans in the event that a plan does not itself make an election within a prescribed time frame. Both of these engagements principally relate to the provision of real estate appraisal, valuation and general accounting services of the type traditionally rendered by accountants. Moreover, both engagements resulted from unsolicited referrals to Arthur Andersen. Accordingly, Arthur Andersen entered into the second engagement in reliance upon the exceptions provided in Sections 202(a)(11)(B) and 203(b)(3) of the Advisers Act. Arthur Andersen anticipates that it may be asked to enter into a number of independent fiduciary engagements in the future. As a result, it proposes to have AFA oversee the performance of these services.

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Advisory Board members will be deemed to be "advisory affiliates" and "persons associated with an investment adviser" for purposes of the Form ADV and the Advisers Act.<sup>11</sup>

In this regard, Arthur Andersen personnel who do not hold themselves out as providing and are not engaged to provide personal financial planning or employee benefit plan consulting services as described herein but who may, from time to time, provide investment advice (including investment advice of a type described herein) solely as an incident to tax or other accounting services and without special compensation for that advice will rely upon the accountant's exception provided in Section 202(a)(11)(B) of the Advisers Act.

**1.5 Custody Of Client Funds And Securities/  
Discretionary Accounts**

Arthur Andersen will not take custody or possession of clients' funds or securities and will not exercise discretionary authority over the investments of client accounts. In instances where clients seek specific advice on securities investments, Arthur Andersen will provide the client with the names of other investment advisers or broker-dealers that meet certain predetermined criteria from which the client may choose. Arthur Andersen will not receive any fees or other economic benefit from such investment advisers or broker-dealers in connection with providing the names of such persons to clients. Arthur Andersen may provide audit or other accounting services to such persons. Whether Arthur Andersen provides audit or other accounting services to investment advisers or broker-dealers will not be a factor in determining whether to put forward the name of an investment adviser or broker-dealer to a personal financial planning or employee benefit planning client.<sup>12</sup>

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<sup>11</sup> See, *supra* note 24.

<sup>12</sup> See *supra* note 5.

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### **1.6 Fees**

The fee for any investment advisory component of financial planning or employee benefit plan consulting services provided to a client will be separately stated. Fees will be billed as they are incurred or upon completion of the engagement. In no event will Arthur Andersen charge performance fees based upon the capital appreciation of a client's assets; nor will it receive any commissions contingent upon effecting the purchase or sale of a security in providing personal financial planning or employee benefit plan consulting services.

### **1.7 Books And Records**

Arthur Andersen will make and keep all books and records as required pursuant to Rule 204-2 of the Advisers Act in connection with personal financial planning or employee benefit plan consulting engagements as described herein. In particular, AAFA partnership documents, AAFA operational and expense records, copies of all compliance policies and procedures developed by the Advisory Board, and copies of all education and training materials will be maintained, and made available to the SEC Staff, at AAFA's headquarters (initially, in Chicago, Illinois). All other books and records required by the Advisers Act with respect to personal financial planning or employee benefit plan consulting engagements will be maintained at each office of Arthur Andersen at which the personal financial planning or employee benefit plan consulting service is provided, and will be made available to the SEC Staff at such Arthur Andersen office. In addition, Arthur Andersen will make available a copy of such of these records as the Staff might request with respect to personal financial planning or employee benefit plan consulting engagements at AAFA's headquarters within a reasonable time after receipt of such a request.

## **2. DISCUSSION**

Traditionally, the SEC Staff has been concerned that a parent company may engage in the investment advisory business by operating a controlled entity to avoid registration under the Advisers Act. In the Staff's view, such a situation may give rise to



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abuses, including, among other things, the possibility that the affiliate might be an undercapitalized shell organized to limit the parent's liability or that the affiliate might be used to shield the activities of the parent and its employees from regulatory scrutiny under the Advisers Act.<sup>13</sup>

In 1987, PW requested, and received, assurances from the SEC Staff that they would not recommend enforcement action to the Commission under the Advisers Act if PW established a registered investment adviser to oversee the rendering of investment advice by PW personnel in connection with PW's personal financial planning services, without PW registering under the Advisers Act.<sup>14</sup> In determining not to recommend enforcement action, the Staff noted a number of factors that were particularly relevant to its conclusion and found that the proposed arrangement addressed the concerns it traditionally had perceived with respect to the registration of a controlled affiliate. Those factors were that:

- PW would own a general partnership interest in PWIA;
- The investment advisory and personal financial planning services provided would be substantially similar in nature to traditional accounting services, and neither PW nor PWIA would recommend investments in specific securities or specific industry sectors;
- Neither PW nor PWIA would have custody or possession of clients' funds or securities;
- Copies of all written financial plans, personal financial planning time records and billing statements, and other engagement letters or communications relating to personal financial planning clients would be maintained at PWIA headquarters and would be available for inspection by the Commission Staff;

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<sup>13</sup> See, e.g., Price Waterhouse, SEC No-Action Letter (Oct. 1, 1987) (LEXIS, Fedsec Library, Noact File).

<sup>14</sup> *Id.*

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- Amounts billed for financial planning services would be separately stated; and
- For purposes of Form ADV and the Advisers Act, PW personnel providing personal financial planning services or overseeing these services would be deemed to be "advisory affiliates" and "persons associated with an investment adviser."<sup>15</sup>

As discussed in greater detail below, the proposed structure and operation of AAFA is substantially identical to the structure and operation of PWIA, and, as was the case in PWIA, addresses the concerns traditionally articulated by the Staff with respect to the registration of a controlled affiliate. Although some differences exist between the proposed operation of AAFA and the operation of PWIA, these differences are not material, and should not raise any new regulatory concerns under the Act.<sup>16</sup>

## **2.1 Ownership Of A Partnership Interest**

One concern articulated by the Staff with respect to the registration of a controlled affiliate is that the affiliate might be an undercapitalized shell, organized by the parent to limit the parent's liability. The proposed arrangement, however, would not insulate Arthur Andersen from liability. As proposed, AAFA will be organized as a general partnership with Arthur Andersen as one of the general partners. As a general partner of AAFA, Arthur Andersen will have general partner liability for the acts of AAFA, and thus will be responsible for any investment advice provided by Arthur Andersen's personal financial planning or employee benefit plan consulting practices.

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<sup>15</sup> *Id.*

<sup>16</sup> We should note that the Staff, at least with respect to a foreign parent, has indicated that it would not require the registration of the parent if: (i) the affiliate was organized as a separate legal entity, (ii) the affiliate is staffed with personnel capable of providing investment advice, (iii) personnel providing investment advice and their supervisors are "associated persons" of the affiliate and subject to its supervision, and (iv) the Commission is given access to the books and records of the affiliate and its personnel. Division of Investment Management, Securities and Exchange Commission, *Protecting Investors: A Half Century of Investment Company Regulation* 233-234 (May 1992). Although the Staff has not indicated that it is prepared to apply such conditions to domestic entities, and, accordingly, we have not specifically discussed the application of such conditions to Arthur Andersen's proposal, we believe that Arthur Andersen's proposal would satisfy these conditions.

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## **2.2 Services Substantially Similar To Traditional Accounting Services/No Specific Investment Advice**

In its no-action request, PW advised the Staff that it proposed to provide advice with respect to asset allocation, portfolio diversification, risk hedging and other general economic topics under the supervision of PWIA in connection with PW's personal financial planning services. Neither PW nor PWIA would recommend investments in specific securities or specific industry sectors. In cases where clients sought more specific advice on investments, PW would recommend an investment adviser or a securities brokerage firm. Finally, PWIA's Form ADV indicated that PW, if a client desired, would provide its client with a list of mutual funds that match the client's profile and assist the client in selecting several mutual funds in each category for further consideration.<sup>17</sup> The Staff found that these services, at least those specifically identified in the no-action request, were substantially similar in nature to traditional accounting services.

Like PW, Arthur Andersen's personal financial planning and employee benefit plan consulting practices will provide advice that would encompass such matters as asset allocation, portfolio diversification, the hedging of portfolio risk, defining investment objectives, and other topics concerning personal financial and employee benefit planning under the supervision of AAFA. Neither Arthur Andersen, nor AAFA, will recommend investing in specific securities or specific industry sectors. In connection with a client's asset allocation plan, Arthur Andersen will, if the client desires, identify categories of mutual funds that satisfy the client's investment objectives, risk tolerances, and other client criteria, and provide the client with the names of various mutual funds in each category that satisfy certain predetermined criteria from which the client may choose. In the event that a client desired to create a portfolio consisting not of mutual funds but of specific securities, Arthur Andersen, like PW, will provide the client with the names of money managers or broker-dealers that meet certain predetermined criteria from which the client may choose.

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<sup>17</sup> PWIA Form ADV, Schedule F, Item 3 (Sept. 30, 1987); PWIA Form ADV, Schedule F, Item 3 (Aug. 31, 1992) (Amendment).

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Arthur Andersen will provide these same types of services not only to individuals, but also to employee benefit plans. As described earlier, Arthur Andersen will develop an appropriate asset allocation matrix to show the plan sponsor the risk and return characteristics of various asset allocation models. Arthur Andersen also will draft an investment policy statement for review by, and approval of, the client, and will assist the plan fiduciary in the selection of appropriate investment managers or mutual funds for the plan. Although it appears that PW provided the above services only to individuals or groups, and not employee benefit plans, the Staff's characterization of these same services as substantially similar to traditional accounting services in the PW no-action letter should not change simply because Arthur Andersen also will provide these services to employee benefit plans. Whether a service is similar to traditional accounting services properly depends upon the nature of the services, and not the person or persons to whom they are provided.

In addition to the services that PW described in its no-action letter, Arthur Andersen, in its newsletter or similar document, may, from time to time, discuss asset allocation, portfolio diversification, investment objectives and other topics concerning personal financial planning. The newsletter would not include any recommendation with respect to investing in specific securities or industry sectors. Although not mentioned in the PW no-action request, or PWIA's registration materials, we believe that a newsletter should not raise any new regulatory concerns. The provision of generic investment advice was contemplated in PW's no-action request and was found by the Staff to be substantially similar to traditional accounting services. The fact that Arthur Andersen may include the same substantive information in a slightly different format (*i.e.*, in a newsletter rather than orally or in a report to a client) should not change that conclusion or the Staff's response.

If a client desires, Arthur Andersen also will review, on a periodic basis, a client's asset allocation plan and will compare the performance of the client's portfolio to benchmarks agreed upon with the client (*e.g.*, the performance of other funds in the same category, appropriate market indices, etc.). Although not mentioned in PW's no-action request, neither of these proposed services should raise any new regulatory concerns. Since providing a client with asset allocation advice was viewed by the Staff as being substantially similar to traditional accounting services and a permissible activity under the proposed structure, periodically revisiting that advice should not present any additional

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regulatory concerns.<sup>18</sup> Similarly, comparing a client's or pension plan's portfolio with agreed upon benchmarks also should not raise any new regulatory concerns or alter the Staff's response. Such a comparison will not involve an evaluation of a specific stock, but rather will be limited to presenting to a client a comparison with other mutual funds based on published ranking data and/or appropriate market indices, or, in a case where the client has chosen a money manager to implement the asset allocation plan, a comparison with the performance of other money managers and/or appropriate market indices. Such a comparison does not involve a recommendation with respect to a specific security or specific industry sector. Indeed, we believe that such a report involving the compilation of objective data is the type of role expected of accountants.

As discussed above, Arthur Andersen, on occasion, also may be engaged to act as an independent fiduciary on behalf of an ERISA fiduciary with respect to transactions involving the fiduciary and ERISA plan assets. Although not mentioned in PW's no-action request, the services to be provided by Arthur Andersen as an independent fiduciary, like the other services described above, are substantially similar to traditional accounting services. In each case, the purpose of the engagement will be the resolution of a specific conflict of interest pursuant to ERISA, and not the retention of an investment adviser for the purpose of rendering investment advice or exercising investment discretion over plan assets other than as needed to resolve the conflict. Each engagement will be limited to a specific transaction or series of transactions, the terms of which will be proposed not by Arthur Andersen but by the plan's or Commingled Fund's trustee. As an independent fiduciary, Arthur Andersen will be responsible for confirming the appropriateness, reasonableness and/or propriety of a sale or exchange of plan assets between an ERISA fiduciary and an ERISA plan, or the sale by the trustee of real estate assets held by a Commingled Fund and/or the unit values proposed by the trustee. In this regard, the services to be provided by Arthur Andersen will consist principally of review, appraisal, valuation and accounting services of the type traditionally provided by accountants. Arthur Andersen will review the methodology determined by the trustee for estimating the values of the underlying assets, review the appraisals performed by third parties retained by the trustee for that purpose, and, where appropriate, make adjustments

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<sup>18</sup> In this regard, we should note that an amendment to PWIA's Form ADV indicates that while PWIA's engagements generally do not provide for additional reviews of plans or reports prepared for clients after they have been prepared, such reviews will be performed if the engagement provides for them. PWIA Form ADV, Schedule F, Items 11.A., 11.B. (Aug. 31, 1992).

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to the values so determined. Unit values will be determined by dividing the value so arrived at by the number of units. In performing these responsibilities, Arthur Andersen will not recommend investing in specific securities or specific industry sectors and will not have broad-based investment management or overall discretionary control over ERISA plan assets.

Arthur Andersen, on rare occasions, also may be asked to assume the role of the conflicted plan fiduciary (*e.g.*, the trustee) and elect from options determined by the trustee, and authorized by the Department of Labor, pursuant to which a plan participant in a Commingled Fund may either retain or liquidate its interest in the fund in the event that a plan participant does not make an election within a prescribed time. In the PW no-action letter<sup>19</sup>, the Staff found it important that PW would not recommend investments in "specific securities or specific industry sectors." In our view, Arthur Andersen's role in electing among options determined by the trustee differs materially from recommending that a plan participant invest in a specific security or specific industry sector. A participating plan's investment in a Commingled Fund will predate Arthur Andersen's engagement by the trustee. Moreover, the purpose of Arthur Andersen's engagement will be to resolve a specific conflict of interest that arises by reason of the trustee's dual role as trustee of the Commingled Fund and as a plan fiduciary. Arthur Andersen will not exercise broad-based management authority or control over plan assets, nor will it have open-ended fiduciary responsibility. In each case, the terms of the alternatives from which plan participants may elect will be determined not by Arthur Andersen but by the trustee and will be authorized by the U.S. Department of Labor pursuant to the terms of an exemption granted by the Department. Alternative elections are limited to whether a participating Plan will redeem its units and on what payment terms. Equally important, the potential for abuse that the Staff apparently is concerned about when specific securities or specific industry sectors are recommended -- namely scalping -- does not exist in the independent fiduciary context. First, information with respect to elections made by Arthur Andersen acting as an independent fiduciary will not be disclosed to Arthur Andersen personnel in general or other clients, but will be kept confidential by the Arthur Andersen personnel involved in the engagement. More importantly, interests in the Commingled Fund are not freely tradable, and, as a practical matter could not be

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<sup>19</sup> Price Waterhouse, SEC No-Action Letter (Oct. 1, 1987) (LEXIS, Fedsec Library, Noact File).

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acquired by Arthur Andersen personnel. Accordingly, there is no possibility of scalping in this context.

Although neither Arthur Andersen, nor AAFA, will recommend investing in specific securities or specific industry sectors, Arthur Andersen may make a recommendation regarding the purchase or sale of a specific security in providing tax, compensation and benefits, or estate planning services in connection with its personal financial planning practice. For example, Arthur Andersen may recommend that a client sell, or donate to charity, a specific stock for tax planning reasons. Although such advice was not mentioned in the PW no-action request or PWIA's registration materials, it should not raise any new regulatory concerns.

The above type of advice is driven by tax, compensation and benefits, estate planning or other considerations peculiar to a client's particular tax or financial circumstances and does not reflect a view as to the intrinsic merits of the specific security as an investment. Thus, such advice cannot, and should not, be construed to be a recommendation to invest in a specific security. Further, such recommendations are, in fact, part and parcel of traditional accounting services generally rendered by certified public accountants.

Moreover, this type of recommendation does not present the potential for "scalping" by the parent company or its employees about which the Staff, in other contexts, has expressed concern.<sup>20</sup> As noted, the advice offered does not reflect a view as to the intrinsic investment merits of the security, but rather is limited to the unique tax or other circumstances of a particular client, and thus does not provide a likely basis for trading decisions by other individuals. Moreover, such recommendation is communicated solely to the client for whom it is applicable and is not communicated to a broad client base. Accordingly, this type of advice does not present the same regulatory concerns found in the case of buy/sell recommendations issued by the traditional investment adviser.

### **2.3 Clients' Funds and Securities**

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<sup>20</sup> Price Waterhouse, SEC No-Action Letter (Oct. 1, 1987) (LEXIS, Fedsec Library, Noact File).

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One of the facts that the Staff found to be of importance in granting PW's no-action request was that neither PW, nor PWIA, would have custody or possession of clients' funds or securities. As in the case of PW and PWIA, neither Arthur Andersen, nor AAFA, will have custody of clients' funds or securities.

#### **2.4 Inspection of Books and Records**

One of the concerns articulated by the Staff regarding the registration of a controlled affiliate has been that regulation of an affiliated entity may be used to shield the activities of the parent from regulatory oversight.<sup>21</sup> One factor cited by the Staff in granting PW's no-action request was that PW would maintain copies of all written financial plans, personal financial planning time records and billing statements, and other engagement letters or communications relating to personal financial planning clients at PWIA headquarters and that such records would be available for inspection by the Commission Staff.

Arthur Andersen also will make and keep the books and records required by the Advisers Act and will make such records readily available for inspection by the Staff. In particular, copies of AAFA's partnership documents, AAFA operational and expense records, policies and procedures developed by the Advisory Board and education and training materials will be maintained and will be available for inspection at AAFA's headquarters. Other books and records required by the Advisers Act with respect to personal financial planning or employee benefit plan consulting engagements will be maintained, and made available to the Staff, at each Arthur Andersen office out of which such services will be provided. In addition, Arthur Andersen will make a copy of such records as the SEC Staff might request with respect to personal financial planning or employee benefit plan consulting engagements available to the Staff at AAFA's headquarters within a reasonable time after receipt of such a request from the Staff.<sup>22</sup>

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<sup>21</sup> Price Waterhouse, SEC No-Action Letter (Oct. 1, 1987) (LEXIS, Fedsec Library, Noact File).

<sup>22</sup> Price Waterhouse, SEC No-Action Letter (Oct. 1, 1987) (LEXIS, Fedsec Library, Noact File).



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## 2.5 Billing

One of the factors cited by the Staff in granting PW's no-action request was that amounts billed for financial planning services would be separately stated. Arthur Andersen will state separately the amount billed for any investment advisory component of the personal financial planning or employee benefit plan consulting services provided to the client.

## 2.6 Disclosure Regarding Arthur Andersen Personnel

Another concern voiced by the Staff in connection with the registration of a controlled entity is that registration of the affiliate might not provide sufficient disclosure with respect to the parent or its personnel.<sup>23</sup> In granting PW's request for assurances that the Staff would not recommend enforcement action if PW did not register, the Staff noted that for purposes of the Form ADV and the Advisers Act, PW personnel providing personal financial planning services or overseeing those services would be deemed to be "advisory affiliates" and "persons associated with an investment adviser." As in the case of PW, Arthur Andersen personnel who will hold themselves out as personal financial planners or who enter into engagements to provide investment advice in connection with personal financial planning services, and Arthur Andersen personnel who will hold themselves out as providing investment advice of the type described above to benefit plans or who enter into engagements to provide such advice in connection with employee benefit plan consulting services, their supervisors responsible for the engagements and AAFA's Advisory Board members will be deemed to be "advisory affiliates" and "persons associated with an investment adviser" for purposes of the Form ADV and the Advisers Act.<sup>24</sup>

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<sup>23</sup> Price Waterhouse, SEC No-Action Letter (Oct. 1, 1987) (LEXIS, Fedsec. Library, Noact File).

<sup>24</sup> In this regard, all Arthur Andersen personnel who determine the names to be included in the Mutual Fund Summary or the Money Manager Summary, or who determine the names of the mutual funds or money managers to be provided to employee benefit plan clients will be persons from the personal financial planning and employee benefit plan consulting groups. Accordingly, such persons will be deemed to be "advisory affiliates" and "persons associated with an investment adviser" for purposes of the Form ADV and the Advisers Act.

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In this regard, Arthur Andersen personnel who do not hold themselves out as providing and are not engaged to provide personal financial planning or employee benefit plan consulting services but who may, from time to time, provide investment advice (including investment advice of a type described herein) solely as incident to tax or other accounting services and without special compensation for that advice will rely upon the accountant's exception provided for in Section 202(a)(11)(B) of the Advisers Act.

3. CONCLUSION

As discussed above, the proposed structure and operation of AAFA comports with the structure and operation of PWIA in all material respects, and, as was the case in PWIA, addresses the concerns previously articulated by the Staff with respect to the registration of an affiliate without registration of the parent. Accordingly, we respectfully request that the Staff confirm that they will not recommend any enforcement action to the Commission under the Advisers Act if Arthur Andersen establishes a registered investment adviser, AAFA, to conduct operations as described herein, without Arthur Andersen registering under the Advisers Act.

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Please call the undersigned at (212) 820-8109 or Mark Dorsey at (202) 639-7173 to discuss this after you have had an opportunity to review it.

Sincerely,

*Rachel L. Arfa*  
by *M. Dorsey*  
Rachel L. Arfa

cc: David P. Shelow, Esquire  
Arthur Andersen & Co.