MICHIGAN CORPORATION & SECURITIES BUREAU

RELEASE NO. 93-3-BD

TO: ALL INTERESTED PARTIES

SUBJECT: Investment Adviser Custody or Access to Customer Funds and Securities

General Background:

Earlier this year the Bureau issued Release 93-2-BD on the subject of Investment Adviser Custody or Access to Customer Funds and Securities. That release indicated that "The Corporation and Securities Bureau (the Bureau) has broadly interpreted this provision [Section 102(e) of the Michigan Uniform Securities Act] to prohibit not only direct, but also constructive custody of customer funds and securities, including direct billing of advisory fees to custodians of advisory funds." The Bureau's intent in issuing Release 93-2-BD was to ease the Michigan restriction on investment advisers having access to customer securities or funds for the limited purpose of payment for services. It has become clear that the release had significant unintended consequences. Since issuing Release 93-2-BD on April 21, 1993, the Bureau has had a number of advisers come forward and explain that because of the absence of any previous releases from the Bureau and the fact that no specific rule existed specifically spelling out the parameters of the prohibition on custody contained in Section 102(e), many advisers believed the Bureau had accepted the same interpretation as that adopted by the Securities and Exchange Commission. Consequently, it is obvious to the Bureau that a number of investment advisers operating in Michigan are in compliance with the SEC position on constructive custody as set down in Investment Counsel Association of America, Inc., (Sec, 1982), 1982 CCH Dec. 77243, but are not satisfying the requirement of Section 102 of the Michigan Uniform Securities Act as traditionally interpreted by the Bureau. The Bureau has evaluated the situation and believes that adherence to a strict position on this matter would result in a major disruption to the industry.

The Bureau has received further information in regard to the nature and circumstances of the clients most likely to benefit from the ability to have fees withdrawn from their accounts rather than being required to pay for investment advisory services directly. The Bureau had not previously taken into consideration factors such as the client's desire to insure that the fee is collected out of proceeds from a qualified plan rather than the client's current cash flow. In addition, the Bureau has reviewed information in regard to the likely effect of the Bureau's position on the availability of investment advisory services to small investors and believe that the net effect of the Bureau's position as specified in Release 93-2-BD would be an unacceptable reduction on the availability of service by independent registered investment advisers.

As indicated in Release 93-2-BD, the Bureau recognizes that the U.S. Securities and Exchange Commission in its Release IA-1000 (17 CFR Part 276) in question 5 has taken the position that a person has custody directly or indirectly of client funds or securities, has any authority to obtain possession of them or has the ability to appropriate them. Accordingly, the SEC position is also that an adviser may be deemed to have custody where the adviser is paid automatically from client funds upon presentation of a bill to the custodian of the client's account. The SEC staff takes the position that the adviser may be deemed not to have custody under these circumstances; however, if (1) the client provides written authorization permitting the adviser's fees to be paid directly from the client's account held by an independent custodian, (2) the adviser sends to the client and the custodian at the same time a bill showing the amount of the fee, the value of the client's assets on which the fee was based, and the specific manner to which the adviser's fee was calculated, and (3) the custodian agrees to send to the client a statement, at least quarterly, indicating all amounts disbursed from the account including the amount of the advisory fees paid directly to the adviser.

Action or Interpretation:

Effective immediately, the terms and conditions set forth in Release 93-2-BD are replaced by the provisions of this release. The Bureau will not consider investment advisers to be in violation of Section 102(e) of the Michigan Uniform Securities Act where access to a client's account is obtained pursuant to express written authorization and the following requirements are satisfied:

a) The authorization or agreement must be limited to withdrawing contractually agreed upon investment adviser fees.

b) The investment adviser must notify the client, in writing by at least first class mail not less than seven (7) days prior to the proposed date of withdrawal, of the exact amount of the proposed withdrawal and the specific manner or basis on which the fee has been calculated. The notice shall advise the client of the opportunity to object to the invoiced amount and the manner in which the objection shall be made.

c) The frequency of fee withdrawal must be specified in the written authorization or agreement.

d) The custodian of the account must be advised in writing of the limitation on the adviser's access to the account. This requirement may be satisfied by furnishing to the custodian a copy of the authorization or agreement.

e) The custodian must provide the client, not less than quarterly, a statement indicating all amounts disbursed from the account including, separately, the amount of advisory fees paid. This may be contained in the custodian's regular periodic report to the client.

f) The client must be able to terminate the written billing authorization or agreement required by this release at any time.

Signed by Carl L. Tyson, Director
Corporation & Securities Bureau
Dated: June 25, 1993