June 10, 2025

Submitted by email to Jacob.Strait@tn.gov

Commissioner Carter Lawrence
Attn: Mr. Jacob Strait, Associate Counsel
Tennessee Department of Commerce and Insurance
500 James Robertson Parkway
Davy Crockett Tower
Nashville, TN 37243

RE: Notice of Rulemaking Hearing on June 11, 2025

Dear Commissioner Lawrence:

As organizations representing the financial planning community, the Financial Planning Association® ("FPA®")[1], the XY Planning Network ("XYPN")[2], CFP Board[3], and the National Association of Personal Financial Advisors ("NAPFA")[4], together respectfully submit the following written comments and testimony in connection with the June 11, 2025 Rulemaking Hearing before the Tennessee Department of Commerce and Insurance, Securities Division, and in response to proposed changes to the Tennessee Investment Adviser Regulations related to the definition of "custody" found in proposed Chapter 0780-04-.05 of the Rules of the Tennessee Department of Commerce and Industry.

Background Information

1. Tennessee Policy Statement on Custody and Standing Letters of Authorization (May 29, 2024) Incorrectly Identifies First-Party Transactions as Custodial.

On May 29, 2024, the Securities Division of the Department of Commerce and Insurance ("Division") issued a Policy Statement[5] regarding Custody and Standing Letters of

[1] FPA is the nation's leading membership organization for CFP® professionals and those engaged in the financial planning process. FPA supports more than 17,000 members and 76 chapters and state councils.
[2] XYPN is a turnkey advice and planning platform that makes it possible for fee-only financial advisors to build an independent advisory firm to serve Generation X and Y clients. XYPN has more than 2,000 financial advisors, having launched from 0 just over 10 years ago, specifically by serving working-age consumers under a fiduciary obligation with no asset minimums.
[3] CFP Board operates the CFP® certification program, which sets high standards of competency and ethics for financial planning in the United States. Today, more than 104,000 CFP® professionals (approximately one-third of retail financial professionals in the United States), including almost 2,000 CFP® professionals in the State of Tennessee, voluntarily commit to CFP Board as a part of their certification to act as a fiduciary, and therefore, to act in the best interests of the client at all times when providing financial advice.
[4] NAPFA is the nation's leading organization of fee-only, comprehensive financial planning professionals. There are more than 4,700 NAPFA members across the country serving clients from all backgrounds.
[5] Tenn. Dept. of Comm. & Ins. Sec. Div. (May 29, 2024) Policy Statement Custody and Standing Letters of Authorization. Available at: https://www.tn.gov/content/dam/tn/commerce/documents/securities/posts/Statement-Policy-SLOAs-Custody.pdf.

Authorization ("SLOAs"). The Policy Statement declined to follow long-standing guidance[6] by the U.S. Securities and Exchange Commission ("SEC") to treat first-party asset transfers by an investment adviser on behalf of a client through SLOAs or otherwise as not creating a custodial arrangement. In the Policy Statement, in response to a request that the Division treat first-party and third-party transfers differently for the purpose of identifying when an investment adviser has custody of client funds or securities, the Division declined, stating:

> "The requestor of this policy interpretation has asked the Division to draw distinctions between first-party asset transfers and third-party asset transfers for purposes of enforcing Tennessee's custody rule. Distinguishing between these two types of asset transfers focuses only on the payee. However, there is no focus on the payee in determining whether an investment advisor has custody of a client's funds or securities. The determining factor is only whether there is an arrangement under which the investment adviser is authorized or permitted to withdraw the client's funds or securities…there is no focus on the payee in determining whether an investment adviser has custody of a client's funds or securities…*the Division makes no distinction between first-party asset transfers and third-party asset transfers for purposes of enforcing Tennessee's custody rule*."[7]

This departure from SEC guidance has significant consequences for Tennessee investment advisers and their clients. Under the Policy Statement, investment advisers' accounts where only first-party transactions occur are made subject to the costly annual surprise exam and financial audits by an independent public accountant as required by Rule 206(4)-2(a)(4) / Tenn. Comp. R. & Regs. 0780-04-03-.07 and 0780-04-03-.02(4)(a)2. While the Division argues that it has always interpreted custody rules as including first-party transactions[8], investment advisers have, for the first time in their years of operating in Tennessee, become subject to audit and surprise exam rules.[9] Such audits and exams come with never-before seen compliance costs between $20,000 - $30,000, which forces advisers to either pass some of these costs on to their clients or obtain signed

---

[6] U.S. Sec. & Exch. Comm'n. (Last visited June 9, 2025) "Staff Responses to Questions About Custody Rule." Available at: https://www.sec.gov/rules-regulations/staff-guidance/division-investment-management-frequently-asked-questions/staff-responses-questions-about-custody-rule.

[7] Tenn. Dept. of Comm. & Ins. Sec. Div. Policy Statement Custody and Standing Letters of Authorization. (emphasis added.

[8] Financial Planning Association can provide email communications with the Division about this issue, upon request.

[9] In addition to these fees, many NAPFA Advisors operate smaller, independent RIAs and are not part of large broker dealer "wirehouses" or financial services conglomerates that have significant regulatory compliance budgets. Tenn. Comp. R. & Regs. 0780-04-03-.02(4)(a)2(i) generally requires each TN investment adviser which has custody of client funds or securities to file with the Division annually a copy of its annual statement of financial condition (balance sheet) that has been certified by an independent certified public accountant or independent public accountant. The Division should clarify whether the certified public accountant or independent public accountant that certifies the required annual statement must be a PCAOB-registered accounting firm. An interpretation of the rule that requires certification only by PCAOB-registered accounting firms imposes significant additional costs and unnecessary administrative burdens on smaller RIAs operating in areas where few PCAOB-registered accounting firms, if any, are available.

authorizations to complete each first-party transaction. Both requirements also create additional, costly and unwanted burdens for clients. To the best of our knowledge, Tennessee is the only state with such a requirement. Exams and audits are required only for accounts utilizing third-party transactions in all other jurisdictions.

In explaining its reasoning to make no distinction between first-party asset transfers and third-party asset transfers for purposes of enforcing Tennessee's custody rule in the Policy Statement, the Division references only an SEC February 21, 2017 no-action letter to the Investment Adviser Association ("IAA"). However, this no-action letter is in response to the IAA's request for interpretive guidance or no-action relief with respect to certain SLOAs, specifically those involving the authority for the adviser to disburse funds to one or more third-parties on behalf of the client. The letter establishes the SEC's position that third-party transactions using SLOAs do constitute custody, but introduces seven specific safeguards, on which the SEC's non-enforcement position is conditioned upon, specifically addressing situations where the adviser is given authority to make third-party transfers on behalf of the client. If these seven safeguards are met, the SEC takes a position of "non-enforcement" related to the surprise examination and financial audit requirements found in the Custody Rule 206(4)-2(a)(4).

The Division opined in the Policy Statement that while the Commissioner does rely on SEC guidance in construing "terms used in the [Investment Advisers] Act and [Tennessee] Rules," SEC guidance in the form of a "no-action" or "non-enforcement" position will not be considered, and that the "Division does not adopt the SEC's policy of circumstantial non-enforcement."[10] Notably, the Division's interpretation in the Policy Statement that it cannot rely on the SEC's February 21, 2017 no-action letter is unique among states. Connecticut[11], Washington[12], Arkansas[13], and Idaho[14] are several examples of states that have adopted interpretive guidance based on the SEC February 21, 2017, no-action letter, creating a substantially uniform interpretation and application of the custody rule regarding SLOAs *and* distinguishing between first- and third-party transactions. For example, Arkansas Securities Division stated in interpretive guidance dated February 28,

---

[10] Tenn. Dept. of Comm. & Ins. Sec. Div. Policy Statement Custody and Standing Letters of Authorization.

[11] Conn. Dept of Banking. (Nov. 2022) "Statement of Policy Regarding Custody Requirements for Investment Advisors With Standing Letters of Authorization and Similar Arrangements." Available at: https://portal.ct.gov/dob/securities-licensing/advisers-state/standing-letters-of-authorization

[12] Washington Dept of Fin. Inst. (Sept. 29, 2017). Securities Act Policy Statement 23. Available at: https://dfi.wa.gov/industry/securities-act-interpretive-statements/securities-act-policy-statement-23. *See also* Mass. Sec. Div. (Dec. 2019). Policy Statement Massachusetts-Registered Investment Adviser Compliance with Custody and Independent Verification Requirements. Available at: https://www.sec.state.ma.us/divisions/securities/download/switch-ps.pdf.

[13] Ark. Sec. Dept. (Feb. 28, 2019). Standing Letters of Authorization No Action Letter No. 19-NA-0001. Available at: https://securities.arkansas.gov/wp-content/uploads/2022/06/Standing-Letters-of-Authorization-19-NA-0001.pdf.

[14] Id. Dept of Fin. (Sept. 2023). Order: Exemption from Independent Verification. Available at: https://www.finance.idaho.gov/wp-content/uploads/2023/09/Investment-Advisers-with-Custody-Solely-in-connection-with-Standing-Letter-of-Instruction.pdf.

2019, that an investment adviser who "enters into an SLOA with a client which permits the investment adviser to transfer the client's funds or securities to a third party's account, the investment adviser has custody under the Act and Rules." The Arkansas Securities Division does not apply the same framework to first-party transactions. Similarly, while the Washington State Department of Financial Institutions acknowledges that SLOAs can be used in both first-party and third-party transactions, the custody rules only apply to the third-party transactions.

Notwithstanding the recognition in the IAA request and SEC's February 21, 2017 no-action letter that SLOAs can be utilized in first- and third-party transactions, neither of these communications deal with the long-standing guidance that first-party transactions do not create custody to begin with, making these letters less relevant guidance for the purposes of interpreting whether first-party transactions should trigger custody rules at all.

We respectfully argue that, in its Policy Statement, the Division fails to rely on additional and more relevant guidance on the SEC's position of custody in the case of first-party transfers. Indeed, written guidance from the staff of the SEC's Division of Investment Management entitled "Staff Responses to Questions About the Custody Rule"[15] provides a more relevant framework for interpreting issues of custody in the context of first-party transactions. This guidance is unrelated to the non-enforcement position taken by the SEC in the February 21, 2017, no action letter in response to IAA.

2. The SEC's "Staff Responses to Questions About the Custody Rule" Clearly Identifies First-Party Transfers with or without SLOAs as Non-Custodial Transactions.

In the SEC's guidance titled "Staff Responses to Questions About the Custody Rule," SEC staff explicitly differentiate between first- and third-party transfers within a single qualified custodian and between multiple qualified custodians in Question II.4:

> "**Q:** Does an adviser have custody if it has authority to transfer client funds or securities between two or more of a client's accounts maintained with the same qualified custodian or different qualified custodians?
>
> **A:** Under rule 206(4)-2(d)(2)(ii), an adviser has custody if it has the authority to withdraw client assets maintained with a qualified custodian upon the adviser's instruction to the custodian. *We do not interpret the authority to withdraw assets to include the limited authority to transfer a client's assets between the client's accounts maintained at one or more qualified custodians* if the client has authorized the adviser in writing to make such transfers and a copy of that authorization is provided to the qualified custodians, specifying the client accounts maintained with qualified custodians. In the staff's view, "specifying" would mean that the written authorization signed by the client and provided to the sending custodian states with particularity the name and account numbers on sending and

[15] U.S. Sec. & Exch. Comm'n. "Staff Responses to Questions About Custody Rule."

receiving accounts (including the ABA routing number(s) or name(s) of the receiving custodian) such that the sending custodian has a record that the client has identified the accounts for which the transfer is being effected as belonging to the client. That authorization does not need to be provided to the receiving custodian. *Moreover, in the staff's view, an adviser's authority to transfer client assets between the client's accounts at the same qualified custodian or between affiliated qualified custodians that both have access to the sending and receiving account numbers and client account name (e.g., to make first-party journal entries) does not constitute custody and does not require further specification of client accounts in the authorization*." (emphasis added).

Although this guidance states that Question II.4 was last modified on February 21, 2017, the same day as (and presumably in conjunction with) the no-action letter to IAA in response to its request for clarification about *third-party* transfers under the auspices of SLOAs, that modification was unrelated to the issue of first-party transfers.[16]

Given that the Division can rely on separate interpretive guidance from the SEC related to first-party transactions and custody and avoid reliance on a no-action letter or position of non-enforcement, we request that the Division clarify in an amended policy statement or guidance that first-party transfers are not considered custody under the Investment Advisers Act or the Tenn. Comp. R. & Regs.

Comments on Proposed Chapter 0780-04-05 of the Rules of the Tennessee Department of Commerce and Industry

The Division is currently proposing to codify the North American Securities Administrators Association ("NASAA") model rule and definition of "custody."[17] The definition is very similar to the definition of "custody" currently utilized by the Division found in Appendix C of "Form ADV", which the Division has previously codified as the proper form for investment adviser registration.[18] In general, our organizations support actions by states that will align and create continuity between state and federal regulations where possible.

As an alternative to retracting or amending the Policy Statement or issuing a new policy statement clarifying that first-party transactions do not constitute "custody," as requested above, we request that the Division include language to the currently proposed Chapter 0780-04-05 definition of "custody" clearly excepting first-party transactions from the definition of custody. This would clarify and align Tennessee's interpretation of the custody rules with the guidance followed by SEC and, to our knowledge, every other state.

---

[16] U.S. Sec. & Exch. Comm'n. (Feb. 21, 2017). Investment Advisers Act of 1940 – Section 206(4) and Rule 206(4)-2 "No Action Letter." Available at: https://www.sec.gov/divisions/investment/noaction/2017/investment-adviser-association-022117-206-4.htm.

[17] North Am. Sec. Admin. Assoc. (Sept. 11, 2011). NASAA Custody Requirements for Investment Advisers Model Rule 102(e)(1)-1. Available at: https://www.nasaa.org/wp-content/uploads/2011/07/IA-Model-Rule-Custody.pdf.

[18] Tenn. Comp. R. & Regs. 0780-04-01-.04(4)(b).

Specifically, we propose language substantially similar to the following addition to Chapter 0870-04-05-.10(3)(e)(2):

2. "Custody" means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them, or has the ability to appropriate them. The investment adviser has custody if a related person holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with investment advisory services the investment adviser provides to clients.

   (i) Custody includes:

      (I) Possession of client funds or securities unless the investment adviser receives them inadvertently and returns them to the sender promptly, but in any case, within three (3) business days of receiving them;

      (II) Any arrangement, including a general partner of attorney, under which the investment adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon the investment adviser's instruction to the custodian; and

      (III) Any capacity, such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust that gives the investment adviser or its supervised person legal ownership of or access to client funds or securities.

   (ii) Receipt of checks drawn by clients and made payable to third parties will not meet the definition of custody if forwarded to the third party within three (3) business days of receipt and the investment adviser maintains the records required under Rule 0780-04-05-.06.

   (iii) An investment adviser's authority to transfer client assets between a client's accounts at the same qualified custodian or between qualified custodians that both have access to the sending and receiving account numbers and client account name (e.g., to make first-party journal entries) does not constitute custody and does not require further specification of client accounts in the authorization.

The Division's Current Interpretation of Custody Rules Harms Tennessee Investment Advisers Without Any Noted Benefit to Consumers

In addition to the long-standing, applicable SEC guidance clearly distinguishing between first- and third-party transactions in determining if a custodial relationship exists, the costs associated with the Division's current policy interpretation for Tennessee investment advisers and their clients are unjustifiably high. Significantly, there are no meaningful benefits to consumers for this level of oversight for first-party transactions (with or without SLOAs) because of the practical impossibility that an investment adviser could misuse client funds or securities, defraud, or otherwise harm a client through first-party transactions.

While we recognize the potential risk that comes with an adviser having standing authority to engage in third-party transfers[19], research conducted by XYPN, examining prior orders, actions, complaints, or issued guidance across jurisdictions from recent years, revealed no examples of fraudulent activity or evidence of investor harm resulting specifically from an adviser's limited authority to engage in first-party transfers on behalf of the client, upon the adviser's instructions to the custodian.

In addition to the financial and resource burdens to both investment advisers and clients noted earlier in this letter, there are broader consequences for the profession of the Division's current interpretation of the custody rule. First-party transactions using SLOAs are a common and cornerstone tool for financial planners working with clients who are saving for retirement. Investment advisers that have been impacted by this policy position to date have reported to us that the interpretation has forced changes in their business models and left them severely disadvantaged by Tennessee's current interpretation of the custody rule. Many advisers want to remain smaller, community-based businesses but are forced to grow as quickly as possible to become SEC-regulated because the cost of compliance with the Policy Statement is exorbitant and unsustainable. This discourages advisers with entrepreneurial goals from opening or maintaining small, local firms because the costs can be too great for small businesses to bear. This is particularly discouraging for those advisers who sacrifice to earn and maintain their CERTIFIED FINANCIAL PLANNER™ mark, and who already voluntarily agree to abide by a fiduciary standard of care as part of that distinguishing achievement. Ultimately, it is the clients themselves who will face unnecessary increased costs of financial planning services, and without any notable benefit or protections.

We appreciate the opportunity to share our concerns regarding Tennessee's current policy position on first-party transactions and custody and provide comment on the proposed rulemaking to codify the NASAA model definition of "custody" in the Tenn. Comp. R. &

[19] U.S. Sec. & Exch. Comm'n. (Dec. 9, 2024). "SEC Charges Morgan Stanley Smith Barney for Policy Deficiencies that Resulted in Failure to Prevent and Detect its Financial Advisors' Theft of Investor Funds." Available at: https://www.sec.gov/newsroom/press-releases/2024-193.

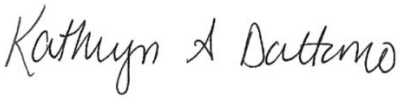
Regs. We look forward to opportunities to continue this discussion and welcome any questions you may have for our organizations.

Sincerely,

Dennis Moore
Interim Chief Executive Officer and Chief Operating Officer
Financial Planning Association

Travis Johnson
Managing Director, XYPN Compliance
XY Planning Network

Erin Koeppel, J.D.
Managing Director, Government Relations and Public Policy Counsel
CFP Board



Kathryn Dattomo, MNA, CAE, CFRE
Chief Executive Officer
National Association of Personal Financial Advisors