

SPOTLIGHT ON

Registration Requirements and Filings for Investment Advisors and Their Employees

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Advisors are generally required to register with the Securities and Exchange Commission (“SEC”) or the states in which they do business unless the advisor only manages certain types of clients or has a limited number of clients and assets under management (“AUM”). In addition, states (but not the SEC) require some individual employees of registered advisory firms to get registered as Investment Advisor Representatives (“IARs”) in their ownright.

Which advisory firms must get registered.

What is an “investment adviser”?

The Investment Advisor Act of 1940 (“the Act”) defines an “investment adviser” as any person or firm that:

“for compensation, engages in the business of advising others, either directly or indirectly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.”

Certain entities are not considered to be an “investment adviser” including:

- U.S. banks and bank holding companies;
- Lawyers, accountants, engineers, and teachers who only offer investment advice that is incidental to the practice of their profession;
- SEC-registered broker/dealers if the investment advice they provide is solely incidental to their broker or dealer business, and they do not receive any special compensation for providing that advice;
- Government securities advisors who only provide advice concerning certain securities issued by or guaranteed by the U.S. government;
- Credit rating agencies that are regulated as national recognized statistical rating organizations; and
- Family office advisors.

Which advisory firms must get registered (cont.)

Because these entities are not advisors under the Act, they are not subject to any of the Act's requirements.

A firm falling within the Act's definition of an "investment adviser" must register with the SEC unless it:

- Qualifies for one of the exclusions discussed above;
- Qualifies for an exemption from the Act's registration requirement (which we discuss below); or
- Is prohibited from registering with the SEC because it is a smaller firm regulated by one or more of the states.

Categories of advisors who must register.

Large Advisors: Generally speaking, securities advisors must register with the SEC if they have more than \$100 million in assets under management ("AUM"). These advisors are deemed "large" advisors and state laws are preempted for them. The Act defines "assets under management" as the securities portfolios over which the advisor has discretion or provides continuous advisory services.

Mid-Sized Advisors: Advisors with between \$25 million and \$100 million AUM – commonly referred to as "mid-sized" advisors – are required under federal law to register with the state(s) in which they are located or in which they have more than the state's de minimis number of clients. A few categories of mid-sized advisors may or must register with the SEC:

- Advisors who would be required to register in 15 or more states may instead choose to register with the SEC.
- Mid-sized advisors whose home state does not have securities regulators that conduct examinations of advisors (i.e., Minnesota, New York, and Wyoming) must register with the SEC.

Small Advisors: Advisors with less than \$25 million AUM – commonly referred to as "small" advisors – and who are not SEC-registered must get registered with the state(s) in which they do business only if they are required to under state law. (I.e., the SEC does not require small advisors to be registered and leaves that to the states.)

Categories of advisors who must register (cont.)

States generally require that advisors who are not SEC-registered but have more than a certain number of clients must get registered with the state. The state rules vary substantially but the following general rules may help advisors get started in determining whether they need to register with their state(s):

- The number of clients from each state that an advisor can have before needing to be registered with that state ranges from 0 to 15 but most states set the limit at 0 or 5.
- State rules apply to all advisors who have an office in that state (even if that office is the advisor's home) and who have clients from that state. Therefore, registering in the state where the advisor has its principal office and place of business may not be sufficient if the advisor does business in other states.
- States often allow advisors located in another state (i.e., out-of-state advisors) to have a higher number of clients before needing to get registered than unregistered in-state advisors can have.
- States may have exemptions for advisors who only have certain types of clients, such as advisors who only manage funds for accredited investors.
- Most states apply these rules to advisors located in the state as well as out-of-state advisors with clients in or actively soliciting clients in the state, although many states allow out-of-state advisors to have more clients before needing to get registered.

Advisors must compute their AUM annually to confirm which category (large, mid-sized or small) the advisor fits and include that AUM on the firm's Form ADV. The SEC has built in cushions on either side of these thresholds so SEC-registered advisors whose AUM temporarily falls less than \$10 million below the \$100 million threshold do not have to register with a state instead and state-registered advisors whose AUM rises only temporarily \$10 million or less above the \$100 million threshold do not need to register with the SEC.

Entities exempt from SEC registration.

Under the Act, advisory firms with certain, narrow categories of clients are generally exempt from SEC registration.

The following types of advisors are exempt from registration with the SEC but must still make filings with the SEC, are subject to some SEC regulation and oversight, and so are referred to as “exempt reporting advisors.” Among other things, these advisors are required to file an abbreviated Part 1A of Form ADV and at least annual updating amendments and are subject to SEC examinations.

- **Private fund advisors** whose only clients are private funds like hedge funds, and who have less than \$150 million AUM in the United States.
 - These advisors may be:
 - U.S. advisors that act as investment advisers solely to private funds, and have less than \$150 million AUM; or
 - Non-U.S. advisors whose only U.S. clients are private funds and manage less than \$150 million in private fund assets from a place of business in the U.S.
 - When calculating their AUM each year to make sure they qualify for this exemption, advisors must include the market or fair value of all the private funds managed, including any uncalled capital commitments on a gross basis, i.e., without deducting any liabilities.
- **Venture capital advisors** that only advise one or more venture capital firms, no matter how large.

States may still require exempt reporting advisors to register or submit certain reports.

The following types of advisors are exempt from SEC registration, are not exempt reporting advisors, and therefore do not have to make the filings described above:

- **Commodity trading advisors** registered with the U.S. Commodity Futures Trading Commission are exempt from registration if:
 - Their business does not consist primarily of acting as an investment advisor; and
 - They do not advise a registered investment company or a business development company.
- **Insurance company advisors** whose only clients are insurance companies;
- **Small business investment company advisors** who solely advise small business investment companies;

Entities exempt from SEC registration (cont.)

- **Intrastate advisors:**

- Whose clients are all residents of the state where the advisors maintain their principal office and place of business; and
- Do not provide advice about securities on any national exchange;

- **Foreign private advisors:**

- With no place of business in the United States;
- With fewer than 15 clients in the United States and investors in the United States in private funds advised by the advisors;
- Who manage less than \$25 million for U.S. clients or investors in U.S. private funds; and
- Who do not hold themselves generally to the public in the United States as investment advisors.

Advisors who fall within these exemptions but would otherwise qualify for SEC registration may nonetheless choose to register with the SEC.

Although many of the Act's requirements apply to advisors that are registered or required to be registered with the SEC, other provisions, including antifraud provisions, apply to all firms meeting the "investment adviser" definition above. This includes exempt reporting advisors, foreign private advisors, and other advisors exempt from SEC registration.

The "family office" exclusion.

Family offices are excluded altogether from the definition of an investment advisor so do not have to register for that reason.

A "family office" is defined as a company that: (a) provides investment advice only to family clients; (b) is wholly owned and controlled by family members; and (c) does not hold itself out to the public as an investment advisor. A "family client" includes any member of the advisor's household, other direct relatives (e.g., children and parents), employees of the family office and their direct relatives and any trusts, estates or investment vehicles composed of these people's assets.

The “family office” exclusion (cont.)

There is a “grandfathering” provision available for family offices that were not registered or required to be registered with the SEC on January 1, 2010 that only provide advice to: (a) accredited investors who, at the time of the investment, were officers, directors, or employees of the family office, and invested with the family office before January 1, 2010; (b) any company owned exclusively and controlled by one or more family members; or (c) SEC-registered investment advisors that provide investment advice to and identify investment opportunities to the family office, make approximately the same trades for their own account, and meet certain other requirements. Advisors relying on the grandfathering provision are still subject to the Act’s general antifraud provision.

Registering an advisory firm.

To register with the SEC and/or one or more states, advisors must take at least the following steps:

- Register with FINRA’s Investment Adviser Registration Depository (“IARD”);
- Prepare a Form ADV, which requires detailed information about the firm, its clients, and its activities and file it through the IARD site;
- Have their employees who qualify as Investment Advisor Representatives (“IARs”) take appropriate registration exams, including the Series 65 or Series 66, and make any required filings; and
- Follow up with regulators to confirm that registration was granted.

Specific registration filings by advisory firms.

Advisors required to be registered must prepare and file a Form ADV with the SEC or the state(s) in which the advisor must register. The Form ADV generally requires detailed information about the firm, its clients, and its activities. Advisors must annually review and amend their Form ADV within 90 days of the firm’s fiscal year end and promptly file amendments if the information becomes materially inaccurate during the year.

Part 1A of Form ADV must be filed by both SEC- and state-registered advisors. It requires information on items such as the advisor’s business, employees, number and type of advisory clients, compensation arrangements, custody of client funds or securities, AUM, types of advisory services provided, other business activities, conflicts of interest, and disciplinary history. State-registered advisors (but not SEC-registered ones) must also file **Part 1B** of the Form ADV, which largely includes information on bonding and net capital.

Specific registration filings by advisory firms (cont.)

Part 2 of Form ADV serves as the basis for a disclosure document that advisors must provide their clients to inform them of the advisor's services, qualifications, and potential conflicts of interest.

The **Part 2A Brochure** must be filed by both SEC- and state-registered advisors, and includes information on the advisor's business, including general business practices, advisory business, fees and compensation, performance-based fees, types of clients, method of analysis, investment strategies, risk of loss, conflicts of interest, disciplinary information, Code of Ethics, participation in client transactions, personal trading, brokerage practices, review of accounts, client referrals, custody, investment discretion, proxy voting, and certain financial information. Advisors must file Part 2A on the IARD site and provide it to clients at onboarding, annually after that, or whenever material information changes.

The **Part 2B Brochure Supplement** contains disclosures about advisor personnel who provide advisory services to clients, including information on the person's formal education and business background, legal and disciplinary events, capacities in which he or she participates in investment-related business, compensation for sale of securities and investment products, economic benefits received from someone other than a client for providing advisory services, and contact information for the person's supervisor. Advisors do not have to file Part 2B with the regulators but must provide the supplement(s) to clients whenever a new representative begins to provide advisory services to clients, information becomes materially inaccurate, a new disciplinary event occurs, or previously disclosed disciplinary information changes.

States also typically require filings in addition to those mandated by the SEC, although the specific requirements vary by state. For instance:

- All states (except Wyoming) require SEC-registered advisors with an office or a certain number of clients in the state to "notice-file", i.e., provide state securities regulators with copies of parts of Form ADV filed with the SEC and a consent to service of process on an annual basis.
- Some states require advisory firms to file a balance sheet, audited financial statements, a surety bond, sample advisory agreements, articles of incorporation, privacy policy, proof of errors and omissions insurance coverage, written compliance policies and procedures, solicitor agreements, and promotional/marketing and disclosure materials.
- And some states also require advisors to register their branch offices located in the state.

Qualification and licensing of Investment Adviser Representatives.

Advisory firms must also determine which of the firm's employees need to be registered with the individual states. Only the states, not the SEC, require registration and licensing of advisory firm employees but employees of SEC-registered advisors may need to register with the state(s) in which the employee does business or works.

Generally, states may require employees of SEC-registered advisors and certain state-registered advisors individually to register as "Investment Adviser Representatives" (IARs). Typical state laws define an IAR as anyone employed by or associated with a registered advisor who makes recommendations or gives advice on securities; manages client accounts; holds himself out as providing investment advice; or is compensated for soliciting clients for an advisory firm. The definition generally excludes clerical or ministerial employees, and supervised persons without a place of business in the state or who have no more than five natural person clients.

The states may impose licensing, registration, examination, or qualification requirements on IARs of SEC-registered advisory firms if the employee has a place of business in the state and has more than five clients who are individuals (natural persons) and more than 10% of his or her clients are natural persons. IARs of SEC-registered advisory firms with no place of business in a state do not need to register. Similarly, many states only require the registration, licensing or qualification of IARs of a state-registered advisor if the firm has a place of business located in the state or had five or more clients residing in the state during the prior twelve months.

Because the exact definition of an IAR varies by state and depends on whether the employer is an SEC- or state-registered advisor, advisors should research the specific rules in their state(s).

States also require IARs to qualify for registration. Most states require that IARs at least pass the Series 65 or Series 66 examination but waive this requirement for IARs who hold certain professional designations like a CFP or CFA.

To register, IARs must typically file a Form U4 (the Uniform Application for Securities Industry Registration) through the IARD/CRD system, pay registration fees, and file fingerprint cards. In some states, applicants registering as IARs are automatically approved unless the state securities regulator requests additional information on any disciplinary items in the application. As discussed above, advisory firms must also create Form ADV Part 2B brochure supplements for each IAR, and, in most states, must also upload those brochure supplements to the IARD system.

Advisors are responsible for ensuring that they are registered in all applicable jurisdictions and making the requisite regulatory filings that allow the regulators to confirm that the advisor is appropriately registered or exempt from registration.

Although there are similarities among state registration rules, advisors should keep in mind that each state has its own registration requirements that it enforces independently and advisors should research the rules of each state in which they do business to ensure they are properly registered.

Advisors should keep in mind that they are subject to a certain amount of regulation even in jurisdictions that may not require them to register. For instance, all advisors, whether registered or not, are subject to the Act's anti-fraud provisions, and the SEC has authority to pursue fraud actions against state-registered advisors. In addition, even SEC-registered advisors are subject to certain state requirements including:

- State anti-fraud prohibitions;
- State notice filing provisions requiring advisors to provide copies of their SEC registration filings;
- Paying licensing and renewal fees; and
- Licensing their representatives who have a place of business in the state.