

***RUNNING THE TRAPS:***

**FEDERAL VERSUS STATE REGISTRATION  
OF  
INVESTMENT ADVISERS  
AND  
INVESTMENT ADVISER REPRESENTATIVES**

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## INTRODUCTION

*The Dodd-Frank Act<sup>1</sup> enacted in July 2010 made significant changes to the laws that govern whether advisers are required to register and, if so, where. As a result, many advisers will become subject to registration requirements for the first time and many advisers previously registered with the SEC will have to switch their registrations to the states.*

*These developments have renewed interest in the fundamental question of where advisers are required to register -- with the SEC or the states. Years ago, there was hope that the National Securities Markets Improvement Act of 1996 ("NSMIA")<sup>2</sup> would divide the adviser regulatory universe once and for all, with larger advisers regulated by the SEC and smaller advisers regulated by the states. Unfortunately, NSMIA did not create the hoped-for clean break, and the Dodd-Frank Act did nothing to clear this up. As a result, even today advisers must still "run the traps" to determine whether they -- and the representatives and solicitors that work for them -- must register with the SEC under federal law or with the individual states under applicable state securities or "Blue Sky" laws.*

*This paper offers flowchart-style decision trees to help analyze those basic registration questions. It also discusses the myriad other federal and state adviser regulations that have to be considered aside from registration.*

*A lot of explanatory detail appears in the endnotes accompanying the flowcharts and text. Readers will therefore find it beneficial to spend a fair amount of time focusing there.*

*Note that many of the changes made by the Dodd-Frank Act will not go into effect until mid-2011 and will not be fully implemented until the SEC completes formal rulemaking. As a result, this paper discusses the changes made by the Act with the caveat that final details will have to be discerned once the transition period is over and rulemaking is complete. Citations to Advisers Act sections in this paper are to the sections as amended by the Dodd-Frank Act.*

## Investment Adviser Registration

The decision tree at the end of this section addresses whether an investment adviser must register<sup>3</sup> with the SEC or with a particular state (State X). It assumes the adviser meets the basic "investment adviser" definition<sup>4</sup> and aims to analyze whether the adviser is nonetheless excepted from the definition or exempted from federal registration and, in any case, whether it must register with the states. Terms and concepts in **bold face** on the decision tree are addressed in more detail in the endnotes cited there. The text in this section supplements the decision tree and should be read in conjunction with it and the endnotes.

*Federal Registration and State "Notice Filings" for Federally-Registered Advisers.* As shown in the decision tree, an adviser that is not excepted from the definition of investment adviser,<sup>5</sup> nor otherwise exempt from<sup>6</sup> or ineligible for<sup>7</sup> federal registration, will be required to register with the SEC under the Advisers Act.<sup>8</sup> If an adviser is required to register federally, it must register with the SEC. In other words, the adviser may not elect to register with a state in lieu of the SEC.<sup>9</sup>

An application for SEC registration must be submitted electronically on Form ADV<sup>10</sup> via the Web-based Investment Adviser Registration Depository ("IARD") system,<sup>11</sup> which was developed by the Financial Industry Regulatory Authority ("FINRA," or its predecessor, the NASD)<sup>12</sup> and is co-sponsored by the SEC and the North American Securities Administrators Association ("NASAA").<sup>13</sup> Once an application is filed, the SEC has up to 45 days within which to issue an order granting the registration or institute proceedings to determine whether the registration should be denied.<sup>14</sup>

If an adviser has registered federally with the SEC, it will not be required to also register at the state level.<sup>15</sup> Thanks to provisions in NSMIA that preempt state law, federally-registered advisers cannot be required to also register with a state.<sup>16</sup>

However – and this is a big however – even though a federally-registered adviser need not register with the states, it may still be required to “notice file” in every state in which it is doing business as an investment adviser<sup>17</sup> before it can legally do business there. “Notice filing” in a state is accomplished by submitting to the state a copy of the adviser’s Form ADV. This is done electronically, via IARD, by designating in Part 1.A., Item 2.B., of ADV which states should receive a copy of the ADV at the same time it is transmitted for filing with the SEC. Notice filing serves to give the designated states notice the adviser is conducting business there, allowing them to monitor securities-related activities within their borders and enforce their own laws, most notably their own anti-fraud laws.<sup>18</sup> Of course, notice filings also serve as a vehicle for states to collect filing fees.<sup>19</sup>

What permits the states to require notice filings when NSMIA preempts state laws requiring the “registration, licensing or qualification” of federally-registered advisers? The answer is that NSMIA specifically preserved state authority to require the filing “solely for notice purposes” of any documents filed with the SEC under the securities laws,<sup>20</sup> together with a consent to service of process and any required filing fees.<sup>21</sup> As a result, a state “notice filing” and a state “registration” do not look much different in form, from the standpoint of the adviser. Both involve Blue Sky research to determine if a filing is required in any particular state. Both involve submitting documents to the state if a filing is required. Both involve paying filing fees to any state where filings are required.

However, there is a substantive difference between a state “notice filing” and a state “registration.” Since a notice filing is made “solely for notice purposes” and cannot include anything other than documents also filed with the SEC, a state cannot impose its own separate filing requirements on a federally-registered adviser, nor “reject” its notice filing on the basis of the state’s own qualification criteria and thereby block the adviser from doing business in that state.<sup>22</sup> In contrast, a state could apply its own qualification criteria to reject the registration of any adviser that were required to register with it at the state level.

The bottom line for federally-registered advisers is that state law still has to be researched to determine whether notice filings are required there. Prudence dictates that the state laws be checked in every state where an adviser has a place of business, has clients or otherwise makes significant contact -- whether directly, through agents or through the Internet<sup>23</sup> -- while rendering investment advisory services.<sup>24</sup> For advisers with nationwide operations, this may necessitate a time-consuming 50-state Blue Sky survey, which some of us naively hoped would be dead following NSMIA, at least for advisers registered with the SEC.

*State Registration for Advisers Not Registered with the SEC.* If an adviser does not meet the parameters for federal registration, it is prohibited from registering with the SEC. An adviser generally may not elect to register with the SEC.<sup>25</sup> Rather, advisers that are not federally-registered (or excepted from the federal definition of investment adviser)<sup>26</sup> must analyze whether they are required to register with any state authorities instead of the SEC. It is possible that an adviser will have to register with more than one state,<sup>27</sup> if the adviser is doing business in more than one state.<sup>28</sup> It is also possible that an adviser will not have to register with any state, if under the law of each state where the adviser is doing business, it falls outside applicable definitions or regulatory parameters requiring registration.

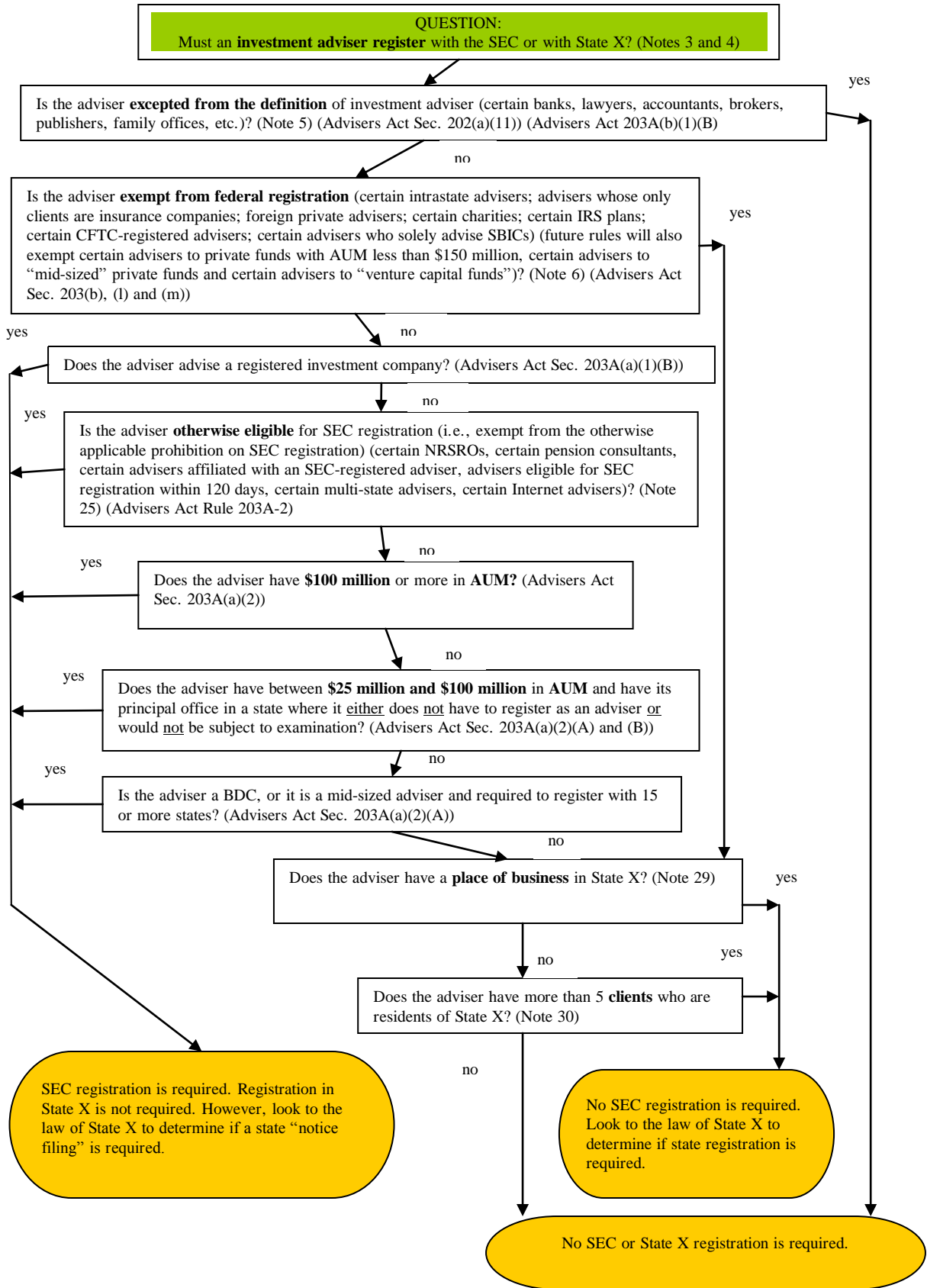
Although there is more uniformity than before, state laws regulating investment advisers still vary from state to state. As a result, the decision tree in this paper cannot definitively address whether an adviser not registered with the SEC must register in any particular state. In that case, advisers must still look at state law in each relevant state to determine that state’s specific requirements.

However, this much is clear and is uniform across the 50 states: An adviser cannot be required to register in any state where it does not meet the “National *de Minimis* Standard” established by NSMIA, which prohibits state law from requiring an adviser to register there if it does not have a place of business<sup>29</sup> located within the state and during the preceding 12 months had fewer than 6 clients<sup>30</sup>

who are residents of that state.<sup>31</sup> Put another way, states can require registration there only if an adviser has a place of business there or has more than 5 clients there. Although the National *de Minimis* Standard has the most direct impact on advisers that are not federally-registered and are trying to determine whether they have any state registration requirements, most states have adopted the National *de Minimis* Standard to define which federally-registered advisers are relieved from the state's notice filing requirements as well.<sup>32</sup>

State adviser registrations are accomplished by filing Form ADV via the IARD system with the appropriate state(s).<sup>33</sup> Although there is still some variation among the states in the handling of state registrations, particularly Part 2 of Form ADV,<sup>34</sup> most states now are mandating or allowing filings to be submitted via IARD for state-registered advisers.

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## Registration of Employees and Solicitors of Federally-Registered Advisers

There is some good news and some bad news. The good news is that federal law does not require the separate SEC registration of individual employees who work for an investment adviser, even if they provide investment advice.<sup>35</sup> Moreover, solicitors acting on behalf of an adviser will also not be required to register separately with the SEC, unless their solicitation activities themselves constitute providing investment advice (or other regulated activity) within applicable federal definitions and are not considered part of the adviser's own business covered by the adviser's federal filing.<sup>36</sup>

The bad news is that under NSMIA, states retained their authority to require state registration of certain persons acting on behalf of an adviser, even if those persons are acting on behalf of a federally-registered adviser.<sup>37</sup> As a result, even after an adviser has "run the traps" to determine whether the adviser itself must register with the SEC or the states, it must also "run the traps" to determine whether those persons acting on behalf of the adviser -- such as employees or solicitors -- are required to be registered with one or more states as well.

The decision tree at the end of this section addresses the question of whether a person who acts on behalf of a federally-registered adviser must register with a state (State X). The decision tree assumes the person is acting on behalf of a federally-registered adviser because that is when a state registration requirement for persons acting on behalf of the adviser is most surprising and could be most easily overlooked. Certainly, persons acting on behalf of state-registered advisers might very well have to register at the state level as well.<sup>38</sup>

Just as in the prior section, terms and concepts in **bold face** on the decision tree below are addressed in more detail in the endnotes cited there. The text in this section provides additional information to help analyze the questions addressed and should be read in conjunction with the decision tree and the endnotes.

Supervised Persons. The first question the decision tree asks is whether the person acting on behalf of the federally-registered adviser is a "supervised person" of the adviser.<sup>39</sup> If so, the decision tree then asks a series of questions to determine whether the person is an "investment adviser representative"<sup>40</sup> ("IAR") as well. This is because NSMIA preempts (and therefore prohibits) laws that require state registration of a "supervised person" unless the person is also an IAR (under the federal definition) with a place of business in that state.<sup>41</sup> As a result, states are still free to require registration of IARs with a place of business there,<sup>42</sup> even if they are acting on behalf of a federally-registered adviser.

By retaining the authority to register IARs, states have maintained the ability to identify and monitor those individuals who may pose the greatest risk to clients in their states, particularly less sophisticated, retail clients. The key lies in the definition of IAR. Under the federal definition, an IAR is a supervised person who has more than 5 clients that are natural persons and more than 10% of whose clients are natural persons.<sup>43</sup> People meeting certain wealth and sophistication standards are not counted as clients for this purpose.<sup>44</sup> In addition, supervised persons who do not solicit, meet with or otherwise communicate regularly with clients of the adviser, or who provide only "impersonal" investment advice, are specifically excluded from the IAR definition under federal law.<sup>45</sup>

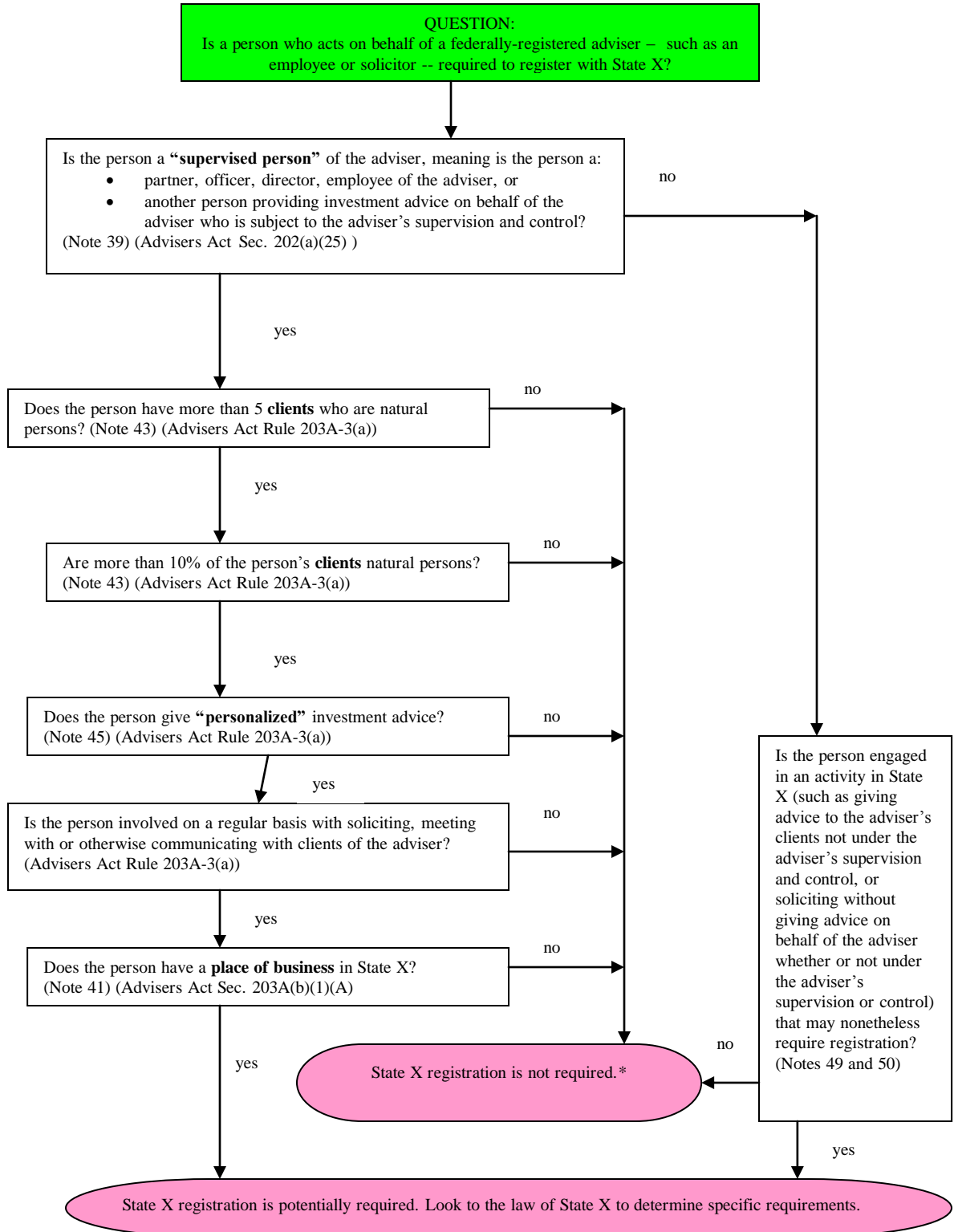
Non-Supervised Persons. If the person acting on behalf of the adviser is not a "supervised person," all bets are off. In that case, NSMIA will not preempt state registration, even if the person is acting only on behalf of federally-registered advisers and falls outside the federal definition of IAR. Rather, the person could be required to separately register in each state in which the person is doing business<sup>46</sup> if the person's activities viewed separately constitute providing investment advisory services or other regulated activities under applicable state law.

One circumstance where this could come up with some frequency is with so-called “third-party solicitors.”<sup>47</sup> By “third-party solicitor” I mean a solicitor who is unaffiliated with the adviser and who may or may not be under the adviser’s supervision and/or control, but nonetheless falls outside the “supervised person” definition.<sup>48 49</sup> These solicitors may be authorized (for example, by contract) to solicit on the adviser’s behalf. Whether that type of solicitor must register with a state would depend on whether the solicitor’s activities themselves constitute providing “investment advisory services” or whether the state’s definition of “investment adviser” or “investment adviser representative” is broad enough to include solicitors, or whether through some other state law interpretation, the solicitor falls within applicable provisions requiring state registration. Keep in mind that -- unlike the federal definitions of “investment adviser” and “investment adviser representative” -- states often expressly include in the operative provisions of their adviser laws persons who solicit on behalf of an adviser.<sup>50</sup>

While not handled uniformly across-the-board, most (if not all) states now either require or allow IARs to register electronically, using the IARD<sup>51</sup> system and Forms U-4 and U-5. States also typically require IARs to pass certain standardized exams in order to register<sup>52</sup> or, alternatively, that they have one of a number of professional designations.<sup>53</sup>

The bottom line for persons acting on behalf of investment advisers – even federally-registered advisers -- is that state law still has to be checked to determine whether registration is required there. A conservative approach would dictate checking the laws in every state where the person has a place of business, gives advice to clients or otherwise makes significant contact (for example through solicitation) in connection with the adviser’s business.<sup>54</sup>

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\* However, look to the law of State X to determine if a state “notice filing” is required from the adviser on whose behalf the person is acting. (Note 42)

## Other Federal and State Regulations Affecting Advisers

The focus of the first two sections of this paper was to sort out the registration requirements imposed on advisers and IARs at the federal and state levels. Unfortunately, registration is not the only area where advisers still have to “run the traps.” Advisers must still sort out myriad other federal and state laws that regulate advisers and determine whether those laws apply to them, since some apply to federally-registered advisers, some to state-registered advisers and some to both. Here are a few important pieces of the puzzle:

Federal Provisions Applicable to All (or Most) Advisers. These provisions of the Advisers Act apply to all or most advisers, including state-registered and unregistered advisers, as noted:

- The general adviser anti-fraud provisions (Advisers Act Section 206) (all advisers);
- The pooled vehicle anti-fraud rule (Rule 206(4)-8)(all advisers to pooled vehicles);
- The prohibition on performance-based fees in most advisory contracts (Advisers Act Section 205(a)(1)) (all advisers except those specifically exempted from registration under Section 203(b) of the Advisers Act\*);
- The prohibition on assignment of an advisory contract without client consent (Advisers Act Section 205(a)(2)) (all advisers except those specifically exempted from registration under Section 203(b) of the Advisers Act\*);
- The requirement to adopt and enforce written procedures designed to prevent the misuse of material nonpublic information (meaning insider trading) (Advisers Act Section 204A) (all advisers covered by Section 204 of the Advisers Act\*\*).

\* Advisers exempted from registration under Section 203(b) include certain intrastate advisers; advisers whose only clients are insurance companies; foreign private advisers (meeting the new definition); certain charities; certain IRS plans; certain CFTC-registered advisers; and certain advisers who solely advise SBICs. While not impossible, most state-registered advisers would not be exempted under Section 203(b). Rather, they would typically be required to register, but would be prohibited from registering with the SEC under Section 203A and hence relegated to state registration. As a result, this statutory prohibition would effectively apply to all SEC-registered advisers, most (if not all) state-registered adviser and unregistered advisers unless exempt under 203(b).

Note that the Dodd-Frank Act eliminated old Section 203(b)(3), which used to exempt “private advisers” (advisers with than fewer than 15 clients), an exemption on which many private fund advisers relied. At the same time, the Dodd-Frank Act added new exemptions for certain advisers to private funds with AUM of less than \$150 million, certain advisers to “mid-sized” private funds and certain advisers to “venture capital funds.” However, those exemptions are provided for in new Sections 203(l) and (m) (and perhaps in future rules implementing those sections), not in Section 203(b). Accordingly, exactly which private fund advisers are left within the scope of Sections 205(a)(1)<sup>55</sup> and (2) is unclear.

\*\* Portions of Section 204 apply to all advisers except those exempt from registration under Section 203(b). Other portions (as amended by the Dodd-Frank Act) apply to all investment advisers registered under the Advisers Act. Still other portions apply to all advisers, whether SEC-registered or state-registered. It is not clear whether Congress intended all these advisers to be considered “covered by Section 204” and therefore subject to the requirement to have insider trading prevention procedures.

Federal Provisions Specifically Applicable Only to SEC-Registered Advisers. By their express terms, these rules apply only to advisers registered or required to be registered under the Advisers Act. Therefore, they purportedly do not apply to state-registered advisers (or unregistered advisers):<sup>56</sup>

- The books and records requirements under Rule 204-2;
- The prohibition on certain advertisements deemed fraudulent under Rule 206(4)-1;
- The adviser custody rule (Rule 206(4)-2);

- The cash solicitation rule (Rule 206(4)-3),<sup>57</sup>
- The proxy voting rule (Rule 206(4)-6); and
- The compliance rule requiring advisers to adopt compliance policies and procedures (Rule 206(4)-7).

Of course, this does not mean that state-registered advisers are not regulated on these issues. It just means that they must look to state law to determine the applicable requirements, and many states have adopted equivalent rules. Moreover, the SEC seems to have kept its regulatory “foot in the door” to enforce the substance of these rules against state-registered advisers whenever it feels it is necessary – at least in the case of the rules which were originally adopted under the anti-fraud provisions of Section 206 of the Advisers Act.<sup>58</sup>

*Federal Provision Applicable to SEC-Registered Advisers and Certain Unregistered Advisers.*

Another variation on this theme developed in mid-2010 when the SEC adopted Rule 206(4)-5, which restricts political contributions by certain investment advisers (the so-called adviser “pay to play” rule). By its terms, that rule applies to SEC-registered advisers and advisers that are unregistered in reliance on what was then Section 203(b)(3), which exempted certain advisers from registration if they had fewer than 15 clients (the so-called “private adviser” exemption). However, the Dodd-Frank Act eliminated the private adviser exemption from the Advisers Act. It added back a different Section 203(b)(3), which exempts from registration certain “foreign private advisers” (meeting a new definition), but it is unclear whether they are among the advisers that the SEC would intend to cover in under the “pay to play” rule. The Dodd-Frank Act also added some new exemptions from registration for certain private fund advisers under Sections 203(l) and (m), but again it is unclear whether they are among the advisers the SEC would intend to cover under the “pay to play” rule. Accordingly, we will have to wait for further rulemaking to see what the eventual scope of Rule 206(4)-5 will be. In the meantime, there is no doubt that the rule applies at least to SEC-registered advisers.

*State Provisions Applicable to All Advisers; Retained State Jurisdiction Over SEC-Registered Advisers.* States retained full jurisdiction and authority under NSMIA to investigate and enforce any violation of state laws with respect to fraud or deceit.<sup>59</sup> This includes jurisdiction over all advisers -- including federally-registered advisers -- and their associated persons.<sup>60</sup> However, at least according to the SEC, states are precluded from indirectly regulating the activities of federally-registered advisers by defining “dishonest” or “unethical” business practices, unless the prohibited practice would be fraudulent or deceptive absent the definition.<sup>61</sup> Otherwise, states could take their reserved authority to the logical extreme and, by adopting a pervasive set of anti-fraud rules, essentially reinstitute the system of overlapping and duplicative regulation that NSMIA sought to end.

The concern that under the guise of their reserved authority, states might effectively reinstitute the old system underpins the SEC’s overarching view that NSMIA preempts not only a state’s specific registration, licensing and qualification requirements, but all regulatory requirements imposed by state law on federally-registered advisers relating to their advisory activities or services, except those provisions that are specifically preserved under NSMIA.<sup>62</sup> If this position is upheld in its most robust form,<sup>63</sup> states will have retained under NSMIA authority over federally-registered advisers only to (1) investigate and enforce anti-fraud laws; (2) require notice filings; and (3) require filing fees.<sup>64</sup>

*State Provisions Applicable to State-Registered Advisers; Required Uniformity.* Of course, states have plenary authority to regulate the activities of advisers registered in their states, including the ability to set qualification requirements, regulate business practices, require disclosures and prevent fraud. However, in the interest of promoting uniformity for advisers subject to requirements in more than one jurisdiction, NSMIA calls for uniform state regulation in these areas:

- Maintenance of books and records;
- Bonding;
- Minimum net capital.

NSMIA achieves this goal by prohibiting states from enforcing any law that would require an adviser to maintain any books or records in addition to those required under the laws of its home state, so long as the adviser is registered in its home state and in compliance with that state's requirements.<sup>65</sup> Similarly, states cannot enforce laws requiring a higher minimum net capital or any bond in addition to those required by an adviser's home state.<sup>66</sup>

## NSMIA Preemption Tested in Court

Given the controversy surrounding NSMIA, it is not surprising that at least a few cases have tested its preemptive effect. Most of those cases, however, have tested the NSMIA preemptive provisions applicable to offerings of federally-registered or "covered" securities, rather than the preemptive provisions applicable to investment advisers.

For example, in one closely watched case in 2005, the California Attorney General claimed, in substance, that an adviser and its distributor affiliate committed fraud by not sufficiently disclosing certain "shelf space" arrangements in a funds' disclosure documents, thereby violating certain provisions in the California Corporations Code. The adviser in that case prevailed in the lower court, which found the state's claim preempted by the provisions in NSMIA that prohibit states from imposing conditions on the disclosure of any information in an offering document for "covered securities," including shares of registered investment companies. According to the court, leaving determinations of materiality or adequacy of disclosures to states would undermine NSMIA and place funds in the untenable position of having to seek review of their offering documents by regulators in all states in which their shares are sold, one of the very redundancies that NSMIA was enacted to avoid.<sup>67</sup>

However, that lower court decision was reversed on appeal in January 2007. The appellate court interpreted the preemptive provisions of NSMIA and decided that although the Attorney General cannot sue the fund to force it to change its disclosure documents, it can sue the adviser and broker-dealer/distributor to force them to disclose their allegedly undisclosed shelf-space arrangements, even if that might indirectly encourage the issuer to alter its disclosure documents. The court further summarily rejected the lower court's finding that NSMIA preserved only common law fraud claims not arising under the California statutes on which the Attorney General based its claims against the adviser and distributor.<sup>68 69</sup>

There has been one case involving NSMIA preemption as it relates to adviser regulation, in which the State of New Hampshire pursued the financial advisory unit of American Express (AEFA) for allegedly fraudulent conduct under state law. AEFA tried to block the state's action by filing its own lawsuit in federal court, arguing in part that the state was attempting to regulate a federally-registered adviser in violation of NSMIA's preemption clause. However, this case reportedly settled out of court and we were therefore left without any new court opinion helping to interpret NSMIA's preemptive effect.<sup>70</sup>

\* \* \*

It is an unfortunate result of our federal system that even the preemptive force of NSMIA could not cleanly divide the regulatory universe for advisers between the SEC and the states. Congress imposed changes in 2010 via the Dodd-Frank Act, but did nothing to address these remaining regulatory overlaps and unclarity. As a result, until there is a more complete solution, advisers and those that work for them will have to keep "running the traps" to determine whether they must register and, if so, where.

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<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), H.R. 4173, included the Private Fund Investment Advisers Registration Act of 2010, which amended many sections of the Investment Advisers Act of 1940 (the "Advisers Act"), including many not related to private fund advisers.

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<sup>2</sup> The Investment Advisers Supervision Coordination Act was enacted October 11, 1996, effective July 8, 1997, as Title III of NSMIA, Public Law 104-290. NSMIA amended, among other things, the Advisers Act.

<sup>3</sup> In this paper, the term “register” is used for brevity. Other terms -- including the phrase “license, register or qualify” -- are sometimes used to refer in substance to the same thing.

<sup>4</sup> That is, the paper assumes the adviser meets the operative provisions of Section 202(a)(11) of the Investment Advisers Act of 1940, which provides that an investment adviser is any person who, for compensation, engages in the business of advising others, either directly 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.

<sup>5</sup> The federal definition of investment adviser (and many parallel state provisions) contains 7 statutory exceptions and permits the SEC to designate others by rule. Entities excepted by statute generally are: (i) banks and bank holding companies to the extent not advising registered investment companies; (ii) lawyers, accountants, engineers and teachers if advice is given solely incidental to professional practice; (iii) brokers and dealers if advice is given solely incidental to their business and no special compensation is received; (iv) publishers of financial publications of regular and general circulation; (v) persons advising only about U.S. government and certain other exempted securities; (vi) NRSROs (like credit rating agencies) unless they engage in securities recommendations or managing securities assets on behalf of others; and (vii) certain family offices. Advisers Act, Section 202(a)(11). The Dodd-Frank Act added the family offices exception and left it to the SEC to define “family office” by rule.

<sup>6</sup> Principal exemptions from federal registration are found in Section 203(b) of the Advisers Act (and in some state statutes with parallel provisions), which generally provides that the federal registration requirement does not apply to: (i) an adviser (other than an adviser to a private fund) all of whose clients are residents of the state in which it maintains its principal office, so long as it does not advise on listed securities; (ii) an adviser whose only clients are insurance companies; (iii) any foreign private adviser (as defined); (iv) an adviser that is a charity or advises only charities; (v) an IRS section 414(e) plan; (vi) certain commodities trading advisors registered with the Commodities Futures Trading Commission; and (vii) any adviser (other than a BDC) who advises solely Small Business Investment Companies. The Dodd-Frank Act amended several of these provisions, added (iii) and (vii), and eliminated the so-called “private adviser” exemption, which in general used to exempt advisers with fewer than 15 clients.

The Dodd-Frank Act also added two new exemptions: (1) The SEC must provide an exemption from registration (to be implemented by future regulation) to any adviser that acts solely as an adviser to private funds and has AUM in the U.S. of less than \$150 million. Even though not required to register, these advisers would still have certain reporting requirements. The Dodd-Frank Act further directs the SEC, when prescribing future regulations for advisers to “mid-sized private funds” (no definition is provided of “mid-sized”) to provide registration and examination requirements that reflect the level of systemic risk they pose. Accordingly, future regulations may also impact the registration requirements for advisers to “mid-sized” private funds. and (2) Advisers that advise solely 1 or more venture capital funds will also be exempt from registration. The SEC must define “venture capital fund” by regulation within 1 year. These advisers will also have reporting requirements even though exempt from registration.

<sup>7</sup> See the decision tree questions that address eligibility for SEC registration and thresholds of assets under management.

<sup>8</sup> If they are not otherwise excepted from the definition of investment adviser or exempt from registration under federal law, advisers located in any state or U.S. jurisdiction that has not enacted laws regulating investment advisers must also register with the SEC. Currently, that includes only the State of Wyoming. Since there are so few advisers affected by this issue, it was not addressed as a separate question on the decision tree. The SEC

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also maintains regulatory responsibility over certain foreign investment advisers doing business in the U.S., which is beyond the scope of this paper.

<sup>9</sup> However, see also note 25, *infra*, discussing the exceptions to the prohibition on SEC registration.

<sup>10</sup> See Rule 203-1 under the Advisers Act.

<sup>11</sup> The IARD system is a Web-based electronic filing system that facilitates registration, regulatory review and the public disclosure information of investment adviser firms and investment adviser representatives. The IARD system can be accessed via the Internet at <http://www.iard.com>. The public disclosure component of the IARD system, known as the IAPD (Investment Adviser Public Disclosure), can be accessed at <http://www.adviserinfo.sec.gov>.

<sup>12</sup> FINRA (then, the NASD) helped to develop the IARD system, based on the WebCRD system it originally developed for the registration of broker-dealers. Even though the IARD system is operated by FINRA, investment advisers that are not also broker-dealers are neither subject to regulatory oversight by the FINRA nor subject to the FINRA Conduct Rules just because they file their Form ADV via IARD.

<sup>13</sup> NASAA is a voluntary organization whose members include the securities administrators from the 50 states and various other jurisdictions. It is largely due to NASAA's involvement that the IARD system has achieved widespread acceptance at the state level.

<sup>14</sup> See generally Section 203(c)(2) of the Advisers Act. Although the SEC statutorily has up to 45 days to consider an application, in practice, adviser registrations may be declared effective well within 45 days.

<sup>15</sup> Limited circumstances are conceivable where a federally-registered adviser would need or perhaps want -- for business reasons -- to register with a state securities authority as well. Dual federal-state registration has been specifically accommodated in some states. See, for example, the Texas Blue Sky regulations, which specifically note that a federally-registered adviser is not prohibited from registering in Texas and may elect to register there. Texas Administrative Code, Title 7, Part 7, Chapter 116, Rule §116.1(a)(12).

<sup>16</sup> NSMIA added Section 203A(b)(1)(A) to the Advisers Act, which in substance preempts state registration requirements for federally-registered advisers by providing that no state law requiring the "registration, licensing or qualification" of any adviser shall apply to any adviser that is registered with the SEC, or that is not registered with the SEC because it is excepted from the definition of investment adviser under Section 202(a)(11) of the Advisers Act. See also note 6, *supra*, for more on the exceptions in Section 202(a)(11). This preemption is often implemented at the state level by excluding from the state definition of investment adviser any adviser registered with the SEC (sometimes referred to as a "federally covered investment adviser") or any adviser not required to register with the SEC due to an exception from the federal definition under Section 202(a)(11). Other states implement the preemption by adopting exceptions, exclusions or exemptions to their adviser laws that track the same wording as that used in the relevant federal counterparts.

<sup>17</sup> The phrase "doing business as an investment adviser" is used generally here. State laws vary in their terminology and their thresholds as to when an adviser is viewed as transacting business in that state or the adviser's business is viewed as falling within that state's jurisdiction. Many consider an adviser to be rendering investment advisory services "in the state" or "within the state" if either the client or the adviser (or the adviser's representative) is present in the state. See, for example, the Texas Blue Sky regulations, which provide that "[a] person is an 'investment adviser' who engages 'within this state' in rendering services as an investment adviser . . . if either the person or the person's agent is present in this state or the client/customer or the client/customer's agent is present in this state at the time of the particular activity." Texas Administrative Code, Title 7, Part 7, Chapter 116, Rule §116.1(a)(10)(A). See also note 24, *infra*.

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<sup>18</sup> Several provisions in NSMIA expressly avoid preempting or limiting a state’s ability to investigate and enforce its own anti-fraud laws. See, for example, Section 203A(b)(2) and Section 222(d) of the Advisers Act.

<sup>19</sup> An adviser can pay any relevant notice filing fees to the states via its IARD Financial Account.

<sup>20</sup> It has been noted that this broad phrasing (“any documents filed with the Commission pursuant to the securities laws”) may actually open the door to federally-registered advisers being required to notice file more documents with the states than they ever filed prior to NSMIA, since it technically includes everything advisers file with the SEC, such as Form 13F and Schedules 13D and 13G. While this was not likely the intent of the phrase, it would be cleaner if the Advisers Act were amended to clarify that states can only require federally-registered advisers to notice file Form ADV (or any successor federal registration/disclosure document).

<sup>21</sup> This preservation of state authority appears in Section 307 of NSMIA, a section which did not amend and therefore cannot be found in the Advisers Act.

<sup>22</sup> That would arguably constitute one of two things (or a combination of them): either (1) the state imposing its own “licensing, registration or qualification” requirement on a federally-registered adviser, which is preempted by NSMIA (see note 16, *supra*, and text surrounding); or (2) the state imposing on a federally-registered adviser a requirement that “conflicts with” the Advisers Act requirements and SEC rules, which would not be within the state’s reserved jurisdiction under Section 222(a).

<sup>23</sup> NASAA has issued an Interpretive Order which spells out conditions under which advisers that use the Internet to distribute information on available products and services – including posting on Bulletin Boards, displays on “Home Pages” or similar methods (“Internet Communications”) – will not be deemed to be “transacting business” in a particular state for purposes of the state’s registration requirements if the conditions are observed. Among other conditions are the following:

1. The Internet Communication contains a legend clearly stating that:
  - the adviser may only transact business in a state if first registered, excluded or exempted from state registration requirements; and
  - follow-up, individualized responses to persons in a state by such adviser that involve rendering personalized investment advice for compensation will not be made absent compliance with state investment adviser registration requirements or an applicable exemption or exclusion.
2. The adviser institutes policies and procedures reasonably designed to ensure that prior to any subsequent direct communication with prospective clients in a state, the adviser is first registered or qualifies for an exemption or exclusion there.
3. The Internet Communication does not involve rendering personalized investment advice for compensation in the state over the Internet, but is limited to dissemination of general information on products and services.

A vast majority of states have reportedly adopted some version of the NASAA Order. While not seemingly widespread, legends adapted from the NASAA provisions do appear on adviser websites.

<sup>24</sup> See note 17, *supra*, for more on when an adviser’s activities might be considered within a state’s jurisdiction. Note that the National *de Minimis* Standard and “place of business” definition discussed at notes 29 and 30, *infra*, technically only apply to state registration. This opens the door to a state applying its own *de minimis* standard for state notice filings. Even though in practice most states apply the National *de Minimis* Standard to determine which federally-registered advisers are relieved from notice filing requirements as well, at least a few reportedly do not. See, for example, Nebraska Revised Statute 8-1103(2)(b); New Hampshire Statutes Sec. 421-B:6 I; Texas Administrative Code, Title 7, Part 7, Chapter 116, Rule §116.1(b)(2)(C).

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<sup>25</sup> Although it may not technically constitute a “choice” to register with the SEC, Rule 203A-2 does provide certain advisers another route to federal registration even though they may be otherwise prohibited from registering with the SEC, by providing that the statutory prohibition on SEC registration does not apply to them. These advisers include certain NRSROs (like credit rating agencies), certain pension consultants, certain advisers affiliated with an SEC-registered adviser, advisers expecting to be eligible for SEC registration within 120 days, certain multi-state advisers and certain advisers that conduct substantially all their advisory business through an interactive website on the Internet (so-called “internet advisers”). Once federally-registered, these advisers would avoid any otherwise applicable state registration requirements.

<sup>26</sup> See note 5, *supra*, concerning exceptions from the definition.

<sup>27</sup> See Advisers Act Rule 203A-2 generally. Among others, advisers that would be required to register in 30 or more states under applicable state laws are permitted instead to register with the SEC. Rule 203A-2(e). The Dodd-Frank Act sets the threshold at 15 or more states for certain advisers, that is, advisers with AUM between \$25 million and \$100 million that would be facing multiple state registrations as a result of certain newly enacted provisions of the Act. It remains to be seen whether the SEC in future rulemaking will lower the 30-state threshold in Rule 203A-2 for all “multi-state” advisers to be consistent with the 15-state threshold that Dodd-Frank made applicable to only certain “multi-state” advisers.

<sup>28</sup> See notes 17 and 24, *supra*, and text surrounding, concerning “doing business” in a state. See also the discussion in the text surrounding notes 29-31, *infra*, explaining the National *de Minimis* Standard.

<sup>29</sup> For this purpose, “place of business” is defined to mean: (1) an office at which the adviser regularly provides investment advisory services, solicits, meets with or otherwise communicates with clients; and (2) any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services, solicits, meets with or otherwise communicates with clients. Advisers Act Rule 222-1.

<sup>30</sup> According to Advisers Act Rule 222-2, “clients” may be counted under the National *de Minimis* Standard the same way they are other provisions of the Advisers Act and rules. See Advisers Act Rule 203(b)(3)-1 generally. This means that in certain cases, a client may be counted together with others as a “single client,” such as a natural person and certain of their relatives, certain accounts and trusts of natural persons and their relatives, and certain corporations and other entities. Moreover, clients for whom an adviser provides services without compensation need not be counted as a client.

<sup>31</sup> Section 222(d) of the Advisers Act.

<sup>32</sup> However, as alluded to above in note 24, some states do not extend the National *de Minimis* Standard to notice filings made by federally-registered advisers.

<sup>33</sup> Advisers using Form ADV for registration with any state securities authorities must complete both Parts 1A and 1B of the Form, whereas federally-registered advisers complete only Part 1A. Similarly, in addition to the items applicable to SEC-registered advisers, state-registered advisers must complete certain state-specific items in their firm brochures (Part 2A of Form ADV) and brochure supplements (Part 2B of Form ADV).

<sup>34</sup> Even among those states accepting IARD registration filings, there is apparently still no uniformity on the handling of Part 2 of Form ADV. According to NASAA’s website, some states allow the Part 2 to be filed electronically through IARD, while other states mandate electronic filing. NASAA Investment Adviser FAQs: [http://www.nasaa.org/industry\\_regulatory\\_resources/investment\\_advisers/445.cfm#5](http://www.nasaa.org/industry_regulatory_resources/investment_advisers/445.cfm#5).

<sup>35</sup> Even though they will not be required to separately register with the SEC, key individuals affiliated with an adviser may well have to be disclosed on the adviser’s Form ADV, for example, in Part 1A (Schedule A), or in Part 2A (the firm brochure) or 2B (brochure supplements).

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<sup>36</sup> Solicitors that are providing advice to a client as to the selection or retention of an adviser could be deemed to be “advising others” within the meaning of the definition of “investment adviser” under the Advisers Act. SEC Release IA-1092 (October 8, 1987). However, solicitors who are truly doing no more than soliciting, and not providing “advice” or making “recommendations,” would not typically fall within the federal definition of “investment adviser.” Advisers Act, Section 202(a)(11). Accordingly, they should not normally be required to register with the SEC, even if their activities are technically outside the supervision and control of the adviser for whom they solicit. That does not mean, however, that their solicitation activities are not regulated by the SEC. See Rule 206(4)-3 under the Advisers Act, which among other things imposes certain requirements on cash solicitation arrangements between solicitors and federally-registered advisers. On at least one occasion, the SEC has taken the position that a solicitor who is in compliance with the cash solicitation rule (Rule 206(4)-3) is not deemed to be an “investment adviser” solely as a result of solicitation activities. SEC Release IA-688 (July 12, 1979). Certain solicitation activities are also regulated under Advisers Act Rule 206(4)-5, the so-called adviser “pay to play” rule.

<sup>37</sup> According to the IARD website, there are currently only 7 states that do not register investment adviser representatives: Georgia, Louisiana, Michigan, Minnesota, New York, Tennessee and Wyoming. (Wyoming does not currently regulate investment advisers at all.) Some states provide an exemption from investment adviser representative registration for persons who are also registered representatives of a broker-dealer. See “State Participation and Exemptions of the Electronic Registration of Investment Adviser Representatives” on the IARD website at [http://www.iard.com/bulletin\\_0302.asp#participation](http://www.iard.com/bulletin_0302.asp#participation). Some jurisdictions that require IARs to register include solicitors in the definition of “adviser” or “investment adviser representative” under state law. See the NASAA “Investment Adviser Guide” at [http://www.nasaa.org/industry\\_regulatory\\_resources/investment\\_advisers/456.cfm](http://www.nasaa.org/industry_regulatory_resources/investment_advisers/456.cfm).

<sup>38</sup> The SEC has noted that, in some cases, a solicitor may solicit on behalf of both a state-registered adviser and a federally-registered adviser. The SEC believes that, in that case, NSMIA would not preempt states from subjecting the solicitor to state registration requirements. “Rules Implementing Amendments to the Investment Advisers Act of 1940,” SEC Release IA-1633 (May 15, 1997), at section II.F.1.e., p.60.

<sup>39</sup> Section 202(a)(25) of the Advisers Act provides that a “supervised person” is any “partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.”

<sup>40</sup> “Investment adviser representative” is defined in Rule 203A-3 adopted under the Advisers Act. Under that definition, “investment adviser representatives” are a subset of “supervised persons.”

<sup>41</sup> Section 203A(b)(1)(A) of the Advisers Act. For this purpose, “place of business” of an investment adviser representative means (1) an office at which the representative regularly provides investment advisory services, solicits, meets with or otherwise communicates with clients; and (2) any other location that is held out to the general public as a location at which the representative provides investment advisory services, solicits, meets with or otherwise communicates with clients. Advisers Act Rule 203A-3(b). This parallels the “place of business” definition established for investment advisers under Rule 222-1(a). See note 29, *supra*. Although clause (1) covers the typical office scenario, clause (2) is broad enough to cover, for example, a temporary location (such as a hotel conference room) if that location is held out in ads or announcements as a place where any of the listed activities are or will be conducted.

<sup>42</sup> At least one state still purports to “reach” adviser representatives that are located outside of the state, apparently without regard to whether the representative falls within the federal definition of investment adviser representative. For example, the Texas Blue Sky regulations provide that adviser representatives that do not have a place of business in Texas but otherwise render investment advice in Texas are exempt from registration in Texas, so long as the adviser for whom they act as a representative notice files in Texas and pays fees equal

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to what would have been paid had both the adviser and the representative registered there. Texas Administrative Code, Title 7, Part 7, Chapter 116, Rule §116.1(b)(2)(B) and (C)(i). At least with respect to the payment of filing fees, this appears to be a way to end-run around the preemptive provisions of NSMIA, which prohibit states from requiring the “licensing, registration or qualification” of investment adviser representatives (meeting the federal definition) unless they have a place of business located in the state. See note 41, *supra*.

<sup>43</sup> See Rule 203A-3(a) under the Advisers Act. Under this rule, clients are measured with respect to all of an IAR’s clients nationwide. Release IA-1633, *supra* note 38, at section II.F.1.b, p. 55, n. 117. Also, note that the definition of “investment adviser representative” under state law is often different and much broader than that under federal law.

<sup>44</sup> “Qualified clients” are excepted from the client count under both the “more than 5” and “more than 10%” tests in the investment adviser representative definition. See Rule 203A-3(a). In substance, “qualified clients” are natural persons (i) who have at least \$750,000 under management with the adviser, (ii) who have either a net worth of more than \$1.5 million or are a “qualified purchaser” under the Investment Company Act of 1940; or (iii) who are an executive officer, director, trustee or general partner of the adviser or an ‘investment function’ employee of the adviser with more than a year of experience. See Rule 205-3(d)(1). The SEC will likely be adjusting upwards for inflation the monetary tests used in this definition, as a result of the Dodd-Frank Act. In addition, under the investment adviser representative definition, certain clients and others can be counted as a single “client” and others not counted as “clients” at all, in reliance on Rule 203(b)(3)-1 (see note 30, *supra*), and persons that are not residents of the U.S. need not be counted. See Rule 203A-3(a)(4).

<sup>45</sup> Rule 203A-3(a)(2). In the decision tree, the term “personalized” investment advice is used to avoid a double negative in trying to identify a representative who is not giving impersonal investment advice. For this purpose, “impersonal investment advice” means services provided by written or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts. Rule 203A-3(a)(3)(ii).

<sup>46</sup> See note 17, *supra*, as to when an adviser may be deemed to be transacting business within a state, concepts that could similarly under these circumstances apply to a person acting on behalf of an adviser.

<sup>47</sup> In general, a “solicitor” is someone who “finds” clients for an adviser or who refers clients to an adviser.

<sup>48</sup> The SEC has taken the position that regardless of whether a solicitor is a “supervised person” for purposes of the IAR definition, it is nonetheless a “person associated with an investment adviser” under Section 202(a)(17) of the Advisers Act, and therefore has an obligation to supervise its solicitors with respect to activities performed on its behalf. Release IA-1633, *supra* note 38, citing Release IA-688, *supra* note 36. However, on the face of it, an unaffiliated third-party solicitor would not appear to fall within the “person associated with an investment adviser” definition, which generally contemplates persons in a control relationship to the adviser.

<sup>49</sup> The SEC has referred to a “third-party solicitor” in a slightly different way, that is, as a solicitor who is not a “partner, officer, director or employee” of the adviser. Release IA-1633, *supra* note 38, at II.F.1.e., p. 59. Such a solicitor could conceivably be a “supervised person” if it were providing advice to the adviser’s clients in addition to soliciting and were also subject to the adviser’s supervision and control. It would then be subject to state registration requirements only if it were also an IAR having the requisite number and percentage of natural persons as clients under the federal definition.

In contrast, as the term “third-party solicitor” is used in this paper, the solicitor does not fit within the “supervised person” definition at all. (See note 39, *supra*, for the full definition of “supervised person.”) This is first because the third-party solicitor is unaffiliated with the adviser and is therefore not under the “partner, officer, director or employee” portion of the “supervised person” definition. Second, the third-party solicitor would not fit within the “other person” portion of the “supervised person” definition because third-party solicitors typically do not provide investment advice on behalf of the adviser. Third, even if it were providing investment advice on behalf of the adviser and/or were in some respect under the adviser’s “supervision,” the

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solicitor would most likely not be deemed to be under the adviser's "control" since it is not an affiliate of the adviser and presumably the adviser would have no influence over the solicitor's management or policies even if it had certain contractual rights against the solicitor under the solicitation arrangement. Thus, the typical third-party solicitor would not fit within the "supervised person" definition for one or more reasons.

Even if a third-party solicitor is not a "supervised person" of an adviser and therefore cannot potentially become subject to state registration requirements as an IAR of that adviser, it could nonetheless become subject to state registration requirements through a different pathway, which is discussed in the body of this paper -- that is, if the solicitor's activities cause it to otherwise fall within the applicable state definitions requiring registration, such as under the state definition of investment adviser or IAR, which may be broad enough to cover solicitors.

<sup>50</sup> See, for example, the Texas Blue Sky regulations that require every non-exempt person meeting the jurisdictional thresholds to register -- or to notice file if permitted -- (i) as an adviser if the person is acting as an adviser, including acting as a solicitor; or (ii) as an adviser OR an adviser representative if the person is employed, appointed or authorized by an adviser to render advisory services, which includes acting as a solicitor (whether or not under the adviser's supervision or control). See, Texas Administrative Code, Title 7, Part 7, Chapter 116, Rule §116.1(b)(1)(A) and (2). These Texas Blue Sky provisions would appear to require third-party solicitors for federally-registered advisers who are not giving advice on behalf of the adviser to do one of several things to comply with Texas law (assuming they meet the jurisdictional thresholds and are not otherwise exempt there): (1) register as an investment adviser with the SEC and notice file in Texas; (2) register as an investment adviser in Texas; or (3) arrange with every adviser on whose behalf they solicit in Texas to make the necessary filings to accomplish the solicitor's registration in Texas as an investment adviser representative of the adviser. However, option (1) will be unavailable if the solicitor is ineligible for SEC registration. Moreover, option (3) may be unavailable as a practical matter since it would require the cooperation and involvement of the advisers themselves to a degree that they may not be willing to participate. As a result, the solicitor may have little choice but to register separately in Texas as an investment adviser. This is consistent with the position of the Texas State Securities Board, which states on its website: "A third-party solicitor for an SEC-registered investment adviser (i.e., a solicitor who is not an employee of the adviser) is not a supervised person and, therefore, has to register with the Texas Securities Commissioner." See "Dealer and Investment Adviser Registration FAQs" at [http://www.ssb.state.tx.us/Dealer\\_And\\_Investment\\_Adviser\\_Registration/Frequently\\_Asked\\_Questions.php#twob](http://www.ssb.state.tx.us/Dealer_And_Investment_Adviser_Registration/Frequently_Asked_Questions.php#twob) (Question 2.B.3)

That result would be also be consistent with statements made by the State of Wisconsin on its website, which explains that it gives third-party solicitors who solicit for federally-registered advisers the option of arranging with each investment adviser for which it solicits to become licensed as an investment adviser representative in Wisconsin or becoming a separately licensed investment adviser. See "Investment Adviser Representatives – For Federal Advisers Only" (as updated for changes effective January 1, 2009) at <http://www.wdfi.org/fi/securities/licensing/iarep.htm>.

<sup>51</sup> Actually, individuals register via IARD using the WebCRD (Central Registration Depository) component the system. Web CRD is also used to register representatives of broker-dealer firms. See What is IARD? on the IARD website at: <http://www.iard.com/WhatIsIARD.asp>.

<sup>52</sup> The exams accepted most commonly for registered investment adviser representatives are the Series 65 exam (NASAA-Investment Advisors Law Exam), or the Series 66 exam (NASAA-Combined State Law Exam) along with the Series 7 exam (General Securities Representative Exam). These exams are administered by the FINRA and many were developed in conjunction with NASAA.

<sup>53</sup> One or more of these 5 professional designations are accepted by some states as an alternative to the exam requirement or in waiver of the exam requirement: CFP (Certified Financial Planner) awarded by the Certified Financial Planner Board of Standards, Inc.; ChFC (Chartered Financial Consultant) awarded by the American

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College, Bryn Mawr, Pennsylvania; PFS (Personal Financial Specialist) awarded by the American Institute of Certified Public Accountants; CFA (Chartered Financial Analyst) awarded by the CFA Institute; and CIC (Chartered Investment Counselor) awarded by the Investment Adviser Association. See “Professional Designations and IA Representative (RA) Registration” at [http://www.iard.com/bulletin\\_0302.asp#professional](http://www.iard.com/bulletin_0302.asp#professional).

<sup>54</sup> This would catch the states where NSMIA allows the state to require registration for persons who meet the federal definition of IAR and have a place of business in the state. It would also catch the states that might impose a registration requirement on representatives (like solicitors) who meet the state’s broader definition of “investment adviser representative” whether or not they have a place of business in the state, so long as they nonetheless make significant contact with the state. Finally, it would also catch a state like Texas (see note 42, *supra*), which purports in some cases to impose a notice filing requirement on even SEC-registered advisers whose representatives give advice in the state, whether or not the representative has a place of business there.

<sup>55</sup> Note that Advisers Act Rule 205-3 provides a limited exemption from the performance fee prohibition in Section 205(a)(1) for advisers – SEC-registered, state-registered and unregistered – if the performance fee is charged only to “qualified clients.” While this may help in some respects for private fund advisers that become subject to the performance fee prohibition for the first time as a result of the private adviser exemption being eliminated from Section 203(b), it will nonetheless create confusion with respect to any pre-existing performance fee arrangements those advisers have if they do not fit the Rule 205-3 parameters.

<sup>56</sup> Although it was not under a mandate to do so, the SEC amended some of these rules following NSMIA to make them apply only to federally-registered advisers, believing this comported with the Congressional intent expressed in NSMIA to avoid subjecting state-registered advisers to substantive federal regulatory requirements and to leave it up to the states to impose prophylactic provisions for state-registered advisers. Release IA-1633, *supra* note 38 at sections II.I.2. and 5., pp. 77, 80.

<sup>57</sup> The cash solicitation rule continues to apply to SEC-registered advisers, however, even if they are making payments to a state-registered solicitor. Release IA-1633, *supra*, note 38 at section II.F.1.e., p. 60, n. 125.

<sup>58</sup> This is evidenced by these SEC statements about the amendments to these rules following NSMIA: “By excluding advisers not registered with the Commission from these rules, the Commission is not suggesting that the practices prohibited by these rules would not be prohibited by section 206 [of the Advisers Act, the general anti-fraud section still applicable to all advisers, including state-registered advisers]. Rather, the Commission recognizes that these rules contain prophylactic provisions, and that after the effective date of [NSMIA], the application of these provisions to state-registered advisers is more appropriately a matter for state law.” Release IA-1633, *supra*, note 38 at section II.I.5, p. 81. Notably, the SEC said these were “more appropriately a matter for state law,” and not simply “a matter for state law” or “exclusively a matter for state law.”

<sup>59</sup> See note 18, *supra*.

<sup>60</sup> Generally speaking, associated persons (or “persons associated with an investment adviser”) would include IARs under the federal definition. Advisers Act Section 202(a)(17).

<sup>61</sup> Release IA-1633, *supra* note 38, at section II.H.2., p. 73. This interpretation of NSMIA is contested. See the discussion of comments received on the proposed rules in the cited release and the discussion in this paper under the heading “NSMIA Preemption Tested in Court” for more information.

<sup>62</sup> Release IA-1633, *supra* note 38 at section II.H.1., p. 69. It is unclear how the SEC’s position and discussion on this point interplays with Section 222(a) of the Advisers Act, added by NSMIA, which says that nothing in the Advisers Act shall affect the jurisdiction of the states over any security or person insofar as it does not “conflict with” the Advisers Act or related rules.

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<sup>63</sup> See the Capital Research case cited in note 67 below to see where courts seem to be headed on this.

<sup>64</sup> Notice filings and fees are discussed in the first section of this paper.

<sup>65</sup> Advisers Act, Section 222(b). “Home state” here means the state where the adviser maintains its principal place of business. Even though this uniformity provision of NSMIA appears on its face to apply to all advisers - both federally-registered and state-registered -- the SEC’s interpretation of NSMIA’s preemptive scope (see notes 61 and 62, *supra*, and the text surrounding) means the provision will apply in practice only to state-registered advisers. Otherwise, the “old” overlapping and conflicting federal/state regulatory system could in effect be restituted, with each state being allowed to impose its own books and records, net capital and bonding requirements on federally-registered advisers since federally-registered advisers are not registered in their home states. Nonetheless, the provision will be helpful to promote uniformity among the state requirements applicable to state-registered advisers registered in more than one state.

<sup>66</sup> Advisers Act, Section 222(c), subject to the same conditions as set out in the text surrounding note 65, *supra*.

<sup>67</sup> Capital Research and Mgmt. Co. v. Lockyer, LASC Case No. BC330770 (Nov. 22, 2005) (consolidated with California v. American Funds Distributors, Inc., LASC Case No. BC 330774).

<sup>68</sup> Capital Research and Management Co. v. Brown, 147 Cal. App.4th 58, 53 Cal. Rptr.3d 770, 2007 Cal. App. LEXIS 108 (Cal. App. 2d Dist. 2007).

<sup>69</sup> Other cases seem to come to a similar result. See, for example, Eddie Papic v. John P. Burke, Commissioner, Department of Banking and Department of Banking, Superior Court, New Britain Judicial District (Connecticut), Case No. HHB CV-05-4008511 (Mar. 22, 2007) (held, NSMIA did not preempt the state's authority to enforce laws under the Connecticut Uniform Securities Act with respect to fraud in connection with the offer and sale of securities. NSMIA preserved, therefore, the authority of the Commissioner to find a statutory violation based on the omission and misrepresentation of material facts in the sale of a federal "covered security" offered under Rule 506 of Regulation D.)

<sup>70</sup> “State, American Express Financial Advisors settle case” (AP), Wednesday, July 13, 2005 <http://www.fosters.com/apps/pbcs.dll/article?AID=/20050713/NEWS0201/107130009>.