RUNNING THE TRAPS:

FEDERAL VERSUS STATE REGISTRATION
OF
INVESTMENT ADVISERS
AND
INVESTMENT ADVISER REPRESENTATIVES

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Introduction

The Dodd-Frank Act[1] 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 have become subject to registration requirements for the first time and many advisers previously registered with the SEC have switched 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")[2] 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 between the SEC and the states, and the Dodd-Frank Act did nothing to help to clear things up. As a result, advisers must still "run the traps" to determine whether they -- and the personnel and solicitors who work for them -- must register with the SEC under federal law or with the individual states under state law.

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 are therefore urged to spend a fair amount of time focusing there.

Note that certain changes made by the Dodd-Frank Act are not yet fully implemented. Consequently, this paper discusses those changes with the caveat that final picture will not be understood until the dust has settled. 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[3] with the SEC or with a particular state (State X). It assumes the adviser meets the basic "investment adviser" definition – meaning that it is in the business of advising others about investing in securities[4] -- and aims to determine 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 the decision tree 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, [5] nor otherwise exempt from[6] or ineligible for[7] federal registration, will be required to register with the SEC under the Advisers Act.[8] If an adviser is required to register federally, it must register with the SEC. Generally speaking, an adviser may not elect to register with a state in lieu of the SEC.[9]

An application for SEC registration must be submitted electronically on Form ADV[10] via the Web-based Investment Adviser Registration Depository ("IARD") system,[11] which was developed by the Financial Industry Regulatory Authority ("FINRA")[12] and is co-sponsored by the SEC and the North American Securities Administrators Association ("NASAA").[13] 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.[14]

If an adviser is registered federally with the SEC, it will not be required to register at the state level as well.[15] Thanks to provisions in NSMIA that preempt state law, federally-registered advisers cannot be required to also register with a state.[16]

However, even though a federally-registered adviser need not register with the states, it may be required to "notice file" in every state in which it is doing business as an investment adviser[17] before it can legally do business there. "Notice filing" is accomplished by submitting a copy of the adviser's Form ADV electronically via IARD, and designating in Part 1.A., Item 2.B., which states should receive a copy of the ADV at the same time it is transmitted for filing with the SEC. Notice filing gives the designated states notice that 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.[18] Of course, notice filings also serve as a vehicle for states to collect filing fees.[19]

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,[20] together with a consent to service of process and any required filing fees.[21] As a result, a state "notice filing" and a state "registration" do not look much different 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.[22] In contrast, a state could apply its own qualification criteria to reject the registration of any adviser that were required to register there.

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[23] -- while rendering investment advisory services.[24] For advisers with nationwide operations, this may necessitate a time-consuming 50-state Blue Sky survey, which some optimistically hoped would be no longer necessary following NSMIA, at least for advisers registered with the SEC.

Exempt Reporting Advisers. SEC rules adopted pursuant to the Dodd-Frank Act[25] created a new category of advisers known as "exempt reporting advisers" -- advisers that are exempt from federal registration but nonetheless must file Form ADV with the SEC reporting certain information about their advisory businesses. Exempt reporting advisers currently include advisers solely to "venture capital funds" as defined in Rule 203(l)-1 and advisers solely to "qualifying private funds" with assets in the U.S. of less than $150 million, as detailed in Rule 203(m)-1.[26] Form ADV has been amended to specify the subset of items required to be answered by exempt reporting advisers, which focus on information about the advisers and their funds.

The types of funds managed by exempt reporting advisers are generally considered not to pose the same level of risk as other funds and their advisers are therefore not required to be fully registered and subject to regulatory examination. However, the SEC will still have their Form ADV filings to track those advisers and gauge whether their activities present sufficient concern to warrant future action. Similar to registered advisers, exempt reporting advisers are required to update their Form ADV filings annually, as well as "promptly" whenever certain information becomes inaccurate.

Note that exempt reporting advisers are exempt from federal registration only. It is therefore possible that an exempt reporting adviser would have to register (or submit a report) at the state level.[27] If required to state register, the adviser would have to fill out and file the entire Form ADV, including the portions designated for state-registered advisers. [28]

State Registration for Advisers Not Registered with the SEC. If an adviser does not meet the parameters making it eligible for federal registration, it is prohibited from registering with the SEC. An adviser ineligible for federal registration may not choose to register with the SEC over the states.[29] Unless excepted from the definition of investment adviser altogether,[30] advisers that are not federally-registered must analyze whether they are required to register with any state instead of the SEC. As previously mentioned, this may include exempt reporting advisers and advisers that have availed themselves of other exemptions to avoid federal registration.[31]

It is possible that an adviser will have to register with more than one state,[32] if the adviser is doing business in more than one state.[33] 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.[34]

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 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[35] located within the state and during the preceding 12 months had fewer than 6 clients[36] who are residents of that state.[37] Put another way, states can require an adviser to register 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.[38]

State adviser registrations are accomplished by filing Form ADV via the IARD system with the appropriate state(s).[39] Although there is still some variation among the states in the handling of state registrations, particularly Part 2 of Form ADV, [40] most states now are mandating or allowing filings to be submitted via IARD for state-registered advisers.

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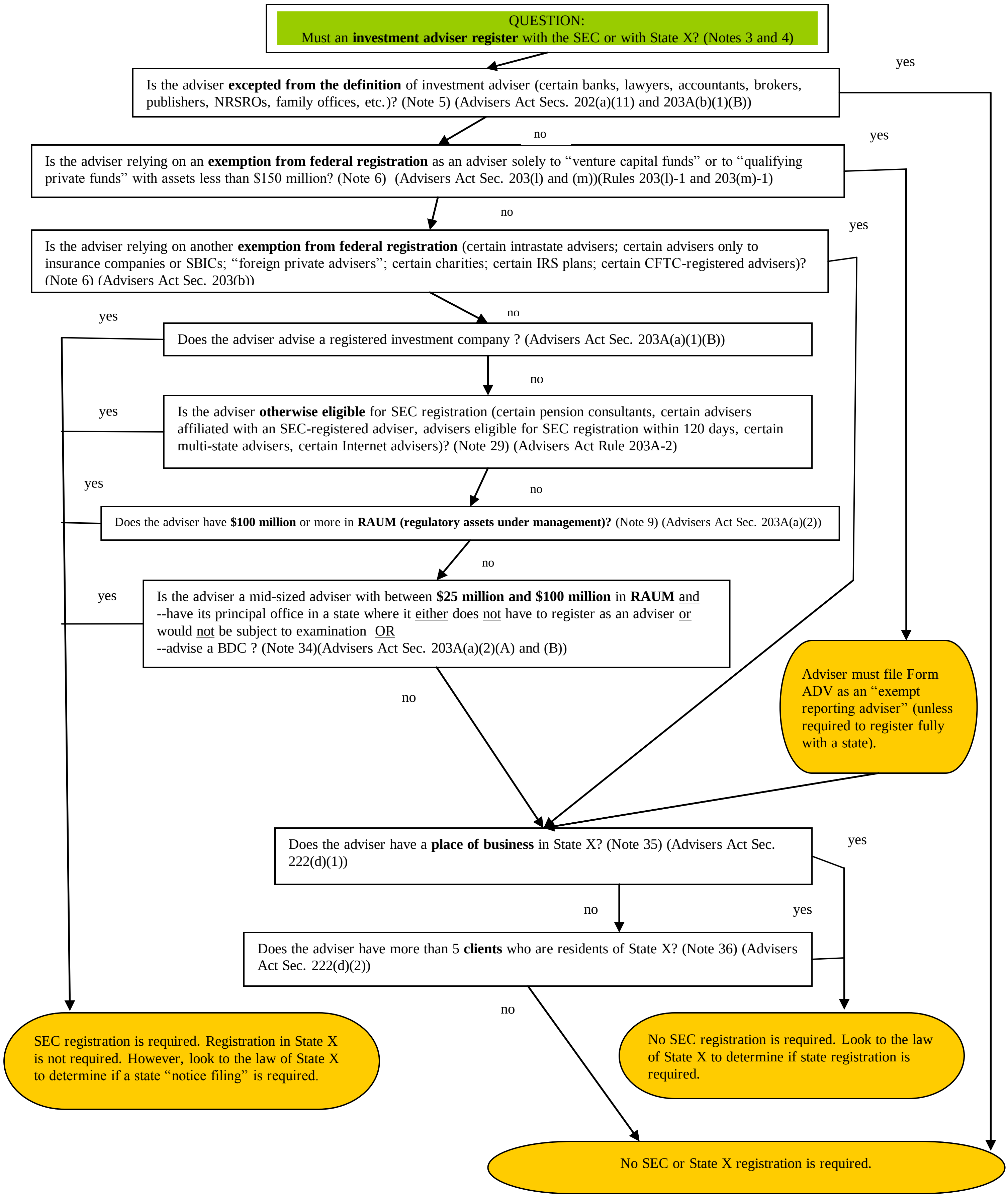
QUESTION:
Must an **investment adviser register** with the SEC or with State X? (Notes 3 and 4)
Is the adviser **excepted from the definition** of investment adviser (certain banks, lawyers, accountants, brokers, publishers, NRSROs, family offices, etc.)? (Note 5) (Advisers Act Secs. 202(a)(11) and 203A(b)(1)(B))
yes
no
Is the adviser relying on an **exemption from federal registration** as an adviser solely to "venture capital funds" or to "qualifying private funds" with assets less than $150 million? (Note 6) (Advisers Act Sec. 203(l) and (m))(Rules 203(l)-1 and 203(m)-1)
yes
no
Is the adviser relying on another **exemption from federal registration** (certain intrastate advisers; certain advisers only to insurance companies or SBICs; "foreign private advisers"; certain charities; certain IRS plans; certain CFTC-registered advisers)? (Note 6) (Advisers Act Sec. 203(b))
yes
no
yes
Does the adviser advise a registered investment company ? (Advisers Act Sec. 203A(a)(1)(B))
no
yes
Is the adviser **otherwise eligible** for SEC registration (certain pension consultants, certain advisers affiliated with an SEC-registered adviser, advisers eligible for SEC registration within 120 days, certain multi-state advisers, certain Internet advisers)? (Note 29) (Advisers Act Rule 203A-2)
yes
no
Does the adviser have **$100 million** or more in **RAUM (regulatory assets under management)?** (Note 9) (Advisers Act Sec. 203A(a)(2))
no
yes
Is the adviser a mid-sized adviser with between **$25 million and $100 million** in **RAUM** and
--have its principal office in a state where it either does not have to register as an adviser or would not be subject to examination OR
--advise a BDC ? (Note 34)(Advisers Act Sec. 203A(a)(2)(A) and (B))
no
Adviser must file Form ADV as an "exempt reporting adviser" (unless required to register fully with a state).
Does the adviser have a **place of business** in State X? (Note 35) (Advisers Act Sec. 222(d)(1))
yes
no
yes
Does the adviser have more than 5 **clients** who are residents of State X? (Note 36) (Advisers Act Sec. 222(d)(2))
no
SEC registration is required. Registration in State X is not required. However, look to the law of State X to determine if a state "notice filing" is required.
No SEC registration is required. Look to the law of State X to determine if state registration is required.
No SEC or State X registration is required.

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.[41] 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.[42]

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.[43] 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, employees and solicitors acting on behalf of state-registered advisers might very well have to register at the state level as well.[44]

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.[45] If so, the decision tree then asks a series of questions to determine whether the person is an "investment adviser representative"[46] ("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.[47] As a result, states are still free to require registration of IARs with a place of business there,[48] 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, which hinges on the concept of retail client. 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.[49] People meeting certain wealth and sophistication standards are not counted as clients for this purpose.[50] 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.[51]

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[52] 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."[53] Used here, "third-party solicitor" means 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. [54] [55] 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.[56]

Most (if not all) states now either require or allow IARs to register electronically, using the IARD[57] system and Forms U-4 and U-5. States also typically require IARs to pass certain standardized exams in order to register [58] or, alternatively, that they have one of a number of professional designations.[59]

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.[60]

A Word About IARs and Brochure Supplements. As a result of 2010 rule amendments, advisers are required to disclose to clients certain information about the individual advisory personnel who are providing services to those clients, specifically those who are (i) formulating investment advice for the client and having direct client contact, or (ii) making discretionary investment decisions for the client, even if they have no direct client contact.[61] This disclosure is made on "brochure supplements" governed by Form ADV, Part 2B.

Brochure supplement requirements are easy to confuse with IAR registration requirements because they both focus on the individuals within an advisory firm who are providing services to clients. As a result, it might be mistakenly assumed that the only advisory personnel required to be disclosed on a brochure supplement are the adviser's IARs or that all IARs acting on behalf on an adviser must be disclosed on a brochure supplement. However, those individuals required to be disclosed on brochure supplements and those registered to be registered as IARs are separate and distinct. Each is governed by its own set of definitions and rules. As a result, not all personnel required to be disclosed on brochure supplements are necessarily required to register as IARs, and vice versa.[62]

Accordingly, advisers analyzing IAR registration requirements and brochure supplement requirements must carefully determine which personnel must be registered and which must be disclosed, keeping in mind that the two categories of personnel are not necessarily the same.

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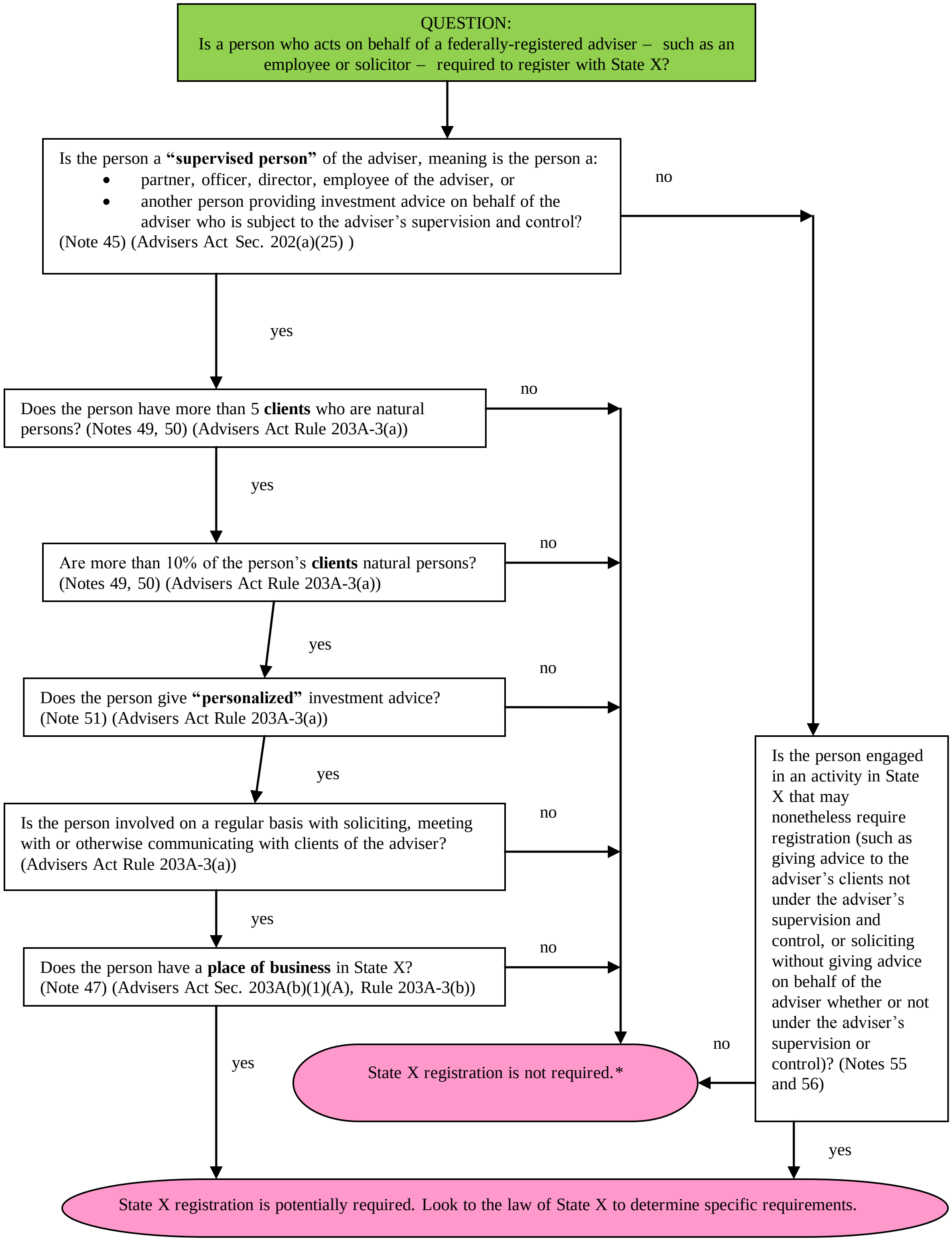

* However, look to the law of State X to determine if a state "notice filing" is required from the adviser on whose behalf the person is acting. (Note 48)

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, some to unregistered advisers and some to a variety of those categories. Here are a few important pieces of the puzzle:

Federal Provisions Applicable to All 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 requirement to adopt and enforce written procedures designed to prevent the misuse of material nonpublic information (i.e., insider trading) (Advisers Act Section 204A) (all advisers covered by Section 204 of the Advisers Act).[63]

Federal Provisions Specifically Applicable Only to SEC-Registered Advisers. By their express terms, these provisions 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):[64]

- The prohibition on performance-based fees in most advisory contracts (Advisers Act Section 205(a)(1), as amended by the Dodd-Frank Act); [65]
- The requirement that an advisory contract be assignable by the adviser only with client consent (Advisers Act Section 205(a)(2), as amended by the Dodd-Frank Act);
- The requirement that an advisory contract for an adviser organized as a partnership provide for notice to the client of any change in the membership of the partnership within a reasonable time after such change (Advisers Act Section 205(a)(3), as amended by the Dodd-Frank Act);
- 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);[66]
- 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 the same or similar rules applicable to advisers registered in their state. 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.[67]

Federal Provision Applicable to SEC-Registered Advisers and Certain Unregistered and Exempt Advisers. Advisers Act Rule 206(4)-5 restricts political contributions by certain investment advisers and their associated persons (the so-called adviser "pay to play" rule). As now amended, the pay to play rule applies to SEC-registered advisers, advisers that are unregistered in reliance on Advisers Act Section 203(b)(3) (so-called foreign private advisers[68]) and exempt reporting advisers as defined in Rule 204-4 (advisers solely to "venture capital funds" as defined in Rule 203(l)-1 and advisers solely to "qualifying private funds" with assets in the U.S. of less than $150 million, as detailed in Rule 203(m)-1).

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.[69] This includes jurisdiction over all advisers --

including federally-registered advisers -- and their associated persons.[70] 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.[71] 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.[72] If this position is upheld in its most robust form,[73] states will have retained under NSMIA regulatory authority over federally-registered advisers only to (1) investigate and enforce anti-fraud laws; (2) require notice filings; and (3) require filing fees.[74]

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; and
- Minimum net capital.

Under NSMIA, states are prohibited 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.[75] 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.[76]

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.[77]

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.[78] [79]

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.[80]

* * *

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. Consequently, advisers and those that work for them must keep "running the traps" to determine whether they must register and, if so, where. The decision trees in this paper offer one method to help make those determinations.

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[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), H.R. 4173,

[2] 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.

[3] 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.

[4] That is, this 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.

[5] 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). A detailed analysis of each of these exceptions is beyond the scope of this paper.

[6] 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, implemented by SEC rule: (1) advisers to solely "venture capital funds" (as defined in Rule 203(l)-1); and (2) advisers solely to private funds with assets in the U.S. of less than $150 million (as detailed in Rule 203(m)-1). As discussed in the text, even though exempt from registration, these advisers still have reporting requirements on Form ADV as "exempt reporting advisers." See Advisers Act Rule 204-4.

[7] See the decision tree questions that address eligibility for SEC registration and thresholds of assets under management.

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

[9] However, see also note 29, *infra*, discussing the exceptions to the prohibition on SEC registration. In addition, mid-sized advisers whose RAUM (regulatory assets under management, as calculated according to the instructions on Form ADV) falls in the "buffer zone" of $90 million to $110 million have choices about where to remain registered in order to avoid the need to switch their registrations back and forth between the SEC and the states due to RAUM fluctuations that may occur around the now applicable $100 million threshold dividing state and SEC registration. For a more complete explanation of the "buffer," see Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, SEC Release No. IA-3222 (June 22, 2011) (the "Exemptions Adopting Release"), and its companion release Rules Implementing Amendments to the Investment Advisers Act of 1940, SEC Release No. IA-3221 (June 22, 2011) (the "Implementing Adopting Release").

[10] See Rule 203-1 under the Advisers Act.

[11] 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.

Advisers required to file Form PF (private funds) will also file that form via IARD, although the form is not considered part of an adviser's registration and will not be made public. See Advisers Act Rule 204(b)-1 and Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, SEC Release No. IA-3308 (October 31, 2011).

[12] 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.

[13] 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.

[14] 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.

[15] 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)(11).

[16] 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 5, *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.

[17] 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 states 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 "renders services as an investment adviser 'in this state'… 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. A person can be an investment adviser in more than one state at the same time." The regulations also say: "Rendering services as an investment adviser or as an investment adviser representative can be made by personal contact, mail, telegram, telephone, wireless, electronic communication, or any other form of oral or written communication." Texas Administrative Code, Title 7, Part 7, Chapter 116, Rule §116.1(a)(5). See also note 24, *infra*.

[18] 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.

[19] An adviser can pay relevant notice filing fees to the states via its IARD Financial Account.

[20] 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, Schedules 13D and 13G, Form 13H, Form PF and any other applicable SEC filings. While this was not likely the intent of the phrase, it would be clearer if the Advisers Act were amended to provide that states can only require federally-registered advisers to notice file Form ADV (or any successor federal registration/disclosure document).

[21] 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.

[22] 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).

[23] 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.

[24] 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 in the text and at notes 35 and 36, *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).

[25] See the Exemptions Adopting Release and the Implementing Adopting Release, *supra* note 9.

[26] See Advisers Act Rule 204-4.

[27] See the Exemptions Adopting Release, *supra* note 9, at n. 24: "An adviser choosing to avail itself of an exemption under section 203(l), 203(m) or 203(b)(3), however, may be required to register as an adviser with one or more state securities authorities," citing Section 203A(b)(1) of the Advisers Act which exempts from state regulatory requirements any adviser registered with the SEC or that is not registered because such person is excepted from the definition of an investment adviser under Section 202(a)(11).

[28] See Instruction 14 in the General Instructions to Form ADV:

> "14. I am an exempt reporting adviser. Is it possible that I might be required to also register with or submit a report to a state securities authority?
>
> "Yes, you may be required to register with or submit a report to one or more state securities authorities. If you are required to register with one or more state securities authorities, you must complete all of Form ADV."

[29] Although it does not constitute a "choice" to register with the SEC over the states, certain advisers may choose whether to register voluntarily with the SEC by relying on Rule 203A-2, which relieves them from the otherwise applicable prohibition on federal registration. These include 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.

Similarly, the exemptions from federal registration in Rule 203(l)-1 (for advisers to solely "venture capital funds") and Rule 203(m)-1 (advisers solely to private funds with assets in the U.S. of less than $150 million) are not mandatory. An adviser that otherwise qualifies for those exemptions could choose to register or remain registered with the SEC, so long as they have more than $100 million in RAUM. As federally-registered advisers, these advisers too would avoid any otherwise applicable state registration requirements.

[30] See note 5, *supra*, concerning exceptions from the definition.

[31] See note 6, *supra*, concerning exemptions from federal registration.

[32] Advisers that would be required to register in 15 or more states under applicable state laws are permitted instead to register with the SEC. Rule 203A-2(d).

[33] See notes 17 and 24, *supra*, and text surrounding, concerning "doing business" in a state. See also the discussion in the text surrounding notes 35-38, *infra*, explaining the National *de Minimis* Standard.

[34] Note, however, that this could not happen with an adviser looking to rely on its mid-sized status (having RAUM between $25 million and $100 million) to avoid registration altogether because a mid-sized adviser must register or remain registered with the SEC if its principal office and place of business is in a state where it either does not have to register as an adviser or would not be subject to examination as an adviser if registered there. See Advisers Act Section 203A(a)(2). Currently, the only states that have indicated they do not examine investment advisers are New York and Wyoming. As a consequence, we know all mid-sized advisers in those states must be registered with the SEC. Mid-sized advisers in other states must look to the law of their state to see whether they are required to register there and be subject to examination. If not, they too must register with the SEC. See Division of Investment Management: Frequently Asked Questions Regarding Mid-Sized Advisers at http://www.sec.gov/divisions/investment/midsizedadviserinfo.htm.

[35] 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(a).

[36] According to Advisers Act Rule 222-2, "clients" may generally be counted under the National *de Minimis* Standard the same way they are under other provisions of the Advisers Act and rules. See Advisers Act Rule 202(a)(30)-1. 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 legal entities and other entities.

[37] Section 222(d) of the Advisers Act.

[38] However, as noted above in note 24, some states do not extend the National *de Minimis* Standard to notice filings made by federally-registered advisers.

[39] 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).

[40] Even among those states accepting IARD registration filings, there is apparently still no uniformity on the handling of Part 2 of Form ADV (the Firm Brochure). According to the IARD website, all states will accept Part 2 through IARD and some states may require Part 2 to be filed through IARD. Advisers uncertain whether a particular state requires submission via IARD are referred to state securities regulators directly. See: http://www.iard.com/part2instructions.asp.

[41] "Although many individuals who are employed by advisers fall within the definition of 'investment adviser,' the SEC generally does not require those individuals to register as advisers with the SEC. Instead, the advisory firm must register with the SEC. The adviser's registration covers its employees and other persons under its control, provided that their advisory activities are undertaken on the adviser's behalf." The Regulation of Investment Advisers by the United States Securities and Exchange Commission, by Robert E. Plaze, Associate Director, SEC Division of Investment Management (updated to November 22, 2006), p. 10, citing Kevin J. Hughes, SEC Staff No-Action Letter (Dec. 7, 1983) and SEC Release No. IA-688 (July 12, 1979) (persons

associated with a registered adviser need not separately register as investment advisers solely as a result of their activities as associated persons).

Even though they will not be required to separately register with the SEC, key individuals associated 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). Moreover, associated persons who otherwise fall within the definition of "investment adviser" can be held liable as primary violators under various provisions of the Advisers Act even if they are not registered, particularly if the adviser is viewed as an alter ego of the associated person or is controlled by the associated person. See In the Matter of John J. Kenny and Nicholson/Kenny Capital Management, Inc., SEC Release No. IA-2128 (May 14, 2003), 56 S.E.C 448, 485 n.54, aff'd, 87 Fed. Appx. 608 (8th Cir. 2004) (unpublished), citing SEC v. Berger, 2001 U.S. Dist. LEXIS 18448, at 28 (S.D.N.Y. Nov. 13, 2001) (finding associated person liable under Sections 206(1) and (2) based on control of investment adviser), aff'd on other grounds, 2003 U.S. App. LEXIS 3562 (2d Cir. Feb. 27, 2003) and SEC v. Gotchy, 981 F.2d 1251 (4th Cir. 1992) (unpublished table decision) (finding president and half-owner of investment adviser liable under Sections 206(1) and (2)). Accord, In the Matter of Montford and Company, Inc. d/b/a Montford Associates and Ernest V. Montford, Sr., Initial Decision Release No. 457, SEC Administrative Proceeding File No. 3-14536 (April 20, 2012); and In the Matter of Gualario & Co., LLC and Ronald Gualario, Initial Decision Release No. 452, SEC Administrative Proceeding File No. 3-14340 (February 14, 2012).

[42] 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 No. 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 No. 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.

[43] Despite this retained authority, some states do not require the registration of investment adviser representatives. Some provide an exemption from investment adviser representative registration for persons who are also registered representatives of a broker-dealer. 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-resources/investment-advisers/investment-adviser-guide/.

[44] 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. See Rules Implementing Amendments to the Investment Advisers Act of 1940, SEC Release No. IA-1633 (May 15, 1997), at section II.F.1.e., p.60.

[45] 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." Advisers Act Section 202(a)(25).

[46] "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."

[47] Advisers Act Section 203A(b)(1)(A). 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 35, *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.

[48] 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, provided that the adviser for whom they act as a representative notice files in Texas and pays fees equal 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). 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.

[49] 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 No. IA-1633, *supra* note 44, 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.

[50] "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)(3)(1). In substance, "qualified clients" are natural persons (i) who have at least $1 million under management with the adviser, (ii) who have either a net worth of more than $2 million (excluding the value of their primary residence) 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) for details. The dollar amounts used in this definition will be adjusted every 5 years based on a consumer price index. In addition, under the IAR definition, certain clients can be counted as "one" as they are under Rule 202(a)(30)-1 (see note 36, *supra*), and clients that are not residents of the U.S. need not be counted at all. See Rule 203A-3(a)(4).

[51] 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).

[52] 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.

[53] In general, a "solicitor" is someone who "finds" clients for an adviser or who refers clients to an adviser.

[54] 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. SEC Release No. IA-1633, *supra* note 44, citing SEC Release No. IA-688, *supra* note 42. 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.

[55] 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. SEC Release No. IA-1633, *supra* note 44, 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 45, *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 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.

[56] 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 unaffiliated 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 with the state 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 (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.

State IAR registration for both solicitors and employees can also be complicated by the fact that some states prohibit IARs from being registered or acting concurrently as a representative of more than one adviser, unless an exemption, written permission or order from the state is available or obtained. See, for example, Sec. 36b-

31-6g of the Connecticut Uniform Securities Act regulations; and Section 35-1-404(d) of the South Carolina Uniform Securities Act of 2005.

[57] 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.

[58] The exams accepted most commonly for registered investment adviser representatives are the Series 65 exam (NASAA-Uniform Investment Advisors Law Exam), or the Series 66 exam (NASAA-Uniform 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.

[59] 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 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" at http://www.nasaa.org/industry-resources/investment-advisers/ia-links/professional-designations/.

[60] 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 48, *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.

[61] See Advisers Act Rule 204-3(b)(3) for details.

[62] This potential for confusion is explained in more detail, along with illustrative examples, in "New Form ADV Part 2: 10 Tips for Coping with the 2010 Amendments," by Lorna Schnase, *Practical Compliance and Risk Management for the Securities Industry* (September-October 2010) at 24-26.

[63] 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 regulated. Despite the broad coverage of Section 204 post-Dodd-Frank, 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.

[64] 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. SEC Release No. IA-1633, *supra* note 44 at sections II.I.2. and 5., pp. 77, 80.

[65] Note that Advisers Act Rule 205-3 provides a limited exemption from the performance fee prohibition in Section 205(a)(1) if the performance fee is charged only to "qualified clients."

[66] The cash solicitation rule continues to apply to SEC-registered advisers, however, even if they are making payments to a state-registered solicitor. SEC Release No. IA-1633, *supra*, note 44 at section II.F.1.e., p. 60, n. 125.

[67] 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." SEC Release No. IA-1633, *supra*, note 44 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."

[68] Generally, a foreign private adviser is an adviser with no place of business in the U.S., fewer than 15 clients and private fund investors in the U.S. and less than $25 million in assets under management in the U.S. See Advisers Act Section 202(a)(30) for details.

[69] See note 18, *supra*.

[70] Generally speaking, associated persons (or "persons associated with an investment adviser") would include IARs under the federal definition. Advisers Act Section 202(a)(17).

[71] SEC Release No. IA-1633, *supra*, note 44, 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.

[72] SEC Release No. IA-1633, *supra*, note 44 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.

[73] The cases cited below in notes 77-79 call into question whether courts will be upholding this position in it most robust form.

[74] Notice filings and fees are discussed in the first section of this paper. In addition to preserving a state's authority to enforce its own anti-fraud laws, NSMIA does nothing, of course, to preempt other state laws from applying to advisers, including federally registered advisers, such as state laws governing state corporate filings necessary to do business in the state, state privacy laws, state contract law, state employment law, state anti-corruption/bribery laws, state tax laws and so on.

[75] Advisers Act Section 222(b). "Home state" here means the state where the adviser maintains its principal office and place of business. Even though this uniformity provision of NSMIA appears on its face to apply to both federally-registered and state-registered, the SEC's interpretation of NSMIA's preemptive scope (see notes 71 and 72, *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 essentially be reinstituted, 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.

[76] Advisers Act Section 222(c), subject to the same conditions as set out in the text surrounding note 75, *supra*.

[77] 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).

[78] 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).

[79] 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.)

[80] "State, American Express Financial Advisors settle case" (AP), Wednesday, July 13, 2005 http://www.fosters.com/apps/pbcs.dll/article?AID= /20050713/NEWS0201/107130009.