Chapter 1

Overview

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§ 1:1 The Investment Advisory Profession

The investment advisory profession as we know it today dates back to the 1920s. Before then, investment advice was generally provided only through trust arrangements, and by lawyers, accountants, and brokers in the normal course of their business activities.

An investment adviser is a person or an entity that is in the business of providing investment advice. The adviser is the first cousin of the broker. Although both give investment advice, the broker is primarily in the business of executing securities transactions.

Investment advisers come in many shapes and sizes. On one end of the spectrum, a single person can be an adviser. At the other end of the spectrum, an adviser may be a large corporation that employs thousands of people, including money managers, marketing experts, financial analysts, lawyers, and accountants. The scope of investment adviser activity also varies. Some advisers limit their activity to producing a financial plan while other advisers manage client money (on either a discretionary or nondiscretionary basis).

While many advisers are affiliated with brokerage firms, banks, or insurance companies, many others are independent entities. Some advisers serve only individuals, while others serve only institutions, including mutual funds, pension plans, hedge funds, and offshore funds. Of course, many advisers serve both individuals and institutions.

§ 1:2 Sources of Law

Typically, the investment adviser and the client have a contractual relationship. Less frequently, a trust instrument creates the relationship between them. Accordingly, the investment management lawyer may deal with common law principles of contract, agency, and trusts. However, because various statutes govern a wide range of advisory conduct, the investment management lawyer will deal primarily with statutory law.

Prior to 1997, advisers were directly regulated both by the Investment Advisers Act of 1940, a federal statute, as well as by state securities laws. Legislation that became effective on July 8, 1997, reallocated federal and state regulation of advisers. Generally, larger advisers fall under the Investment Advisers Act while smaller advisers are left to the states.

If an adviser manages investment company assets or private pension plan assets, the Investment Company Act of 1940 and the Employee Retirement Income Security Act of 1974 (ERISA), respectively, will govern important aspects of the adviser's conduct.

Advisers are not subject to regulation by any self-regulatory body, such as Financial Industry Regulatory Authority (FINRA). Although

the Securities and Exchange Commission submitted a legislative proposal to Congress in 1989 calling for the self-regulation of investment advisers, it was not enacted. As discussed below in section 1:7, the Madoff scandal and the financial crisis has renewed calls by some for an adviser SRO.

In addition to being familiar with the statutory scheme, the investment management lawyer should be familiar with the operation of the various agencies that administer the statutes. The practicing lawyer will probably have frequent contact with the Securities and Exchange Commission (SEC), which administers the Investment Advisers Act of 1940 and the Investment Company Act of 1940, and the Department of Labor, which administers the provisions of ERISA relevant to advisers.

The SEC's Division of Investment Management is the operating division primarily responsible for administering the Investment Advisers Act. The Division's Chief Counsel Office is responsible for interpretations of legal and policy issues arising under the Advisers Act. The Division's Office of Disclosure and Adviser Regulation is responsible for rulemaking under the Advisers Act. Other offices outside the Division of Investment Management also play a role in administering the Advisers Act. These include the Office of Compliance Inspections and Examinations, which, together with the SEC regional offices, inspects advisers. Also, the Office of Applications Report Services is responsible for processing adviser registration forms.

In addition to administering the Advisers Act, the Division of Investment Management is responsible for administering the Investment Company Act of 1940.

An ongoing task for the investment management lawyer is to stay abreast of SEC pronouncements relevant to advisers. Generally, the most important of these emerge through rulemaking, enforcement actions, and requests for "no-action letters." No-action letters include all letters to the SEC staff requesting advice, interpretation, opinions, or assurances that no enforcement action will be recommended by the staff to the Commission under given circumstances. "No-action" refers to the staff's written responses to such requests, responses that are generally public.

Another form of substantive law is generated by the SEC through exemptive orders. These orders relate to the authority given to the SEC by Congress in the Investment Company Act and the Investment Advisers Act to grant exemptions from provisions of those acts. Exemptive orders are frequently requested under the Investment Company Act but less frequently requested under the Investment Advisers Act. The Division of Investment Management's Office of Investment Company Regulation reviews most such requests.

The ERISA provisions relevant to investment advisers are administered by the Department of Labor's Employee Benefits Security Administration (EBSA). The EBSA offices most relevant to advisers are the Office of Regulations and Interpretations, the Office of Exemption Determinations, and the Office of Enforcement. An important procedure of which the investment management lawyer should be aware is the Department of Labor's mechanism under which transactions may be exempted (on an individual or class basis) from particular ERISA prohibitions. To obtain an exemption, it is generally necessary to show that the arrangement will provide a fair, or better, deal for the plan.

§ 1:3 The Investment Advisers Act of 1940

The need for federal regulation of the investment management industry was recognized by Congress in 1935. In a provision of the Public Utility Holding Company Act of 1935, Congress directed the SEC to make a study of investment trusts. That study led to the enactment of the Investment Company Act of 1940 and the Investment Advisers Act of 1940.

The major focus of the SEC study was investment trusts and investment companies. In contrast, the subject of investment advisory services was given a limited review that resulted in a supplemental SEC report entitled "Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services." The report found various abuses taking place in the investment advisory industry: the proliferation of "tipster services" in which unsubstantiated and unfounded claims were made to individuals; problems with respect to solvency and custody; issues relating to the assessment of performance fees, where advisers were compensated based on how well the client account performed; and problems with advisers assigning advisory contacts.

As originally enacted, the Investment Advisers Act provided little substantive regulation and was intended in large part merely to provide a census of the industry. David Schenker, the Chief Counsel of the SEC Investment Trust Study, described the purposes of the Act at a Congressional hearing in this way:

> [The Act] does not attempt to say who can be an investment counselor . . . and does not even remotely presume to undertake to pass upon their qualifications. All we say is that in order to get some idea of who is in the business and what is his background, you cannot use the mails to perform your investment counsel business unless you are registered with us.

The Act also set forth an antifraud provision and restricted certain practices such as the assessment of performance fees.

The Advisers Act has been amended on several occasions. Amendments in 1960 established, among other things, requirements for the maintenance of books and records by advisers. Those amendments also gave the SEC the right to routinely inspect those books and records. The 1960 amendments also extended the antifraud provisions to all advisers, whether or not they were registered, and gave the SEC the power to establish rules pursuant to the antifraud section. Amendments in 1970 increased the SEC's disciplinary arsenal against advisers. Legislation that became effective in 1997 reallocated federal and state regulation of advisers. Most recently, in 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] was enacted and, among other things, required many unregistered advisers to private funds to register.

The Advisers Act today stands as a formidable substantive body of regulation. As we will discuss in greater detail throughout the book, the Act attempts to check adviser misconduct in several ways.

First, unless subject to an exemption, advisers are required to register. As noted above, legislation effective in 1997 generally requires larger advisers to register with the SEC and smaller advisers to register with the states. Registration is accomplished by filing the Form ADV.

Second, advisers are required to disclose important information to clients. For instance, they must describe their services and fees and disclose potential conflicts of interest.

Third, certain conduct by an adviser is expressly restricted. This includes charging certain types of performance fees, entering into contracts that lack a nonassignment clause, and some types of trading transactions (for example, principal and agency cross-transactions).

Fourth, there is a specific antifraud provision, section 206. Significantly, in *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, the Supreme Court noted that in applying the antifraud provision, an adviser is to be held to a fiduciary standard. This fiduciary standard will guide an adviser throughout its course of conduct. In addition, the SEC has established a series of rules pursuant to section 206 which set forth a specific framework applying to certain types of advisory activity, including advertising and maintaining custody of client assets.

Finally, there are provisions for SEC inspections and an enforcement mechanism. However, there is no provision in the Act that expressly sets forth a private right of action for adviser misconduct. In *TransAmerica Mortgage Advisors Inc. v. Lewis*, the Supreme Court held that the Advisers Act provides only a limited private right of action for the voiding of an investment adviser contract.

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1. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, H.R. 4173 (July 21, 2010).

§ 1:3.1 A Glance at the Advisers Act Regulatory Framework

[A] Registration Under the Investment Advisers Act

- Registration under the Advisers Act is effected by filing the Form ADV with the SEC and paying a fee.
- A distinction needs to be made between the adviser itself and individuals with the adviser.
- Registration is required of the adviser itself.
- Individuals associated with the adviser (which includes employees and those otherwise associated) are not separately registered as advisers.
- The form ADV consists of following parts:
  - Part 1 is principally for use by regulators.
  - Part 2A (the "Brochure") serves as the basis for the disclosure document the adviser must provide to each of its advisory clients.
  - Part 2B (the "Brochure Supplement") is provided to clients with respect to certain advisory personnel.

[B] Conduct Standards/Restrictions on Activities

An adviser's conduct is shaped first and foremost by the fiduciary duty it owes clients.

Section 206 of the Advisers Act contains the antifraud provisions of the Advisers Act. That section provides that is unlawful for an adviser directly or indirectly to:

- employ any device, scheme, or artifice to defraud any client or prospective clients (section 206(1));
- engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client (section 206(2)); and
- engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative (section 206(4)).

In *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*,[2] the U.S. Supreme Court noted that in applying the antifraud provision, an adviser is to be held to a fiduciary standard.

2. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

This fiduciary standard will guide an adviser throughout its course of conduct.

Among the most important requirements of section 206(1) and (2) is making full and adequate disclosure to clients regarding matters that my have an impact on the adviser's independence and judgment.

The Advisers Act restricts certain specific activities that may be grouped into the following categories:

- Attracting Clients;
- Components of the Advisory Relationship;
- The Advisory Contract;
- Compensation;
- Suitability;
- Custody;
- Proxy Voting;
- Brokerage Transactions and Trading Practices; and
- Interactions with Municipalities: Pay to Play Practices

[C] Attracting Clients

[C][1] Advertising

Rule 206(4)-1 is the primary rule covering advertising under the Advisers Act. The Rule includes four specific categories of misleading advertising and one catchall provision. The most significant of the four specific categories are:

- No Testimonials; and
- Past Specific Recommendations (cannot refer to successful securities recommendations without referring to unsuccessful recommendations).

The catchall category prohibits the use of any advertisement that "contain any untrue statement of a material fact, or which is otherwise false or misleading." One particular kind of advertising—performance advertising—has been the source of many interpretative questions under the catchall category.

[C][2] Referral Fees

Many advisers rely on parties providing referrals—commonly known as "solicitors"—as sources of new business. Adviser cash payments to solicitors are governed by Rule 206(4)-3:

- Written agreement between solicitor and adviser is required; and
- Disclosure statement must be provided to the client and a signed acknowledgment received from the client when the solicitor is not affiliated with the adviser.

[D] The Adviser-Client Relationship

[D][1] Advisory Agreements

Every advisory agreement with a client must provide, in substance, that the adviser may not assign the agreement without the client's consent.

[D][2] Compensation

Generally, advisers are given wide latitude in structuring advisory fees, except for performance fees. The prohibition against the deduction of performance fees is contained in section 205(a)(1) of the Advisers Act. Exceptions to the performance-fee prohibition include:

- Asset-based fees;
- Fulcrum fees (popular arrangement with mutual funds that allows an adviser to adjust its base fee up or down depending on performance of the fund compared to an index);
- Wealthy client (Rule 205-3);
- Qualified Purchaser Fund; and
- Foreign Clients.

[D][3] Suitability

Advisers owe their clients a duty to provide only suitable investment advice. This duty generally requires an adviser to make a reasonable inquiry into the client's financial situation, investment experience, and investment objectives, and to make a reasonable determination that the advice is suitable in light of the client's situation, experience, and objectives.

[D][4] Custody

The Advisers Act imposes various requirements when an adviser maintains custody of client assets. A registered adviser that holds, directly or indirectly, client funds or securities, or has authority to obtain possession of clients' funds or securities, is deemed to have "custody" of those funds or securities. Rule 206(4)-2 establishes the following standards that apply when an adviser has or is deemed to have custody.

- Qualified custodian;
- Delivery of account statements;
- Surprise Audit;
- Internal Control Report (if custody by adviser or affiliate);
- Special rules for pooled investment vehicles.

[D][5] Proxy Voting

Rule 206(4)-6 provides that proxy voting policies and procedures must be adopted that are reasonably designed to ensure that the adviser votes proxies relating to clients' securities in the best interest of clients.

[E] Brokerage and Trading Pictures

[E][1] Duty of Best Execution

As a fiduciary, an adviser is required to carry out its selection of brokers subject to the standard of "best execution."

The advisory contract typically specifies whether the adviser or the client will be responsible for selecting the broker to execute orders on behalf of the client.

[E][2] Soft Dollars

As fiduciaries, advisers should negotiate with broker-dealers for lower commissions for its clients. In practice, brokers are reluctant to lower their usual commissions to clients, instead providing rebates that are paid in kind (by "soft" dollars) rather than in cash. An advisers' receipt of soft dollars could constitute a breach of the adviser's fiduciary duty.

Section 28(e) of the Securities Exchange Act of 1934 provides that advisers fall within the safe harbor when they pay more than the lowest available brokerage commissions if they receive research and benefits from the brokers.

The limits of section 28(e) have been addressed in various SEC releases and letters.

[E][3] Trading

Section 206(3) of the Advisers Act restricts advisers from acting in ways in which the advisers' interest conflicts with clients' interests. This includes principal transactions and agency cross-transactions.

In a principal transaction the adviser engages in transactions in which it buys securities for the adviser's own inventory from a client or sells securities from the adviser's own inventory to the client.

Agency cross-transactions involve the adviser operating on behalf of its advisory clients and those of the party on the other side of the brokerage transaction.

The Investment Advisers Act regulates principal transactions and agency cross-transactions by requiring that an adviser disclose the conflict and receive the consent of the client before effecting the transaction.[3]

Rule 206(3)-2 provides for safe harbor for agency cross-transactions and allows for blanket consent.

[F] Interaction with Government Municipalities: Pay to Play Practices

On June 30, 2010, the SEC adopted Rule 206(4)-5 (the "Pay to Play Rule") under the Investment Advisers Act. The Rule is designed to curtail "pay to play" practices by investment advisers.

There are three key aspects of the Pay to Play Rule:

(1) Two-Year Compensation "Time Out"—a two-year "time out" from receiving compensation for providing advisory services to certain government entities after certain political contributions are made;

(2) Solicitor Ban—a prohibition from paying third parties for soliciting government clients, except where such payments are made to "regulated persons" as defined in the rule; and

(3) Restriction on Coordinating Contributions—a prohibition on coordinating or soliciting contributions and payments.

[G] Compliance

[G][1] Record-Keeping Obligations

Rule 204-2 under the Advisers Act requires that a broad range of books and records be maintained, including:

- the registered adviser's accounting records;
- the registered adviser's corporate records;
- records relating to the compliance policies and procedures records relating to clients, including transactions information, portfolio records and contracts;
- records relating to advertising and performance presentations;

3. Investment Advisers Act § 206(3).

- records relating to clients' assets that are, or are deemed to be, in the custody of the adviser; and
- records relating to personal securities transactions by principals and employees of the adviser.

Books and records must generally be maintained and preserved in an easily accessible place for five years from the end of the fiscal year during which the last entry was made on such record, and the first two years in an appropriate office of the adviser.

Books and records relating to the advertisements or performance information used in marketing materials must be maintained for a period of not less than five years from the end of the fiscal year during which the adviser last published or disseminated the materials.

Articles of incorporation, charters, minute books, and stock certificate books of the adviser and of any predecessor must be maintained in the principal office of the adviser and preserved until at least three years after termination of the enterprise.

[G][2] Compliance Program: Rule 206(4)-7

A registered adviser must adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act by the registered adviser or any of its supervised persons.

These policies and procedures must be reviewed annually by the registered adviser to determine their adequacy and effectiveness.

Registered advisers are required to designate a chief compliance officer that has a position of sufficient seniority and authority within the organization to administer the compliance policies and procedures.

[G][3] Insider Trading and Code of Ethics

Under section 204A of the Advisers Act, an adviser must establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information by the adviser or any person associated by the adviser.

Each registered adviser must adopt a code of ethics that:

- Sets out a standard of business conduct for the adviser and its supervised persons;
- Prevents access to material non-public information of the adviser's securities recommendations and client services, unless needed by personnel of the adviser for their duties; and
- Requires periodic reporting and review of the personal trading reports from "access persons" of the adviser and the implementation of personal trading procedures.

[G][4] Privacy

Under Regulation S-P, a registered adviser must adopt policies and procedures that address administrative, technical, and physical safeguards for the privacy protection of private customer records and information.

[G][5] Business Continuity Planning

The SEC has taken the position that a registered adviser's fiduciary obligations to its clients include the obligation to take steps to protect the clients' interests from being placed at risk as a result of significant business disruptions.

§ 1:4 State Law

States generally have a regulatory framework similar to that of the Investment Advisers Act. Many states exclude from the definition of investment adviser many of the same categories excluded in the Investment Advisers Act: banks, attorneys, accountants, teachers, and broker-dealers. Some states provide that these exclusions from the definition are unavailable to an entity that "holds itself out" to the public as an investment adviser.

Currently, forty-nine states and the District of Columbia require investment advisers to register. Wyoming has no such requirement. In addition to the adviser itself, many states require registration of the adviser's employees. Many states also require that these individuals pass certain qualifying exams.

Some states have substantive regulation stricter than that of the federal Advisers Act. For example, some states prohibit an adviser from keeping custody of client assets, require the bonding of the investment adviser against larceny or embezzlement, and require an adviser to meet certain net capital requirements.

Finally, states generally have an enforcement mechanism to ensure compliance with the law. While some states routinely inspect advisers, others limit their activity to investigating those advisers that they suspect of wrongdoing.

§ 1:4.1 Overview of State Securities Regulation

As discussed in chapter 3, "The Jurisdictional Divide Between the SEC and the States," the regulatory landscape applying to investment advisers changed dramatically in 1996 as a result of the National Securities Markets Improvement Act (NSMIA). Advisers were freed from overlapping SEC and state regulation. Consequently, today, advisers are subject to regulation at only one level: large advisers by

the SEC and small advisers and their associated persons by the states. The states also have authority to register and qualify certain personnel of SEC-registered advisers.

In this section, we provide an overview of state securities regulation of advisers. We first provide an overview of the state securities regulatory framework. We then look at state regulation of state-registered advisers and their associated persons. Finally, we examine the reach of state regulation over SEC-registered advisers and their associated persons.

All fifty states, as well as the District of Columbia, Puerto Rico, and Guam, regulate securities through laws typically referred to as Blue Sky Laws. These laws are administered by the state securities department responsible for securities.[4]

Virtually every state regulates advisory activities as part of its Blue Sky Laws. Only one state, Wyoming, does not provide for adviser regulation.

[A] State Uniformity

Over the years there have been several attempts to unify the patchwork of state law applying to advisers.

These attempts include a set of Uniform Securities Acts and a Model Law promulgated by the North American Securities Administrators Association, Inc. (NASAA). While these serve as useful general guidance, each state's requirements may only be determined by reference to that state's blue sky law.[5]

In 1996, NSMIA imposed a measure of uniformity on behalf of those advisers subject to multiple state registration. We discuss this farther below.

[A][1] Uniform Securities Acts

In 1956, the National Conference of Commissioners on Uniform State Laws adopted a Uniform Securities Act. Portions of that Act were devoted to adviser regulation. For example, section 102 deals with practices in which advisers are prohibited from engaging. That section deals with such things as certain custody arrangements and performance fee arrangements. Section 201 deals with adviser registration. The Uniform Securities Act was adopted (in many cases with significant modifications) by a majority of states.

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4. The North American Securities Administrators Association, Inc. website, www.nasaa.org, has a guide that lists the addresses and telephone numbers of each of the state securities regulators.
5. In researching state-specific requirements, note that many states have a website which provides useful guidance. These state sites are identified at the SEC's website, www.sec.gov/rules/othern/advfaq.htm.

Subsequently, in August 1985, a revised Uniform Securities Act was set forth. Strong opposition from many groups resulted in the 1985 Act not replacing the 1956 Act as the Official Uniform Securities Act.[6] In light of the enactment of the National Securities Markets Improvements Act in 1996 (discussed below) and the opposition to the 1985 Act, a new Uniform Securities Act was advanced in 2002. Despite all of this activity, as a practical matter, many jurisdictions still operate under the Uniform Securities Act of 1956.

[A][2] North American Securities Administrators Association, Inc.'s Model Laws

The NASAA is an association that brings together the fifty state securities regulators. The Association regularly deals with state investment adviser regulatory initiatives through various project groups.

[A][3] National Securities Markets Improvements Act

The 1996 legislation imposed some degree of uniformity with respect to advisers subject to registration with multiple states. That legislation set forth that an adviser subject to multiple state registration will be subject to the record-keeping, net capital, and bonding requirements of that state where the adviser maintains its principal place of business.[7] We explore this in more detail below at section 1:4.2[A][2][a][1].

§ 1:4.2 State Regulation of State-Registered Advisers and Their Personnel

For purposes of our discussion, state regulation of state-registered advisers and their personnel may be grouped into the following categories:

(i) jurisdictional issues;

(ii) registration;

(iii) substantive regulation; and

(iv) examinations.

We discuss each of these categories below.

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6. For a good discussion of the Uniform Securities Act, see LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION (2d ed.) 1988.
7. Section 222(d) of the Investment Advisers Act.

[A] Jurisdictional Issues

[A][1] Definition of an Adviser Under State Law

The definition of investment adviser in many states parallels the definition in the Investment Advisers Act. In this connection, many states provide exclusions for

(i) banks, savings institutions, and trust companies;

(ii) lawyers, accountants, engineers or teachers whose performance of advisory services is incidental to their profession; and

(iii) broker-dealers whose performance of advisory services is solely incidental to their brokerage business and who receive no special compensation.

Some states include some variations from the Investment Advisers Act. For instance, some states, following the Uniform Securities Act, provide an exception for advisers whose only clients are financial or institutional investors.

In addition, some states specifically include in their definition of advisers persons who "hold themselves out" as advisers. In so doing, these states make crystal clear that financial planners are subject to the state's adviser regulation.

[A][2] Which State's Law Applies

An adviser subject to state regulation generally will be required to register in each state in which it operates. As such, an adviser registered in multiple states will need to concern itself with each state's law.

[A][2][a] Sorting Out Multiple State Regulation

Because of the lack of uniformity among the states, compliance with multiple state law is a source of never-ending frustration for advisers registered in multiple states. An important provision introduced into the Investment Advisers Act as part of NSMIA provides advisers with some welcome relief. Also, NASAA has various initiatives underway seeking to provide for uniformity.

[A][2][a][i] Relief for Advisers Registered in Multiple States—Section 222 of the Investment Advisers Act

Section 222 of the Investment Advisers Act establishes that an adviser is required to follow the record-keeping, net capital, and bonding requirements of its home state; other states where an adviser

is registered are precluded from imposing more burdensome requirements.

Specifically, section 222 provides that no state may enforce record-keeping requirements in addition to those required under the laws of the state in which the adviser maintains its principal place of business.[8] This provision is conditioned on such adviser being registered or licensed in its home state and being in compliance with the state's record-keeping requirements. Similar provisions apply with respect to net capital and bonding requirements.[9]

An adviser's principal place of business is the location of its executive office from which its officers, partners, or managers direct, control, and coordinate its activities [10]

At least one state requires an adviser to certify that it is in compliance with its home state's requirements in order to avail itself of the relief provided for in section 222.[11]

[A][2][a][ii] NASAA's Initiative to Provide Relief to Advisers Registered in Multiple States

During the past few years NASAA has sought to ease the compliance burdens imposed on advisers registered in multiple states. A Memorandum of Understanding adopted on April 27, 1997, calls for NASAA to: review certain of its model rules, seek to coordinate inspections by state regulators; and develop model adviser registration forms.[12] To date, this Memorandum has resulted in NASAA establishing or revising its Model Rules in such areas as net capital and bonding requirements, investment advisory contracts, record-keeping, and custody.

[B] Registration Issues

An adviser subject to state regulation will need to concern itself with registering the adviser itself in applicable states and also making sure that its personnel are properly qualified and licensed.

In qualifying and licensing advisory personnel, state regulation stands in stark contrast to the federal regulatory scheme provided for by the Investment Advisers Act. You will note from the discussion in chapter 4, "Investment Adviser Registration and Disclosure," that the

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8. Section 222(b) of the Investment Advisers Act.
9. Section 222(c) of the Investment Advisers Act.
10. Rule 222-1(b) of the Investment Advisers Act.
11. *See* G. Philip Rutledge, *NSMIA . . . One Year Later: The States' Response*, 53 BUS. LAW. 563 (1998) at n.49 and accompanying text (citing Pennsylvania's requirement that a Form IA-Cert be filed to attest to compliance with an adviser's home state's net capital and bonding requirements).
12. NASAA's Memorandum of Understanding can be found at its website, www.nasaa.org.

Advisers Act does not impose qualification or licensing requirements on advisory personnel.

In addition to registration of the adviser and advisory personnel, some states require that an adviser register its physical locations that have been established in the state to carry out its business. Once again, this is in contrast to the Investment Advisers Act, which has no similar provision.

[B][1] Registering the Adviser

An adviser subject to state regulation is generally required to register in each state where it transacts business (for example, has clients in the state).[13] Generally, in order to register with a state, an adviser is required to submit to that state: a Form ADV; a Form U-4 for each advisory representative; evidence of each representative having satisfied applicable exam requirements; and the applicable fee. Once effective, registration needs to be renewed on a regular basis.

Because it is very common for an adviser to transact business in more than one state, many advisers are registered in multiple states. A de minimis exception provides one possible avenue for relief from multiple state registration.

[B][1][a] De Minimis Exception from Registration

The de minimis exception from registration, provided for by section 222(d) of the Investment Advisers Act, sets forth that an adviser is required to register in a state only if the adviser has a place of business in that state and during the preceding twelve-month period has had more than five clients who are residents of the state.[14] This is a national standard, applying across the board to all states. States are free, however, to establish additional or more permissive de minimis exceptions.[15] By way of example, New York provides an exception from registration for advisers with fewer than six clients in New York regardless of whether they have a place of business in the state.[16]

[B][2] Registration of Advisory Personnel

Advisory personnel of a state-registered adviser are generally required to be registered in a state. As discussed in chapter 3, states also have the authority to register certain personnel of an SEC-registered adviser. The states can't register all persons working for an SEC-registered adviser.

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13. *See, e.g.*, www.sec.gov/rules/othern/advfaq.htm.
14. Rule 222-1(a) defines the term "place of business" and Rule 222-2 defines the term "client" (by reference to revised Rule 203(b)(3)-1).
15. *See, e.g.*, www.sec.gov/rules/othern/advfaq.htm.
16. N.Y. GEN. BUS. LAW § 359-eee(1)(a)(5).

Their authority is limited to persons who fall within the definition of investment adviser representative (that is, individuals who have a place of business in that state).

States are not obligated to impose the same registration requirements on individuals working for state-registered advisers and individuals who are investment adviser representatives of an SEC-registered adviser, but they usually do.

These requirements generally include passing a qualifying exam and submitting an application with the state. We discuss these requirements more in depth at section 35:15.5.

[B][3] Registration of Branch Offices

Some states require state-registered advisers to register the various physical locations at which the adviser or its associated persons carry out their advisory activities. For example, Connecticut's law requires an adviser to register branch offices located in Connecticut.[17]

[C] Substantive Regulation

[C][1] Conduct Regulation

State blue sky laws typically contain many of the same conduct prohibitions that are in the Investment Advisers Act. For example, similar provisions that are in the Advisers Act dealing with advertisements, payment of referral fees, and performance-based compensation are often found in state securities laws.

[C][2] Net Capital Requirements

In contrast to the Investment Advisers Act, many state blue sky laws impose financial requirements on advisers. These provisions require an adviser to maintain a specified, minimum level of net capital. As discussed above, an adviser registered with multiple states is subject to the net capital requirements imposed by that state in which it has its principal business.

NASAA recently assembled a working group to review its model rule covering net capital.[18] The review was initiated with a view to establishing a uniform state approach to net worth requirements. The review culminated with a proposed amendment to NASAA's net worth rule that, among other things, requires a state-registered adviser to

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17. Connecticut Uniform Securities Act § 36b-6(d). A branch office is defined generally to mean any location other than the main office, identified by any means to the public, customers or clients as a location at which an investment adviser conducts an advisory business.

18. NASAA Model Rule 202(d)-1.

maintain a minimum net worth of $35,000 if they have custody of client accounts or $10,000 if they merely have discretion over the account.

[C][3] Safekeeping of Assets

State law generally has custody and bonding provisions that are concerned with keeping safe those assets over which an adviser has custody.

[C][3][a] Custody

Some states outright prohibit an adviser from maintaining custody of client accounts. Other states impose requirements similar to those required under the Investment Advisers Act in Rule 206(4)-2. Note that NASAA's model rules have a provision dealing with custody.[19]

[C][3][b] Bonding Requirements

Many states require investment advisers having custody of clients' assets or discretionary authority to maintain a surety bond. NASAA recently proposed amendments to its model rule covering bonding.[20] Bonding requirements are unique to state law; the Investment Advisers Act does not contain a similar provision.

[D] Record-Keeping Requirements and Inspections

[D][1] Record Keeping

Many states model their record-keeping requirements on Rule 204-2 of the Advisers Act; however, many states impose additional requirements. For example, some states require advisers to keep records showing suitability information about clients (for example, investment objectives and approximate current income); to maintain a litigation file providing information about criminal or civil actions and administrative proceedings against the adviser; to keep records of complaints made by their clients; and to maintain written supervisory procedures. NASAA's model record-keeping rule serves as a useful guide in this area.[21]

State requirements vary with respect to the length of time that advisers are required to maintain records. Some states require records to be kept longer than the periods set forth in Rule 204-2. Most states permit advisers to maintain records in nonpaper form under the same terms as Rule 204-2, but variations exist; for example, some states permit storage on microfilm but not on computer.

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19. NASAA Model Rule 102(e)(1)-1.
20. NASAA Model Rule 202(e)-1.
21. NASAA Model Rule 203(a)-2.

[D][2] Inspections

Most state securities departments have units that are responsible for conducting investment adviser inspections. Like the SEC, state adviser inspections are conducted both on a routine basis and when wrongdoing is suspected. As noted, NASAA's 1987 Memorandum of Understanding sets forth understandings between the states to coordinate routine inspections.

§ 1:4.3 State Regulation of SEC-Registered Advisers and Their Personnel

As explained in chapter 3, states retain limited authority with respect to SEC-registered advisers. In particular, they can require an SEC-registered adviser to make certain filings and pay fees. Other than these filings and fees, that is pretty much it for state regulation of SEC-registered advisers. One exception: the 1996 legislation preserved the states' authority to enforce their antifraud provisions against SEC-registered advisers. However, this does not contemplate an avenue for the states to impose their substantive regulation against SEC-registered advisers. So, for example, a state cannot obligate an SEC-registered adviser to comply with its net capital requirements by saying that such compliance is mandated by its antifraud provisions. But a state could, for instance, enforce its antifraud provisions against an SEC-registered adviser that is stealing money.

State authority over advisory personnel is more far-reaching. States retain the authority to license persons working for an SEC-registered adviser who have a place of business in the state.

[A] Notice Filings by SEC-Registered Advisers

The 1996 law permit states to require a notice filing of any SEC-registered adviser doing business in a state. Such notice filing may consist only of copies of any documents filed with the SEC (such as the adviser's Form ADV). States may also require SEC-registered advisers to file a consent to service of process. Finally, states may continue to assess fees. States have generally amended their Blue Sky Laws to provide for such filings and fee assessments.[22]

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22. Technically, the national de minimis exception from state registration discussed at *infra* section 35:4.3 does not apply to SEC-registered advisers since such advisers are not registered with the states. However, many states permit SEC-registered advisers to avail themselves of this exception with respect to notice filings. *See, e.g.*, www.sec.gov/rules/othern/advfaq.htm.

[B] Registration of Advisory Personnel

As discussed fully in chapter 3, under the 1996 legislation states retain the authority to license investment adviser representatives having a place of business within the state. States have exercised their authority in this area and, as a result, legal and compliance personnel of SEC advisers routinely deal with state licensing requirements on behalf of advisory personnel.

Generally, licensing an individual is a two-step process. First, an individual is required to pass a qualifying exam. Then, an application must be filed with the state on behalf of the individual.

[B][1] Exam Requirement

Until recently, state exam requirements varied across the board. A recent NASAA initiative changed all that. That initiative, which generally took effect across the states on January 1, 2000, brought about uniformity to state exam requirements while at the same time introducing a means to test the competency of advisory personnel.

First, some background. The NASD administers various qualifying exams for personnel from both the brokerage industry and the advisory industry. The NASD administers these exams on its own behalf and also on behalf of the states.

The qualifying exam for advisory personnel is the Series 65.[23] However, certain advisory personnel who are also in the brokerage business can take the Series 66 instead of the Series 65.

By way of explanation, registered representatives are generally required by the NASD to take one of two exams depending on the type of business in which they are engaged. The Series 7 qualifies an individual to engage in the general securities business (for example, stocks, bonds, investment companies, variable insurance products, etc.) while the Series 6 qualifies an individual to engage in limited securities activity (investment companies and variable contracts).

In addition to the NASD requirements, registered representatives need to satisfy a state exam requirement—the Series 63. Instead of requiring registered representatives who are also in the advisory business to satisfy both the Series 63 and the Series 65, states have developed a Series 66 exam.[24] To be able to take the Series 66, an individual must have passed the Series 7 exam.

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23. A revised Series 65 exam was rolled out on January 1, 2000. The revisions were done with a view to testing adviser competency. The revised exam has four primary content areas: (i) economics and analysis; (ii) investment vehicles; (iii) investment recommendations and strategies; and (iv) ethics and legal guidelines. The exam contains 130 questions and ten pre-test questions. Candidates are given 180 minutes to take the exam.

24. Like the revisions that were made to the Series 65 exam, modifications were also made to the Series 66 exam to test adviser competency.

[B][1][a] State Uniformity

As noted, NASAA has spearheaded an initiative to impose uniform state examination requirements. In particular, under the NASAA proposal, the only exam requirement imposed on an individual would be Series 65 or the Series 66.[25] The Series 7 exam is a corequisite for the Series 66 examination.

The NASAA proposal would provide a waiver from the examination requirement for individuals who hold one or more of the following designations:

- Certified Financial Planner (CFP) (awarded by the Certified Financial Planner Board of Standards, Inc.);
- Chartered Financial Consultant (ChFC) (awarded by the American College, Bryn Mawr, Pennsylvania);
- Personal Financial Specialist (PFS) (awarded by the American Institute of Certified Public Accountants);
- Chartered Financial Analyst (CFA) (awarded by the Institute of Chartered Financial Analysts);
- Chartered Investment Counselor (CIC) (awarded by the Investment Counsel Association of America, Inc.); or
- Such other professional designation as the state administrator may by rule or order recognize.

To date, virtually all states have adopted the NASAA proposal.[26]

[B][2] Application Process

In order to be licensed in a state, in addition to satisfying an individual's exam requirement, an application generally must be submitted on behalf of the individual. Generally, a Form U-4 is required to be submitted for each individual along with an application fee.[27]

This exam has two primary content areas: (i) investment analysis, recommendations, and strategies and (ii) ethics and legal guidelines. The Series 66 exam contains 100 questions and 10 pre-test questions. Candidates are given 150 minutes to take the exam.

25. Under the NASAA proposal, individuals who were already licensed as an investment adviser representative as of January 1, 2000, would not be required to take the revised examinations.

26. NASAA maintains a list of all states that have adopted its Model Exam requirements at www.nasaa.org.

27. The Form U-4 is the Uniform Application for Securities Industry Registration or Transfer.

§ 1:4.4 *Investment Adviser Registration Depository*

Individuals familiar with broker-dealer registration know that the NASD maintains a Web-based searchable database—the CRD—which maintains certain information about broker-dealers and their registered representatives. A similar database, called the Investment Adviser Registration Depository (IARD), has been developed for investment advisers and their investment adviser representatives.[28]

The IARD, which began operation on January 1, 2001, does away with the previous paper-based filing system. All states currently accept electronic filings through the IARD by state-registered advisers. In fact, many states require electronic filing.[29] Also, SEC and state-registered advisers are able to use IARD for investment adviser representative filings with a state. Information on IARD is available to the general public. IARD now also supports the electronic filing of ADV Part II.

§ 1:5 The Investment Company Act of 1940

The Investment Company Act of 1940 imposes a very broad and detailed scheme of regulation upon investment companies and the advisers to investment companies. As already noted, the Investment Company Act grew out of an SEC study mandated by Congress. Before the Investment Company Act, investment companies were generally subject only to disclosure regulation under the Securities Act of 1933, thereby escaping regulation of the type that was applied to other financial intermediaries such as banks and insurance companies. Congress believed that a specialized body of regulation was appropriate because the investment company structure and the portable nature of its assets afforded the opportunity for self-dealing on the part of persons, such as the investment adviser, having a relationship with the company.

In approaching the Investment Company Act, it is important to determine first whether the entity in question falls under the definition of investment company in section 3. Once it has been concluded that an investment company is involved, it is then essential to determine the particular type of investment company involved. This is because certain provisions of the Act apply only to certain types of companies.

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28. Investment Advisers Act Release No. 1862 (Apr. 5, 2000) (proposing release); Investment Advisers Act Release No. 1897 (Sept. 12, 2000) (Electronic Filing by Investment Advisers; Amendments to Form ADV-adopting release).
29. NASAA maintains a survey of those states requiring electronic filing at www.nasaa.org.

Section 4 of the Act divides investment companies into "face amount certificate companies," "unit investment trusts," and "management companies." Face amount certificate companies, which today are almost extinct, issue certificates obligating them to pay a fixed sum on the maturity date. A unit investment trust issues redeemable securities representing an undivided interest in a fixed portfolio of specified securities. Because it has a fixed portfolio, this type of investment company does not employ an investment adviser. A management company is any investment company that is neither a face amount certificate company nor a unit investment trust.

Management companies are further subdivided into open-end companies and closed-end companies by section 5(a). An open-end company is one that offers shares that the company stands ready to redeem at net asset value upon tender by a shareholder. A closed-end company is any company that is not an open-end company. Both the open-end company and the closed-end company (together referred to as "mutual funds") employ investment advisers.

The investment adviser is generally understood to be the most important service provider to the mutual fund. To understand their relationship properly, one should think of the investment adviser as the mother of the mutual fund. The adviser establishes the fund, registers it, seeds its initial minimum capital, and puts in place all of the necessary service arrangements (such as the distribution agreement, the shareholder servicing agreement, and the transfer service agreements).

The advisory relationship with a mutual fund can be either externalized or internalized. The vast majority of funds have an externalized structure, under which the adviser's relationship to the fund is a contractual one. Under the arrangement, the adviser agrees to provide personnel and the means to manage the fund, such as office space. The fund is merely a shell with few employees. The adviser's fee is determined contractually pursuant to some prescribed formula; it is not like a salary that an employer pays an employee.

In contrast, the internalized structure is similar to the structure of the typical corporation. In this structure, investment decisions are made by employees of the fund.

In both types of arrangements, the adviser is in a position to take advantage of the fund. As noted, the assets of the fund are liquid and portable. This fact, combined with the adviser's influence over distribution and portfolio brokerage, makes fund assets vulnerable to abuse by the adviser.

The Investment Company Act established various means to keep the adviser in check. There are provisions that

(1) provide for prospectus disclosure of investment objectives and investment policies;

(2) place controls over the nature of the investment advisory contract;

(3) impose a board of directors to serve as a watchdog over the adviser;

(4) provide an express private right of actions for shareholders; and

(5) restrict transactions between the fund and the adviser.

These provisions are discussed below.

First, a fund is required to disclose its investment objective and investment policies. The investment objective of the fund is, in effect, its major goal (for example, aggressive growth). The investment policies are the means by which the fund intends to achieve its objective. Disclosure is also required concerning those policies that are changeable only by shareholder vote. These provisions serve to limit the discretion that an adviser has to alter unilaterally a fund's investment strategy.

Second, section 15 of the Investment Company Act places controls on the advisory contract. Specifically, the advisory contract must be written; must precisely describe all compensation; may continue for more than two years after execution only if continuance is approved annually by the majority of the board of directors or by a majority vote of shareholders; must provide that the fund may terminate it at any time without penalty on sixty days' written notice; and must provide for the contract's automatic termination if it is assigned.

Third, various provisions of the Investment Company Act establish a corporate structure to police conflicts between the fund and the adviser. Generally, section 15 imposes a duty on the board of directors to evaluate and review the advisory contract. In evaluating the terms of the advisory contract, directors are required to request and evaluate, and the adviser is required to furnish, certain information. This includes information about investment performance, compensation, brokerage and portfolio transactions, and overall fund expenses and expense ratios.

Fourth, the Investment Company Act imposes a fiduciary duty on the investment adviser with respect to the compensation the adviser receives from the company and its shareholders. The SEC and shareholders are authorized to bring an action against the adviser for breach of this duty.

Finally, various provisions of the Investment Company Act restrict transactions between a mutual fund and its affiliates, including the fund's investment adviser. In relevant part,

(1) section 17(a) prohibits transactions between a fund and adviser where the adviser is acting as principal;

(2) section 17(d), together with Rule 17d-1, restricts joint transactions involving a fund and an adviser;

(3) section 17(e) restricts the amount of compensation an adviser may receive when acting as an agent to the fund; and

(4) section 10(f) restricts a mutual fund's acquisition of securities from an underwriting syndicate if a member of the syndicate is affiliated with the fund in certain ways.

The SEC has established a variety of rules which serve to provide flexibility in the application of these provisions.

§ 1:6 The Employee Retirement Income Security Act of 1974

Because a growing number of pension plans hire investment advisers to manage pension plan assets, the law governing pension plans is increasingly important to investment advisers. In approaching pension law, it is important to distinguish the laws that regulate public pension plans from those regulating private pension plans. The regulation of public pension plans is accomplished generally by common law and state or local statute. In contrast, the regulation of private pension plans, as relevant to investment advisers, is generally accomplished through the Employee Retirement Income Security Act of 1974 (ERISA).

ERISA, which is divided into four titles, establishes a comprehensive regulatory structure with significant liability attached to the operation of a pension plan. Title I, which establishes various protections from mismanagement and misuse of plan assets, is the title relevant to registered investment advisers.

To understand the operation of Title I, one must be familiar with pension plan structure and the various parties playing a role in that structure. By way of background, before ERISA, plan structure was generally straightforward; an employer provided for the retirement needs of its employees either by paying directly from general assets or by setting aside assets. In contrast, ERISA requires that plan assets be held in trust and that persons responsible for plan assets be identified.

Every plan must be in writing and must designate at least one "named fiduciary." Consistent with ERISA sections 402 and 405, the named fiduciary has the principal responsibility and authority to

manage the plan's operation and administration and to hire and fire other persons with investment discretion over plan assets. Typically, the plan sponsor (for example, the employer) selects itself as the named fiduciary.

ERISA also requires every plan to provide for one or more parties who have the authority to oversee the safekeeping of plan investments. This party is referred to as the trustee. A plan sponsor may choose to serve as its own trustee. However, because many plan sponsors are not financially sophisticated, an outside trustee, typically a bank, will often be selected.

Recognizing the possibility that named fiduciaries will seek to enter into arrangements with others to carry out the investment management function, ERISA creates a special category of fiduciaries called "investment managers." If, pursuant to ERISA section 402(c)(3), a named fiduciary appoints an investment manager, limited relief from the fiduciary provisions is afforded the named fiduciary. However, the named fiduciary remains responsible for the initial appointment of the investment manager, for monitoring the actions of the investment manager, and for the continuing appointment.

To be an investment manager, which is defined in section 3(38), two requirements must be satisfied. First, only banks, insurance companies, or advisers registered under the Investment Advisers Act or under state law are eligible to be investment managers. Second, the investment manager must acknowledge in writing that it is a fiduciary with respect to the plan.

Section 3(21)(A)(ii) and the regulations thereunder create another category of potential fiduciaries consisting of persons who provide investment advice, for compensation, with respect to plan or IRA assets.

The Department of Labor in Regulation 2510-3-21 clarified the scope of the applicability of ERISA to such persons. This regulation provides that such a person becomes a fiduciary if, for a fee or other compensation, a recommendation regarding plan or IRA investment activities is made by an admitted fiduciary, provided pursuant to a written or verbal understanding that advice is based on the needs of the advice recipient, or is directed to the recipient about a particular management or investment decision. Persons unaware of these provisions may become inadvertent fiduciaries. This may be problematic, because if a person is not aware of being a fiduciary, he or she may not take precautions against engaging in prohibited transactions.

There are various duties that ERISA imposes on a fiduciary managing plan or IRA assets.[30] First, it must discharge its duties solely in the

30. Certain provisions of ERISA appear in parallel provisions of the Internal Revenue Code, including the prohibited transactions rules (discussed *infra*),

interests of plan participants and beneficiaries and for the exclusive purpose of providing plan benefits to them and defraying the reasonable expenses of administering the plan. Second, it must act with care, skill, prudence, and diligence under the circumstances then prevailing and in a manner consistent with the actions of a prudent person acting in like capacity. Third, as a general matter, it must diversify plan investments in order to minimize the risk of large losses unless it is clearly prudent not to do so. Finally, its operations must be consistent with plan documents and other instruments.

Of special importance to those who are fiduciaries with respect to plans, including those managing pension plan assets, section 406 bars fiduciaries from engaging in certain transactions and activities, even if they are otherwise prudent. This is intended to expand the common law duties imposed on fiduciaries and the general duties imposed by ERISA, by prohibiting certain transactions that are potentially abusive.

Significantly, ERISA prohibits a fiduciary from dealing with plan assets for his or her own account or in his or her own interest. Also, a fiduciary cannot cause a plan to engage in a transaction with a "party in interest" if the transaction involves, directly or indirectly, the sale, exchange, or lease of property; lending money or extending credit; furnishing goods, services, or facilities; or the transfer of assets to, or use of assets by or for the benefit of, a party in interest. A "party in interest" is generally someone who provides services to a plan (including a fiduciary) or sponsor of a plan or one who at least in part owns or is owned by such a person.

Moreover, the fiduciary may not deal in any capacity involving the plan on behalf of a party whose interests are adverse to the interests of the plan, its participants, or beneficiaries. Further, the fiduciary may not receive any consideration for his or her personal account from any party dealing with the plan in connection with a transaction involving plan assets. As a final example, the fiduciary cannot be paid for his or her services if he or she is already receiving full-time pay from the employer or union whose employees or members are participants.

Because of these prohibitions, persons providing services to plans, including investment managers or investment advisers, generally must avail themselves of the protection afforded by the statutory exemption of section 408(b)(2) of ERISA. This section requires that such services must be provided on a reasonable basis (terminable on reasonably short notice by the plan) and the plan must not pay any more than reasonable compensation.

Under ERISA section 409, a fiduciary who causes a plan to engage in a prohibited transaction which the fiduciary knows or should know

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and are applicable to IRA fiduciaries, but ERISA's fiduciary duties are not among them.

is prohibited is personally liable to compensate the plan for any resulting losses. Also, under the Internal Revenue Code, a party in interest (referred to as a "disqualified person" by the Internal Revenue Code), which includes a fiduciary, is liable for an excise tax for engaging in a prohibited transaction with a plan.

As discussed later in the book, the Department of Labor has granted various class exemptions relevant to money management activities. For example, an adviser that is itself a broker-dealer or affiliated with a broker-dealer is permitted to effect or execute securities transactions on behalf of a plan and/or to perform clearance, settlement, custodial, or other functions incidental to such transactions, provided that the conditions of Prohibited Transaction Class Exemption (PTE) 86-128 are satisfied. The principal condition is compliance with impartial conduct standards, including acting in the best interest of plans when exercising fiduciary authority. In addition, PTE 86-128 covers transactions in which an adviser to plan assets effects a sale or purchase of a security for the plan's account while acting as a broker for a person other than the client.

§ 1:7 Financial Industry Regulatory Authority (FINRA)

As noted above, there is no self-regulatory organization that regulates advisory conduct, however, in the aftermath of the Madoff scandal and the financial crisis, some have urged that advisers be subject to self-regulatory organization (SRO) oversight. Broker-dealers engaging in advisory activity are subject to FINRA requirements regarding supervisors. More specifically, FINRA requires that its member broker-dealers properly supervise the advisory activities of registered representatives that are independently engaged in advisory activity or associated as an investment adviser representative with the firm itself or one of the firm's affiliates. As discussed in chapter 2, the extent of the supervision required depends on the type of advisory activity that is being engaged in by the registered representatives.

§ 1:8 Private Associations

Various private associations help shape the regulation of investment advisers by setting forth standards of conduct with which their members are expected to comply. Among the more popular associations are:

- Investment Adviser Association;
- Association of Investment Management and Research;
- Investment Company Institute;

- GIPS; and
- CFP.

§ 1:9 A Note About Citations

As this book is designed for practitioners who may or may not specialize in securities law, its citations of statutory and regulatory authority—including administrative rules, interpretations, releases, and no-action letters—have been kept simple.

The primary federal statutes for our purposes are the Investment Company Act, the Investment Advisers Act, and the Employee Retirement Income Security Act of 1974 (ERISA), promulgated respectively under 15 U.S.C. §§ 80a-1 *et seq.*, 15 U.S.C. §§ 80b-1 *et seq.*, and 29 U.S.C. §§ 1001 *et seq.* In practice, however, references to the three statutes are invariably couched in terms of the section numbers delineated by the Acts themselves rather than the sections of the United States Code (U.S.C.). In this regard, the book follows the general industry practice.

The Investment Advisers Act consists of sections 201 through 222, with corresponding U.S.C. provisions. The number following the hyphen in 15 U.S.C. §§ 80b-1 *et seq*. identifies the appropriate Advisers Act section (with one exception: section 222 of the Investment Advisers Act is codified as 15 U.S.C. § 80b-18a). For example, section 206 of the Advisers Act, Prohibited Transactions by Investment Advisers, is codified as 15 U.S.C. § 80b-6.

Investment Company Act sections range from 1 to 65, again with corresponding U.S.C. provisions. Similarly, the number following the hyphen of 15 U.S.C. §§ 80a-1 *et seq*. identifies the section of the Act. However, starting with section 30 of the Investment Company Act, corresponding U.S.C. sections are one number behind the provisions of the Act. For example, the statutory authority for section 30 of the Investment Company Act, Reports and Financial Statements of Investment Companies and Affiliated Persons, is 15 U.S.C. § 80a-29.

Rules and regulations for the Investment Advisers Act are officially published in Title 17 of the Code of Federal Regulations, Part 275 ("17 C.F.R. § 275.____"). Rules and regulations under the Investment Company Act are promulgated under 17 C.F.R. § 270. For example, Rule 205-3 under the Investment Advisers Act is promulgated as 17 C.F.R. § 275.205-3, while Rule 2a-7 under the Investment Company Act is promulgated as 17 C.F.R. § 270.2a-7. In this book, all references to rules and regulations are made to the respective Acts rather than to the Code of Federal Regulations.

Securities and Exchange Commission interpretations, releases, and no-action letters are frequently reprinted in the Federal Securities Law

Reporter, a multivolume loose-leaf reporter published by the Commerce Clearing House ("Fed. Sec. L. Rep."). However, in light of the fact that all relevant authority is available through online computer-assisted legal research services such as Westlaw or LEXIS, this book refers to Commission interpretations, releases, and no-action letters (reported and unreported) by the title of the authority and the date the material became publicly available.

With respect to ERISA, the Title I provisions are organized into six parts as follows: Reporting and Disclosure (Part 1), Participation and Vesting (Part 2), Funding (Part 3), Fiduciary Responsibility (Part 4), Administration and Enforcement (Part 5), and Continuation Health Coverage (Part 6). There is no formula for translating ERISA section numbers into the corresponding U.S.C. section numbers. However, most of this book's references to ERISA are to Part 4, and the provisions there do correspond to the U.S.C. Part 4 of ERISA is numbered sequentially from 401 to 414, in one-to-one correspondence with sections 1101–1114 of Title 29 of the U.S.C. For example, section 406 of ERISA, Prohibited Transactions, is 29 U.S.C. § 1106. ERISA Rules and Regulations are published in Title 29 of the Code of Federal Regulations, Part 2550. For example, the rule providing an exemption for the provision of services to plan can be found at 29 C.F.R. § 2550.408b-2.