Investment Adviser Registration and Regulation

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Who Must Register? If you have $30 million or more under management but have advised fewer than 15 clients in the past 12 months and you do not hold yourself out as an investment advisor (meaning that you are not actively seeking more clients), you may not have to register with the SEC in Washington, DC. However, most likely, you will have to register with your home state securities commission as an investment advisor. Each state in the United States has varying laws and regulations applicable to investment advisors. In the context of investment advisor registration, your "home state" is determined by where you actually run your money management business (regardless of the state of incorporation). Generally, the state where your customers expect to find you (or would file a complaint about your business practices) is where you are "based" for purposes of investment advisor registration (even if you have multiple "offices" based on multiple residences).

Private Advisor Exemption. For an unregistered investment advisor to remain exempt from registration with the state securities commission or the SEC, it is necessary to keep a low profile. The Investment Advisers Act of 1940 exempts from SEC registration any investment advisor who during the course of the preceding 12 months has had fewer than 15 clients and who neither holds himself out generally to the public as an investment advisor nor acts as an investment advisor to any investment company. The state law statutory equivalents are far less generous than federal law. The private investment advisor exemption (hereafter "Private Advisor Exemption") is not available to any advisor who is offers his services to the public generally. If you are actively seeking to increase your client base, do not plan to rely on the Private Advisor Exemption from registration. In our experience, we have yet to encounter an advisor who was not looking for more clients. We tell our clients to register appropriately.

What is "Holding Out"? A person "holds himself out generally to the public" as an investment advisor if he lets it be known by word of mouth or by other means that he wants more clients. Identifying oneself as an investment advisor in any communication that you know (or has reason to know) will reach potential advisory clients (such as business cards, letterhead, a web site, a mass mailing, a trade show display, etc.) is sufficient to destroy the Private Advisor Exemption.

Limits of the Private Advisor Exemption. Whether dealing with the SEC, a state securities commission, or the NFA, the regulators interpret "holding out" very broadly. You are holding yourself out as an investment advisor for purposes of Section 203(b)(3) if you use the term "investment advisor" or "forex advisor" (or similar terminology) on a web site, at a trade show, on a business card, or a listing in a telephone, business or building directory. If you tell others by word of mouth or otherwise that you are available to provide investment advice, advisory services, or that you will accept new clients, you are "holding out" and cannot rely on the Private Advisor Exemption. Consider this. If you are actively adding investors to a private fund you run, it may be hard to argue to the regulators that you are not "holding out" your services in some respect as an investment advisor (or forex advisor, as the case may), given the typical "sales and advisory dialogue" involved between a fund manager and a prospective investor.

Investment Newsletters. Should you register as an investment advisor if you write an investment newsletter? In many cases, you need to register as an investment advisor as each state's laws are different and few qualify for the exemption from registration for bona fide publishers of news or information. In our experience, most flunk the "publishers test" and are providing tailored investment advice for a fee.

Hedge Fund Web Sites. Using a web site to provide information about your advisory services is considered as "holding out" and if you are not registered appropriately, you destroy your ability to rely on the Private Advisor Exemption. Can your newly registered advisory firm have a web site? Yes, but if you are launching a new fund at the same time, tread lightly for a while as there is a legal issue known as the "Coterminous Launch" that could cause legal problems for your business.

Can I Self Register? While it is possible for you to self-register, you may find the process to be harder and more tedious than you expected, especially if you are trading daily. While a registration package is easily obtained at IARD.com or from the office of a state securities commission, state employees will not assist you with the registration process or give you legal advice. Generally, they expect you to know what forms need to be filled out as well as be capable of completing the forms on your own. There are complex issues to address. Many states require disclosures that relate to custody issues which if not addressed correctly can increase your bonding requirements and minimum capital requirements.

At some point during the registration process, you should schedule to take the appropriate securities exam to complete the licensing requirement for your home state. In those states where the fund manager must register as an investment advisor, the Series 65 (or its equivalent) is required, unless the state is satisfied with some other credential, such as that of a Certified Financial Planner. No sponsor is needed to take the Series 65 exam.

Investment Advisor Registration. Generally, to become an investment advisor, you must register electronically through the Investment Adviser Registration Depository (IARD), available on the Internet. Setting up an IARD Account is the first step in the registration process. Once you establish an IARD account, you must complete Form ADV (Parts 1 and 2) on the IARD system, fund your IARD account, and submit it electronically through IARD to the SEC or relevant state. The state (or SEC) will review your application and most likely, you will go through several rounds of revisions before your application is finalized.

What if I am not required to register? For investment advisors to remain exempt from registration with the state or SEC, it is necessary to keep a low profile. Section 203(b)(3) of the Investment Advisers Act of 1940 exempts from registration any investment advisor who during the course of the preceding 12 months has had fewer than 15 clients and who neither holds himself out generally to the public as an investment advisor nor acts as an investment advisor to any investment company. The private investment advisor exemption is not available to anyone holding himself out as an advisor to the public generally.