



Risk Management Update April 2009

Investment Adviser State Registration and De Minimis Exemption

Current market events and economic downturns have created a domino effect for investment advisers when it comes to registration requirements and annual updates. With the recent passing of the March 31st SEC deadline for annual amendments to a firm's Form ADV, more firms are realizing that they no longer qualify for registration with the SEC. When assets under management fall below the required minimum a firm becomes ineligible to maintain its registration with the SEC. In most cases, if a firm's AUM drops under \$25 million then it no longer qualifies for registration with the SEC and must look to individual states for their separate requirements. So where does a firm begin when starting a state registration?

In determining which state(s) a firm must register in, a series of questions need to be addressed. (1) Does the firm have a physical place of business in the state (whether a home office or a separate location)? If the answer is YES then the firm must register in each state a physical place of business is maintained. However, if the answer is NO, then a follow-up question must be considered. (2) How many clients does the firm have residing in that state? Commonly referred to as the "de minimis" exemption, most states have a maximum number of clients an investment adviser may have without being required by law to register in that state. This is where confusion can set in, as each state has its own governing laws. In several states the de minimis number of clients is five (5) or fewer. These states currently include, but are not limited to: Connecticut, Florida, Massachusetts, Ohio, South Carolina and Washington, not to mention many, many others. Yet there are other states, such as Arizona, California and Georgia that have a de minimis of six (6) or fewer clients. Furthermore, there are some states with more stringent rules and regulations. For example, Texas and Arkansas have no de minimis exemption and a firm must register with the state even if it has just one (1) client residing in that state.

Additionally, once state registration is deemed necessary and the Form ADV is submitted, investment advisers should be prepared to provide the state with further documentation. This process can be rigorous, costly and time consuming. For instance, California provides an Application Checklist¹ of all the documents that must be included when applying for investment adviser registration with the state. These documents include:

- Advisory Contract(s);
- Application (Form ADV Parts 1A, 1B and 2) and Filing Fee;
- California Corporation or Limited Liability Company Securities Filing;
- Conflict of Interest Disclosure;
- Customer Authorization of Disclosure of Financial Records (Form QR 500.261);
- Financial Information (Balance Sheet and Minimum Financial Requirements Worksheet - Form 260.237.2);
- Financial Planning Conflict of Interest Statement;
- Form U-4 and Reporting Fee for each investment adviser representative/associated person ("IAR");

¹ California Department of Corporations Securities Division, *Investment Adviser Application Checklist*, available at http://www.corp.ca.gov/SRD/BDIA/IA_Checklist.asp, Posted as of April 27, 2009.

- Form U-4 for each officer, director or partner or each person who owns 10% or more, as shown on Schedule A or B of Form ADV, not reported as an IAR or associated person;
- Performance Fees Disclosure; *and*
- Statement of Citizenship, Alienage, and Immigration Status (Form 250.61).

Furthermore, many times a state may request additional information not listed during the review process. Firms should be prepared to produce supplemental information promptly upon the state's request and plan sufficient time to address these requests. Since each state has unique requirements, it is strongly recommended that firm personnel familiarize themselves with state registration requirements prior to beginning the application process.

When registering as an investment adviser with a state, it is imperative that the number of clients your firm has is correctly calculated and state de minimis exemptions are researched accurately. This will drastically aid the firm in avoiding any unnecessary costs and filings. Similarities may exist among various state laws regarding investment adviser registration requirements, but that does not equate to the full process in each state being exactly the same. Therefore, firms should spend the appropriate time and resources to ensure it is fully aware of each state's particular rules and regulations for investment adviser registration to help prevent any delays. If you have any questions or need assistance determining if a state registration is needed for your firm, please contact us at (619) 278-0020.

Author: Michelle L. Jacko, Esq., CEO and Serenity Harding, Consultant, Core Compliance & Legal Services ("CCLS"). CCLS works extensively with investment advisers, broker-dealers, investment companies, hedge funds and banks on regulatory compliance issues. For more information about this topic and other compliance consultation services, please contact us at (619) 278-0020, info@corecls.com or visit www.corecls.com.

This article is for information purposes and does not contain or convey legal or tax advice. The information herein should not be relied upon in regard to any particular facts or circumstances without first consulting with a lawyer and/or tax professional.