



CORE COMPLIANCE & LEGAL SERVICES, INC.  
SOLUTIONS FOR TODAY'S BUSINESS

## **Risk Management Update June 2009**

### **Alternative Adviser Registration Options**

#### **Introduction**

In our April Risk Management Tip we discussed how a reduction in assets in management to below \$25,000,000 could force certain investment managers to de-register with the SEC and register with the individual states in which they conduct business. As each state has different rules this can often be confusing. If a firm conducts business in more than one state it may find the firm is subject to different standards. Further, individual state registration requirements can often be more expansive than that which currently is required by the SEC.

Importantly, registering with individual states is not the only option available to firms whose assets are below \$25,000,000. If certain conditions apply, such firms still may be able to register with the SEC. Core Compliance & Legal Services, Inc. ("CCLS") has considered these options and discusses the more common scenarios below.

#### **Pension Consultant**

If as part of its investment advisory services a firm provides investment advice to certain pension plans, that firm may be permitted to register with the SEC.<sup>1</sup> In order to take advantage of this option, the plan must be an employee benefit plan, a government plan or a church plan and governed by the Employee Retirement Income Security Act of 1974. In addition, the firm must advise the plan in relation to at least \$50,000,000 of its assets. This does not mean that the firm must manage these assets, it just has to provide advice in relation to these assets. For example, it is sufficient simply to provide "advice with respect to the selection of an investment adviser to manage such assets."<sup>2</sup>

CCLS is aware of many advisory firms who provide this service that elect to exercise this registration option. Additionally, this option may be appropriate for someone who wishes to operate a pure pension consultancy business.

#### **Multi- State Investment Advisers**

Some firms have clients spread across various states but for a number of reasons they still may not have \$25 million in assets under management. For example, such advisers may not have high net worth clients or may exclusively provide financial planning services. If the adviser would be

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<sup>1</sup> SEC Rule 275.203A-2 §(b)

<sup>2</sup> Id at § (b)(3)

required to register in at least 30 states, it could elect to register with the SEC instead keeping in mind the following provisions.<sup>3</sup>

Notably, it is not sufficient merely to have clients in 30 states. If a firm only has one client in a state, and the de minimis rule for that state is five clients, the adviser would not be required to register in that state and as such, could not count that state towards the 30 required to register with the SEC.

Once a firm is registered with the SEC, the adviser is permitted to remain registered with the SEC provided it would otherwise be required to register with at least 25 states.

As a further condition to taking advantage of this option, the firm must maintain as part of its books and records, a list of the states with which it would be required to register but for this option. This record must be retained for at least five years from the date of the firm's application for registering with the SEC.<sup>4</sup>

### **Internet Advisers**

An internet adviser is a firm who "provides investment advice to all of its clients exclusively through an interactive website."<sup>5</sup> An "interactive website" is defined as "a website in which computer software-based models or applications provide investment advice to clients based on personal information each client supplies through the website."<sup>6</sup>

When introducing this option, the SEC made it clear that the definition of interactive website had been drafted to exclude "advisers that merely use websites as marketing tools or that use Internet vehicles such as E-mail, chat rooms, bulletin boards and webcasts or other electronic media in communicating with clients."<sup>7</sup> With this in mind, it is not enough simply to have a website in order to qualify as an internet adviser. Further, it is arguably not enough merely to collect information about a client via the internet, have a live person analyze it, formulate the necessary advice and then disseminate that advice back to the client via the website. Instead, the website or the back office software behind it must "crunch the numbers" and provide the necessary advice.

The investment adviser's fiduciary duty to its clients dictates that there must be some human oversight to the advice provided in this manner but it is not clear how much oversight is acceptable without losing the right to rely on this exception.

### **Conclusion**

Given the fact that state registration can often be more onerous than the SEC registration process, many advisers who qualify may elect to register with the Commission even though they have

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<sup>3</sup> Id at § (e)

<sup>4</sup> Id at § (e)(4)

<sup>5</sup> Id at § f(1)(i)

<sup>6</sup> Id at §f(2)

<sup>7</sup> www.sec.gov. December 16, 2002, SEC Release No. IA-2091, June 12, 2009, (<http://www.sec.gov/rules/final/ia-2091.htm>)

less than \$25 million in assets under management. If you are currently a state registered adviser or faced with the prospect of becoming one, you should consider the options discussed above and contact CCLS if you have any questions in this regard.

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