

# **IA Switch Seminar**

## **Navigating the Dodd-Frank Act's New Regulatory Requirements for Investment Advisers**

# Maine Office of Securities

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# About Us

Primary goal is to **protect investors**

- The Maine Office of Securities regulates
  - Investment Advisors & Investment Advisor Rep.
  - Broker – Dealers and their agents
- Other responsibilities
  - Enforcement of the Maine Uniform Securities Act
  - Examinations / Investigations
  - Securities Registrations
  - Licensing of IAs and BDs
  - Investor Education

# Disclaimer

This seminar and the accompanying materials are presented as an educational experience, covering some of the changes mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

You may be subject to all relevant laws, regulations, rules and orders whether or not they are included in this presentation. The views expressed are those of the presenters and the Maine Office of Securities reserves the right to change its position. Presenters believe all information is truthful and accurate; however, mistakes can occur.

# **IA Switch Seminar**

## **Navigating the Dodd-Frank Act's New Regulatory Requirements for Investment Advisers**

# What Dodd-Frank Means for IAs

Under the **Dodd-Frank Wall Street and Consumer Protection Act**, state securities regulators will have greater responsibility for the regulation of investment advisers.

# Dodd-Frank Section 410

- Mid-sized investment advisor
- AUM of \$25-\$100 million.
- Principal office and place of business in a state where IA is required to be registered and, if registered, is subject to examination.
- Investment advisers required to register in 15 or more states can register with the SEC.

# AUM Buffer

- Current buffer.
  - \$25 million - \$30 million eliminated.
- New buffer.
  - \$90 million - \$110 million.
- An adviser may register with the SEC once it reaches AUM of \$100 million. An adviser must register with the SEC if its AUM is \$110 million or more.
- Once registered with the SEC, a mid-sized adviser can remain registered with the SEC as long as its AUM is at least \$90 million. This means that a mid-sized adviser currently registered with the SEC may remain registered with the SEC if the adviser's AUM is at least \$90 million.



# Important Dates

- July 21, 2011

- Mid-sized advisers registered with SEC as of this date remained SEC registered until 1/1/12.
- New mid-sized advisers could have registered with the SEC or State prior to this date.
- New mid-sized adviser were required to register with the state after this date.

# Important Dates

- January 1, 2012- March 30, 2012 (the “Switch”)
  - Mid-sized advisers required to register with the State can submit their application beginning December 1, 2011.
  - Applications will remain pending until 1/1/12.
  - Last day to submit an application is 3/30/12.

# Important Dates

- June 28, 2012
  - Mid-sized advisers no longer eligible for SEC registration must file ADV-W by 6/28/12.
  - Advisers should be licensed in all states required to be licensed prior to submitting ADV-W.

# Important Dates-Recap

- July 21, 2011-New mid-sized advisers were required to register with appropriate states after this date.
- December 1, 2011-Advisers “Switching” to state licensure can begin submitting their applications.
- January 1, 2012-Applications begin to be processed.
- March 30, 2012-Last day an application can be submitted.
- June 28, 2012-Advisers must submit ADV-W for SEC registration.

# SEC v. Maine

## Points to consider

- Surprise Audit-Maine only requires if Adviser has custody and sends statements to clients.
- Direct Fee Deduction-Maine requires Adviser to send invoice to custodian and client.
- Code of Ethics-Maine does not require, however WSP required.
- See Rule 515 for additional requirements.

Questions??

# Licensing Process

- Submit ADV via the IARD.
- The Office will be notified by FINRA of your Form ADV filing and payment of the fees.
- The Office will send you an email requesting additional documents required for registration.

# Licensing Process

- What will be requested?
  - Net Worth Statement (custody or discretion)
  - Fingerprint Cards on File with the Office
  - Seminar Attendance
  - Advisory Contract
  - PPM and subscription docs, if an advisor to Pooled Investment Vehicle (PIV)



# Licensing Process

## Application Review

- Desk Audit
- Review of Form ADV, Contract(s), website, evidence of net-worth, and secretary of state filing.
- Review all investment adviser representatives U-4s.
- Compliance with statute and rules.
- Consistency, Consistency, Consistency.

# Licensing Process Application Review

- Deficiency Letter sent via email.
- Response requested within 30 days.
- Additional information/changes may be requested based on response.
- Approval letter sent via email.

# Licensing Process Coordinated Review

- Advisers required to be licensed in four or more jurisdictions can request a coordinated review.
- Request period: 12/1/11 through 3/30/12
- Contact Chris Caruso

# Form ADV

- Form ADV Part 1 - used to determine eligibility to remain SEC registered or switch to state registration. (electronic submission)
- Form ADV Part 2 – New and current IAs are required to use the new ADV Part 2 and upload to the IARD.
- Form ADV Part 2A – Firm Brochure – 19 Items
- Form ADV Part 2A Appendix 1 – Wrap Fee Program – 10 Items
- Form ADV Part 2B – Brochure Supplement – 7 Items
  - For supervised personnel who provide investment advice and have direct client contact.

# Key point of Form ADV Part 2

- Plain English – no more “check the box”
- Describes business practices & investment strategies
- Provides meaningful disclosure regarding material or potential conflicts of interest
- Describes background of IA and advisory personnel

# Wrap Fee Program Brochure

Who must deliver a Wrap Fee Program Brochure?

- If you sponsor a wrap fee program, you must deliver a wrap fee program brochure to each client of the program
- If a wrap fee program has multiple sponsors and another sponsor creates and delivers a brochure to your client, then you don't have to create and deliver a separate one.
- This brochure takes the place of your advisory firm brochure required by Form ADV Part 2A

# Form ADV Part 2B Brochure Supplement

- You must prepare a brochure supplement for the following IARs –
  - Any representative that formulates investment advice for a client and has direct client contact and,
  - Any representative who has discretionary authority over a client's assets, even if the representative has no direct client contact
  - Sole IAs are not required to submit Part 2B if the information contained in Part 2B is already included in Part 2A.

# Form ADV Updates

## 11/7/11

- SEC amendments to Form ADV.

-See Rules Implementing Amendments to the Investment Advisers Act of 1940. Release IA-3221 on the SEC's website.

- IARD Form ADV amendments.

-available at [FINRA.org](http://FINRA.org)



Questions??

# What to Expect from State Examinations

- The Examination Schedule
  - New Investment Advisors including “Switch” Advisors – 12 months
  - All other advisors – 3-5 years
- Two types of exams
  - Routine
  - For cause
- Usually 2 examiners, but ...
- One day to one week on site

# What to Expect from State Examinations

- The Examination Process
  - Pre exam
  - On-site
  - Post exam
  - Exam report
  - Response

# What to Expect from State Examinations

- Pre Exam
  - Review of ADV Part 1
  - Cross reference with ADV Part 2.
  - Consistency!!
  - Review prior exam file
  - Review licensing file
  - Review regulatory filings
  - Web search
  - Contact IA & B&R Request

# What to Expect from State Examinations

## Onsite Exam

- Introduction and purpose of the visit
- Identify contact person for the examiner
- Initial Interview
  - Tour of the office
    - Where are your records?
    - Where is the copier?
    - Where can we work?
- IA Interviews – Questions about your practice

# What to Expect from State Examinations

- Books and Records
  - if announced, a list of B&R will be emailed or faxed
- Business Practices
- Financials
- Investment Activities
- Complaint & Advertising File

# What to Expect from State Examinations

- Conflicts of Interest
- Adequate Supervision
- Custody
- Client Files
- E-mails & general correspondence
- Business Continuity

# What to Expect from State Examinations

## Post Exam

- Once the examiners have left the office, the examination is not over.
  - Most of the exam is done at the regulator's office and frequently additional documents and information is required
  - May take several weeks, depending on several factors



# What to Expect from State Examinations

## Exam Report

- Once post exam work is complete, a deficiency letter will be sent to you
- Licensee must respond to the deficiency letter in writing, usually within a set amount of time
- Once all deficiencies have been satisfactorily addressed, a notification is sent to you and the exam is complete, however;
- Certain issues may be referred to the Principal Attorney for further consideration

Questions?

# 2011 COORDINATED INVESTMENT ADVISER EXAMS

North American Securities  
Administrators Association

# Who Was Examined?

## **825 State-level advisers, of which...**

155 advisers (18.8%) were affiliated with a BD

75 advisers (9.1%) used or acted as solicitors

71 advisers (8.6%) managed pooled investments

98 advisers (11.9%) had financial only planning clients

594 advisers (72%) had one IAR only

## Who Conducted the Exams?

Securities examiners from 45 jurisdictions including British Columbia, Ontario, Nova Scotia, Quebec, and Saskatchewan, Canada

## What Was Found?

3543 total deficiencies in 13 categories

# The Categories

- Books and Records
- Financials
- Registration
  - ADV, U4, Firm, IARs, ADV Delivery
- Fees
- Advertising
  - Ads, **Websites**, Business Cards, Seminars,
- Privacy
- Supervisory/Compliance
  - Supervisory Procedures, Compliance Procedures, Policies
- Investment Activities
  - Adherence to Investment Policy, Fairness, Conflicts
- Performance Reporting
- Custody
- Solicitors
- Pooled Investment Vehicles (Hedge Fund)
- Unethical Business Practices
  - 21 from NASAA Model Rule 120(a)(4)-1
    - **Unsuitable Recommendations**
    - **Contracts**
    - **Unauthorized trades**
    - **Excessive Fees**
    - **Borrowing from client**
    - **Etc...**

# The "Average" Adviser

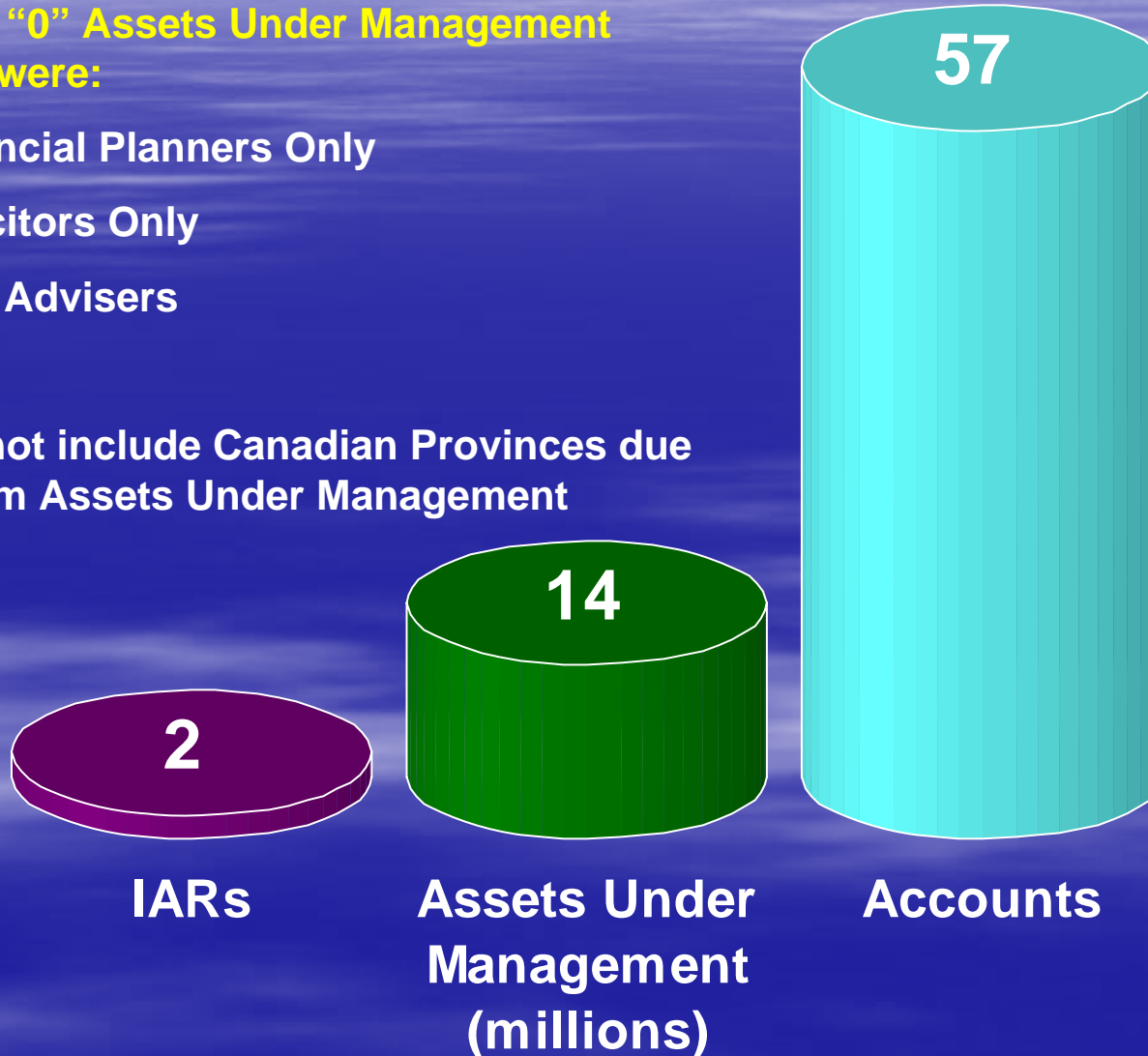
Averages do not include advisers which had "0" Accounts and "0" Assets Under Management because they were:

Financial Planners Only

Solicitors Only

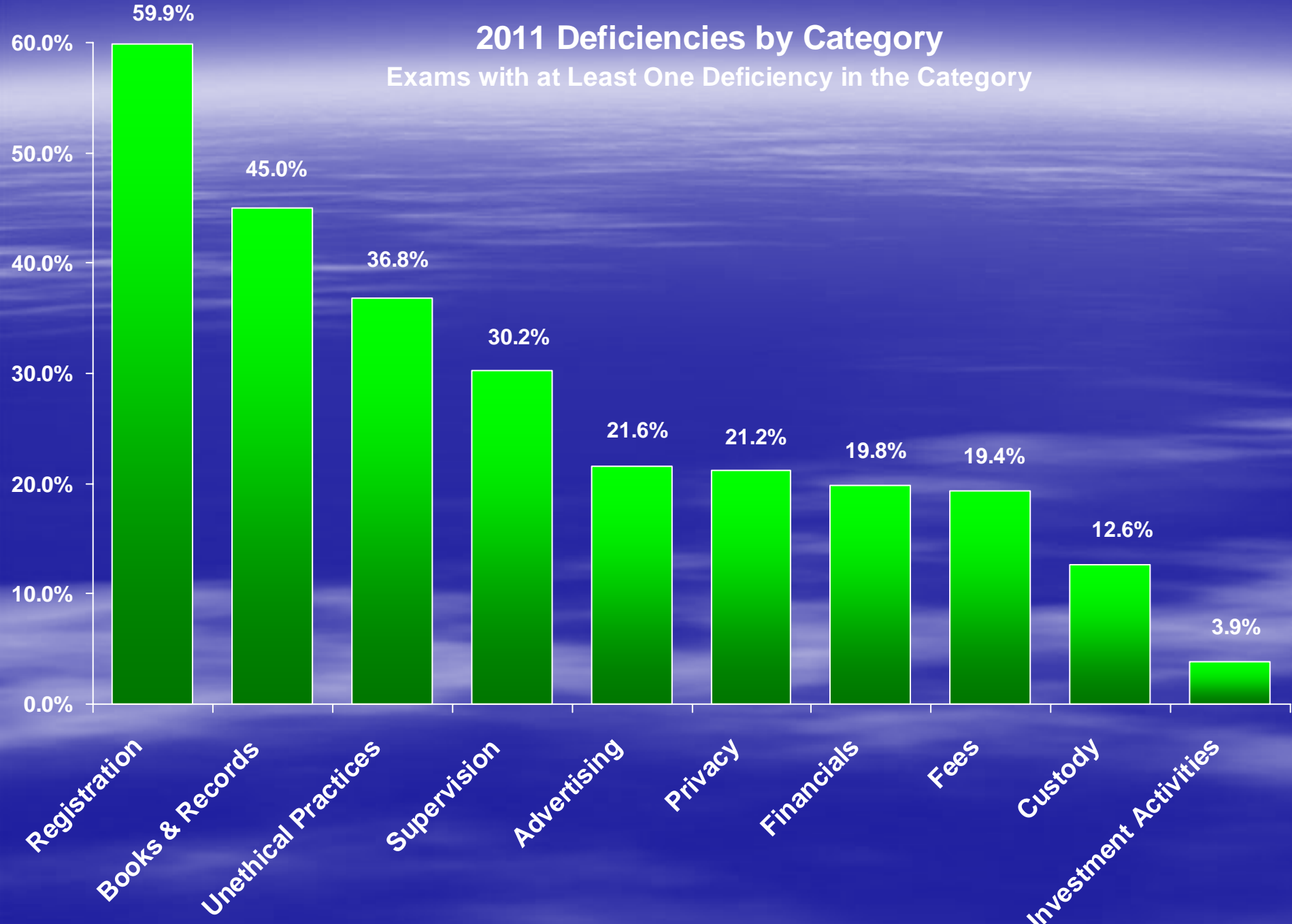
New Advisers

Averages do not include Canadian Provinces due to no maximum Assets Under Management



# 2011 Deficiencies by Category

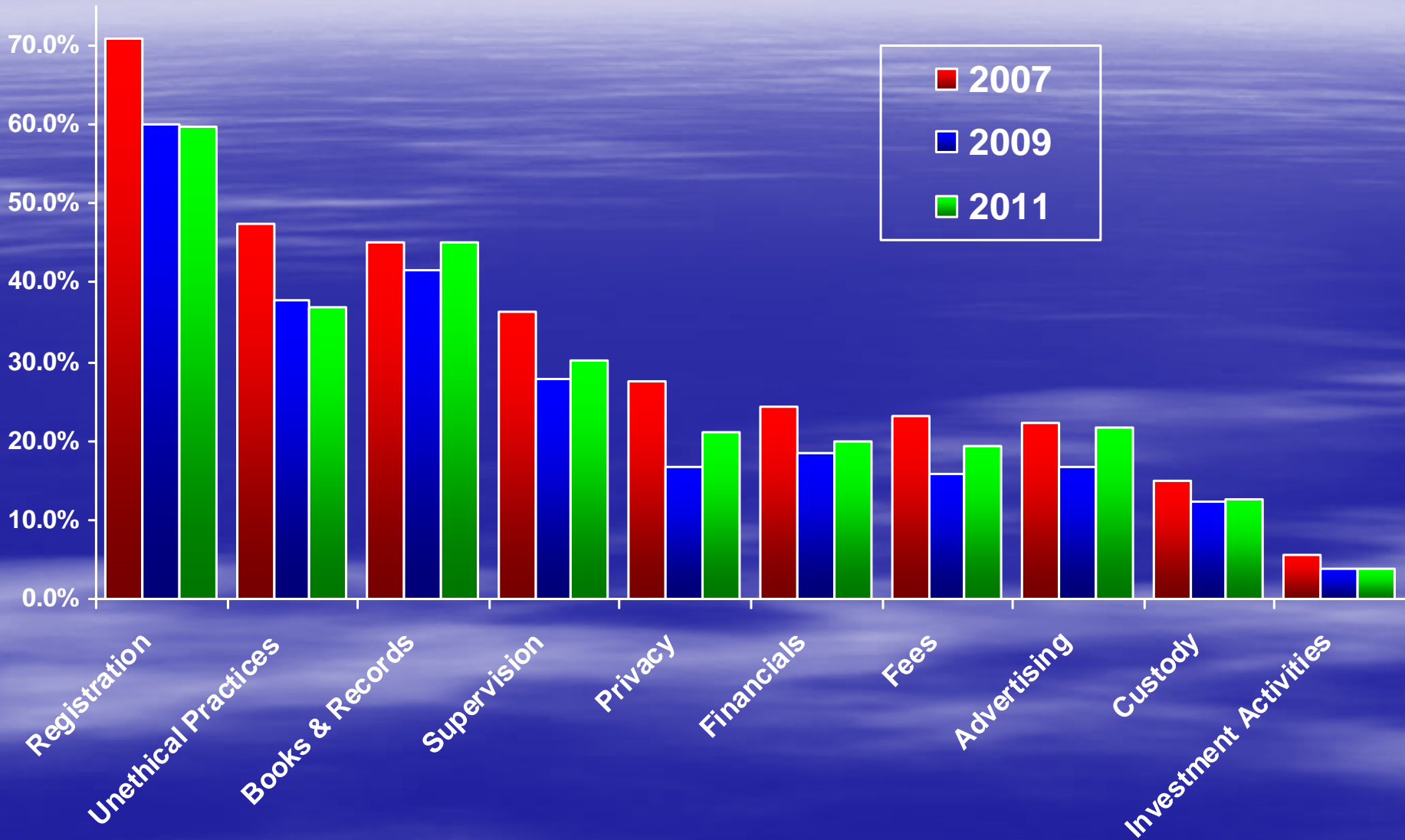
Exams with at Least One Deficiency in the Category





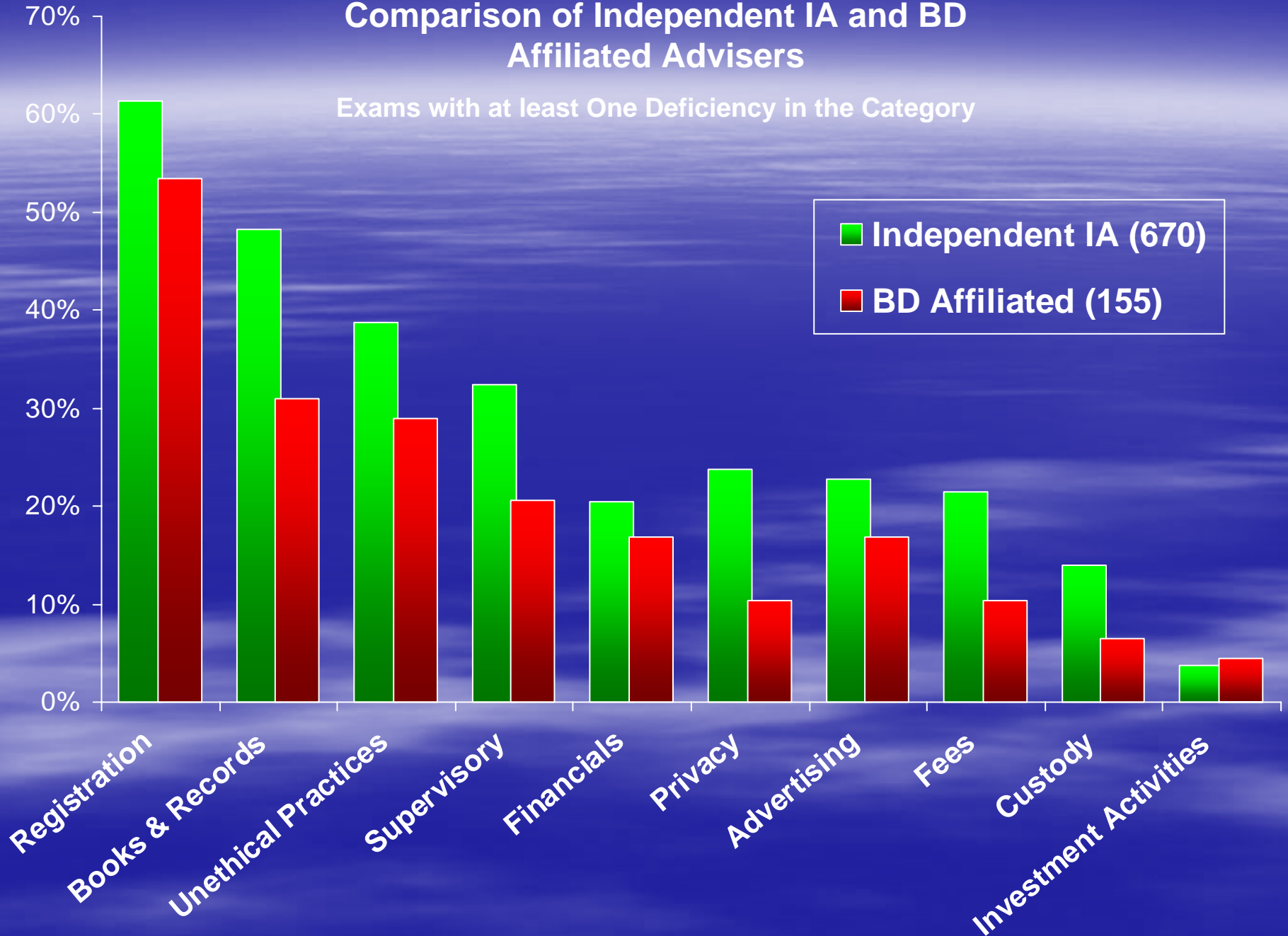
# Comparing 2007, 2009, & 2011 Deficiencies

## Exams with at Least One Deficiency in the Category



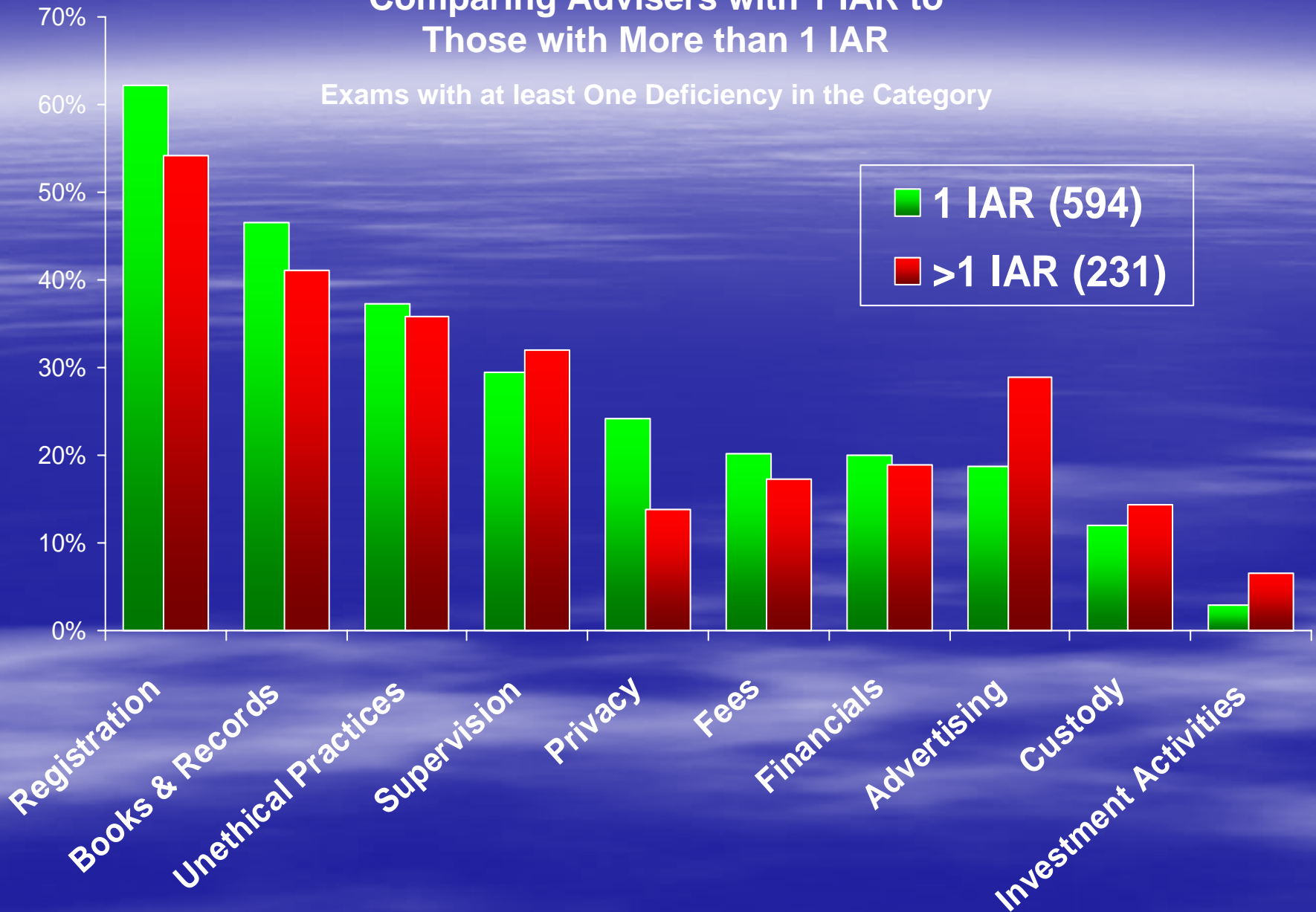
# Comparison of Independent IA and BD Affiliated Advisers

Exams with at least One Deficiency in the Category



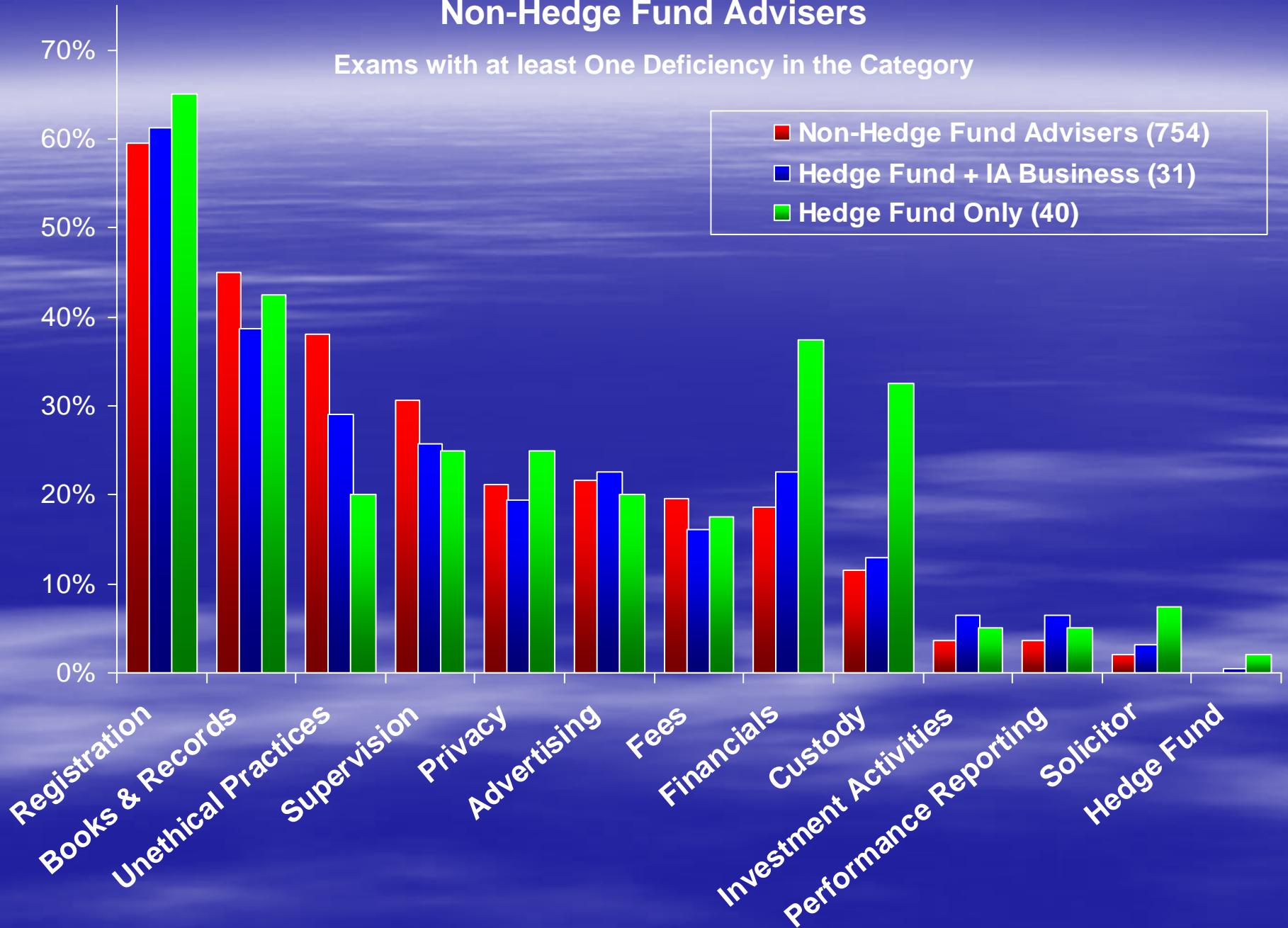
# Comparing Advisers with 1 IAR to Those with More than 1 IAR

Exams with at least One Deficiency in the Category



# Comparing Hedge Fund Advisers to Non-Hedge Fund Advisers

Exams with at least One Deficiency in the Category



# Best Practices for Investment Advisers

- Review and revise Form ADV and disclosure brochure annually to reflect current and accurate information.
- Review and update all contracts.
- Prepare and maintain all required records, including financial records. Back-up electronic data and protect records. Document checks forwarded.
- Prepare and maintain client profiles.
- Prepare a written compliance and supervisory procedures manual relevant to the type of business to include business continuity plan.
- Prepare and distribute a privacy policy initially and annually.
- Keep accurate financials. File timely with the jurisdiction. Maintain surety bond if required
- Calculate and document fees correctly in accordance with contracts and ADV.
- Review all advertisements, including website and performance advertising, for accuracy.
- Implement appropriate custody safeguards, if applicable.
- Review solicitor agreements, disclosure, and delivery procedures.

Questions?

# Dodd-Frank and Private Fund Advisers

## Private Fund Investment Advisers Registration Act of 2010 (Title IV of Dodd-Frank)

- ❖ Eliminates the “private adviser exemption” at 203 (b)(3)
- ❖ Requires SEC registration for advisers to “private funds” with AUM of at least \$150 million
- ❖ Requires SEC reporting for:
  - (1) advisers to “private funds” with AUM of less than \$150 million; *and*
  - (2) advisers to “venture capital funds”
- ❖ Defines “foreign private adviser” and exempts from SEC registration

# Private Fund Defined

## Private Fund:

An issuer that would be an investment company under the Investment Company Act, *but for* an exclusion provided from that definition for securities offered pursuant to sections 3(c)(1) or 3(c)(7) of that Act



# Section 3(c)(1)

A fund whose securities are:

- ❖ not publically offered
- ❖ owned by not more than 100 persons
- ❖ typically offered pursuant to Reg D, Rule 506
- ❖ accredited investors

# Section 3(c)(7)

A fund whose securities are:

- ❖ not publically offered
- ❖ generally not owned by more than 499 persons
- ❖ investors must be “qualified purchasers”
  - individuals with investments of \$5 million; or
  - institutions with investments of \$25 million

# A Model Rule for States

- ❖ In December 2010, NASAA (North American Securities Administrators Association) published for comment, a proposed “Model Rule on Private Fund Adviser Registration and Exemption”
- ❖ 5 comments received, most directed at the model rule’s limited scope in including only an exemption for 3(c)(7) funds

# A Model Rule for States (con't)

- ❖ NASAA revised its model rule to cover an exemption for advisers to venture capital funds
- ❖ NASAA agreed with commentators that there are legitimate reasons to include some (3)(c)(1) exemptions including: need for small business capital formation and economic development at local level

# A Model Rule for States (con't)

- ❖ NASAA stopped short of including exemption for all 3(c)(1) funds, however, based on concerns for the level of investor protection provided by that section.
- ❖ NASAA agreed to exempt advisers to 3(c)(1) funds, but only if those funds are made up of investors who satisfy the new “qualified client” standard adopted by the SEC.

# A Model Rule for States (con't)

- ❖ On September 19, 2011 the dollar amount thresholds in the AUM and Net Worth tests in SEC rule 205-3's definition of "qualified client" increased.
- ❖ A "qualified client" now requires:
  - ❖ \$1 million AUM (up from \$750k)
  - ❖ \$2 million Net Worth\* (up from \$1.5 million)

\*Now excludes value of the primary residence

# A Model Rule for States (con't)

- ❖ NASAA has just begun discussions on this proposed model rule
- ❖ a vote of NASAA's full membership on the model rule may happen as early as December or the beginning of 2012

# Maine and Private Fund Advisers

- ❖ Maine requires advisers to private funds to be licensed as investment advisers
- ❖ There are limited situations where a request for an exemption may be granted.
- ❖ Past orders granting exemptions have imposed conditions including requirement that adviser submit to periodic examination at the discretion of the Administrator.



# Maine and Private Fund Advisers (con't)

- ❖ When the Model Rule is acted upon by NASAA, the Office of Securities will carefully review the final language and determine whether and how Maine should implement any part or all of the rule.
- ❖ Until then, if you are working with private funds and have questions regarding where you fall within this rubric, please call the Office of Securities at 624-8551 for individual assistance.

Questions?

# Common IA Licensing Deficiencies

- Form ADV Part 1
  - Item 5 – Inconsistent with Part 2, contract and websites (if applicable)
  - Item 6&7 – Answer from the Firm's perspective, unless you are a sole prop.
  - Part 1A, Item 8 - Inconsistent with Part 2, contract and websites (if applicable)
  - Part 1A, Item 9D(1)(2) – Not providing answer

# Common IA Licensing Deficiencies

- Form ADV Part 2

- Be as thorough and detailed as possible. Review to ensure all items have been adequately addressed.
- Must respond to each item and present the information in the proper order
- If item is not applicable, you must include the heading and an explanation that the information is not applicable.
- Item 3 – All Items must be identified in the Table of Contents, including the Cover Page and Material Changes

# Common IA Licensing Deficiencies

- Form ADV Part 2

- Item 5 – Indicate whether fees are negotiable.
- Item 5 – All fees and expenses should be listed, (trading commissions, out-of-pocket and mutual fund expenses, maintenance fees)
- Item 5 – List what the fee will be
- Item 5 – State whether fees in arrears or advance.
- Item 5 – State the pre-paid fee refund policy
- Item 12 – If you recommend BD's, disclose the names.

# Common IA Licensing Deficiencies

- Form ADV Part 2B
  - Any IAR that formulates investment advice for a client and has direct client contact; and any IAR who has discretionary authority over a client's assets, even if the IAR has no direct client contact must file a Part 2B

# Common Client Agreement Deficiencies

- The Contract must disclose in substance:
  - Service to be provided
  - Term of contract
  - Fees
  - Formula for computing fee
  - Amount of pre-paid refund
  - Discretionary authority
  - Assignment
  - If partnership – IA must state that it will notify of change of membership within a reasonable time

# Common Client Agreement Deficiencies

- The IA shall not include any term that binds a client to waive compliance with any provisions of our Act, Chapter 515, or any other rule,
- or provide for compensation to the IA on the basis of a share of capital gains or capital appreciation of the funds or any portion of the client's funds.



# Common Exam Deficiencies

- Inaccurate, incomplete or inconsistent Form ADV Part 1 and Part 2
- Incomplete, inaccurate or no client contracts
- Failing to maintain suitability information
- Non-compliance with privacy requirements (GLBA)
- Incomplete or no written supervisory or compliance procedures

# Common Exam Deficiencies

- Non-compliance with advertising rules
- Failing to maintain applicable books and records
- Actual business practice and ADV description materially different in scope
- Direct fee deduction / invoice deficiencies
  - No fee calculation (formula)
  - No time period
- No advertising / complaint files

# Common Website Deficiencies

- Content not consistent with Form ADV Part 1 and 2
- Content not consistent with contract
- Social Media (advertising)
- IA/BD – applicable disclosure

# Resources

- Maine Office of Securities
  - [www.investors.maine.gov](http://www.investors.maine.gov)
- North American Securities Administrators Association
  - [www.nasaa.org](http://www.nasaa.org)

# Questions?

For more information, contact:

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