Federal vs. State Regulation of Investment Advisers

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David Guin
PARTNER | US

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On June 22, 2011, the US Securities and Exchange Commission (the " SEC") issued Release IA-3221 (the "Release"), which adopts several rules implementing various provisions of the Dodd-Frank Act that amend the US Investment Advisers Act of 1940 (the "Advisers Act"). One of the issues addressed are the final rules and guidance regarding the allocation of investment adviser regulation between the SEC and state regulators.

Under the new rules, an investment adviser with regulatory assets under management between $25 million and $100 million is generally not eligible for registration with the SEC.

However, except as discussed below, an investment adviser with more than $25 million, but less than $100 million, in regulatory assets under management is still required to register with the SEC if:

- it is not required to register as an investment adviser in the state in which it maintains its principal place of business, or
- even if registered, it is not subject to an investment adviser examination by its applicable state securities regulatory authority.

Wyoming has advised the SEC that it does not require investment adviser registration. Both Minnesota and New York have been deemed not to subject investment advisers to an examination program. As such, investment advisers in Minnesota, New York and Wyoming with $25 million or more in regulatory assets under management will be required to register with the SEC.

It is important to note that investment advisers relying on the private fund adviser or venture capital fund adviser exemptions are not required to be registered at the state level in order to take advantage of the federal exemption from registration. We address the exemptions for advisers exclusively to private funds with less than $150 million in regulatory assets under management and for advisers to venture capital funds in a separate Briefing Note.

For advisers whose regulatory assets under management may fluctuate from time to time, the Release outlines new transition rules that provide investment advisers with a $10 million, or 20%, cushion.

All SEC-registered investment advisers must file an amendment to their Form ADV on or before March 30, 2012 reporting their regulatory assets under management. Any such adviser reporting less than $90 million in assets under management (other than those with their principal place of business in Minnesota, New York or Wyoming) must withdraw from SEC registration on or before June 28, 2012. In the future, an investment adviser will not be required to withdraw from SEC registration until its regulatory assets under management fall below $90 million as of the date of the most recent annual amendment to its Form ADV.

Investment advisers that are currently unregistered or registered with a state must switch to SEC registration once their regulatory assets under management reach $110 million.

Regulatory assets under management for this purpose generally includes all securities portfolios for which the adviser provides "continuous and regular supervisory management services" and specifically includes (a) sub-advised assets, (b) private fund assets, © uncalled capital commitments, (d) proprietary assets, and (e) assets where no fee is paid. To calculate the value of assets under management, firms must use market value or fair value.

Conclusion

While the release provides some much needed clarification regarding registration obligations at the federal level, uncertainty remains whether state securities regulators will adopt new exemptions that mirror the "assets under management approach" mandated at the federal level by the Dodd-Frank Act. Many states currently have de minimis exemptions based on the number of investment advisory clients within the state or automatically exempt any adviser that is exempt at the federal level.

By way of example, Connecticut currently provides an exemption from state registration for any adviser that qualifies for exemption from federal registration under Section 203(b)(3) of the Advisers Act – also known as the "private adviser exemption". The Dodd-Frank Act eliminates the private adviser exemption. It is unclear whether Connecticut will implement a replacement exemption or whether all Connecticut-based investment advisers currently relying on the private adviser exemption will be required to register with the State of Connecticut.

You should also be aware that investment advisers relying on the private fund adviser or venture capital fund adviser exemptions will become "exempt reporting advisers" and must still file reports with the SEC on Form ADV. As such, it may be that advisers to private or venture capital funds will be required to both (1) register with a state securities regulator and (2) file reports with the SEC.

Investment advisers will need to follow developments at the state level following the effectiveness of the Dodd-Frank Act and consider how state requirements will affect their overall regulatory compliance obligations.

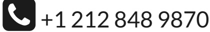
For further information in relation to anything covered by this briefing note, please speak to your primary contact or to David Guin or Jeffrey Blomberg.

Authors

David Guin

PARTNER | NEW YORK

Corporate

 +1 212 848 9870

david.guin@withersworldwide.com