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**COMMON STATE LAW ISSUES FACING
SEC-REGISTERED INVESTMENT ADVISERS**

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The material in this outline is not intended to provide legal advice as to any of the subjects mentioned but is presented for general information only. Readers should consult knowledgeable legal counsel as to any legal questions they may have.

I. State Law Definitions.

- A. After the regulatory split effected by the National Securities Markets Improvement Act of 1996 (“NSMIA”)¹, some States split their definition of “investment adviser” and adopted a newly defined term, “federal covered adviser,”² to describe investment advisers registered with the Securities and Exchange Commission (“SEC”) pursuant to the Investment Advisers Act of 1940. *See, e.g.*, § 102(b)(f.2) of the Pennsylvania Securities Act of 1972; *see also* § 102(6) of the Uniform Securities Act of 2002.
1. Under this model, “investment adviser” remains as a definition to describe investment advisers subject to State regulation.
 2. Under this model, in general SEC-registered advisers are subject to State statutory provisions applicable to “federal cover advisers” and “persons,” *but not* provisions applicable to “investment advisers.”
- B. Some States maintain one definition of “investment adviser,” (*see, e.g.* Ohio Revised Code § 1707.01(X)), but then specify which provisions apply to investment advisers “licensed or required to be licensed” by the State.

II. Notice Filing Obligation.

- A. Section 307 NSMIA preserved a State’s ability to require from an investment adviser “the filing of any document filed with the [Securities and Exchange] Commission pursuant to the securities laws solely for notice purposes, together with a consent to service of process and any required fee.”
- B. All States, except Wyoming³, require that federal covered advisers providing investment advice in the State make a “notice filing” with the State, unless the federal covered adviser does not have a “place of business”⁴ in the State and during the preceding twelve month period and had fewer than six clients who are residents of the State.⁵

¹ Pub. L. No. 104-290, 110 Stat. 3416 (1996).

² This outline uses “federal covered adviser” to describe an investment adviser registered with the SEC.

³ Wyoming does not have state-level investment adviser regulation.

⁴ *See* § IV.D.1. of this outline for the definition of “place of business.”

⁵ This exception flows from § 304 of NSMIA, codified at § 222 of the Investment Advisers Act of 1940. It appears that Texas requires a notice filing even if the adviser has no place of business in Texas and fewer than six clients; *see* Texas Administrative Code Title 7, Part 7, Chapter 116, Rule § 116.1(b)(2)(C).

1. Most States also grant an exception from notice filing for federal covered advisers that do not have a place of business in the State and have only institutional, professional or other specified clients. *See, e.g.*, § 303(a)(iii)(A) of the Pennsylvania Securities Act of 1972, §11-401(c) of the Maryland Securities Act, *and* Ohio Revised Code § 1707.141(B)(3); *see also* § 405(b)(1) of the Uniform Securities Act of 2002.
2. Other exceptions to notice filing requirement: By operation of federal law, two other types of entities are excepted from State notice filing requirements (even if the entities have a place of business in the State):
 - a) Pursuant to § 6 of the Philanthropy Protection Act of 1995⁶, certain charitable organizations described in § 3(c)(10)(B) of the Investment Company Act of 1940, and the trustees, directors, officers, employees or volunteers of such charitable organization (acting within the scope of such person’s duties to the organization), whose advice is provided to the charitable organization or other funds or trusts described in § 3(c)(10)(B), unless the State has “opted out” of the Philanthropy Act’s preemption⁷; and
 - b) Pursuant to § 508 of NSMIA, certain church employee benefit plans described in § 414(e) of the Internal Revenue Code of 1986, and certain trustees, directors, officers, employees and volunteers thereof.⁸
- C. A notice filing is made through the Investment Adviser Registration Depository (“IARD”) by indicating the appropriate State (or States) in Item 2B of Part 1A of the Form ADV. In most States, Part 1A of the Form ADV constitutes the notice filing.
- D. Some states require federal covered advisers to file a paper copy of the adviser’s Part II of the Form ADV in order to satisfy the notice filing obligation. According to the North American Securities Administrators Association

⁶ Pub. L. No. 104-62, 109 Stat. 682 (1995). Such organizations also are excepted from State investment adviser licensing requirements (unless the State has opted out of the preemption). *Id.* At least one State has codified this exception: *see* Ohio Revised Code §§ 1707.141(A)(5) and (B)(3).

⁷ *See, e.g.*, § 11-103 of the Maryland Securities Act. The author believes that there are nine other States that have opted out of the preemption: Arkansas, Connecticut, Florida, Mississippi, Nebraska, Pennsylvania, Tennessee, Vermont and Virginia.

⁸ Such organizations also are excepted from State investment adviser licensing requirements. *Id.* At least one State has codified this exception: *see* Ohio Revised Code §§ 1707.141(A)(6) and (B)(3).

(“NASAA”), those States are: Louisiana; New Jersey; New Mexico; and New York (and Puerto Rico).⁹

E. A notice filing must be renewed annually.

III. Applicability of State Law to Federal Covered Advisers.

A. Section 303(a) of NSMIA (codified as § 203A of the Investment Advisers Act of 1940) provides general guidance regarding the applicability of state law to federal covered advisers:

1. A State may not impose any registration, licensing, or qualification requirements on a federal covered adviser or its supervised persons. *See* § 203A(b)(1).¹⁰
2. A State may investigate and bring enforcement action with respect to fraud or deceit by a federal covered adviser or a person associated with the adviser. *See* § 203A(b)(2).

B. SEC Release No. IA-1633 (May 15, 1997)¹¹ provides more specific guidance about the applicability of State law to federal covered advisers:

1. State regulatory provisions such as recordkeeping, disclosure and capital requirements are preempted with respect to federal covered advisers. Rel. No. IA-1633 § II.H.1.
2. A State may not “indirectly regulat[e]the activities of commission-registered advisers by applying state requirements that define ‘dishonest’ or ‘unethical’ business practices unless the prohibited practices would be fraudulent or deceptive absent the requirements.” Rel. No. IA-1633 § II.H.2.
3. “Congress gave the responsibility of adopting and enforcing prophylactic rules with respect to state-registered advisers to states, and with respect to Commission-registered advisers to the Commission.” *Id.*
4. “[NSMIA] does not limit state enforcement of laws prohibiting fraud.” *Id.*

C. As a result, in general:

⁹ *See* <http://www.nasaa.org/nasaa/scripts/Copy%20of%20IARDtable.PDF>.

¹⁰ However, a State may license certain investment adviser representatives as described in § IV of this outline.

¹¹ Available at <http://www.sec.gov/rules/final/ia-1633.txt>.

1. Federal covered advisers are subject to State anti-fraud statutes.
2. Federal covered advisers are not subject to state investment adviser rules and regulations (including rules promulgated under State anti-fraud statutes).

IV. Investment Adviser Representatives.

- A. Section 303(a) of NSMIA (codified as § 203A of the Investment Advisers Act of 1940) permits a State to “license, register, or otherwise qualify any investment adviser representative who has a place of business located within that state.” § 203A(b)(1)(A).
- B. The category of investment adviser representatives of federal covered advisers that States may license is defined in SEC Rule 203A-3(a):
 - (1) "Investment adviser representative" of an investment adviser means a “supervised person”¹² of the investment adviser:
 - (i) Who has more than five clients who are natural persons (other than excepted persons described in paragraph (a)(3)(i) of this section¹³); and
 - (ii) More than ten percent of whose clients are natural persons (other than excepted persons described in paragraph (a)(3)(i) of this section).
 - (2) Notwithstanding paragraph (a)(1) of this section, a supervised person is not an investment adviser representative if the supervised person:
 - (i) Does not on a regular basis solicit, meet with, or otherwise communicate with clients of the investment adviser; or
 - (ii) Provides only impersonal investment advice¹⁴.
- C. State law may contain a different definition of “investment adviser representative” for representatives of State-registered investment advisers. However, in the case

¹² Section 303(c) of NSMIA defines “supervised person,” and that definition is codified in § 202(a)(25) of the Investment Advisers Act of 1940, as “any partner, officer, director (or person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.”

¹³ SEC Rule 203A-3(a)(3)(i) states: "excepted person" means a natural person who is a qualified client as described in § 275.205-3(d)(1).

¹⁴ SEC Rule 203A-3(a)(3)(ii) states: "impersonal investment advice" means investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts.

of a federal covered adviser, a State may require the licensure only of those persons who meet the SEC definition of “investment adviser representative.”¹⁵

- D. In addition to meeting the SEC definition of “investment adviser representative,” a person must have a “place of business” in the State in order to be subject to State licensure.
1. “Place of business” is defined in SEC Rule 203A-3(b) as:
 - (1) an office at which the investment adviser representative regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; and
 - (2) any other location that is held out to the general public as a location at which the investment adviser representative provides investment advisory services, solicits, meets with, or otherwise communicates with clients.
 2. This definition encompasses temporary and permanent locations.¹⁶
- E. Investment adviser representative license applications are submitted on Form U-4 through the Central Registration Depository (“CRD”).
- F. States may require that an investment adviser representative of a federal covered adviser satisfy a qualification requirement.
1. The most common State qualification requirement is the Series 65 (Uniform Investment Adviser Law Examination), or the combination of

¹⁵ It appears that Texas requires a notice filing from a “supervised person” who is not an investment adviser representative and does not have a place of business in Texas, but does have Texas clients; *see* Texas Administrative Code Title 7, Part 7, Chapter 116, Rule § 116.1(b)(2)(B). *See also* “Frequently Asked Questions – Investment Advisers and Their Representatives,” at <http://www.ssb.state.tx.us/Registration/DealerFAQ090103.html#THREE>.

¹⁶ The SEC has stated: “For the purposes of rule 203A-3(b), an adviser representative would be considered to hold himself out to the general public as having a location at which he conducts advisory business by, for example, publishing information in a professional directory or a telephone listing, or distributing advertisements, business cards, stationery, or similar communications that identify the location as one at which the adviser representative is or will be available to meet or communicate with clients. The definition encompasses permanent and temporary offices as well as other locations at which an adviser representative may provide advisory services, such as a hotel or auditorium. Whether an adviser representative will be subject to the qualification requirements of a state in which the hotel or auditorium is located will turn on whether the adviser representative has let it generally be known that he or she will conduct advisory business at the location, rather than on the frequency with which the adviser representative conducts advisory business there.” Rel. No. IA-1633 § II.F.2 (footnotes omitted).

the Series 66 (Uniform Combined State Law Examination) and Series 7 (General Securities Representative Examination).¹⁷

2. Some States waive the examination requirement and deem the qualification requirement satisfied if the investment adviser representative has achieved a particular professional designation (*e.g.* the CFP designation).¹⁸

G. Some States prohibit investment adviser representatives from being affiliated with more than one investment adviser. Some states permit “dual registration,” but only with affiliated firms. Some states permit “dual registration” without limitation.¹⁹

V. Solicitors.

A. A federal covered adviser’s use of solicitors²⁰ can present complex State law licensing issues.

B. NSMIA permits a State to license (and qualify) a solicitor of a federal covered adviser if the solicitor’s activities meet the SEC’s definition of “investment adviser representative” and the solicitor has a place of business in the State. *See* § 203A(b)(1)(A) of the Investment Advisers Act of 1940. Recall that a person must first be a “supervised person” in order to be an “investment adviser representative” under the SEC definition.

C. In addition, some States take the position that a solicitor who does not meet NSMIA’s definition of “supervised person” is subject to State law licensing and qualification requirements (in other words, the non-supervised person solicitor is not “eligible” for the NSMIA preemption).

1. The reasoning is that the NSMIA preemption of State law extends only to investment advisers registered with the SEC and their “supervised persons.” *See* § 203A(b)(1) of the Investment Advisers Act of 1940.

2. Under this approach, a solicitor who does not meet the definition of “supervised person” (which would include a “third party” solicitor) is subject to State licensing and qualification as an:

¹⁷ *See* http://www.nasaa.org/nasaa/exams/status_of_state_adopt.asp. State law should be consulted for specific qualification requirements.

¹⁸ *Id.*

¹⁹ *See* http://www.iard.com/pdf/rep_fee_sch.pdf. State law should be consulted for specific limitations.

²⁰ SEC Rule 206(4)-3(d)(1) defines “solicitor” as any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser.

- a) investment adviser;
 - b) investment adviser representative²¹; or
 - c) “associated person” of a federal covered adviser.
3. The Uniform Securities Act of 2002 takes the approach that a solicitor who has a place of business in the State and is not within NSMIA’s definition of “supervised person” is a State “investment adviser representative” subject to State licensing and qualification requirements. *See* §102(16)(c)(ii).
- C. A federal cover adviser’s solicitation arrangements must be in compliance with the SEC’s “cash payments for client solicitations” rule (SEC Rule 206(4)-3). The arrangements also are subject to State anti-fraud statutes, and may be subject to State solicitation rules or regulations.
- D. Federal covered advisers should be aware of State laws other than State securities law that may impact solicitation arrangements. *See, e.g.*, Board of Commissioners on Grievances and Discipline of the Supreme Court of Ohio Opinion 2000-1 (Feb. 11, 2000)(an Ohio-licensed attorney may not receive a fee from a financial services group for referring clients in need of financial services).²²

²¹ *See, e.g.*, § 11-101(i) of the Maryland Securities Act.

²² Available at 2000 WL 202051 (Feb. 11, 2000).