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ADVISING EXPATS

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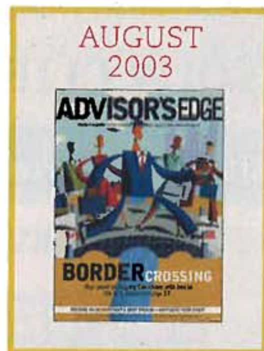
THERE ARE SPECIFIC REQUIREMENTS FOR REPS WHO WANT TO KEEP WORKING WITH CLIENTS WHO'VE MOVED SOUTH.

The bow wave of the baby boomer generation reaches 62 this year. As they hit retirement, many will follow the sun and relocate to the southern U.S., either on a part- or full-time basis. The question for Canadian advisors is how to ensure they're able to continue working with these important clients, for whom they've built substantial wealth, after they move south.

For starters, it's important to know how advisors are regulated in the U.S., because there are differences that can make it difficult to continue your relationships.

Those responsible for oversight of advisory relationships in the U.S. include:

- Federal regulation—the Securities and Exchange Commission (SEC), which directly registers investment-advisor firms (including sole proprietors), and indirectly regulates but does not register those who give investment advice as supervised persons of their registered firms.
- Individual U.S. states, which directly register both investment advisory firms and the advisors themselves.



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In general, SEC registration pre-empts the requirements for state registration. Federal law creates lower limits on the registration requirements states can place on firms and individuals.

Triggerpoints

The first question a Canadian advisor serving clients in the U.S. needs to answer is, "Are you acting as an 'investment advisor' in the U.S.?" The Investment Advisers Act of 1940 (Advisers Act) and other SEC rules and regulations define an investment advisor as any person who receives compensation to engage in the business of advising others, either directly or through writings, as to the value of securities; or as to the advisability of investing in, purchasing and selling securities. The term also covers anyone who, for compensation and as part of a regular business, issues analyses or reports concerning securities.

Under the Advisers Act, it's unlawful for an unregistered person, who should in fact be registered in order to conduct business, to "use any means or instrumentality of interstate commerce" (and, yes, that includes a telephone call). In its enforcement of the Act, the staff at SEC has generally regulated foreign investment advisors

when they give advice within the U.S. or when they give advice from outside the U.S. to clients living there.

So, if a Canadian investment advisor enters the U.S. to work with a client, or if the advisor phones a client and discusses his or her investments, then the Advisers Act applies.

The next question for a Canadian advisor, "During the last 12 months, has your firm had fewer than 15 investment advisory clients in the U.S.; not maintained an office in the U.S.; and had no more than five investment advisory clients in any one state?"

That's important, because the Advisers Act exempts anyone who had fewer than 15 clients during the past year, and who does not hold himself out to the public as an investment advisor. The Act also prohibits any state or political subdivision of a state (such as a city) from requiring registration, licensing, or qualification if the advisor did not have a place of business within the state, and during the preceding 12-month period had fewer than six clients who were residents of the state.

In other words, as long as the numbers stay low, your firm may provide investment advice to its clients who move to the U.S. without being required to register. There can be no more than 15 clients in the U.S. during any 12-month period, and the firm cannot hold itself out to the public as providing investment advice. The firm also can't have a place of business within any state, and must ensure there are no more than five clients in any one state.

But, just because an advisor doesn't have to register doesn't mean he or she is wholly unregulated. The Advisers Act imposes certain requirements on all investment advisors, regardless of whether they're required to be registered or qualified by the SEC or any state. These requirements include:

- Maintenance of procedures, which if used reasonably will protect the privacy of a client's personal information. The requirements apply to both advisors and non-registered persons they work with;
- Limitations on the provisions of investment advisory contracts relating to performance fees, assignment of an advisory contract, and notification of changes in the firm's partnership structure;
- Restrictions on the collection of performance-based fees; and
- Prohibitions against fraud and restrictions on agency cross and principal transactions.

In addition, even when the states are prohibited from requiring registration, they're permitted to adopt laws that prohibit fraudulent conduct. So Canadian advisors should be up to date on fraud statutes in states where their clients reside.

Canadian advisors working with U.S. clients become subject to state registration requirements if their activities place them within the narrow window between the lower limit for federal registration (having fewer than 15 clients within a 12-month period and not holding themselves out to the public as IAs) and the lower limit for permitted state registration requirements (having more than five clients within a state during a 12-month period and having an office within the state).

Each state (except Wyoming), and the District of Columbia and Puerto Rico, has registration or licensing requirements for investment advisors, which apply to advisors acting within its jurisdiction, who are not prohibited from registering under the Advisers Act. Although there are differences from state to state, registration within a state is generally accomplished by:

- Filing a Form ADV with the state;
- Providing state-specific forms; and
- Paying registration fees.

Many states require state-registered advisors to meet standards for required disclosures **continued on page 26**

Registering Down South

IN MOST CASES, filing is accomplished through the SEC's U.S. electronic registration filing system, called the IARD.

Form ADV requires information about the advisor's business, the persons who own and control the advisor, his or her business practices, fees, and the potential conflicts of interest that the advisor may have with clients. A description of the registration and filing process is available on the SEC's website at www.sec.gov/divisions/investment/iard.shtml.

For an overview of substantive requirements applicable to state-registered investment advisors, see "Industry & Regulatory Resources" at www.nasaa.org/home/index.cfm.

Once a Form ADV is approved, advisors are responsible for meeting a variety of requirements. An overview of those requirements is provided by an SEC staff memorandum titled "Information for Newly Registered Investment Advisers," which can be found at www.sec.gov/divisions/investment/advoverview.htm.

Most states also require that individuals who give investment advice for state-registered investment advisors pass a Series 65 exam (or an equivalent). That exam is designed to test whether the individual has a basic knowledge of U.S. securities and investment advisory laws and investing concepts.

continued from page 25 to clients, custody, maintenance of books and records, advertising, bonding, and minimum net capital. States also have the power to impose registration and qualification requirements on individuals who act for state-registered investment advisors in providing investment advisory services.

So, what happens to advisors who aren't exempt from registration? First, ask yourself whether your firm had more than 14 U.S. investment advisory clients in the last 12 months, or if it expects to have more than 14 investment advisory clients within the next 12 months.

If the answer is yes, then the firm and those working for it would need to be registered under the Advisers Act. Further, a non-U.S. investment advisor should register under the Advisers Act if he or she *expects* to have more than 14 U.S. clients during the next 12 months.

A non-U.S. investment advisor can register by filing a Form ADV with the SEC. Form ADV is filed over the Internet through the SEC's IARD electronic filing system (see "Registering Down South," page 25).

Once the registration becomes effective, the advisor is subject to a range of substantive regulatory requirements, including updating the Form ADV, advertising and referral-fee limitations, providing disclosure documents to clients, using appropriate written investment-advisory contracts with clients, maintenance of certain books and records, limitations on performance-based fees, custody requirements, restrictions on trading in securities, including principal and agency cross limitations, a code of ethics, privacy policies, and the establishment of a compliance program, which includes written policies and procedures.

Individual states also have the right to require that IAs provide them with copies of any filings made with the SEC and to receive filing and licensing fees.

Although the Advisers Act generally pre-empts state registration, qualification, or licensing of the supervised persons of federally registered investment advisors, the states are permitted to regulate persons who are deemed "investment-advisor representatives."

The SEC has excluded from IA representative status those supervised persons who do not solicit, meet with, or otherwise communicate with clients of the investment advisor, and supervised persons who provide only impersonal investment advice. AE

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