

The CPA's Guide to Investment Adviser Registration



Note to Reader

The content covered in *The CPA's Guide to Investment Adviser Registration* is generally evergreen; however, changes pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Act") will be made when studies and implementation of the Act are finalized. To keep apprised of movement with the Act's studies and related implementation, visit aicpa.org/PFP/advocacy.

ABOUT AICPA

The American Institute of Certified Public Accountants is the national, professional organization for all Certified Public Accountants. Its mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients.

In fulfilling its mission, the AICPA works with state CPA organizations and gives priority to those areas where public reliance on CPA skills is most significant.

For more information, visit its Web site: www.aicpa.org

ABOUT THE PFP MEMBERSHIP SECTION

Many CPAs venture into Personal Financial Planning (PFP) because it is a logical extension of tax and accounting services. It also broadens the scope of a CPA's practice and provides new opportunities for generating revenue.

The AICPA's Personal Financial Planning specialty area supports CPA professionals who specialize in or have an interest in any aspect of PFP including tax, estate, retirement, investment and risk management planning. This area supports its members by providing information, tools, advocacy and guidance to enable them to perform valuable personal financial planning services in the highest professional manner. Members of this section broaden their technical expertise, improve their professional competence and receive resources to deliver high-quality, profitable PFP services. Our goal is to keep CPA financial planners at the forefront of the profession.

The AICPA Personal Financial Planning (PFP) Center can be accessed at aicpa.org/pfp

The PFP Practice Portal – aicpa.org/pfp/PracticePortal

If you find the information in this Guide helpful, the PFP Practice Portal will help you make sense of the larger issues you face implementing personal financial planning into your practice.

- How can I avoid losing some of my clients to a firm offering both traditional CPA services and personal financial planning?
- How do I efficiently add or expand into personal financial planning?
- How do I decide how to structure my PFP business?
- How do I help my partners understand the value that adding these services can bring to our practice?

As a CPA, you are in a unique position to help your client's in today's economy. Don't let concerns like these stand between you and your clients.

**The CPA's Guide
to
Investment Adviser
Registration**

The American Institute
of Certified Public Accountants, Inc.

The general information contained in this Guide is provided by the American Institute of Certified Public Accountants as a service to our members. The Guide discusses general principles applicable to investment advisers. It is not, and is not intended to serve as, legal or any other professional advice applicable to any particular person or matter. It is not intended to, and the AICPA specifically disclaims any intention to, offer legal advice to members with regard to their own conduct or situation. Members should consult their own legal counsel for application of the principles discussed in this Guide to their particular situations.

Certain definitions used in this Guide are set forth in Attachment 1.

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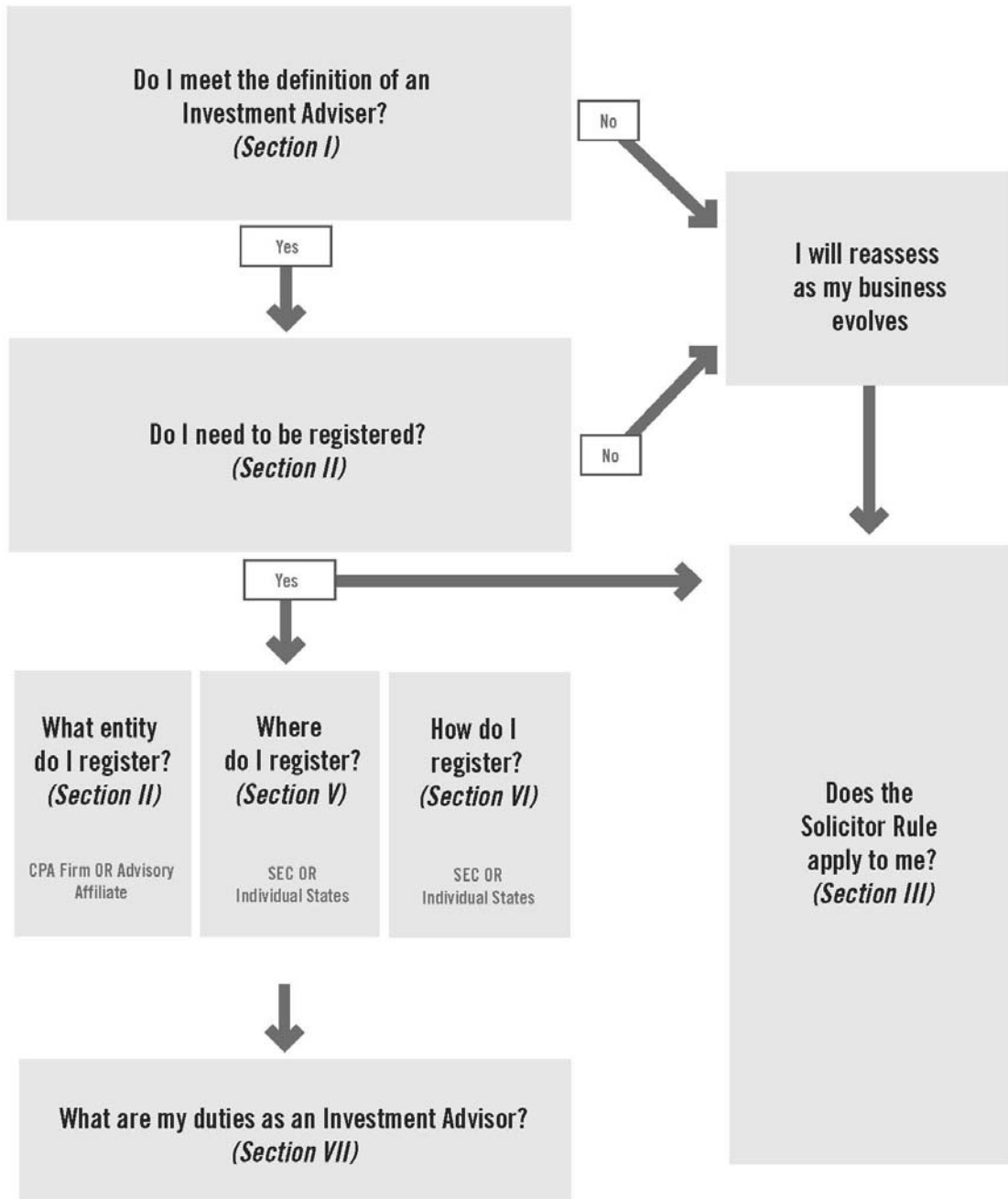
INTRODUCTION

As a certified public accountant you probably have recurring client contact which gives you knowledge of your client's financial affairs, including goals, assets and cash flow. In fact, clients have probably asked you for advice regarding investing in stocks, bonds, mutual funds or other financial products. The question thus becomes, if you advise your client on the advisability or value of investing in securities, does that activity require you to register under the Investment Advisers Act of 1940¹ and subject you to all the other regulatory requirements that pertain to investment advisers? If you are required to register as an investment adviser, but fail to, you may be subject to *serious criminal and civil penalties*.

The purpose of this Guide is to assist AICPA members in understanding the regulatory provisions that are applicable to investment advisers under the Investment Advisers Act of 1940 and similar laws adopted by the various States. The information in this Guide is not intended as legal advice on the issue of whether you need to register as an investment adviser. Whether you need to register can involve complex issues on which you should consult your own legal counsel. We hope this Guide provides assistance to you in knowing what questions you need to ask your lawyer.

¹ Advisers Act, 15 U.S.C. §80-b.

Questions to be answered as you read this Guide



I. WHO IS AN INVESTMENT ADVISER?

A. **Investment Adviser Defined.**

The Investment Advisers Act of 1940 (“Advisers Act”) defines an investment adviser as:

... any person² who, **for compensation**, engages **in the business of advising others**, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities ...³ (emphasis added).

Accordingly, whether a person (including both a natural person and a partnership, limited liability company, corporation or other entity) is an investment adviser within the meaning of the Advisers Act depends on whether such person: (1) provides advice or issues reports or analyses, regarding securities; (2) is in the business of providing such services; and (3) provides such services for compensation.⁴ Each of these elements must be present before a person will be deemed an “investment adviser”.

² For the purposes of the Advisers Act, the term “person” refers to any natural person or any entity, such as a corporation, limited liability company or other entity. Section 202(a)(16) of the Advisers Act, 15 U.S.C. §80b-2(a)(16).

³ Advisers Act §202(a)(11), 15 U.S.C. §80b-2(a)(11) (emphasis added).

⁴ Applicability of the Investment Advisers Act to Financial Planners, Pensions Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092, 39 S.E.C. Docket 494, 1987 WL 112702 (Oct. 8, 1987) (hereafter referred to as “Release No. 1092”).

1. “Advice regarding securities”.

The “advice regarding securities” standard requires that advisory services be provided with respect to an instrument that satisfies the Advisers Act’s definition of a *security* and with which there is a judgmental element in connection with the advice.

a) What is a security?

Many CPAs may assume that a “security” only refers to a stock or bond that is traded on a national exchange. In fact, under federal and state securities laws, the definition of a “security” is very broad and, in addition to stocks and bonds (whether or not publicly traded) includes (i) promissory notes, (ii) limited partnership or limited liability company interests, (iii) fractional interests in oil or gas leases, (iv) interests in any profit-sharing agreement, (v) investment contracts, and (vi) a variety of other rights relating to securities.⁵ The U.S. Supreme Court has said that the definition of a “security” includes “the countless and variable schemes devised by those who seek the use of the money of others”⁶.

b) Must advice relate to *specific* securities?

⁵ See Section 2(a)(1) of the Securities Act of 1933 which provides that, “unless the context otherwise requires”, the term “security” includes:

Any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

⁶ *Marine Bank v. Weaver*, 455 U.S. 551, 555 (1982). *See also*, *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

The seminal authority on registration under the Advisers Act is contained in Release 1092, which was issued by the United States Securities and Exchange Commission (SEC) in 1987. (The Release is attached as Attachment 2 to this Guide). In Release 1092, the SEC addressed the issue of whether advice, recommendations or reports that do not pertain to *specific* securities satisfy the “advice regarding securities” element of the definition. In that Release, the SEC took the position that, assuming the services are being performed as part of a business for compensation, then the SEC “believes that a person who provides advice, or issues or promulgates reports or analyses, which concern securities, but which do not relate to specific securities” *generally will fall under the definition of investment adviser*. The Release also noted that the SEC staff has interpreted the definition of investment adviser to include persons who advise clients concerning the relative advantages and disadvantages of investing in securities *in general* as compared to other investments.⁷ Note that, under some circumstances, recommending an investment adviser to a client may itself trigger investment adviser registration.⁸

2. “In the business of”.

The critical determination under the “in the business” element is whether the degree of the advisory activities constitutes being “in the business of” an investment adviser.⁹ The SEC looks at all facts and circumstances surrounding a person’s activities to determine whether a person is “in the business of” giving advice about securities for compensation. Relevant factors include, but are not limited to:

⁷ Release No. 1092, *supra*, footnote 4.

⁸ See, Section III of this Guide, beginning on page 11.

⁹ Id.

- Whether the person represents or otherwise holds himself out to the public as an investment adviser;
- Whether the person receives separate or additional compensation representing a clearly definable charge for giving advice about securities; and
- The frequency or regularity of providing “specific investment advice”.¹⁰

The term “specific investment advice” includes a recommendation, analysis or report about specific securities or specific categories of securities or a recommendation that a client allocate certain percentages of his assets to life insurance, high yielding bonds and mutual funds or particular types of mutual funds.¹¹ The term does not appear to include advice limited to general recommendations to allocate assets among, for example, securities, life insurance and tangible assets.¹²

3. “For Compensation”.

The “for compensation” element is satisfied by the receipt of *any* economic benefit. The SEC has stated that the compensation element is satisfied if a single fee is charged for a number of different services, including investment advice or the issuing of reports or analyses concerning securities.¹³ In addition, it is not necessary that the

¹⁰ Id.

¹¹ Id.

¹² Id.

¹³ Id. (citing *e.g.* *FINESCO* (pub. avail. Dec. 11, 1979)).

compensation be paid directly by the person receiving the investment advisory services.¹⁴

Thus, if an adviser earns a commission from a third party for the sale of an investment product, that commission satisfies the “for compensation” element.¹⁵

¹⁴ Id.

¹⁵ Id. *See also*, Thomas P. Lemke and Gerald T. Lins, Regulation of Investment Advisers §1:4 (Thomson West 2008 Edition).

II. DO I NEED TO REGISTER AS AN INVESTMENT ADVISER?

If a person falls within the three-part “investment adviser” definition described in the previous section of this Guide, then generally that person would be subject to either state or SEC registration. CPAs, however, may nevertheless be exempt from registration under certain limited circumstances.

A. Are CPAs exempted from registration as an investment adviser?

As a CPA, you may be excluded from the investment adviser definition if the advice you provide is “solely incidental” to the practice of your profession.¹⁶ The Advisers Act does not define the term “solely incidental.” As a result, the determination of whether this exclusion is available depends on the facts and circumstances of each situation.

1. Are investment services you provide “solely incidental” to accounting services rendered to clients?

The SEC has identified three factors that are particularly relevant in determining whether investment services are “solely incidental” to accounting services:

- *Whether the accountant holds himself out to the public as an investment adviser or financial planner;*
- *Whether the professional’s fee structure for investment advisory services is different from the schedule for the professional services; and*

¹⁶ Advisers Act §202(a)(11)(B), 15 U.S.C. §80b-2(11)(B). There are other exclusions from the definition of investment adviser; however, the discussion in this Guide has been limited to the exclusion specifically excluding accountants.

- *Whether the advice given is in connection with and reasonably related to the professional services rendered.*¹⁷

If you satisfy any one of these three factors you may lose the exemption provided to accountants.¹⁸

a) Holding out to the public

In several, so-called “no-action” letters¹⁹, the SEC has taken the position that, when an accountant holds himself out publicly as providing *financial planning*, pension consulting, or other financial advisory services, the performance of those services is not *solely incidental* to his practice as an accountant.²⁰ In other words, the SEC’s position is that every CPA who holds himself out to the public as a financial planner or pension consultant, or as a provider of other financial advisory services, is, by definition, an “investment adviser” who must register under the Advisers Act.²¹

The SEC has stated that a person is “holding himself out” to the public as an investment adviser if he promotes himself as providing financial planning, pension consulting or other financial advisory services:

¹⁷ Thomas P. Lemke and Gerald T. Lins, Regulation of Investment Advisers §1:18 (Thomson West 2008 Edition).

¹⁸ See, e.g., David R. Markley, SEC No-Action Letter, 1985 WK 53850 (February 6, 1985).

¹⁹ Technically, a “no-action” letter is a response by SEC staff to written inquiries received by the SEC, and reflects the opinion of SEC staff that, under the particular circumstances presented, staff may or may not recommend an enforcement action; no-action letters do not necessarily reflect the official position of the SEC.

²⁰ Release No. 1092, *supra*, at footnote 4.

²¹ See, e.g., Hungerford, Aldrin, Nichols & Carter, SEC No-Action Letter, 1991 WL 290535 (Dec. 10, 1991).

- by general advertising or general mailings;
- by using the term “financial planner” or “investment adviser” or other similar term on a business card or stationery;
- by listing himself as a financial planner or investment adviser in a telephone, business or building directory; or
- by letting it be known, through word-of-mouth or otherwise, that he is available to provide financial planning, investment advice or similar advisory services.²²

b) Fee structure

For a CPA’s investment services to be “solely incidental” to accounting services rendered, the CPA’s fees for investment advice should be based on the same factors as the CPA uses to determine his usual charges for accounting services. The SEC has stated that investment advice would not be “solely incidental” where the accountant charges an hourly fee for accounting services and a percentage of assets fee for advisory services.²³ Note that the SEC has stated that, even though the fees charged by an accountant for investment advice may not constitute a major or substantial part of his revenues, this

²² LaManna & Hohman, SEC No-Action Letter, 1983 WL 31009 (Mar. 21, 1983).

²³ Release No. 1092, *supra*, at footnote 4 (citing Hauk, Sole & Fasani, P.C., SEC No-Action Letter (May 2, 1986)).

factor alone does not lead to the conclusion that the person is not in the business of providing investment advice.²⁴

c) Advice given is in connection with and reasonably related to the accounting services

Of the three factors used to determine whether an accountant's investment services are "solely incidental" to accounting services rendered to a client, whether advice is given in "connection with and reasonably related to" accounting services perhaps is the factor that seems least understood. SEC no-action letters responding to questions posed by accountants generally base the determination of whether registration as an investment adviser is required on whether the accountant is "holding himself out to the public" as an investment adviser and, to a lesser extent, on the accountant's fee structure. As a result, little guidance is available to ascertain whether investment advice is "reasonably related to" a CPA's accounting services. Nevertheless, even without more specific guidance from the SEC, presumably, if financial planning or investment advice is provided to a person who has not engaged a CPA to provide accounting services, but has instead hired the CPA *solely* for investment advice, then the SEC would almost certainly determine that registration as an investment adviser is necessary.

2. Registration of Affiliated Entity in Lieu of Registering Accounting Firm.

The SEC has permitted accounting firms to register an affiliated entity (as opposed to the accounting firm itself) to supervise the partners or other professionals of

²⁴ George J. Dippold, SEC No-Action Letter, 1990 WL 286595 (May 7, 1990).

the accounting firm in the rendering of general investment consultant and tax planning services.²⁵ However, to avoid the need for the accounting firm itself, in addition to the affiliate entity, to register as an investment adviser, the accounting firm must satisfy the following conditions:²⁶

- the accounting firm must not recommend specific securities or industry sectors (aside from tax and estate planning services);
- the advisory and personal financial planning services must be substantially similar to traditional accounting services;
- neither the affiliated entity nor the accounting firm can have custody or possession of client funds or securities;
- personnel who participate in personal financial planning or consulting services will be deemed “advisory affiliates” and “persons associated with the investment adviser” for purposes of Form ADV and the Advisers Act;
- amounts billed for financial planning services must be separately stated from traditional accounting services; and
- the affiliated investment adviser must keep and maintain all books and records required under the Advisers Act, including copies of any financial plans and related engagement letters, billing records and letters and other

²⁵ See, e.g., Price Waterhouse, SEC No-Action Letter, 1987 WL 108420 (May 5, 1987).

²⁶ Id.

communications relating to personal financial planning clients created by the accounting firm.

III. THE SOLICITORS RULE: REFERRAL FEES RECEIVED BY CPAS FROM INVESTMENT ADVISERS

CPAs and other professionals often refer their clients to investment advisers and receive a cash referral fee from the investment adviser. The SEC refers to persons receiving such fees as “solicitors” (*i.e.*, persons who solicit business on behalf of the investment adviser).

SEC Rule 206(4)-3 makes payment of referral fees by an investment adviser unlawful unless certain conditions are satisfied. Under Rule 206(4)-3, compensation received by a CPA or other person unaffiliated with an investment adviser who refers business to that investment adviser (a solicitor) will be unlawful unless:

- The investment adviser has registered under the Investment Advisers Act;
- Cash payments to the solicitor are made pursuant to a written agreement between the investment adviser and the solicitor²⁷;
- The solicitor provides the client with a copy of the investment adviser’s brochure or Form ADV Part II;
- The solicitor provides the client with a separate document (sometimes called a “solicitor’s brochure”);²⁸ and

²⁷ The written agreement must contain an undertaking by the solicitor to perform any duties in accordance with instructions provided by the investment adviser and in compliance with the Investment Advisers Act. Requirements Governing Payments of Cash Referral Fees by Investment Advisers Act, Investment Advisers Act Release No. 688, 17 SEC Docket 1293, 1979 WL 18498 (July 12, 1979) (hereafter cited as “Release No. 688”).

²⁸ The solicitor’s brochure must include: (i) the name of the solicitor; (ii) the name of the investment adviser; (iii) a description of the relationship between the solicitor and the investment adviser; (iv) a disclosure that the solicitor will be compensated for its referral of the client; (v) the terms of the compensation, including the specific amount payable; (vi) a disclosure of any increased costs that the client

- The client referred by the solicitor provides to the investment adviser a signed acknowledgement of the receipt of the investment adviser's brochure (or Form ADV Part II) and the "solicitor's brochure".²⁹

The solicitor's rule is highly complex and a more thorough discussion is beyond the scope of this Guide. Suffice it to say that, if you will be paid referrals fees by a registered investment adviser (or by a person who *should* be registered, but has failed to do so³⁰), as with the rest of this Guide, you should first consult with your attorney.

will incur such as higher advisory fees or other costs as a result of the referral fee paid to the solicitor. The solicitor's brochure must be a separate document and not part of an investment adviser's brochure. Release No. 688, *supra*, footnote 27.

²⁹ See, Release No. 688, *supra*, footnote 27.

³⁰ See, Release No. 688, *supra*, footnote 27.

IV. HYPOTHETICAL EXAMPLES HIGHLIGHTING REGISTRATION ISSUES

To help CPAs apply the principles discussed in this Handbook, the following examples describe circumstances under which registration as an investment adviser might be necessary. Keep in mind, however, that these examples are not intended as legal advice and that the determination of whether registration is required depends on the specific facts and circumstances applicable in each instance, and that a change in a single fact may result in a different analysis on the question of whether registration is required. In addition, even on these same facts, no assurance can be given that the SEC, or a State securities administrator, might not reach a different conclusion than is suggested below.

1. Ann is a CPA who offers accounting and tax services through her accounting firm, of which she is the sole professional. On her website, Ann identifies the services she provides as “accounting and financial planning”. Ann also asks Charlie and other clients to please let their friends and acquaintances know that Ann is willing to assist her accounting clients with financial planning. One of her clients, Charlie, asks Ann, during the course of Ann’s preparation of Charlie’s tax returns, for advice on how he should allocate certain of his assets. Ann suggests that Charlie diversify his investments among real estate, bonds and mutual funds. Ann charges for this advice on an hourly basis, at the same hourly rate she charges Charlie for accounting and tax services. In this case, Ann seems to be holding herself out to the public as a financial planner, and Ann therefore probably would need to register as an investment adviser.

2. Bill is a CPA who publishes a newsletter sent to all of his clients that regularly lists specific stocks that Bill believes are a good investment. Bill does not charge for the newsletter and its cost is not directly factored into his hourly rate for accounting services. While Bill isn't explicitly holding himself out to the public as an investment adviser, he clearly is giving investment advice in the monthly newsletter and the "holding out" requirement may be satisfied if that type of advice is a regular feature of the newsletter. Nevertheless, because Bill is not charging for the advice, Bill may try to argue that he is not required to register as an investment adviser. Note, however, that if the newsletter contained a referral to an investment adviser who pays Bill a referral fee for new clients, the "compensation" requirement may well be satisfied, thus requiring Bill to register as an investment adviser. (Even if Bill were not otherwise deemed to be an investment adviser, the payment of the referral fee will subject Bill to the "solicitors rule", discussed above).

3. Catherine is a CPA who has obtained the Personal Financial Specialist (PFS) credential from the AICPA. On her letterhead, under her name are the words "Certified Public Accountant – Personal Financial Specialist". Catherine regularly advises clients that their assets should be diversified among various categories, including real estate, stocks, bonds and mutual funds, with recommendations for specific allocations in each asset category tailored for each client. Catherine charges for this advice on an hourly basis. Because it appears that Catherine is holding herself out as an investment adviser, and because her investment advisory services do not appear to be incidental to her accounting services (but rather an integral part of her business), Catherine probably will need to register as an investment adviser.

4. Dave is a CPA who publishes a newsletter that recommends individual stocks. He sends the newsletter only to those clients of his accounting firm who subscribe and pay a \$300 annual subscription fee. Dave also has a handful of subscribers to his newsletter who are not clients of his accounting firm. Because the investment advisory services are not incidental to his accounting services, and because he receives compensation for the investment advisory services, Dave probably will need to register as an investment adviser.

5. Eleanor is a CPA who utilizes a software program that summarizes the performance of mutual funds over various periods, categorizes funds by objective, performance, sales charges, and risk levels, to inform accounting clients about mutual funds, provides them with a list of funds that meet their investment objectives and provides monthly performance reports. Eleanor charges each client who asks for advice on mutual fund investments a fee of \$250 per quarter to render a report generated by the software. Because Eleanor is holding herself out to the public as providing financial planning services, and because she appears to be providing investment advice for a fee, Eleanor probably will need to register as an investment adviser.³¹

6. Fred is a CPA who advertises on his website that he provides “accounting and investment consulting”. From time to time, Fred will assist clients, for a fee, who are considering investing in real estate limited partnerships by discussing with them the merits and risks of investing in the limited partnership, including advising on the past

³¹ See Hungerford, Aldrin, Nichols & Carter, SEC No-Action Letter, 1991 WL 290535 (Dec. 10, 1991).

performance of the general partner in similar partnerships. Because Fred is holding himself out to the public as providing investment-related services, and because he is rendering advice for compensation on securities (limited partnership interests) as a regular part of his business, Fred probably needs to register as an investment adviser.³²

7. Gloria is a partner in an accounting firm that includes ten other CPAs. Gloria and one of her partners, Hank, have both obtained PFS credential from the AICPA. The firm's partners want to take advantage of Gloria's and Hank's financial planning expertise as a new profit center for the firm. However, if Gloria and Hank provide financial planning services that include advice on the pros and cons of investing in securities, the firm probably would need to register as an investment adviser. If, instead, the firm forms a new entity through which Gloria and Hank will provide those same services, and the accounting firm neither holds itself out as providing investment services nor actually performs such services, only the new entity probably will need to become registered as an investment adviser.

³² See Jan L. Warner, SEC No-Action Letter (Dec. 27, 1988).

V. WHERE DO I REGISTER?

If you need to register as an investment adviser, you generally will need to make your primary registration either with the SEC or with one or more states; however, as explained below, if you register with the SEC, certain other filings may be required in various states.

A. Do I need to register with the SEC?

Rule 203A-1 under the Advisers Act sets forth the minimum requirements that would trigger the need to register with SEC. The threshold for SEC registration is \$30 million of assets under management.³³ If, however, you have assets under management with a value of at least \$25 million, you may (but are not required to) register with the SEC.³⁴ In other words, SEC registration is mandatory for investment advisers with assets under management of \$30 million or more, and is permissive for investment advisers having assets under management between \$25 and \$30 million. Note that, for filing purposes, a key issue is the dollar amount of securities under management. Even if you don't "supervise" or "manage" client securities, if you render advice about securities to a client for compensation, and otherwise qualify as an "investment adviser", you still need to register.

1. How do I calculate assets under management?

³³ Advisers Act Rule 203A-1(a)(1), 17 C.F.R. §275.203A-1(a)(1).

³⁴ Advisers Act Rule 203A-1(a)(2), 17 C.F.R. §275.203A-1(a).

Form ADV: Instructions for Part 1A explains how to complete certain items in Part 1A of Form ADV, including Item 5.F (“Assets Under Management”). (Form ADV can be found at: <http://www.sec.gov/divisions/investment/iard/iastuff.shtml>.) Your assets under management (sometimes referred to as “AUM”) include the **securities portfolios** for which you provide **continuous and regular** supervisory or management services.

There are three important questions to ask when calculating assets under management. First, is the account a securities portfolio? Second, does the account receive continuous and regular supervisory or management services? And, third, what is the entire value of the account?

a) What is a securities portfolio?

An account is a securities portfolio if at least 50% of the total value of the account consists of securities.³⁵ For purposes of this test, cash and cash equivalents may be treated as securities. The following portfolios may be included when calculating the investment adviser’s assets under management: family or proprietary accounts (but not the personal assets of an investment adviser who is a sole proprietor); accounts for which no compensation is received for services provided; and accounts for non – U.S. resident clients.³⁶

b) What does “continuous and regular supervisory or management services” mean?

³⁵ Form ADV: Instructions for Part 1A, item 5.F.

³⁶ Id.

The Form ADV Instructions for Part 1A provide general criteria and factors to consider when evaluating whether you provide continuous and regular supervisory or management services to an account. In general, you provide continuous and regular supervisory or management services if:

- you have discretionary authority over and provide ongoing supervisory or management services with respect to the account; or
- you do *not* have discretionary authority over the account, *but* you have an ongoing responsibility to select or make recommendations, based upon the needs of the client, as to specific securities or other investments the account may purchase or sell and, if such recommendations are accepted by the client, you are responsible for arranging or effecting the purchase or sale.

The following factors should be considered when evaluating whether you provide continuous and regular supervisory or management services to an account:³⁷

- terms of the advisory contract – if you agree in an advisory contract to provide ongoing management services it is likely that you are providing these services for the account.
- form of compensation – compensation based on the average value of your client’s assets over a period of time, set forth in the advisory contract, (for

³⁷ Form ADV: Instructions for Part 1A, available at <http://www.sec.gov/divisions/investment/iard/iastuff.shtml>

example 1% of the assets under management over a six (6) month period) indicates that you are providing continuous and regular supervisory or management services.

- management practices – do you actively manage assets or provide advice? Infrequent trades alone do not mean that the services you provide are not continuous and regular.

c) What is the value of the account?

Remember that an account is a securities portfolio if at least 50% of the total value of the account consists of securities. So long as at least 50% of the total value of the account consists of securities, cash and cash equivalents, the entire value of the account is included in the “assets under management” calculation.³⁸

2. State Notice Filing Requirements

SEC-registered investment advisers have a filing obligation, known as a notice filing, in states where the investment adviser does business. All states except Wyoming require the SEC-registered investment advisers providing investment advice in that state to make a notice filing with the state.³⁹ Generally, this notice filing obligation is imposed if within the preceding twelve (12) month period the investment adviser has a place of

³⁸ Id.

³⁹ Id. Technically, the “notice filing” is a means of providing a state with notice that an SEC-registered investment adviser is doing business in that state. A notice filing is not the same as “registering” as an investment adviser under that state’s investment adviser registration statute. See, “State Registration”, *infra*, at page 21.

business in the state and six or more clients who are residents of the state.⁴⁰ Notice filings are submitted to the states through the Investment Advisers Registration Depository (“IARD”).⁴¹ The IARD is discussed in more detail under Section VI, below.

B. State Registration

Investment advisers with assets under management of less than \$25 million are subject to registration with the state securities regulator in each state. A complete list of state securities regulators is available at http://www.nasaa.org/about_nasaa/2062.cfm. In most states the definition of an investment adviser is identical to the definition in the Advisers Act, but again you should consult with your lawyer on any particular state’s requirements. State registration can be complex because the states have not adopted a uniform approach to registration, and, thus, counsel should be consulted by any CPA contemplating state registration.

In general, an investment adviser subject to state-regulation will need to register with each state in which it operates. As a result, if an investment adviser operates in more than one state, the investment adviser will need to familiarize itself with the registration and regulation requirements of each state.⁴² However, Section 222 of the

⁴⁰ Not all states have the same requirements/obligations. For example, Texas requires an SEC-registered investment adviser providing investment advice in Texas to make an initial notice filing, and an annual fee payment, even if the investment adviser has no place of business in Texas and fewer than six (6) clients. TEXAS ADMIN. CODE tit. 7, Part 7, Ch. 116, Rule §116.1(b)(2)(C).

⁴¹ Form ADV, Part 1, Item 2.B.

⁴² Id.

Advisers Act provides that an investment adviser need only comply with the recordkeeping, net capital and bonding requirements of the state in which the adviser maintains its principal place of business. Section 222 of the Advisers Act prohibits other states in which the investment adviser is registered from imposing more burdensome requirements.

1. Do I need to register with a state if I have less than five clients in that state?

Generally, if a CPA does not have a place of business in the state, you are allowed up to five (5) investment advisory clients before having to register; this is commonly known as the *de minimis* exemption from registration. In Texas, registration is required prior to taking on the first Texas client. However, if the investment adviser is not located in Texas and will have fewer than six (6) clients, a full registration is not required. In those cases, the adviser would make a “Notice Filing for a State-Covered Adviser.”⁴³

⁴³ TEXAS ADMIN. CODE tit. 7, Part 7, Ch. 116, Rule §116.1(b)(2)(C) available at [http://info.sos.state.tx.us/pls/pub/readtac\\$ext.ViewTAC?tac_view=3&ti=7&pt=7](http://info.sos.state.tx.us/pls/pub/readtac$ext.ViewTAC?tac_view=3&ti=7&pt=7).

VI. HOW DO I APPLY FOR REGISTRATION?

The Financial Industry Regulatory Authority (FINRA), working with the SEC and the North American Association of Securities Administrator (NASAA), has developed an on-line system for the registration of investment advisers called the Investment Advisers Registration Depository (“IARD”). Form ADV Part I, must be filed electronically through IARD.

A. How do I get access to IARD?

The forms, called the Entitlement Packet, and other information about setting up an IARD account are available at www.iard.com. On the left side of the screen, click on “How to Get Started” and print off an SEC IARD Entitlement Packet. All forms must be returned to FINRA. Instructions for where and how to submit the forms are provided in the letter from FINRA and on the forms.

After the forms are submitted, FINRA will set up the IARD user account for the investment adviser, grant access to the individuals the investment adviser designated as Authorized Persons so these persons can make electronic filings on your behalf and will set up the IARD financial account for billing and payment of fees. FINRA will send the investment adviser a confirmation packet containing a User ID and password, and instructions on electronic filing through IARD and payment of fees collected by IARD.

The SEC and the states impose filing fees for registration of the firm. Fees are paid to FINRA and disbursed to each regulatory body. Funds may be submitted by check

or wire transfer to your IARD billing account. Allow 48 hours for the processing of funds. Once funds are credited to your IARD account, you can submit the electronic filing.⁴⁴

B. Filing Form ADV Part 1

Form ADV Part 1 is the investment adviser's application for registration. Form ADV Part 1 asks for information about the investment adviser's business. It is important to remember that ADV Part 1 is asking for information about the investment adviser. Business entities (*i.e.*, corporations, limited liability companies, partnerships) often operate as the investment advisers; accordingly, in those cases, it is important that Form ADV be completed to reflect that fact.⁴⁵ A copy of Form ADV Part 1 is attached to this Guide as Attachment 3. You can also access a version of Form ADV Part 1 on the Internet at <http://www.sec.gov/divisions/investment/iard/iastuff.shtml>.

The Advisers Act, specifically Section 207, makes it unlawful for an applicant to make an untrue statement of material fact or to willfully omit a material fact in any

⁴⁴ FINRA also uses Web E-Pay which allows an investment adviser to authorize electronic payments directly from a designated bank account to the investment adviser's Daily and/or Renewal accounts. You can access Web E-Pay from the IARD website www.IARD.com by clicking on Web CRD/ IARD E-pay located on the left side of the screen.

⁴⁵ Thomas P. Lemke and Gerald T. Lins, Regulation of Investment Advisers §1:57 (Thomson West 2008 Edition).

registration application or report filed with the SEC. It is extremely important to complete Form ADV fully and accurately.⁴⁶

C. What are the filing fees?⁴⁷

There are two fees for SEC registration – an initial set-up fee and an annual fee. The initial set-up fee is the fee charged when the investment adviser submits its first electronic Form ADV. The annual fee is charged at the time the investment adviser submits its Annual Amendment which is due within ninety (90) days of the investment adviser’s fiscal year. The amount of the fees depends on the value of the investment adviser’s assets under management, as follows⁴⁸:

Assets Under Management	Initial Set-Up Fee	Annual Fee
SEC under \$25 million	\$150	\$100
SEC \$25 - \$100 million	\$800	\$400
SEC over \$100 million	\$1100	\$550

D. When does the SEC approve my registration?

The investment adviser’s application, Form ADV Part 1, is deemed filed as of the date that you successfully submit the form through IARD.⁴⁹ The SEC will then review your Form ADV Part 1 to determine whether it is complete and in compliance with the

⁴⁶ See, Thomas P. Lemke and Gerald T. Lins, Regulation of Investment Advisers §1:56 (Thomson West 2008 Edition).

⁴⁷ See, http://www.iard.com/fee_schedule.asp and <http://www.sec.gov/divisions/investment/iard.shtml>

⁴⁸ These are the fees in effect as of March 2009. Fees change from time to time.

⁴⁹ Thomas P. Lemke and Gerald T. Lins, Regulation of Investment Advisers §1:59 (Thomson West 2008 Edition).

Advisers Act. The SEC will grant registration or institute a proceeding to determine whether an application should be denied within forty-five (45) days of filing the completed Form ADV.⁵⁰ If your application is approved, you will receive an order from the SEC which evidences effective registration.

⁵⁰ Id. at §1:62. Note that the forty-five day period may be longer if the applicant consents.

VII. WHAT ARE MY DUTIES AS AN INVESTMENT ADVISER?

Investment advisers are *fiduciaries* to their clients. In other words, investment advisers have a fundamental obligation to act in the best interests of the clients and to provide investment advice that is in the client's best interests.

A. What does it mean to be a fiduciary?

As a fiduciary, the investment adviser has an affirmative duty of utmost good faith to act solely in the best interests of the client and to make full and fair disclosure of all material facts.⁵¹ Disclosure is particularly important when the interests of the investment adviser and the interests of the client may come into conflict.⁵²

The SEC has identified specific obligations resulting from the fiduciary duty the investment adviser owes its clients which include, but are not limited to: (1) a duty to have a reasonable independent basis for its investment advice; (2) a duty to obtain the best execution for clients' securities transactions where the adviser is in a position to direct brokerage transactions; (3) a duty to ensure that its investment advice is suitable to the client's objectives, needs and circumstances; (4) a duty to refrain from effecting

⁵¹ Thomas P. Lemke and Gerald T. Lins, Regulation of Investment Advisers §2:33 (Thomson West 2008 Edition).

⁵² Form ADV Part 2 is the investment adviser's written disclosure statement, sometimes referred to as a written brochure, that provides information about the investment adviser's business practices, fees and conflicts of interest that investment adviser may have with its clients.

personal securities transactions inconsistent with client interests; and (5) a duty to be loyal to clients.⁵³

B. Compliance

The Advisers Act and the Rules thereunder contain numerous provisions relating to compliance including, but not limited to, recordkeeping requirements, disclosure requirements, requirements relating to custody of client assets and permissible advertising. Investment advisers need to be aware of and follow these requirements. Violations of the Advisers Act or its Rules may give rise to disciplinary proceedings, monetary penalties and/or criminal penalties.⁵⁴ Finally, information relating to disciplinary proceedings at the very least can prove embarrassing for an investment adviser, as disciplinary information is publicly available.⁵⁵

⁵³ Thomas P. Lemke and Gerald T. Lins, Regulation of Investment Advisers §2:33 (Thomson West 2008 Edition) (internal citations omitted).

⁵⁴ Advisers Act §203(e), 15 U.S.C. §80b-3(e) (disqualification provisions); Advisers Act §203(i), 15 U.S.C. §80b-3(i) (monetary penalties); Advisers Act §217, 15 U.S.C. §80b-17 (criminal penalties).

⁵⁵ See, Investment Adviser Public Disclosure website available at: http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd_SiteMap.aspx

VIII. CONCLUSION

Whether a CPA who provides investment advice must register as an investment adviser with the SEC or with one or more of the states depends on a number of factors. These factors include whether the CPA is in the business of providing advice about securities for compensation, and whether that advice is incidental to his or her accounting practice. This analysis can be complex, and hinges on the facts and circumstances of each case. Because possible civil and criminal penalties can be imposed on the failure to register, you will be well advised to seek out capable legal advice to assist you in making the determination of whether registration is required.

If you determine that registration is required, then you must also determine whether you are required (or permitted) to file your registration with the SEC or whether you must register in one or more states, which hinges largely on whether you have assets under management in excess of \$25 Million. If you file with the SEC, you generally will be required to make a “notice filing” in the state in which you conduct your principal business. If you have less than \$25 Million of assets under management, then you generally will be required to register with the state where you have your principal business location, as well as each other state in which you conduct business. If you have less than five clients in a particular state to which you provide investment advisory services, you may be exempt from registering as an investment adviser in that state.

If a CPA is paid referral fees by an investment adviser, the CPA will be subject to the “solicitor’s rule” and must comply with each of its requirements.

For most CPAs who are required to register as an investment adviser, the cost and complexity of registering is not all that burdensome once you understand the filing procedures and become familiar with Form ADV. Nevertheless, because civil and criminal sanctions may be imposed for the willful omission of material facts in any investment adviser registration, particular care and attention should be given to completing the Form ADV accurately.

Hopefully, this Guide has helped to provide you with a general understanding of the issues surrounding the determination of whether registration as an investment adviser is necessary, and has provided a general overview of how and where to register and a general explanation of your duties as an investment adviser. Please keep in mind that questions you may have should be directed to your legal counsel. This Guide is not intended to be a substitute for legal advice.

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ATTACHMENT 1

DEFINITIONS

Assets Under Management includes the securities portfolios for which the investment adviser provides continuous and regular supervisory or management services as of the date of filing Form ADV.⁵⁶

IARD – Investment Adviser Registration Depository – is an electronic filing system for Investment Advisers sponsored by the Securities and Exchange Commission and the North American Securities Administrators Association (NASAA), with FINRA serving as the developer and operator of the system. The IARD system collects and maintains the registration and disclosure information for Investment Advisers and their associated persons. The IARD system supports electronic filing of the revised Forms ADV and ADV-W, centralized fee and form processing, regulatory review, the annual registration renewal process, and public disclosure of Investment Adviser information.⁵⁷

Investment Adviser – any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.⁵⁸

Investment Adviser Representative means a supervised person of the investment adviser: (i) who has more than five clients who are natural persons and (ii) more than ten percent of whose clients are natural persons. However, 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 advice.⁵⁹

Person means a natural person or a company.⁶⁰

Place of business of an investment adviser representative means (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

⁵⁶ Form ADV: Instruction for Part 1A, item 5.F.

⁵⁷ <http://www.iard.com/WhatIsIARD.asp>

⁵⁸ Section 202(a)(11) of the Advisers Act, 15 U.S.C. §80b-2(a)(11).

⁵⁹ Advisers Act Rule 203A-3(a), 17 C.F.R. §275.203A-3(a)(1).

⁶⁰ Section 202(a)(16) of the Advisers Act

representative provides investment advisory services, solicits, meets with or otherwise communicates with clients.⁶¹

Principal office and place of business of an investment adviser means the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.⁶²

Security means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option or privilege entered into a national securities exchange relating to foreign currency, or , in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guaranty of, or warrant or right to subscribe to or purchase any of the foregoing.⁶³

⁶¹ Advisers Act Rule 203A-3(b), 17 C.F.R. §275.203A-3(b).

⁶² Advisers Act Rule 203A-3(c), 17 C.F.R. §275.203A-3(c).

⁶³ Section 202(a)(18) of the Advisers Act, 15 U.S.C. §80b-2(a)(18).

ATTACHMENT 2

SEC RELEASE NO. IA-1092

SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549

[Rel. No. IA-1092]

Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services.

ACTION: Statement of staff interpretive position.

SUMMARY: The Commission is publishing the views of the staff of the Division of Investment Management on the applicability of the Investment Advisers Act of 1940 to financial planners and other persons who provide investment advice as a component of other financial services. The views expressed in this statement were developed jointly by Division staff and the North American Securities Administrators Association, Inc. ("NASAA") to update Investment Advisers Act Release No. 770 and provide uniform interpretations of the application of federal and state adviser laws to financial planners and other persons. The revised statement clarifies, among other things, the "business" element of the definition of investment adviser.

SUPPLEMENTARY INFORMATION:

Since the Commission published Investment Advisers Act Rel. No. 770 (Aug. 13, 1981) ("IA-770"), the Commission and NASAA have worked together to promote more uniform regulation of investment advisers under federal and state securities laws. At the federal level, advisers are regulated under the Investment Advisers Act of 1940 ("Advisers Act"). Approximately 40 states regulate the activities of advisers under state adviser laws that typically are substantially similar to the Advisers Act. The staff of the Division and the NASAA Financial Planners/Investment Advisers Committee jointly developed the views stated in this release to provide uniform interpretations about the applicability of federal and state adviser laws to the activities of financial planners and other persons. While the views being published are based substantially on IA-770, this release revises IA-770 in some respects. Specifically, the revised release provides additional guidance on the fiduciary responsibilities of advisers, clarifies the "business" element of the definition of investment adviser, and supplements the views contained in IA-770 by references to interpretive letters issued by the Division since IA-770 was published.

I. BACKGROUND

Financial planning typically involves providing a variety of services, principally advisory in nature, to individuals or families regarding the management of their financial resources based upon an analysis of individual client needs. Generally, financial planning services

involve preparing a financial program for a client based on the client's financial circumstances and objectives. This information normally would cover present and anticipated assets and liabilities, including insurance, savings, investments, and anticipated retirement or other employee benefits. The program developed for the client usually includes general recommendations for a course of activity, or specific actions, to be taken by the client. For example, recommendations may be made that the client obtain insurance or revise existing coverage, establish an individual retirement account, increase or decrease funds held in savings accounts, or invest funds in securities. A financial planner may develop tax or estate plans for clients or refer clients to an accountant or attorney for these services.

The provider of such financial planning services in most cases assists the client in implementing the recommended program by, among other things, making specific recommendations to carry out the general recommendations of the program, or by selling the client insurance products, securities, or other investments. The financial planner may also review the client's program periodically and recommend revisions. Persons providing such financial planning services use various compensation arrangements. Some financial planners charge clients an overall fee for developing an individual client program while others charge clients an hourly fee. In some instances financial planners are compensated, in whole or in part, by commissions on the sale to the client of insurance products, interests in real estate, securities (such as common stocks, bonds, limited partnership interests, and mutual funds), or other investments.

A second common form of service relating to financial matters is provided by "pension consultants" who typically offer, in addition to administrative services, a variety of advisory services to employee benefit plans and their fiduciaries based upon an analysis of the needs of the plan. These advisory services may include advice as to the types of funding media available to provide plan benefits, general recommendations as to what portion of plan assets should be invested in various investment media, including securities, and, in some cases, recommendations regarding investment in specific securities or other investments. Pension consultants may also assist plan fiduciaries in determining plan investment objectives and policies and in designing funding media for the plan. They may also provide general or specific advice to plan fiduciaries as to the selection or retention of persons to manage the assets of the plan.ⁱ Persons providing these services to plans are customarily compensated for their services through fees paid by the plan, its sponsor, or other persons; by means of sales commissions on the sale of insurance products or investments to the plan; or through a combination of fees and commissions. Another form of financial advisory service is that provided by persons offering a variety of financially related services to entertainers or athletes based upon the needs of the individual client. Such persons, who often use the designation "sports representative" or "entertainment representative," offer a number of services to clients, including the negotiation of employment contracts and development of promotional opportunities for the client, as well as advisory services related to investments, tax planning, or budget and money management. Some persons providing these services to clients may assume discretion over all or a portion of a client's funds by collecting income, paying bills, and making investments for the client. Sports or entertainment representatives are customarily compensated for their services primarily through fees

charged for negotiation of employment contracts but may also receive compensation in the form of fixed charges or hourly fees for other services provided, including investment advisory services.

There are other persons who, while not falling precisely into one of the foregoing categories, provide financial advisory services. As discussed below, financial planners, pension consultants, sports or entertainment representatives or other persons providing financial advisory services, may be investment advisers within the meaning of the Advisers Act, state adviser laws, or both.

II. STATUS AS AN INVESTMENT ADVISER

A. Definition of Investment Adviser

Section 202(a)(11) of the Advisers Act defines the term "investment adviser" to mean:

...any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities...

Whether a person providing financially related services of the type discussed in this release is an investment adviser within the meaning of the Advisers Act depends upon all the relevant facts and circumstances. As a general matter, if the activities of any person providing integrated advisory services satisfy the elements of the definition, the person would be an investment adviser within the meaning of the Advisers Act, unless entitled to rely on one of the exclusions from the definition of investment adviser in clauses (A) to (F) of Section 202(a)(11).ⁱⁱ A determination as to whether a person providing financial planning, pension consulting, or other integrated advisory services is an investment adviser will depend upon whether such person: (1) provides advice, or issues reports or analyses, regarding securities; (2) is in the business of providing such services; and (3) provides such services for compensation. These three elements are discussed below.

1. Advice or Analyses Concerning Securities

It would seem apparent that a person who gives advice or makes recommendations or issues reports or analyses with respect to specific securities is an investment adviser under Section 202(a)(11), assuming the other elements of the definition of investment adviser are met, *i.e.*, that such services are performed as a part of a business and for compensation. However, it has been asked on a number of occasions whether advice, recommendations, or reports that do not pertain to specific securities satisfy this element of the definition. The staff believes that a person who provides advice, or issues or promulgates reports or analyses, which concern securities, but which do not relate to specific securities, generally is an investment adviser under Section 202(a)(11), assuming the services are performed as part of a businessⁱⁱⁱ and for compensation. The staff has interpreted the definition of investment adviser to include persons who advise clients concerning the relative advantages and disadvantages of investing in securities in general

as compared to other investments.^{iv} A person who, in the course of developing a financial program for a client, advises a client as to the desirability of investing in, purchasing or selling securities, as opposed to, or in relation to, any non-securities investment or financial vehicle would also be "advising" others within the meaning of Section 202(a)(11).^v Similarly, a person who advises employee benefit plans on funding plan benefits by investing in, purchasing, or selling securities, as opposed to, or in addition to, insurance products, real estate not involving securities, or other funding media, would be "advising" others within the meaning of Section 202(a)(11). A person providing advice to a client as to the selection or retention of an investment manager or managers also, under certain circumstances, would be deemed to be "advising" others within the meaning of Section 202(a)(11).^{vi}

2. The "Business" Standard

Under section 202(a)(11), an investment adviser is one who, for compensation, (1) engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or, alternatively, (2) issues or promulgates reports or analyses concerning securities as part of a regular business. Each of these two alternatives in the statutory definition of investment adviser contains a business test -- one involves "engaging in the business" of advising others while the other involves issuing reports about securities as "part of a regular business." While the "business" standards established under Section 202(a)(11) are phrased somewhat differently, it is the staff's opinion that they should be interpreted in the same manner. In both cases, the determination to be made is whether the degree of the person's advisory activities constitutes being "in the business" of an investment adviser. The giving of advice need not constitute the principal business activity or any particular portion of the business activities of a person in order for the person to be an investment adviser under Section 202(a)(11). The giving of advice need only be done on such a basis that it constitutes a business activity occurring with some regularity. The frequency of the activity is a factor, but is not determinative.

Whether a person giving advice about securities for compensation would be "in the business" of doing so, depends upon all relevant facts and circumstances. The staff considers a person to be "in the business" of providing advice if the person: (i) holds himself out as an investment adviser or as one who provides investment advice, (ii) receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within any overall compensation, or receives transaction based compensation if the client implements the investment advice, or (iii) on anything other than rare, isolated and non-periodic instances, provides specific investment advice.^{vii} For the purposes of (iii) above, "specific investment advice" includes a recommendation, analysis or report about specific securities or specific categories of securities (e.g., industrial development bonds, mutual funds, or medical technology stocks). It includes a recommendation that a client allocate certain percentages of his assets to life insurance, high yielding bonds, and mutual funds or particular types of mutual funds such as growth stock funds or money market funds. However, specific investment advice does not

include advice limited to a general recommendation to allocate assets in securities, life insurance, and tangible assets.

In applying the foregoing tests, the staff may consider other financial services activities offered to clients. For example, if a financial planner structures his planning so as to give only generic, non-specific investment advice as a financial planner, but then gives specific securities advice in his capacity as a registered representative of a dealer or as agent of an insurance company, the person would not be able to assert that he was not "in the business" of giving investment advice. See discussion of the broker-dealer exception set forth in Section 202(a)(11)(C) of the Advisers Act, *infra*. In the staff's view, it is necessary to consider these other financial services activities. Section 208(d) of the Advisers Act makes it illegal for someone to do indirectly under the Advisers Act what cannot be done directly.

3. Compensation

The definition of investment adviser applies to persons who give investment advice for compensation. This compensation element is satisfied by the receipt of any economic benefit, whether in the form of an advisory fee or some other fee relating to the total services rendered, commissions, or some combination of the foregoing. It is not necessary that a person who provides investment advisory and other services to a client charge a separate fee for the investment advisory portion of the total services. The compensation element is satisfied if a single fee is charged for a number of different services, including investment advice or the issuing of reports or analyses concerning securities within the meaning of the Advisers Acts.^{viii} As discussed above, however, the fact that no separate fee is charged for the investment advisory portion of the service could be relevant to whether the person is "in the business" of giving investment advice.

It is not necessary that an adviser's compensation be paid directly by the person receiving investment advisory services, but only that the investment adviser receive compensation from some source for his services.^{ix} Accordingly, a person providing a variety of services to a client, including investment advisory services, for which the person receives any economic benefit, for example, by receipt of a single fee or commissions upon the sale to the client of insurance products or investments, would be performing such advisory services "for compensation" within the meaning of Section 202(a)(11) of the Advisers Act.^x

B. Exclusions From Definition of Investment Adviser

Clauses (A) to (E) of Section 202(a)(11) of the Advisers Act set forth limited exclusions from the definition of investment adviser available to certain persons.^{xi} Whether an exclusion from the definition of investment adviser is available to any financial planner, pension consultant or other person providing investment advisory services within the meaning of Section 202(a)(11), depends upon the relevant facts and circumstances.

A person relying on an exclusion from the definition of investment adviser must meet all of the requirements of the exclusion. The staff's view is that the exclusion contained in

Section 202(a)(11)(B) is not available, for example, to a lawyer or accountant who holds himself out to the public as providing financial planning, pension consulting, or other financial advisory services. In such a case it would appear that the performance of investment advisory services by the person would not be incidental to his practice as a lawyer or accountant.^{xii} Similarly, the exclusion for brokers or dealers contained in Section 202(a)(11)(C) would not be available to a broker or dealer, or associated person of a broker or dealer, acting within the scope of the business of a broker or dealer, if the person receives any special compensation for providing investment advisory services.^{xiii} Moreover, the exclusion from the definition of investment adviser contained in Section 202(a)(11)(C) is only available to an associated person of a broker or dealer or "registered representative" who provides investment advisory services to clients within the scope of the person's employment with the broker or dealer.^{xiv} For example, if a registered representative provides advice independent of, or separate from, his broker or dealer employer such as by establishing a separate financial planning practice, then he could not rely on the exclusion because his investment advisory activities would not be subject to control by his broker or dealer employer.^{xv} Similarly, the exclusion would be unavailable if he provides advice without the knowledge and approval of his employer because in that capacity his advisory activities would, by definition, be outside the control of his employer.^{xvi}

III. REGISTRATION AS AN INVESTMENT ADVISER

Any person who is an investment adviser within the meaning of Section 202(a)(11) of the Advisers Act, who is not excluded from the definition of investment adviser by virtue of one of the exclusions in Section 202(a)(11), and who makes use of the mails or any instrumentality of interstate commerce in connection with the person's business as an investment adviser, is required by Section 203(a) of the Advisers Act to register with the Commission as an investment adviser unless specifically exempted from registration by Section 203(b) of the Advisers Act.^{xvii} Also, any person who is an investment adviser within the meaning of any state investment adviser definition, and who is not excluded from that definition, may be required to register with that state. The materials necessary for registering with the Commission as an investment adviser can be obtained by writing the Publications Unit, Securities and Exchange Commission, Washington, D.C., 20549. As to the various states, persons should contact the office of the state securities administrator in the state in which they must register to obtain the necessary materials.

IV. APPLICATION OF ANTIFRAUD PROVISIONS

The antifraud provisions of Section 206 of the Advisers Act [15 U.S.C. 80b-6], and the rules adopted by the Commission thereunder, apply to any person who is an investment adviser as defined in the Advisers Act, whether or not the person is required to be registered with the Commission as an investment adviser.^{xviii} Sections 206(1) and (2) of the Advisers Act, upon which many state antifraud provisions are patterned, make it unlawful for an investment adviser, directly or any indirectly, to "employ any device, scheme, or artifice to defraud client or prospective client" or to "engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."^{xix} An investment adviser is a fiduciary who owes his clients

"an affirmative duty of 'utmost good faith, and full and fair' disclosure of all material facts."^{xx} The Supreme Court has stated that a "[f]ailure to disclose material facts must be deemed fraud or deceit within its intended meaning, for, as the experience of the 1920's and 1930's amply reveals, the darkness and ignorance of commercial secrecy are the conditions under which predatory practices best thrive."^{xxi} Accordingly, the duty of an investment adviser to refrain from fraudulent conduct includes an obligation to disclose material facts to his clients whenever the failure to do so would defraud or operate as a fraud or deceit upon any client or prospective client. In this connection the adviser's duty to disclose material facts is particularly pertinent whenever the adviser is in a situation involving a conflict, or potential conflict, of interest with a client.

The type of disclosure required by an investment adviser who has a potential conflict of interest with a client will depend upon all the facts and circumstances. As a general matter, an adviser must disclose to clients all material facts regarding the potential conflict of interest so that the client can make an informed decision as to whether to enter into or continue an advisory relationship with the adviser or whether to take some action to protect himself against the specific conflict of interest involved. The following examples, which have been selected from cases and staff interpretive and no-action letters, illustrate the scope of the duty to disclose material information to clients in certain common situations involving conflicts of interests.

The advisers' duty to disclose material facts includes the duty to disclose the various capacities in which he might act when dealing with any particular client. For example, an adviser who intends to implement the financial plans he prepares for clients, in whole or part, through the broker or dealer or insurance company with whom the adviser is associated, should inform a client that in implementing the plan the adviser will also act as agent for the broker or dealer or the insurance company.^{xxii}

An investment adviser who is also a registered representative of a broker or dealer and provides investment advisory services outside the scope of his employment with the broker or dealer must disclose to his advisory clients that his advisory activities are independent from his employment with the broker or dealer.^{xxiii} Additional disclosures would be required, depending on the circumstances, if the investment adviser recommends that his clients execute securities transactions through the broker or dealer with which the investment adviser is associated. For example, the investment adviser would be required to disclose fully the nature and extent of any interest the investment adviser has in such recommendation, including any compensation the investment adviser would receive from his employer in connection with the transaction.^{xxiv} In addition, the investment adviser would be required to inform his clients of their ability to execute recommended transactions through other brokers or dealers.^{xxv} A financial planner who will recommend or use only the financial products offered by his broker or dealer employer when implementing financial plans for clients should disclose this practice to clients^{xxvi} and inform clients that the plan may be limited by the products offered by the broker or dealer. Finally, the Commission has stated that "an investment adviser must not effect transactions in which he has a personal interest in a manner that could result in preferring his own interest to that of his advisory clients."^{xxvii}

An investment adviser who structures his personal securities transactions to trade on the market impact caused by his recommendations to clients must disclose this practice to clients.^{xxviii} An investment adviser generally also must disclose if his personal securities transactions are inconsistent with the advice given to clients.^{xxix} Finally, an investment adviser must disclose compensation received from the issuer of a security being recommended.^{xxx}

Unlike other general antifraud provisions in the federal securities laws which apply to conduct "in the offer or sale of any securities"^{xxxii} or "in connection with the purchase or sale of any security,"^{xxxiii} the pertinent provisions of Section 206 do not refer to dealings in securities but are stated in terms of the effect or potential effect of prohibited conduct on the client. Specifically, Section 206(1) prohibits "any device, scheme, or artifice to defraud any client or prospective client," and Section 206(2) prohibits "any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." In this regard, the Commission has applied Sections 206(1) and (2) in circumstances in which the fraudulent conduct arose out of the investment advisory relationship between an investment adviser and its clients, even though the conduct does not involve a securities transaction. For example, in an administrative proceeding brought by the Commission against an investment adviser, the respondent consented to a finding by the Commission that the respondent had violated Sections 206(1) and (2) by persuading its clients to guarantee its bank loans and ultimately to post their securities as collateral for its loans without disclosing the adviser's deteriorating financial condition, negative net worth, and other outstanding loans.^{xxxiii} Moreover, the staff has taken the position that an investment adviser who sells non-securities investments to clients must, under Sections 206(1) and (2), disclose to clients and prospective clients all its interests in the sale to them of such non-securities investments.^{xxxiv}

V. NEED FOR INTERPRETIVE ADVICE

The general interpretive guidance provided in this release should facilitate greater compliance with the Advisers Act and the investment adviser laws of the states. The staff of the Commission will respond to routine requests for no-action or interpretive advice relating to the status of persons engaged in the types of businesses described in this release by referring persons making the requests to the release, unless the requests present novel factual or interpretive issues such as material departures from the nature and type of services and compensation arrangements discussed above. Requests for no-action or interpretive advice from the staff of the Commission should be submitted in accordance with the procedures set forth in Investment Advisers Act Release No. 281 (Jan. 25, 1971). As to requests for no-action or interpretive advice from the states, persons should contact the various state securities departments to inquire as to their procedures.

Accordingly, Part 276 of Chapter 11 of Title 17 of the Code of Federal Regulations is amended by adding Investment Advisers Act Release No. IA-1092, Statement of the staff as to the applicability of the Investment Advisers Act to financial planners, pension consultants, and other persons who provide investment advisory services as a component of other financial services, which supersedes IA-770.

By the Commission.

Jonathan G. Katz Secretary

DATE: October 8, 1987

ⁱ The authority to manage all or a portion of a plan's assets often is delegated to a person who qualifies as an "investment manager" under the Employee Retirement Income Security Act of 1974 [29 U.S.C. 1001 et seq.]. Under that statute, which is applicable to private sector pension and welfare benefit plans, an "investment manager" must be a registered investment adviser under the Advisers Act, a bank as defined in the Advisers Act, or an insurance company that is qualified to perform services as an investment manager under the laws of more than one state.

ⁱⁱ See discussion of Section 202(a)(11)(A) to (F) in Section IIB, *infra*.

ⁱⁱⁱ In this regard, as discussed in detail below, it is the staff's view that a person who gives advice or prepares analyses concerning securities generally may, nevertheless, not be "in the business" of doing so and, therefore, will not be considered an "investment adviser" as that term is used in Section 202(a)(11).

^{iv} See, e.g., *Richard K. May* (pub. avail. Dec. 11, 1979).

^v See, e.g., *Thomas Beard* (pub. avail. May 8, 1975); *Sinclair-deMarinis Inc.* (pub. avail. May 1, 1981).

^{vi} See, e.g., *FPC Securities Corp.* (pub. avail. Dec. 1, 1974) (program to assist client in selection and retention of investment manager by, among other things, recommending investment managers to clients, monitoring and evaluating the performance of a client's investment manager, and advising client as to the retention of such manager); *William Bye Co.* (pub. avail. Apr. 26, 1973) (program involving recommendations to client as to selection and retention of investment manager based upon client's investment objectives and periodic monitoring and evaluation of investment manager's performance). On occasion in the past the staff has taken no-action positions with respect to certain situations involving persons providing advice to clients as to the selection or retention of investment managers. See, e.g., *Sebastian Associates, Ltd.*, (pub. avail. Aug. 7, 1975) (provision of assistance to clients in obtaining and coordinating the services of various professionals such as tax attorneys and investment advisers, including referring clients to such professionals, in connection with business as agent for clients with respect to negotiation of employment and promotional contracts); *Hudson Valley Planning Inc.* (pub. avail. Feb. 25, 1978) (provision of names of several investment managers to client upon request, without recommendation, in connection with business of providing administrative services to employee benefit plans.)

^{vii} See *Zinn v. Parish*, 644 F.2d 360 (7th Cir. 1981).

^{viii} See, e.g., *FINESCO* (pub. avail. Dec. 11, 1979).

^{ix} See, e.g., *Warren H. Livingston* (pub. avail. Mar. 8, 1980).

^x Section 202(a)(11)(C) of the Advisers Act excludes from the definition of investment adviser a broker or dealer who performs investment advisory services that are incidental to the conduct of its broker or dealer business and who receives no special compensation therefor. See discussion of Section 202(a)(11)(C), *infra*.

^{xi} Section 202(a)(11) provides that the definition of investment adviser does not include:

(A) a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956, which is not an investment company;

(B) any lawyer, accountant, engineer or teacher whose performance of such [advisory] services is solely incidental to the practice of his profession;

(C) any broker or dealer whose performance of such [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor;

(D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation;

(E) any person whose advice, analyses, or reports related to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall be designated by the Secretary of the Treasury, pursuant to Section 3(a)(12) of the Securities Exchange Act of 1934, as exempted securities for the purposes of that Act. ...

Section 202(a)(11)(F) excludes from the definition of investment adviser "such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order."

^{xii} See, e.g., *Mortimer M. Lerner* (pub. avail. Feb. 15, 1980); *David R. Markley* (pub. avail. Feb. 8, 1985); *Hauk, Soule & Fasani, P.C.* (pub. avail. May 1, 1986). The "professional" exclusion provided in Section 202(a)(11)(B) by its terms is only available to lawyers, accountants, engineers, and teachers. A person engaged in a profession other than one of those enumerated in Section 202(a)(11)(B) who performs investment advisory services would be an investment adviser within the meaning of Section 202(a)(11) whether or not the performance of investment advisory services is incidental to the practice of such profession. Unless another basis for excluding the person from the definition of investment adviser is available, the person would be subject to the Advisers Act.

^{xiii} See, e.g., *FINESCO*, *supra* note 8. For a general statement of the views of the staff regarding special compensation under Section 202(a)(11)(C), see Investment Advisers Act Release No. 640 (October 5, 1978), and *Robert S. Strevell* (pub. avail. April 29, 1985). See discussion of the "business" standard, *supra*.

^{xiv} See, e.g., *Corinne E. Wood* (pub. avail. April 17, 1986); *George E. Bates* (pub. avail. April 26, 1979).

^{xv} See, e.g., *Robert S. Strevell*, *supra* note 13; *Elmer D. Robinson* (pub. avail. Jan. 6, 1986); *Brent A. Neiser* (pub. avail. Jan. 21, 1986).

^{xvi} *Id.*

^{xvii} Section 203(b) exempts from registration:

(1) any investment adviser all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;

(2) any investment adviser whose only clients are insurance companies; or

(3) any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the [Investment Company Act]....

^{xviii} The antifraud provisions of some state statutes may apply to any person receiving consideration from another person for rendering investment advice even if the person rendering the investment advice is technically excluded from the state definition of investment adviser.

^{xix} In addition, Section 206(3) of the Advisers Act generally makes it unlawful for an investment adviser acting as principal for his own account knowingly to sell any security to or purchase any security from a client, or, acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The responsibilities of an investment adviser dealing with a client as principal or as agent for another person are discussed in Advisers Act Rel. Nos. 40 and 470 (February 5, 1945 and August 20, 1975 respectively).

^{xx} *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 184 (1963) quoting Prosser, *Law of Torts* (1955), 534-535.

^{xxi} *Id.* at 200.

^{xxii} See *Elmer D. Robinson*, *supra* note 15. See also *In the Matter of Haight & Co., Inc.* (Securities Exchange Act Rel. No. 9082, Feb. 19, 1971), where the Commission held that a broker or dealer and its associated persons defrauded its customers in the offer and sale of securities by holding themselves out as financial planners who would, as financial planners, give comprehensive and expert planning advice and choose the best investments for their clients from all available securities, when in fact they were not expert in planning and made their decisions based on the receipt of commissions and upon their inventory of securities. *Accord Institutional Trading Corporation* (pub. avail. Nov. 27, 1972).

^{xxiii} *David P. Atkinson* (pub. avail. Aug. 1, 1977). See also *Corrine E. Wood*, *supra* note 14.

^{xxiv} *Id.*

^{xxv} *Don P. Matheson* (pub. avail. Sept. 1, 1976).

^{xxvi} *Elmer D. Robinson*, *supra* note 15.

^{xxvii} *Kidder, Peabody & Co., Inc.*, 43 S.E.C. 911,916 (1968).

^{xxviii} *SEC v. Capital Gains Research Bureau*, *supra* note 19, at 197.

^{xxix} *In the Matter of Dow Theory Letters et al.*, Advisers Act Rel. No. 571 (Feb. 22, 1977).

^{xxx} *In the Matter of Investment Controlled Research et al.*, Advisers Act Release No. 701 (Sept. 17, 1979).

^{xxxi} Section 17(a) [15 U.S.C. 77q(a)] of the Securities Act of 1933 [15 U.S.C. 77a *et seq.*].

^{xxxii} Rule 10b-5 [17 CFR 240.10b-5] under the Securities Exchange Act of 1934 [15 U.S.C. 78a *et seq.*]. See also Section 15 (c) [15 U.S.C. 78o(c)] of the Securities Exchange Act of 1934.

^{xxxiii} *In the Matter of Ronald B. Donati, Inc. et al.*, Advisers Act Rel. Nos. 666 and 683 (February 8, 1979 and July 2, 1979 respectively). See also *Intersearch Technology, Inc.* [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) Paragraph 80,139, at 85,189.

^{xxxiv} See *Boston Advisory Group* (pub. avail. Dec. 5, 1976).

ATTACHMENT 3

FORM ADV

A PDF of Form ADV (Part 1 and Part 2)

can be found at the SEC's website:

<http://www.sec.gov/about/forms/formadv.pdf>

Further information on

“Electronic Filing for Investment Advisers”

can be found at:

<http://www.sec.gov/divisions/investment/iard/iastuff.shtml>

