General Information on the Regulation of Investment Advisers

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Division of Investment Management

Note: Information on this page may not be current or accurately reflect legal requirements. For more current information see:

- http://www.sec.gov/iard for investment adviser forms and registration information
- http://www4.law.cornell.edu/uscode/15/ch2D.html for Investment Advisers Act of 1940
- http://www.sec.gov/about/laws/secrulesregs.htm#invadva40 for Rules under the Investment Advisers Act of 1940

Introduction

The Securities and Exchange Commission (the "Commission" or "SEC") regulates investment advisers, primarily under the Investment Advisers Act of 1940 (the "Advisers Act"), and the rules adopted under that statute (the "rules"). One of the central elements of the regulatory program is the requirement that a person or firm meeting the definition of "investment adviser" under the Advisers Act register with the Commission, unless exempt or prohibited from registration.

Generally only larger advisers that have $25 million or more of assets under management or that provide advice to investment company clients are permitted to register with the Commission. Smaller advisers register under state law with state securities authorities. This document provides an overview of federal regulation, as applied to SEC-registered advisers.

Many of the concepts discussed, however, also are relevant with respect to state-registered advisers.

The information in this document briefly summarizes some of the more important provisions of federal investment adviser regulation. Additional information on the mechanics of the registration process is contained in the document "How To Register as an Investment Adviser." The information in these documents should not be used as a substitute for the Advisers Act, rules, forms, and instructions to the forms (see "Requesting Copies of the Advisers Act, Rules, Forms, Letters, and Releases" for information on obtaining these documents) .

Sources of Regulation

The primary sources of federal investment adviser regulation are the Advisers Act, 15 U.S.C. 80b-1 et seq., and the rules thereunder, Title 17, Part 275 of the Code of Federal Regulations. In addition, the Commission and its Division of Investment Management (the "Division") provide interpretive guidance in: instructions to forms under the Advisers Act, "no-action letters," "interpretative letters," and "releases," all of which are publicly available. To request copies of the Advisers Act, rules, forms, no-action and interpretative letters, or releases, refer to the instructions at the end of this document under "Requesting Copies of the Advisers Act, Rules, Forms, Letters, and Releases." The copies of the Advisers Act, rules, and forms are current as of August 31, 1998.

Although state-registered advisers are governed primarily by state law, several provisions of the Advisers Act and Commission rules apply to such advisers. For more information on the provisions of federal law that apply to state-registered advisers, refer to the discussion below under "State-Registered Advisers."

Who Is Required To Register?

A person or firm is required to register with the Commission if he or it is:

- an "investment adviser" under Section 202(a)(11) of the Advisers Act;
- not excepted from the definition of investment adviser by Section 202(a)(11)(A) through (E) of the Advisers Act;
- not exempt from Commission registration under Section 203(b) of the Advisers Act; and
- not prohibited from Commission registration by Section 203A of the Advisers Act.

Each of these elements is addressed below.

Who Is an Investment Adviser?

Subject to certain limited exclusions discussed below, Section 202(a)(11) of the Advisers Act generally defines an "investment adviser" as any person or firm that: (1) for compensation; (2) is engaged in the business of; (3) providing advice, making recommendations, issuing reports, or furnishing analyses on securities, either directly or through publications. A person or firm must satisfy all three elements to be regulated under the Advisers Act.

The Division construes these elements broadly. For example, with respect to "compensation," the receipt of any economic benefit suffices. To be deemed compensation, a fee need not be

separate from other fees charged, it need not be designated as an advisory fee, and it need not be received directly from a client. With respect to the "business" element, an investment advisory business need not be the person's or firm's sole or principal business activity. Rather, this element is satisfied under any of the following circumstances: the person or firm holds himself or itself out as an investment adviser or as providing investment advice; the person or firm receives separate or additional compensation for providing advice about securities; or the person or firm typically provides advice about specific securities or specific categories of securities. Finally, a person or firm satisfies the "advice about securities" element if the advice or reports relate to securities. The Division has stated that providing one or more of the following also could satisfy this element: advice about market trends; advice in the form of statistical or historical data (unless the data is no more than an objective report of facts on a non-selective basis); advice about the selection of an investment adviser; advice concerning the advantages of investing in securities instead of other types of investments; and a list of securities from which a client can choose, even if the adviser does not make specific recommendations from the list. An employee of an SEC-registered investment adviser does not need to register separately, so long as all of the employee's investment advisory activities are within the scope of his employment.

For additional guidance on the definition of "investment adviser" and the applicability of the Advisers Act to financial planners, pension consultants, and others, refer to Investment Advisers Act Release No. 1092 (October 8, 1987) (part of the Investment Adviser Registration Package; see below).

Exclusions From the Definition

Section 202(a)(11)(A)-(E) of the Advisers Act expressly excludes certain persons or firms from the definition of an investment adviser. These persons or firms need not register under, and generally are not regulated by, the Advisers Act. Excluded are:

- Domestic banks (defined in Section 202(a)(2) of the Advisers Act) and bank holding companies (defined in the Bank Holding Company Act of 1956). Savings and loan institutions, federal savings banks, foreign banks, and credit unions do not fall within this exclusion.
- Lawyers, accountants, engineers, and teachers if their performance of advisory services is solely incidental to their professions.
- Brokers and dealers if their performance of advisory services is solely incidental to the conduct of their business as brokers and dealers, and they do not receive any special compensation for their advisory services. This exclusion is not available to a registered representative acting as a financial planner outside the scope of his employment with the broker employer.
- Publishers of bona fide newspapers, news magazines, and business or financial publications of general and regular circulation. Under a decision of the United States Supreme Court, to enable a publisher to qualify for this exclusion, a publication must satisfy three elements: (1) the publication must offer only impersonal advice, i.e., advice not tailored to the individual needs of a specific client, group of clients, or portfolio; (2) the publication must be "bona fide," containing disinterested commentary and analysis rather than promotional material disseminated by someone touting particular securities, advertised lists of stocks "sure to go up," or information distributed as an incident to personalized investment services; and (3) the publication must be of general and regular circulation rather than issued from time to time in response to episodic market activity or

events affecting the securities industry. See Lowe v. Securities and Exchange Commission, 472 U.S. 181 (1985).
- Persons and firms whose advice, analyses, or reports are related only to securities that are direct obligations of, or obligations guaranteed by, the United States, or by certain U.S. government-sponsored corporations designated by the Secretary of the Treasury (e.g., FNMA, GNMA).

In addition to these exclusions, the Advisers Act gives the Commission the authority to exclude, by order, other persons and firms not within the intent of the definition of investment adviser. Any person or firm seeking such an order should refer to Rules 0-4 and 0-5 under the Advisers Act and Investment Advisers Act Release No. 969 (April 30, 1985).

Exemptions From Registration

A person or firm meeting the definition of investment adviser in Section 202(a)(11) does not need to register with the Commission if the person or firm qualifies for one of the exemptions from registration set forth in Section 203(b) of the Advisers Act. Investment advisers exempt from registration under Section 203(b) are still subject to certain anti-fraud provisions included in Section 206 of the Advisers Act. For more information on anti-fraud provisions, refer to the discussion below under "Anti-Fraud Provisions."

Section 203(b) of the Advisers Act provides five limited exemptions from registration. Section 203(b)(1) exempts any adviser (1) all of whose clients are within the same state as the adviser's principal business office, and (2) that does not provide advice or issue reports about securities listed on any national securities exchange. Section 203(b)(2) exempts advisers whose only clients are insurance companies. Section 203(b)(3) exempts any adviser that: (1) during the previous twelve months has had fewer than fifteen clients; (2) does not hold itself out generally to the public as an investment adviser; and (3) does not act as an investment adviser to a registered investment company or business development company. Rule 203(b)(3)-1 under the Advisers Act provides guidance on how to count clients when determining eligibility for this exemption. In determining if a person or firm holds himself or itself out as an investment adviser within the meaning of Section 203(b)(3), the Division looks at a number of factors, including, for example, whether the person or firm advertises; refers to himself or itself as an "investment adviser"; maintains a listing as an investment adviser in a telephone, business, building, or other directory; expresses a willingness to accept new advisory clients; or uses letterhead indicating any investment advisory activity. Section 203(b)(4) generally exempts any adviser that (1) is a charitable organization, or is employed by a charitable organization, and (2) provides advice, analyses, or reports only to charitable organizations, or to funds operated for charitable purposes. Section 203(b)(5) exempts advisers to church employee pension plans.

Prohibition on Commission Registration

A person or firm that does not meet any of the criteria in Section 203A of the Advisers Act or Rule 203A-2 thereunder is prohibited from registering with the Commission.

Only the following types of advisers are permitted to register with the Commission (and therefore must register with the Commission, unless exempt under Section 203(b)):

- advisers that have "assets under management" of $25 million or more;
- advisers to registered investment companies;

- advisers that have their principal office and place of business in a state that has not enacted an investment adviser statute (currently, only Wyoming), or that have their principal office and place of business outside the United States; or
- advisers that are exempted from the prohibition by Commission rule or order. The Commission has adopted a rule exempting five categories of investment advisers:
- nationally recognized statistical rating organizations ("NRSROs") (Rule 203A-2(a));
- pension consultants that provide investment advice with respect to $50 million or more of plan assets (Rule 203A-2(b));
- investment advisers sharing the same principal office and place of business with an affiliated investment adviser that is registered with the Commission (Rule 203A-2(c));
- newly-formed investment advisers that have a reasonable expectation of being eligible for Commission registration within 120 days of formation (Rule 203A-2(d)); and
- investment advisers that would otherwise be required to register as investment advisers with the securities authorities of 30 or more states (Rule 203A-2(e)).

Advisers are required to report their eligibility for Commission registration on Schedule I to Form ADV upon initial registration. Additionally, advisers are required to report their continuing eligibility for Commission registration annually by amending Schedule I to Form ADV within ninety days of the end of their fiscal year. For additional information on the prohibition on Commission registration, refer to Investment Advisers Act Release Nos. 1633 (May 15, 1997) and 1733 (July 20, 1998).

Successors to SEC-Registered Investment Advisers

An unregistered firm that is acquiring or assuming substantially all of the assets and liabilities of the investment advisory business of an SEC-registered investment adviser may rely on special registration provisions for "successors" to SEC-registered advisers. Specifically, if an unregistered successor files an application for registration as an investment adviser (on Form ADV) within thirty days following the succession, it may rely on the registration of its predecessor until its registration is declared effective by the Commission. If a new investment adviser is formed solely as a result of a change in an adviser's structure or legal status (e.g., form of organization or state of incorporation), and there is no practical change in control of the adviser, generally the adviser may amend its predecessor's Form ADV within thirty days following the transaction, rather than file a new application. In responding to Part I, Item 9 of Form ADV, a successor is not required to report successions previously reported. For further information on the registration of successors, refer to Investment Advisers Act Release No. 1357 (December 28, 1992). For more information on what constitutes a change of control, refer to the discussion below under "Prohibited Contractual and Fee Provisions, Assignment."

Anti-Fraud Provisions

Section 206 of the Advisers Act prohibits misstatements or misleading omissions of material facts and other fraudulent acts and practices in connection with the conduct of an investment advisory business. As a fiduciary, an investment adviser owes its clients undivided loyalty, and may not engage in activity that conflicts with a client's interest without the client's consent. In S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963), the United States Supreme Court held that, under Section 206, advisers have an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to their clients, as well as a duty to avoid misleading them. Section 206 applies to all firms and persons meeting the Advisers Act's

definition of investment adviser, whether registered with the Commission, a state securities authority, or not at all.

In addition to the general anti-fraud prohibition of Section 206, Rules 206(4)-1, 206(4)-2, 206(4)-3, and 206(4)-4 under the Advisers Act regulate, respectively: investment adviser advertising; custody or possession of client funds or securities; the payment of fees by advisers to third parties for client referrals; and disclosure of investment advisers' financial and disciplinary backgrounds. These rules are discussed in greater detail below.

Disclosure Obligations

The Brochure Rule

Rule 204-3 under the Advisers Act, commonly referred to as the "brochure rule," generally requires every SEC-registered investment adviser to deliver to each client or prospective client a Form ADV Part 2A (brochure) and Part 2B (brochure supplement) describing the adviser's business practices, conflicts of interest and background of the investment adviser and its advisory personnel. An adviser must deliver the brochure to a client before or at the time the adviser enters into an investment advisory contract with a client. The rule also requires an adviser, if there are material changes in the brochure since the adviser's last annual updating amendment, to deliver annually, without charge, to each client within 120 days after the end of the adviser's fiscal year either (i) a current brochure or (ii) a summary of material changes to the brochure as required by Item 2 of the brochure that offers to provide the adviser's current brochure without charge, accompanied by the Web site address (if available) and an e-mail address (if available) and telephone number by which a client may obtain the current brochure from the adviser, and the Web site address for obtaining information about the adviser through the Investment Adviser Public Disclosure system. An adviser must deliver to each client or prospective client a current brochure supplement for a supervised person before or at the time that supervised person begins to provide advisory services to the client.

SEC-registered advisers are not required to deliver a brochure to either (i) clients that are SEC-registered investment companies or business development companies; or (ii) clients who receive only impersonal investment advice from the adviser and who will pay the adviser less than $500 per year. An SEC-registered adviser is not required to deliver a brochure supplement to a client (i) to whom it is not required to deliver a brochure, (ii) who receives only impersonal investment advice, or (iii) certain officers, and employees of the adviser.

Other Disclosure Requirements

Rule 206(4)-4 under the Advisers Act requires every SEC-registered investment adviser that has custody or discretionary authority over client funds or securities, or that requires prepayment six months or more in advance of more than $500 of advisory fees, to disclose promptly to clients and prospective clients (collectively, "clients") any financial conditions of the adviser that are reasonably likely to impair the ability of the adviser to meet contractual commitments to clients. The rule also requires advisers (regardless of whether the adviser has custody or requires prepayment of fees) to disclose promptly to clients legal or disciplinary events that are material to an evaluation of the adviser's integrity or ability to meet its commitments to clients. The rule lists a number of legal and disciplinary events for which there is a rebuttable presumption of materiality for these purposes (although an event may still be material even if it is not on the list).

The Division takes the position that an investment adviser must disclose to clients all material information regarding its compensation, such as if the adviser's fee is higher than the fee typically charged by other advisers for similar services (in most cases, this disclosure is necessary if the annual fee is three percent of assets or higher). An investment adviser must disclose all potential conflicts of interest between the adviser and its clients, even if the adviser believes that a conflict has not affected and will not affect the adviser's recommendations to its clients. This obligation to disclose conflicts of interest includes the obligation to disclose any benefits the adviser may receive from third parties as a result of its recommendations to clients.

An investment adviser (even if unregistered) may be subject to disclosure obligations not only under the Advisers Act, but also under other federal statutes, including the Securities Exchange Act of 1934 (the "Exchange Act"). For example, Section 13(f) of the Exchange Act, and Rule 13f-1 thereunder, generally require an investment adviser exercising investment discretion, or sharing investment discretion with others, over equity securities (which would include convertible debt and options) having a fair market value in the aggregate of at least $100 million to file, on a quarterly basis, a Form 13F disclosing the holdings that it manages on its own behalf and on behalf of clients.

Books and Records To Be Retained

Section 204 of the Advisers Act and Rule 204-2 thereunder require that SEC-registered investment advisers maintain and preserve specified books and records, and make them available to Commission examiners for inspection. Rule 204-2 permits investment advisers, under certain conditions, to maintain books and records on microfilm and magnetic disk, tape, or other computer recordkeeping devices.

Rule 204-2 requires every SEC-registered investment adviser to retain copies of all advertisements and other communications (collectively, "advertisements") that the adviser has circulated, directly or indirectly, to ten or more persons (excluding persons connected with the adviser). Generally, the adviser also must create and retain all documents necessary to substantiate any performance information contained in advertisements. With respect to the advertisement of performance information for managed accounts, an adviser need retain only (1) all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and (2) all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts.

Prohibited Contractual and Fee Provisions

Assignment

Section 205(a)(2) of the Advisers Act requires each investment advisory contract entered into by an investment adviser (whether SEC-registered or not, unless exempt from registration under Section 203(b)) to provide that the contract may not be assigned without the client's consent. Section 202(a)(1) of the Advisers Act defines "assignment" generally to include any direct or indirect transfer of an investment advisory contract by an adviser or any transfer of a controlling block of an adviser's outstanding voting securities. Rule 202(a)(1)-1 under the Advisers Act, however, provides that a transaction that does not result in a change of actual control or management of the adviser (e.g., a reorganization for purposes of changing an adviser's state of incorporation) would not be deemed to be an assignment for these purposes.

Section 205(a)(3) of the Advisers Act provides that if an investment adviser is organized as a partnership, each of its advisory contracts must provide that the adviser will notify the client of a change in its membership.

Performance Fees

Section 205(a)(1) of the Advisers Act prohibits an investment adviser (whether SEC-registered or not, unless exempt from registration under Section 203(b)) from receiving any type of advisory fee calculated as a percentage of capital gains or appreciation in the client's account ("performance fee arrangement"). The Advisers Act contains exceptions from this prohibition for contracts with: (1) registered investment companies and clients having more than $1 million in managed assets, if specific conditions are met; (2) private investment companies excepted from the Investment Company Act under Section 3(c)(7) of that Act; and (3) clients that are not U.S. residents. In addition Rule 205-3 under the Advisers Act permits investment advisers to charge performance fees to: (1) clients with at least $750,000 under management with the adviser or more than $1,500,000 of net worth; (2) clients who are "qualified purchasers" under section 2(a)(51)(A) of the Investment Company Act; and (3) certain knowledgeable employees of the investment adviser.

Advertising Restrictions

Rule 206(4)-1 under the Advisers Act prohibits SEC-registered investment advisers from using any advertisement that contains any untrue statement of material fact or that is otherwise misleading. The rule broadly defines "advertisement" to include any notice, circular, letter, or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, that offers any investment advisory service.

In addition, an advertisement may not:

- use or refer to testimonials (which include any statement of a client's experience or endorsement);
- refer to past, specific recommendations made by the adviser that were profitable, unless the advertisement sets out a list of all recommendations made by the adviser within the preceding period of not less than one year, and complies with other, specified conditions;
- represent that any graph, chart, formula, or other device can, in and of itself, be used to determine which securities to buy or sell, or when to buy or sell such securities, or can assist persons in making those decisions, unless the advertisement prominently discloses the limitations thereof and the difficulties regarding its use; and
- represent that any report, analysis, or other service will be provided without charge unless the report, analysis, or other service will be provided without any obligation whatsoever.

The Division takes the position that an adviser may advertise its past performance (both actual performance and hypothetical or model results) only if the advertisement meets certain conditions and restrictions. An advertisement using performance data must disclose all material facts necessary to avoid any unwarranted inference. Among other things, an investment adviser may not advertise its performance data if the adviser: (1) fails to disclose the effect of material market or economic conditions on the results advertised; (2) fails to disclose whether and to what extent the advertised results reflect the reinvestment of dividends or other earnings; or

(3) suggests or makes claims about the potential for profit without also disclosing the potential for loss.

In addition, generally an adviser may not advertise gross performance data (i.e., performance data that does not reflect the deduction of various fees, commissions, and expenses that a client would pay) unless the adviser also includes net performance information in an equally prominent manner. The staff has taken the position, however, that an adviser may provide gross performance information, accompanied by appropriate disclosure regarding the impact of fees and expenses, in certain limited circumstances that present minimal risk that the client will not understand the impact of fees and expenses, such as when the client is a sophisticated institution, and the adviser presents the information to the client "one-on-one." Neither the Commission nor the Division will pre-approve advertisements for compliance with the above requirements, although advertisements are subject to review during Commission inspections.

Suitability Requirements

As fiduciaries, investment advisers owe their clients a duty to provide only suitable investment advice. This duty generally requires an investment adviser to determine that the investment advice it gives to a client is suitable for the client, taking into consideration the client's financial situation, investment experience, and investment objectives. Investment Advisers Act Release No. 1406 (March 16, 1994).

Custody Requirements

Rule 206(4)-2 under the Advisers Act details how client funds and securities in the custody of the adviser must be held, and requires an SEC-registered adviser with "custody" to provide specified information to clients. An adviser will be deemed to have custody if it directly or indirectly holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them.

Restriction on Payment of Referral Fees

Rule 206(4)-3 under the Advisers Act generally prohibits an SEC-registered investment adviser from paying a cash fee, directly or indirectly, to a third party (a "solicitor") for referring clients to the adviser unless the arrangement complies with a number of conditions. Among other things, the rule requires that: (1)be a written agreement between the adviser and the solicitor (a copy of which the adviser must retain) detailing the referral arrangement; (2) at the time of any solicitation activities, the solicitor provide the prospective client with a copy of the investment adviser's brochure pursuant to Rule 204-3, and a separate, written disclosure document that discloses, among other things, that the solicitor is being compensated for referring or recommending the adviser, and the terms of the compensation (including any additional amounts the client will be charged by the adviser as a result of the referral arrangement); and (3) the adviser receives from the client, prior to, or at the time of, entering into any written or oral investment advisory agreement with the client, a signed and dated acknowledgment that the client received the investment adviser's brochure and the solicitor's written disclosure document. Solicitors generally will not be required to register separately as advisers with the Commission if they comply with the conditions of the rule. Failure to comply with these conditions, however, could result in liability to the adviser under the Advisers Act's

anti-fraud provisions, and could result in the solicitor being deemed an unregistered investment adviser.

Wrap Fee Programs

Many advisers participate in wrap fee programs. Rule 204-3(f) under the Advisers Act requires a sponsor of a wrap fee program to prepare a "wrap fee brochure" that provides, in narrative form, a full explanation of the program and its sponsor, and to deliver the wrap fee brochure to wrap fee clients. A "wrap fee program" for purposes of the rule is a program under which investment advisory and brokerage execution services are provided for a single "wrapped" fee that is not based on the transactions in a client's account. An investment advisory program under which all clients pay traditional, transaction-based commissions is not a wrap fee program. Similarly, a program under which client assets are allocated among mutual funds is not a wrap fee program because normally there is no payment for brokerage execution.

Schedule H to Form ADV sets forth the information required in the wrap fee brochure. The wrap fee brochure must be prepared by the "sponsor" of the wrap fee program, i.e., the person that, for a portion of the fee, sponsors, organizes, or administers the program or recommends portfolio managers under the program. Some wrap fee programs will have more than one sponsor, in which case only one of the sponsors, as selected by the sponsors, needs to prepare the wrap fee brochure. An investment adviser providing portfolio management services to wrap fee clients is not a sponsor unless it performs other duties that would cause it to fall within the definition.

Wrap fee programs and other discretionary advisory programs that provide similar advice to a number of clients should be structured in a manner designed to avoid the creation of an unregistered investment company. The Commission has adopted Rule 3a-4 under the Investment Company Act of 1940 to provide a non-exclusive safe harbor from the definition of an investment company for advisory programs that meet certain requirements. See Investment Company Act Release No. 22579 (March 24, 1997).

Duty of Best Execution

As a fiduciary, an adviser has an obligation to obtain "best execution" of clients' transactions. In meeting this obligation, an adviser must execute securities transactions for clients in such a manner that the clients' total cost or proceeds in each transaction is the most favorable under the circumstances. In assessing whether this standard is met, an adviser should consider the full range and quality of a broker's services when placing brokerage, including, among other things, execution capability, commission rate, financial responsibility, responsiveness to the adviser, and the value of any research services provided. See Exchange Act Release No. 23170 (April 23, 1986).

Aggregation of Client Orders

In directing orders for the purchase or sale of securities to a broker-dealer for execution, an adviser may aggregate or "bunch" those orders on behalf of two or more of its accounts, so long as the bunching is done for purposes of achieving best execution, and no client is systematically advantaged or disadvantaged by the bunching. An adviser may include accounts in which it or its officers or employees have an interest in a bunched order. Advisers must have procedures in

place that are designed to ensure that the trades are allocated in such a manner that all clients are treated fairly and equitably.

Principal Transactions and Agency Cross Transactions

Section 206(3) of the Advisers Act prohibits an adviser (whether SEC-registered or not), acting as principal for its own account, from knowingly selling any security to or purchasing any security from a client ("principal transaction"), without notifying the client in writing, and obtaining the client's consent before the completion of the transaction. Notification and consent for principal transactions must be obtained separately for each transaction. Rule 206(3)-2 under the Advisers Act permits an adviser to act as broker for both its advisory client and the party on the other side of the brokerage transaction ("agency cross transaction") without obtaining the client's prior consent to each transaction, provided that the adviser obtains a prior consent for these types of transactions from the client, and complies with other, enumerated conditions. The rule does not relieve advisers of their duties to obtain best execution and best price for any transaction. A principal or agency cross transaction executed by an affiliate of an adviser is deemed to have been executed by the adviser for purposes of Section 206(3) and Rule 206(3)-2.

Insider Trading Procedures and Duty of Supervision

Section 204A of the Advisers Act requires investment advisers (whether SEC-registered or not) to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by the investment adviser or any of its associated persons. Investment advisers also have a duty to supervise persons associated with the investment adviser with respect to activities performed on the adviser's behalf.

Withdrawal and Cancellation of Registration

As noted above, all SEC-registered investment advisers are required to report their continuing eligibility for Commission registration by amending Schedule I to Form ADV within ninety days of the end of the adviser's fiscal year. If an adviser reports on Schedule I that it is no longer eligible to maintain its Commission registration, it must withdraw its registration by filing a Form ADV-W Notice of Withdrawal from Registration within 180 days after the end of its fiscal year. Additionally, if an SEC-registered investment adviser ceases to conduct business as an investment adviser, the adviser must withdraw its registration by filing a Form ADV-W.

All information provided on Form ADV-W must be accurate and complete; failure to provide accurate and complete information could subject the adviser to liability under Section 207 of the Advisers Act. If the Commission finds that an SEC-registered investment adviser is no longer eligible to maintain its Commission registration or has ceased to conduct business as an investment adviser, the Commission will seek to cancel the adviser's registration. The Commission annually seeks to cancel the registrations of investment advisers that have failed to update Form ADV by amending Schedule I or that otherwise no longer appear to be engaged in business as an investment adviser.

State-Registered Advisers

Investment advisers that are prohibited from registering with the Commission (e.g. advisers that do not have assets under management of $25 million) generally must register with the state(s) in which they transact advisory business (e.g., have advisory clients or have a place of business), unless they are exempt from investment adviser regulation under state law. These advisers will be regulated primarily under state law administered by state securities authorities, rather than federal law administered by the SEC.

An adviser should check with each state in which it proposes to transact business, not just the state in which the adviser is located, for information about investment adviser regulation. The names and addresses of the appropriate regulating official for each state can be obtained by contacting the North American Securities Administrators Association, Inc., One Massachusetts Ave., N.W., Washington, D.C. 20001, telephone (202) 737-0900.

Most provisions of the Advisers Act and Commission rules apply solely to SEC-registered advisers, and therefore are not applicable to state-registered advisers. Thus, state-registered advisers are not required to file and amend Form ADV with the Commission under Rule 204-1; comply with the SEC's books and recordkeeping requirements under Rule 204-2; or deliver a brochure to clients under Rule 204-3. State investment adviser laws, however, may impose substantially the same requirements. For example, many state laws require advisers to register by filing Form ADV with the state.

State-registered advisers are subject to Section 206 of the Advisers Act, which prohibits fraudulent conduct. The Commission has authority to bring enforcement actions against state-registered advisers for fraud. Other provisions of the Advisers Act that apply to state-registered advisers include:

- Section 204A, which requires advisers to establish, maintain, and enforce written procedures reasonably designed to prevent the misuse of material nonpublic information;
- Section 205, which contains prohibitions on advisory contracts that (i) contain certain performance fee arrangements, (ii) permit an assignment of the advisory contract to be made without the consent of the client, and (iii) fail to require an adviser that is a partnership to notify clients of a change in the membership of the partnership. (The exemption provided in Rule 205-3 for certain performance fee arrangements, however, is available to all advisers, including state-registered advisers); and
- Section 206(3), which makes it unlawful for any investment adviser acting as principal for its own account to knowingly sell any security to, or purchase any security from, a client, without disclosing to the client in writing before the completion of the transaction the capacity in which the adviser is acting and obtaining the client's consent. (The exemption provided in Rule 206(3)-2 from the prohibitions of Section 206(3), however, is available to all advisers, including state-registered advisers.)

Requesting Copies of the Advisers Act, Rules, Forms, Letters, and Releases

Paper copies of the Advisers Act, the rules, the forms, no-action and interpretative letters, and releases may be obtained as follows:

- **The Advisers Act and the Forms.** Request a copy of the "Investment Advisers Act of 1940," Forms ADV (which includes Schedule I), Forms ADV-E and ADV-W, and additional copies of this Investment Adviser Registration Package, by calling the Publications Unit of the Commission at (202) 942-4046, or by sending a written request to: Publications Unit, U.S. Securities and Exchange Commission, 450 5th Street, N.W., Mail Stop C-11, Washington, D.C. 20549. There is no charge. When requesting Form ADV or the Investment Adviser Registration Package, advisers that are not U.S. residents should specifically ask for Forms 4-R, 5-R, 6-R, and 7-R concerning consent to service of process.
- **The Rules.** Request a copy of the "Code of Federal Regulations (CFR), Title 17, Part 240 to end," Stock No. 869-026-00056-5, by calling the Superintendent of Documents, Government Printing Office, at (202) 512-1800, or by faxing a request to (202) 512-2250. There is a charge. If requesting by telephone or fax, payment must be made by Visa or MasterCard. Copies of the rules also may be obtained by writing to the Superintendent of Documents, Government Printing Office, P.O. Box 371954, Pittsburgh, PA 15250-7954. When requesting by mail, payment may be made by Visa, MasterCard, personal check, or money order.
- **No-Action and Interpretative Letters and Releases.** Request a copy of a particular no-action or interpretative letter or release from the Office of Filings and Information Services, Public Reference Branch, by faxing a request to (202) 777-1030, by calling (202) 551-8090, or by writing to the Office of Filings and Information Services, Public Reference Branch, U.S. Securities and Exchange Commission, Room 1024, Mail Stop 1-2, 450 5th Street, N.W., Washington, D.C. 20549. There is a charge. Each request must provide the name and date of the letter, or the number and date of the release being requested, and include: the name and address to which the material is to be mailed (the Commission will not fax any material); the requester's telephone number; and a statement that the requester will be responsible for all charges. For additional information, please contact the Public Reference Branch of the Commission at (202) 551-8090.

http://www.sec.gov/divisions/investment/iaregulation/memoia.htm

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