

# **Navigating the Dodd-Frank Act's New Regulatory Requirements for Investment Advisers**

**Presented by**  
**New Jersey Bureau of Securities**

# Topics

- What Dodd-Frank Means for Investment Advisers
- IA Regulation in New Jersey
- What to Expect from Bureau IA Exams

# DISCLAIMER

This presentation and the accompanying materials are presented as an educational experience, covering some of the changes mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

You will be subject to all relevant laws, regulations, rules and orders whether or not they are included in this presentation. The views expressed are those of the presenter, and NJ Bureau of Securities reserves the right to change its position. Presenters believe all information is truthful and accurate; however, mistakes can occur.

# About Us

## Our primary goal is to protect investors

- ❑ New Jersey Bureau of Securities (NJBOS) regulates:
  - Investment Advisers & Investment Adviser Representatives
  - Broker-Dealers
  - Agents / Registered Representatives
  
- ❑ Other responsibilities of the NJBOS:
  - Investigations into alleged violations of the NJ Uniform Securities Law
  - Examinations
  - Securities Registration
  - BD/IA/Agent/IAR Registration
  - Investor Education

# What Dodd-Frank Means For IAs

Under the **Dodd-Frank Wall Street Reform and Consumer Protection Act**, state securities regulators will have greater responsibility for the regulation of investment advisers.

# What Dodd-Frank Means For IAs

- Dodd-Frank establishes a threshold of **\$100 million** assets under management (AUM) for federally covered advisers, with a buffer of \$90 - \$110 million for fluctuation of AUM.
- Approximately **4,000** advisers nationwide will be affected.
- Eliminates the **private adviser** exemption.
- Advisers currently registered with the SEC will have until June 28, 2012 to become registered with the state, but must inform SEC by the end of March 2012.

# What Dodd-Frank Means For IAs

- ❑ In New Jersey, all advisers with \$100 million (\$90 million) or less under management will be required to register with the state **unless**:
  - They fall between \$25 million and \$100 million **and** are required to be registered in 15 or more states, or
  - The investment adviser qualifies for an exemption under Rule 203A-2 of the Investment Advisers Act of 1940.
  - The adviser has five clients or fewer in New Jersey during any consecutive period of 12 months. N.J.S.A 49:3-56(g).

# What Dodd-Frank Means For IAs

- ❑ **State authority over IAs with AUM of \$25-\$100 million**
  - IA's principal office and place of business in a state that requires registration and if registered the IA would be subject to examination
  - If an IA is required to register in 15 or more states, the IA can remain with SEC
- ❑ Some IAs will register with the SEC regardless of AUM, such as IAs to registered investment companies and IAs to a business development company under the Investment Company Act.

# What Dodd-Frank Means For IAs

## About State Regulation:

- ❑ **States are preparing to handle the switch.** State securities regulators are working to ensure a seamless, comprehensive and effective switching process.
- ❑ **Switching is not new.** Regulatory switches regularly happen when the asset levels of IA firms rise above or fall below mandated thresholds.
- ❑ **State registration is a smooth process for most IAs,** especially those that have made the switch before and those that operated prior to 1996 when most IAs were required to register both with the SEC and with each state in which they were doing business.

# What Dodd-Frank Means For IAs

## About State Regulation:

- ❑ **States conduct a thorough review of adviser applications.** State reviews will not change with the migration of IAs with up to \$100 million in assets under management.
- ❑ Firms switching to state regulation for the first time can expect **thorough examinations generally on a more frequent basis** than they may have experienced before.
- ❑ Thorough examinations and strong internal compliance **benefit customer and firm alike.**

# What Dodd-Frank Means For IAs

## NASAA IA Switch Resource Center

- ❑ The North American Securities Administrators Association (NASAA) is assisting states with the migration of investment advisers.
- ❑ NASAA's online **IA Switch Resource Center** includes an FAQ, calendar of events and additional guidance to help advisers make the switch to state regulation.
- ❑ Advisers can use the resource center to submit questions about the switch. The resource center is available at [www.nasaa.org](http://www.nasaa.org)

# **IA Regulation**

## **Registration & Form ADV**

# IA Regulation: The Registration Process

- ❑ File ADV via the Investment Adviser Registration Depository (IARD).
  - IARD is an electronic filing system that facilitates investment adviser registration, regulatory review and public disclosure information of investment adviser firms.
  - FINRA is the developer and operator of the IARD system, which is sponsored by the SEC, the North American Securities Administrators Association (NASAA) and the states.
  - Fees vary from state to state. In New Jersey, the fee is \$200.
- ❑ IARD electronically notifies NJBOS of the ADV submission and a letter is sent to you.

# IA Regulation: The Registration Process

- Once all information is received, your file is reviewed for compliance with rules/statutes/orders.
- The goal is to ensure that your firm is in compliance before conducting business.
- You will receive a deficiency letter if:
  - You failed to include information required or requested;  
or
  - You included information that does not comply with applicable rules/statutes/orders.
- NJ is participating in the NASAA coordinated review process.

# IA Regulation: The Registration Process

□ Additional information requested includes:

- Investment Advisory Contract
- Balance Sheet, with notarized certification, as of a date within 90 days of the application.
- Sample business card, letterhead, brochure, circular, advisory newsletter, form letter, advertisement, or sales literature.
- File Form ADV-W withdrawing from SEC registration.

# IA Regulation: The Registration Process

- ❑ Must respond to deficiency letters to continue with the application process. An application is deemed incomplete until all issues detailed in the deficiency letter are resolved to the satisfaction of NJBOS.
- ❑ When an application is approved, notice is sent via the IARD.
- ❑ Ensure that the contact person's email address is correct as many notifications, sent after the application process has concluded, are sent through electronic communication.
- ❑ To begin the registration process with New Jersey, check "NJ" under Item 1 of Form ADV Part 1B at the time of your annual amendment and at that time also file Form ADV Part 2A.
- ❑ This will put you in a "no status" category.
- ❑ You must then submit the documents required for registration.

# IA Regulation: The Registration Process

## *Investment Adviser Representatives (NJAC 13:47A-3A.1(a))*

- Any IAR with a place of business in NJ must be registered with NJBOS.
- Any IAR located outside NJ, but doing business in NJ must register with NJBOS.
- Federally registered notice filing firms: investment adviser representatives must be registered with NJBOS if the IAR has a place of business located in NJ.
- Single person IA firms may not have to pay an IAR fee in addition to the firm's fee depending upon the firm's corporate structure.

# IA REGULATION: REGISTRATION | ANNUAL RENEWAL PROCESS

- Completed through Web IARD.
- Registrants who fail to renew are considered inactive on Jan. 1 and are no longer a “Registered” Investment Adviser.

# IA Regulation: Registration | Withdrawal Process

- Withdrawal of Registrant is made by following the **Form ADV-W** instructions.
- Withdrawal of IA rep registration is made by following the U5 instructions.
- Do not assume that by letting a registration lapse, the registrant has withdrawn.
  - “Failure to Renew” status
- Make arrangements to maintain books and records for five years (noted in ADV-W).

# IA Regulation: Registration | Form ADV Part 1

## Form ADV Part 1 is:

- Used to register and describe the details of the registrant with the NJBOS.
- Filed online via the IARD.

# IA Regulation: Registration | Form ADV Part 1

- Material changes must be filed within 30 days.
  - This includes all contact information such as email address and mailing address. NJBOS relies upon this information to send notifications to registered IAs.
    - Do not file hard copy changes with our office – Online ONLY
- What is a material change that requires an other than annual amendment?
  - Change of name, address, contact information, form of organization, custodial arrangements, disciplinary actions, etc.
- Required to file annual amendment within 90 days of end of fiscal year.
  - Amend regardless if changes or not.

# IA Regulation: Registration | Form ADV Part 2

- On July 28, 2010 the SEC adopted a new Form ADV Part 2 replacing the old Part II, effective October 12, 2010.
  - All new and current SEC advisers began using new Form ADV Part 2 on Jan. 1, 2011.

# IA Regulation: Registration | Form ADV Part 2

□ The new Part 2 consists of three parts:

- **Part 2A, the Firm Brochure**

- Includes all firm details written in plain English to promote effective communication between you and your clients.

- **Part 2A Appendix 1, Wrap Fee Program Brochure**

- If you sponsor a wrap fee program.

- **Part 2B Brochure Supplement**

- For supervised persons who formulate investment advice for clients and have direct client contact.

# IA Regulation: Registration | Form ADV Part 2

## Key Points

- ❑ Provides new and prospective clients with a brochure and brochure supplements written in plain English. No more “check the box.”
- ❑ Describes business practices, conflicts of interest, and the background of the investment adviser and its advisory personnel.
- ❑ Discloses meaningful information in a clearer format.
- ❑ Electronic filing in IARD is required.
- ❑ Part 2 brochures will be available for viewing through IARD.

# IA Regulation: Registration | Form ADV Part 2

## Key Points

- ❑ An adviser is a fiduciary whose duty is to serve the best interests of its clients.
- ❑ An adviser must deal fairly with clients and prospective clients, seek to avoid conflicts with its clients and, at a minimum, make full disclosure of any material conflict or potential conflict.
- ❑ Disclosures that clients and prospective clients receive is critical to their ability to make an informed decision about whether to engage an adviser.
- ❑ To evaluate the risks associated with a particular IA, its business practices and investment strategies, it is essential that clients and prospective clients have clear disclosure that they are likely to read and understand.

# IA Regulation: Registration | Form ADV Part 2

- What is required?
  - Part 2A: Firm Brochure **or**
    - × Part 2A Appendix 1: Wrap Fee Program Brochure
  - Part 2B: Brochure Supplement
- File all parts of ADV Part 2 on the IARD system.
- You must file your *brochure(s)* (and amendments) through the IARD system using the text-searchable Adobe Portable Document Format (PDF).

# IA Regulation: Registration | Form ADV Part 2

## Annual Delivery Requirements

- ❑ Item 2 of the Instructions for the new Part 2A of Form ADV “Preparing Your Firm *Brochure*” provides that each year a registered investment adviser must:
  - deliver, within 120 days of the end of the IA’s fiscal year, to each client a free updated *brochure* that either includes a summary of material changes or is accompanied by a summary of material changes, or
  - deliver to each client a summary of material changes that includes an offer to provide a copy of the updated brochure and information on how a *client* may obtain the *brochure*.

# IA Regulation: Registration | Form ADV Part 2 | Guidance

- ❑ **Disclosure Obligations as a Fiduciary** -You are a fiduciary and must make full disclosure to your *clients* of all material facts relating to the advisory relationship.

As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your *clients* that could affect the advisory relationship.

- ❑ **Full and Truthful Disclosure** - All information in your *brochure* and *brochure supplements* must be true and may not omit any material facts.

# IA Regulation: Forms Filed Annually with NJBOS

- Form ADV Part 1 amendment (via online).
- IA Reps are under a continuing obligation to update information required by the U4 as changes occur, within 30 days of the change.
- Additional filing required if registrant has discretion and/or custody (mailed to NJBOS).
  - Unaudited balance sheet for discretion that is represented as true and accurate by preparer and notarized
  - Audited balance sheet for custody

# STATE IA EXAMINATIONS

## What to Expect

# State IA Exams: What to Expect

- ❑ Our goal in **examining** state-registered Investment Advisers is to **protect** investors and legitimate business in New Jersey.
  
- ❑ **Two Types of Examinations**
  - **Routine** ► *generally a standard comprehensive exam*
  
  - **For Cause** ► *there for a reason, sometimes a focused exam*
  
- ❑ Some exams are conducted from examiner's office.

# State IA Exams: Examination Focus

□ State IA examinations generally include the following areas:

- Books and records
- Financials
- Registration – Form ADV Part I and II
- Investment Activities
- Complaints
- Advertising and Marketing
- Conflicts of interest
- Custody
- Supervisory/Compliance Procedures
- Business Practices

# State IA Exams: What to Expect

- Routine exams are typically a four-part process.
  - Pre-Exam
  - On-Site
  - Post-Exam
  - Resolution
  
- Onsite portion of exam may last from one day to a week depending on several factors.
  
- Usually one or two examiners.

# State IA Exams: What to Expect | Pre-Exam

## Pre-Exam

- Notification of upcoming exam typically done by fax or e-mail with a list of documents to have ready.
- May request documents be sent to NJBOS prior to on-site visit.
- Some exams may be unannounced.

# State IA Exams: What to Expect | Onsite

## ONSITE

- ❑ Introduction and description of the purpose of the visit.
- ❑ Identify contact/point person for the examiner.
- ❑ Initial interview conducted by examiner.
  - Tour of the office
    - × *Where are your records?*
    - × *Where is the copier?*
    - × *Where can I work?*
  - Interview: Questions about your practice

# IA Regulation: NJBOS Written Examination Questionnaire

- ❑ NJBOS sends every IA registrant a written examination questionnaire annually.
  - The written examination questionnaire is an important aspect of the Bureau's oversight of IAs.
  - The written examination questionnaire will request detailed information about the operations and personnel of the IA.
  - Failure to provide a timely, complete and accurate response to this request for information may result in sanctions.

# State IA Exams: What to Expect | Onsite

## ONSITE

- Be prepared with requested documents readily available.
- Try to have key personnel available.
- Exit interview (optional).
  - The examiner explains what comes next. May be done onsite or may come after the actual visit, but not required.

# State IA Exams: What to Expect | Post-Exam

## Post-Exam

- Once examiner has left your office, the exam is not over.
  - Most of exam is done at the regulator's office and frequently additional documents or information is requested.
  
- Exam report prepared.
  
- May take one to several weeks depending on several factors.

# State IA Exams: What to Expect | Resolution

## Resolution

- Once post-exam work is complete, an exam report or deficiency letter may be sent via certified mail.
- Registrant must respond to the deficiency letter in writing, usually within 30 days.
- Once all deficiencies have been satisfactorily addressed, exam is closed.
- Certain issues may be referred to enforcement.

# State IA Exams: Common Exam Deficiencies

- Failing to file Form ADV Part 1 amendment within 90 days of the end of fiscal year
- Inaccurate or incomplete Forms ADV Part 1 & 2
- Incomplete, inadequate, or no contract with clients
- Failing to meet required net worth requirements
- Failing to maintain current suitability information regarding clients

# State IA Exams: Common Exam Deficiencies

- Non-compliance with privacy requirements
- Non-compliance with advertising rules
- Failing to maintain applicable books and records
- Not sending invoice of fees if auto-deducting fee

# Best Practices for Investment Advisers

- Review and revise Form ADV and disclosure brochure annually to reflect current and accurate information.
- Review and update all contracts.
- Prepare and maintain all required records, including financial records. Back-up electronic data and protect records. Document checks forwarded.
- Prepare and maintain client profiles.
- Prepare a written compliance and supervisory procedures manual relevant to the type of business to include business continuity plan.
- Prepare and distribute a privacy policy initially and annually.
- Keep accurate financials. File timely with the jurisdiction. Maintain surety bond if required
- Calculate and document fees correctly in accordance with contracts and ADV.
- Review all advertisements, including website and performance advertising, for accuracy.
- Implement appropriate custody safeguards, if applicable.
- Review solicitor agreements, disclosure, and delivery procedures.

# Resources

- NJ Bureau of Securities
  - [www.njsecurities.gov](http://www.njsecurities.gov)
  - 973-504-3600
  
- North American Securities Administrators Association
  - [www.nasaa.org](http://www.nasaa.org)
    - Investment Adviser Resources
    - Uniform Forms
    - IA Switch Resource Center

# Questions?

**For more information,  
contact:**

**[askBureauOfSecurities@dca.lps.state.nj.us](mailto:askBureauOfSecurities@dca.lps.state.nj.us)**